

## NAVIGATING ENERGY VULNERABILITY, RESILIENT TRADE AND LIMITED FISCAL CAPACITY

Italy entered 2026 with moderate momentum, posting a real GDP growth of +0.3% q/q in Q4 2025. However, the economy faces increasing risks due to its reliance on LNG and its exposure to the Strait of Hormuz. Consequently, growth is projected to be around +0.7% in 2026 (-0.3 pp), accompanied by weaker investment, consumption and exports. Inflationary pressures are also mounting, as are energy costs for businesses. Despite these challenges, foreign trade remains adaptable. Fiscal consolidation is progressing, although fiscal capacity remains limited.

### FACING A DETERIORATING GEOPOLITICAL ENVIRONMENT

The deterioration of the geopolitical situation and the resulting energy shock have come at a time when the Italian economy was showing the first signs of a modest recovery. Real GDP grew by +0.3% q/q in Q4 2025, mainly due to a rebound in investment, giving the country a growth carry-over of 0.3% into 2026. In January and February, the composite PMI and the Ita-coin indicator still pointed to an expansionary trend, albeit at levels below the Q4 2025 average, and the demand for services was buoyed by the Milan-Cortina 2026 Winter Olympic Games. Although total and foreign orders in the first two months of 2026 hinted at a slight strengthening of the industrial sector, this momentum could stall or reverse if the war in the Middle East continues. In February, industrial production saw a modest increase of 0.1% m/m. Such lacklustre industrial performance is expected to continue throughout Q1 2026.

Assuming the conflict ends by Q2 2026, GDP is projected to slow down or stagnate. The impact of high global energy prices on economic activity is expected to become particularly evident in Q2 2026, when GDP is projected to slow down slightly relative to Q1. If tensions subside within around four months, the overall growth rate for 2026 would be around 0.7% (a downward revision of 0.3 pp). Investment would be most affected, while the NRRP remains the main stabilising force.

Despite an increase in total income in 2025, consumption remained structurally weak due to stagnation in per-capita wages. While employment growth contributed to a rise in aggregate labour income, it did not enhance its per-capita value; moreover, most of the income increase came from non-labour sources, which predominantly benefit the top income quintile, whose households have a very high propensity to save (45%).

### FRESH INFLATIONARY PRESSURES AMID ENERGY VOLATILITY

Italy's oil intensity – measured as barrels of oil per euro of GDP – has more than halved over the past 45 years, falling from 1.6 in 1980 to 0.66 in 2024. Between 2023 and 2026, Italy significantly transformed its energy supply mix, replacing Russian gas with LNG and with Mediterranean/Caucasus pipelines. This reduced dependence on a single supplier but created a new energy vulnerability: exposure to global maritime routes and chokepoints such as the Strait of Hormuz. A notable statistic illustrates this well: in 2024, over 46% of LNG came from Qatar. Energy accounts for 10.9% of Italy's consumer-price basket (4.7% attributable to fuel and transport, and 6.2% to household energy), a higher proportion than the Euro area average of around 9%.

Following a period of negative energy inflation in early 2026 (-6.2% y/y in January and -6.6% y/y in February), energy HICP prices are expected to rebound in Q2, ranging between +0% and +4%.

In a scenario where oil and gas prices peak at USD 130 and the war lasts for ten months, Confindustria<sup>1</sup> estimates that headline inflation would rise by 13 pp. By comparison, Italy's inflation rose by 12 pp

<sup>1</sup> Confindustria, Rapporto di previsione: Guerre, dazi, incertezza, a rischio la crescita, March 2026

### Growth and inflation

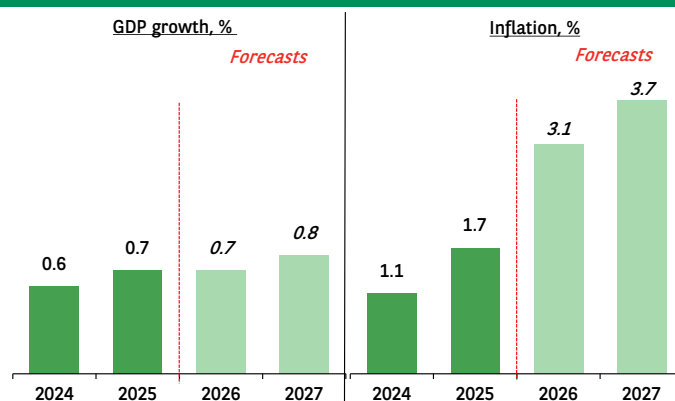


CHART 1

SOURCE: BNP PARIBAS GLOBAL MARKETS

from trough to peak during the 2021-2022 period. Historical patterns suggest that second-round effects are likely to materialise around six months after the initial shock, although weaker demand and potential price mitigation measures (similar to those in 2022) could mitigate the impact.

Preliminary estimates indicate that the HICP increased by +1.6% m/m and +1.7% y/y in March 2026 (the highest level since March 2025). Higher energy prices and partial pass-through to core inflation could push headline inflation close to 3% in 2026.

A prolonged energy shock would increase costs for businesses, increasing the share of energy in total costs to around 5.9% in 2026 (4.9% in 2025). Given that Italian businesses already face higher energy costs than their main European competitors, any further increase in overall production costs would affect manufacturing output, which had already declined in 2025 (-0.5% y/y; -0.2% for industry as a whole), thereby impeding the ongoing recovery effort.

### THE EXCEPTIONAL EMPLOYMENT GROWTH THAT BEGAN IN 2023 IS BEGINNING TO RUN OUT OF STEAM

In the 15-64 age group, employment rose by just 0.8% in 2025, roughly half the rate seen in 2024, resulting in an employment rate of 62.5%. Job creation was driven mainly by the over 50s. The unemployment rate fell to 6.1%, the lowest annual rate ever recorded, while the inactivity rate returned to the 2023 low of 33.3%.

On the productivity side, between 2024 and 2025, value added grew by 2.2% cumulatively, whereas labour input fell by 0.4%. This combination brought labour productivity per employee back to pre-pandemic levels



by the end of 2025, although productivity per hour worked remains lower. Hourly wages rose by 3.1% y/y in 2025.

Early indicators for 2026 point to a labour market that remains generally robust but is clearly beginning to slow.

## PUBLIC FINANCES: REAL PROGRESS, THIN MARGINS

Italy's fiscal deficit decreased to 3.1% of GDP in 2025, down from 3.4% the year before, while public debt rose to 137.1% of GDP (+2.2 pp compared with 2024). These figures demonstrate that consolidation is underway, but they are insufficient to secure an early exit from the EU's Excessive Deficit Procedure; the shortfall misses the target by 0.1 pp, largely due to the Superbonus scheme. Eurostat is set to confirm these figures on 22 April.

The shortfall is unlikely to derail the broader trajectory. Current spending remains on track, and tax revenues have exceeded expectations, raising the primary surplus from +0.5% to +0.7% of GDP, marking one of the highest primary surpluses in the Eurozone, alongside Portugal, Greece, Cyprus, Ireland and Luxembourg. Rating agencies have acknowledged these developments: S&P revised its outlook to "positive" in January 2026, Fitch maintained a "stable" outlook in March, and Moody's (27 March) described Italy's consolidation trajectory as credible and achievable, highlighting political stability as a key factor. According to Confindustria, this stability helped narrow the BTP-Bund spread and cut yields by 115 basis points between the end of 2023 and the end of 2025, reducing corporate borrowing costs by 12-14% in 2024-2025 and potentially saving up to EUR 30 billion in interest if debt were refinanced at current rates over the average 8-year maturity.

Nevertheless, the energy shock complicates the outlook and threatens to erode already tight budgetary margins. The government's response on 19 March consisted of temporary fuel-duty cuts (worth EUR 417 million), which were later extended to 1 May (with an additional EUR 500 million), together with anti-speculation measures. Finance Minister Giorgetti ruled out any immediate corrective actions but left the door open for EU coordination under the general safeguard clause.

Markets have already reacted: the BTP-Bund spread reached 100 basis points on 27 March, with the 10-year yield hovering above 4%. Interest expenditures now amount to 3.8% of GDP—almost double that of France and Spain, and four times that of Germany—and total debt exceeds EUR 3,095 billion. Even modest declines in growth caused by higher energy prices could reduce revenues and further reduce the limited fiscal margin available to absorb shocks without resorting to corrective measures.

## ITALIAN FOREIGN TRADE REMAINS RESILIENT DESPITE REPEATED AND UNPREDICTABLE SHOCKS

Over the past few years, exports have demonstrated strong adaptability, thanks in large part to rapid geographical reallocation: approximately 8% of Italian products change their destination annually (6% for Germany)<sup>2</sup>. Imports have also been highly dynamic, with a 12% annual recomposition rate in 2022-2023 (indicating the share of goods sourced from different suppliers) and have stabilised at around 9% in the last two years, significantly higher than the corresponding figure for Germany.

<sup>2</sup> Istat, March, 2026, Rapporto sulla competitività dei settori produttivi.

<sup>3</sup> Istat 2026.

<sup>4</sup> Bank of Italy, April 2026, Indagine sulle aspettative di inflazione e crescita.

## Share of energy in consumer basket

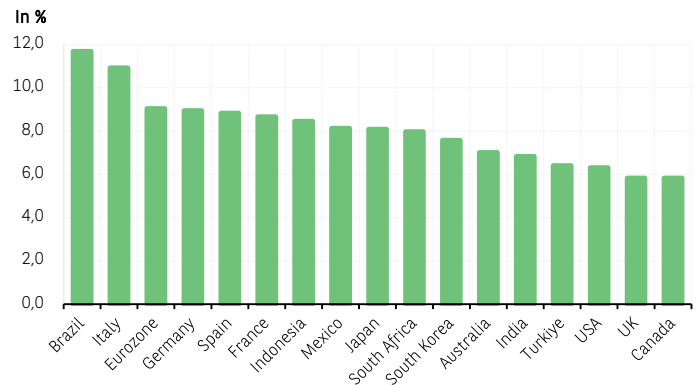


CHART 2

SOURCE: BNL ECONOMIC RESEARCH, OCSE

Multinational companies continue to play a key role, accounting for around three-quarters of manufacturing exports. Their significance is particularly evident in distant markets, where they account for 85.9% of exports to China and 83.1% of exports to the United States.

Nevertheless, the import side remains vulnerable to potential disruptions in the supply of strategic goods. Although Italy's dependence on strategic goods imports is broadly comparable to that of other major EU economies, it is more exposed to foreign energy inputs than Germany and France<sup>3</sup>. Moreover, 40.4% of Italy's strategic imports originate from countries classified as having "low" or "limited" political risk (51% for the four leading EU countries).

In January 2026, Italian imports fell by 1.3% m/m (-7.4% y/y), while exports were essentially flat (-0.1% m/m; -4.6% y/y). Exports to the United States, which had risen by +7.2% in 2025, declined by -6.7% y/y, with all product categories, except for pharmaceuticals, posting lower figures. Preliminary data for February suggest a modest rebound, but the comparison with early 2025 is distorted by the exceptional increase due to frontloading.

In the first half of 2026, foreign trade will be affected by the fallout from the conflict in Iran: a slowdown in global demand, reduced confidence, higher energy prices, rising transport costs, and increased prices for raw materials and imports, are all likely to negatively impact Italy's trade balance<sup>4</sup>.

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