

## ITALY

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## GROWTH SLOWS; PUBLIC FINANCES IMPROVE

In Q2 2025, Italy's real GDP fell by -0.1% q/q. This decline marks the end of seven consecutive quarters of growth. Investment rose (+1% q/q) but could not compensate for the fall in net exports, while industrial production slipped 1.1% y/y. Despite the challenges, the latest turnover data and qualitative indicators show an increase in activity and new orders, as well as improved business confidence. The labour market remains robust: employment held steady at 24.2 million and the unemployment rate kept falling. Inflation stayed low at 1.7%, enabling purchasing power to rebound (+0.9% q/q). Public finances have improved - the deficit has halved and a primary surplus has been recorded - but future spending pressures will increase as the working age population is projected to shrink by around 5 million people by 2040.

### IN Q2, INVESTMENT GROWTH WAS UNABLE TO OFFSET THE NEGATIVE CONTRIBUTION FROM NET EXPORTS

In Q2 2025, Italy's real GDP fell by -0.1% q/q. On the supply side, this can be explained by a decline in value added in agriculture and industry and a stagnation in services. On the demand side, growth in domestic components did not offset the decline in net exports. Final domestic consumption remained stable while gross fixed capital formation increased by 1% q/q (with investment in machinery, equipment and armaments rising by +2.1% and investment in transport equipment rising by +2.5%).

Affected by weaker foreign demand, Italian industrial production continues to decline. In the first half of the year, it fell by 1.1% y/y (vs. -1.7% in Germany, -0.3% in France, and +0.3% in Spain). Of the main sectors, only the food industry recorded positive growth.

Despite these apparent difficulties, manufacturing companies surveyed in the Bank of Italy's inflation and growth forecast survey appear slightly more optimistic about operating conditions compared to previous months. The latest data on turnover and qualitative indicators, such as the PMI indices and Istat surveys, show an increase in activity and new orders, as well as an improvement in business confidence, particularly in transport and storage services. The increase in tourist spending also reflects a modest recovery in this sector.

The Bank of Italy<sup>1</sup> has also pointed out that, despite the challenges, Italian industry has undergone a significant restructuring process in recent years. The share of employees in medium-sized and large companies has increased, as has the rollout and use of advanced technologies. The profitability and financial soundness of companies have also improved.

### LABOUR MARKET CONDITIONS REMAIN STRONG

The outlook for the labour market remains favourable. After rising in Q1 2025 (+0.5% q/q), the number of people in employment remained unchanged in Q2 (24,169 million people). The increase in self-employed workers (+74,000, +1.4% q/q) was offset by the decrease in the number of permanent employees (-21,000, -0.1% q/q) and fixed-term employees (-45,000, -1.7% q/q). The employment rate, unemployment rate and inactivity rate also remained stable compared to Q1 2025, standing at 62.7%, 6.3% and 33.0% respectively. Compared to the pre-pandemic period (Q4 2019), Italy has 1.12 million more people in employment (vs. +0.6 million in Germany, +1.8 million in France, and +2.4 million in Spain). However, the employment rate remains low compared to the EU-27 average (71.2% in Q1).

In this scenario, employment growth (measured using full-time employment figures) in 2025 and 2026 would exceed GDP growth. The

<sup>1</sup> Bank of Italy, Annual Report, The Governor's Concluding Remark, May 2025

#### GROWTH AND INFLATION (YEARLY AVERAGE)

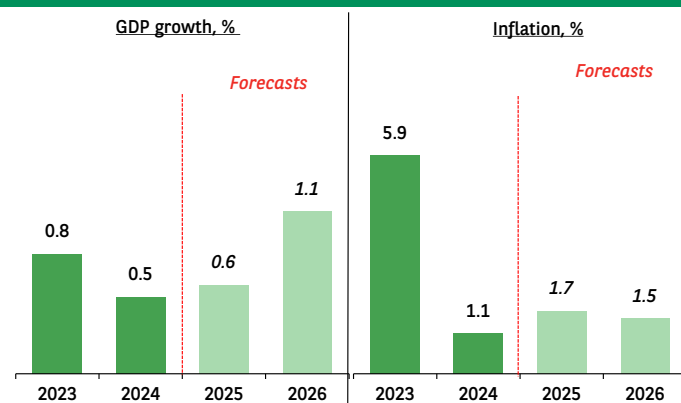


CHART 1

SOURCE: BNP PARIBAS GLOBAL MARKETS

unemployment rate is expected to keep falling in 2025, a trend that would continue in 2026.

### CONTAINED INFLATION FUELS REBOUND IN PURCHASING POWER

In August, the Harmonised Index of Consumer Prices (HICP) recorded an increase of +1.7% y/y (unchanged from July, and lower than the Euro area average). Energy prices deflation increased, from -3.5% in July to -4.4% in August. On the other hand, food prices rose slightly (from 3.8% in July to 3.9% in August), mainly due to higher prices for unprocessed food (from 5.9% in July to 6.4% in August). Core inflation has remained stable at 2.0% since June.

With the exception of March 2025, inflation in Italy has remained below 2% since October 2023. This trend has led to a slight increase in household purchasing power, which recovered in Q1 2025 (latest data available), rising by 0.9% q/q after falling in the previous quarter.

Over the coming months, moderate inflation is expected, supported by lower energy prices and weaker demand. Private consumption is expected to grow at a moderate but stable rate (below 1% in both 2025 and 2026), supported on the one hand by wage and employment growth, and held back on the other by the climate of uncertainty, with a likely increase in the propensity to save. Indeed, in Q1 2025 (latest data available), the personal savings rate is estimated at 9.3% (+0.6 p.p. q/q).

### PUBLIC FINANCES ARE GRADUALLY IMPROVING

Italy's public finances have strengthened markedly over the last fifteen



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years, supported by improved macroeconomic fundamentals. In 2024, the general government deficit-to-GDP ratio halved compared to 2023 (-3.4% vs. -7.2%), and the country returned to a primary surplus (0.4% of GDP) for the first time since 2019. The Government debt-to-GDP ratio increased only moderately (135.3%).

The IMF recently highlighted Italy's better than expected fiscal results, mainly due to lower than expected expenditure and public revenues supported by a resilient labour market. The 2025 Public Finance Document, published last April, confirms the fiscal roadmap agreed by the European Commission, forecasting a deficit-to-GDP ratio of 3.3% in 2025 and 2.8% in 2026 (thus respecting the 3% ceiling set by the EU Stability and Growth Pact).

Although Italy's public debt exceeded EUR 3 trillion in June 2025, thanks to improved fiscal metrics and political stability, the spread between Italian and German government bonds has continued to narrow (83 bp vs 135 on average in 2024). In April 2025, S&P raised Italy's sovereign rating for the first time since October 2017 (from BBB to BBB+), while maintaining a stable outlook. Shortly afterwards (in May 2025), Moody's left the rating unchanged (at Baa3) but revised Italy's outlook rating from stable to positive.

## POPULATION DECLINE THREATENS LONG-TERM GROWTH POTENTIAL

Over the next few years, public spending will come under increasing pressure, mainly due to population ageing, the green and digital transitions, and the need to increase spending to strengthen defence capabilities. Medium- and long-term debt sustainability will depend mainly on the implementation of structural reforms<sup>2</sup> and the efficient use of available resources. Economic growth and fiscal sustainability are mutually reinforcing: confidence in public finances promotes investment, while stronger growth facilitates fiscal consolidation.

Population ageing and low birth rates are expected to have a profound impact on the growth potential of the Italian economy. According to Istat, the working-age population will decline by around 5 million people by 2040. Furthermore, 700,000 Italians have emigrated in the last ten years, a fifth of whom are young graduates. Legal immigration could help, but among the major EU countries, Italy has the lowest proportion of immigrants with university degrees.

## EXPORTS SUSTAINED BY INTRA-EU TRADE AND TRADE WITH THE US

In the first six months of 2025, Italy's trade balance was largely positive, amounting to EUR 22.82 billion. Exports increased (+2.1% y/y), mainly driven by intra-EU trade, particularly with Spain (+11.8% between January and June; 5.5% of total Italian exports) and Germany (+2.6%; 11.4% of Italian exports and Italy's main destination market). Outside the EU, exports declined almost everywhere, with the exception of the United States, where they increased by 7.8% in the first half of the year (mainly due to a +10.4% y/y increase in June). This increase was driven by the pharmaceutical sector (+77% y/y in June and +77.9% in the first half of 2025) and the chemicals sector (+10.9% y/y in June).

The dynamics of Italian exports to the United States are very different from those observed in the rest of the EU: according to Eurostat, EU-27 exports to the United States fell by 10.3% y/y in June. It is likely, therefore, that Italy has continued to benefit from stockpiling by its US counterparts, who have attempted to anticipate the impact of the

<sup>2</sup> The IMF recently pointed out how Italy should focus on boosting productivity and innovation and improving labour participation, while advancing the transition to renewable energy and a resilient energy infrastructure.

<sup>3</sup> Istat, Rapporto sulla competitività dei settori produttivi - Edizione 2025, March 2025.

ITALY: EMPLOYMENT BY AGE GROUP (THOUSANDS, JULY 2025, S.A)

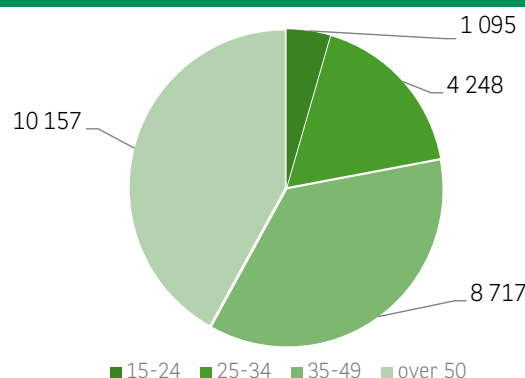


CHART 2

SOURCE: ISTAT, BNP PARIBAS

ITALY: INFLATION IN ITALY AND THE EURO AREA (HPCI, % CH A/A)

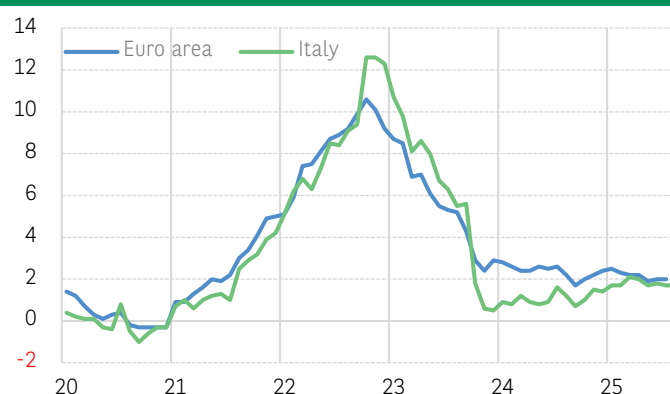


CHART 3

SOURCE: EUROSTAT, BNP PARIBAS

tariffs. This phenomenon should therefore come to an end with the implementation of the new measures, which came into force in August. In recent months, a survey conducted by Istat<sup>3</sup> has shown that just over 23,000 companies (0.5% of the total) are vulnerable to exports (due to excessive concentration of products and geographical areas). Of these vulnerable companies, 3,300 have the United States as their main destination market, while around 2,800 have Germany as their main market.

All in all, although the ongoing trade tensions are expected to ease gradually in the second half of 2025, they might have a negative impact on the economic cycle in Italy, with more pronounced effects on investments and foreign trade and, to a lesser extent, on household consumption, by negatively affecting their confidence.

Article completed on 3<sup>rd</sup> September 2025

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