ITALY

EUROPEAN FUNDS BOLSTER GROWTH, WHILE MANUFACTURING AND DEBT CONSTRAINTS PERSIST

Italian GDP grew 0.2% q/q in Q2 2026, bolstered by household consumption and investment financed by European funds, while the manufacturing sector is not benefitting from the same improvement seen elsewhere in Europe (due to lower exposure to the tech sector). As a result, we expect growth to remain quite stable in 2026 and 2027 (0.9% and 0.8%, respectively), despite an improving momentum in the Eurozone. Inflation acceleration is mainly driven by energy prices, which are weighing on the recovery of purchasing power. Disinflation should be observed in 2027, with inflation standing at 2.1%, after 2.9% in 2026. The fiscal deficit narrowed to 3.1% of GDP in 2025 on the back of a stronger primary surplus, but the rising debt burden points to increasingly tight fiscal margins.

ECONOMIC ACTIVITY IS GROWING, THANKS TO THE NATIONAL RECOVERY AND RESILIENCE PLAN (NRRP)

GDP rose 0.2% q/q in Q2, extending a positive trend under way since Q4 2022. Real GDP is now 7.7% above its pre-pandemic level (Q4 2019), compared with 1.9% in Germany, 6.3% in France and 12.1% in Spain. As a result, the growth carry-over for 2026 reaches 0.8%, higher than estimates published in July by the Bank of Italy (+0.6%) and the IMF (+0.5%). We expect growth to keep running at the same pace as in Q1 and Q2 during the upcoming quarters, helping it to reach 0.9% in 2026 and then 0.8% in 2027 in annual average terms.

Household consumption accelerated in Q2 (+0.3% q/q), marking the tenth consecutive quarter of growth. Consumption of durable goods (+0.9% q/q) continued to benefit from government incentives, including NRRP-related incentives. Consumption growth reflects a rebound in disposable income. After the decline seen at the end of 2025, disposable income began to rise again from Q1, boosting purchasing power, while the overall savings rate remained stable at around 8% for the quarter. In Q2, growth was also bolstered by positive investment dynamics, particularly in non-residential buildings and other construction works (+7.4% q/q), benefiting from NRRP spending. By contrast, investment in machinery and equipment declined (-2.3% q/q), as did investment in transport equipment (-1.9% q/q).

The NRRP has allocated a total of EUR 194.4 bn in grants and loans to Italy, equivalent to around 9.1% of GDP. According to the UPB[1], in 2026 – the peak year for NRRP-related spending – Italy's GDP growth rate would be around 0.5 pp lower if there were no additional projects financed by the Plan. The impact of the NRRP has been particularly significant on investment, as, over the last five years, the value of tenders for public works has averaged 3.6% of GDP (more than double the previous decade's level), and around 20% has been financed or co-financed with Plan resources. Expectations for 2026 remain positive, as, according to the Invind survey conducted between February and May 2026 by the Bank of Italy on firms' expectations, 47% of firms with at least ten employees expect to receive NRRP-related public contracts in 2026 (down from 51% in the second half of 2025). Public investment was therefore lifted above 3.8% of GDP, the highest rate in 40 years.

THE MANUFACTURING SECTOR LAGS BEHIND

Industry continues to make no contribution to the growth of the country's value added, reflecting the smaller tech sector in Italy (investment in intellectual property products reached 3.4% of GDP in 2025, compared with 4.4% in Germany and 5.4% in France and 5.3% in the UK in 2025), which is partially driving the recovery seen in other Eurozone countries or in the United Kingdom. In Q2, the industrial output (excluding construction) declined by 0.5% y/y. The post-pandemic years have been a bumpy path for the sector, with the aggregate figure masking widely diverging trends across industries. In H1 2026, manufacturing output stood at 5.9% below its 2019 average level, and sectors accounting for around 70% of the overall index recorded negative variations. The negative gap was particularly significant in textiles (-37.1%), chemicals (-15.9%) and metals (-10.4%), sectors that continued to post negative annual changes in H1 2026 as well. On the other hand, car production rebounded 14.6% y/y in H1 (but was down 23.5% in 2019). Compared with 2019, output levels rose significantly in food (+6.2%), pharmaceuticals (+15.5%) and electronics (+15.1%), despite these sectors slowing in 2026, however.

Growth and inflation

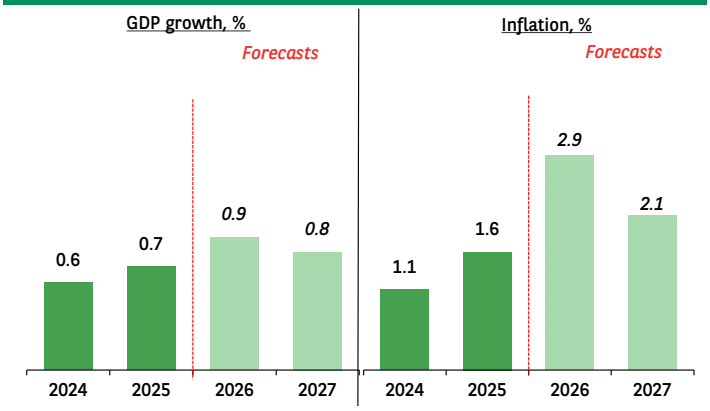


CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

THE LABOUR MARKET IS TIGHT

The labour market is benefiting from an improving employment rate and a steadily falling unemployment rate (standing at 5.8% in July, -0.1 pp m/m), below the Eurozone's 6.4% and the EU's 6.1%. Between July 2021 and July 2026, the employment rate increased 4.4 pp to stand at 63.2%, mainly among the over-50s (+7.8 pp). The main weak point of the labour market is the persistently high youth-unemployment rate, which rose in July to 18.9% (+0.2 pp m/m; +1.2 pp over 5 years), a level that remains well above the Eurozone average (14.9%). This trend reflects an aging labour force, despite the employment rate among those over 50 (67.9%), which is now roughly double that of those under 35, marking a reversal of the trend observed fifteen years ago (2011). New Istat projections estimate a population decline from 58.9 million in 2025 to 55 million by 2050. Over the same period, the working-age population is expected to fall from 63.4% to 55.3% of total population,

1 UPB, Report on Fiscal Policy, June 2026.

equivalent to 7 million fewer working-age people. Mitigating this trend will require policies that encourage broader labour market participation, particularly among young people and women.

INFLATION ACCELERATES, DRIVEN BY ENERGY PRICES

The harmonised index of consumer prices (HICP) rose 3% y/y in Q2 and continued to rise over the summer, peaking at 3.2% in August (from 2.9% in July), driven mainly by energy prices (+17.1%). On the back of high energy prices, we expect inflation to reach 2.9% y/y in 2026 before easing to 2.1% in 2027, as we expect somewhat lower energy prices next year. The significant exposure to gas, more widely used in Italy compared with European peers, is an upside risk to our inflation forecasts, since gas prices are currently surprising on the upside. This increase may also favour a wider pass-through to manufacturing producer prices.

However, wage growth, is losing momentum just as inflation is reaccelerating. According to the Italian National Institute of Statistics (Istat), this is the first quarter in ten where contractual wage growth has fallen below inflation, reversing the real-wage gains built up since 2023. With no wage-price spiral, inflation should decrease more significantly in Italy in 2027 compared to the Eurozone.

A LOWER FISCAL DEFICIT, BUT LIMITED ROOM FOR MANOEUVRE

In 2025, Italy's fiscal deficit fell to 3.1% of GDP (from 3.4% in 2024), continuing the consolidation under way since the pandemic peak of 9.4% of GDP in 2020. The improvement reflects a strengthening primary balance, which posted a surplus for the second consecutive year, rising from +0.5% to +0.8% of GDP on the back of higher contribution revenues. Compared with 2019, total revenues have risen by more than 1 pp of GDP (from 47% to 48.1%), bringing the tax burden to 43.1% of GDP (+0.8 pp *vs.* 2019). The deficit-reduction path set out for 2026 government documents (2.9% in 2026) still points to Italy exiting the Excessive Deficit Procedure in 2027, albeit with very tight spending margins. We expect a fiscal deficit of 2.8% of GDP in 2026 and 2027.

Interest expenditure, which is stable at 3.9% of GDP in 2025, is expected to rise gradually to 4.5% by 2029 (4.0% in 2026 and 4.1% in 2027), due to higher yields linked to higher long rates on the markets.

Against this backdrop, the public debt-to-GDP ratio has stabilised recently and is not expected to increase in 2027 (136.8% in 2027, after 137.5% in 2026). At the same time, Italy's public debt financing model is shifting from a structure dominated by domestic institutional investors to one where foreign and private savings cover the bulk of the financing needs. The foreign-held share reached 35.9% in June (over EUR 1,100 bn), the highest level since November 2011.

Meanwhile, the energy shock continues to weigh on already limited fiscal margins. Starting in March, the government has made repeated use of the "mobile excise duty" mechanism (which, under certain conditions, allows the additional VAT revenue generated by rising fuel prices to be used to reduce excise duties) for cumulative spending of EUR 2.3 bn (0.1% of GDP). On the EU side, Minister of Economy and Finance Giancarlo Giorgetti has announced that Italy will request the full available fiscal margin of 0.6% (up to a maximum of EUR 14.4 bn over the 2026–2028 period), usable only for structural measures.

Italy's merchandise trade with EU and non EU countries

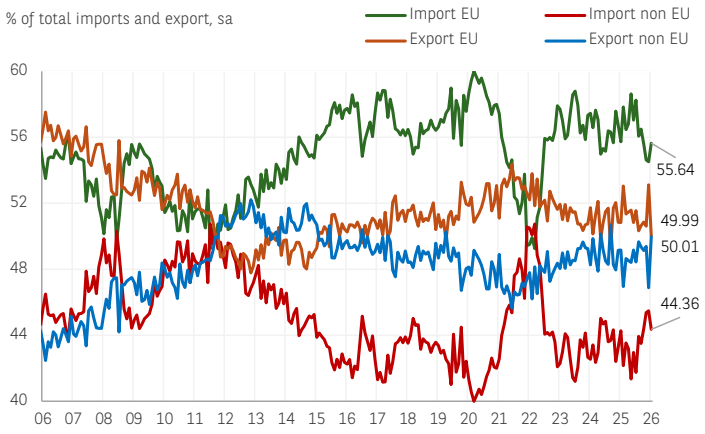


CHART 2

SOURCE: ISTAT, BNL ECONOMIC RESEARCH

ITALIAN FOREIGN TRADE IS HOLDING UP WELL

Italy's goods exports held up well, as, in H1, they rose 4.5%, continuing the growth seen in 2025. However, Italy's limited specialisation in AI-related segments has prevented the country from fully benefiting from strong demand in this area. The increase in exports was roughly similar in the EU and non-EU markets. Outside the EU, exports to the United States rose 2% (the second destination for Italy's exports, after Germany). Overall, non-EU markets accounted for 48.7% of Italy's exports (the same share as in 2025) and 44.2% of its imports (43% in 2025).

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