ITALY

PUBLIC FINANCES ARE IMPROVING, WHILE PRODUCTIVITY REMAINS SLUGGISH

The Italian economy is showing some resilience: GDP experienced a modest rebound in Q3 2025, and moderate inflation is helping to maintain household purchasing power. We forecast growth to be around 1% over the next two years (1% in 2026 and 0.9% in 2027). Market confidence has been bolstered, as evidenced by improved ratings, due to political stability, fiscal consolidation, and a growing share of public debt held abroad. Exports are benefiting from a robust pharmaceutical sector and intra-EU sales, while trade with the United States remains positive. Despite an historically strong labour market, productivity remains low due to weak intangible investment, limited digitalisation and significant fragmentation within the business sector.

UNDERPERFORMANCE IN TERMS OF GROWTH IS EXPECTED TO LESSEN

In Q3, Italian GDP rose by 0.1% q/q, driven by a rise in value added in agriculture and services, which offset the decline in industry. Consumption grew by 0.1%, investment by 0.6%, and imports and exports increased by 1.2% and 2.6% q/q, respectively. This Q3 result follows a -0.1% q/q contraction in Q2, marking the first decline after seven consecutive quarters of stability or modest growth. Italy's real GDP now stands at 6.5% above its pre-pandemic level (Q4 2019), compared with +5.6% in France, +0.1% in Germany and +10% in Spain.

Although growth has slowed over the past two years, low inflation – remaining mostly below 2% since October 2023 – and a shrinking population have facilitated an increase in PPP-adjusted GDP per capita. In 2023, Italy overtook the United Kingdom in terms of GDP per capita for the first time in a decade, with this gap widening further in 2024.

Over the next two years, Italian growth is projected to hover around 1% (1.0% in 2026 and 0.9% in 2027). The main drivers of this growth are anticipated to be consumption and investment (the latter being boosted by the final stages of the NRRP). Net exports are expected to have a negative impact on GDP growth due to increased difficulties in global trade.

GROWTH AND INFLATION (YEARLY AVERAGE)

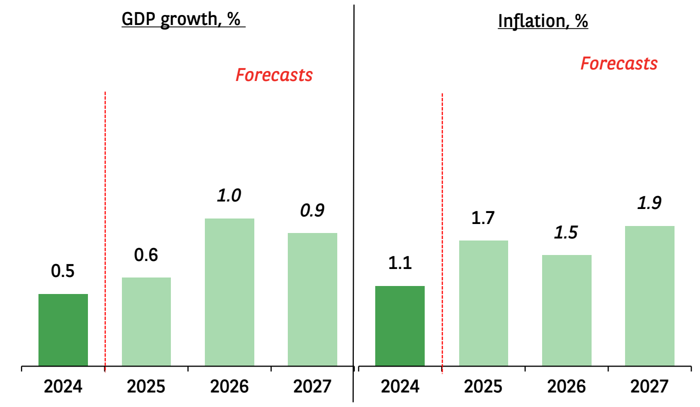

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

LABOUR MARKET DYNAMICS ARE BEING DRIVEN BY WORKERS AGED OVER 50

The Italian labour market continues to perform well. In Q3, employment remained stable at around 24.2 million workers (+0.1% vs Q2). The growth in employment was primarily seen among permanent employees, self-employed individuals and people aged over 50. In comparison with Q2, both the employment and inactivity rates remained stable at 62.7% and 33.1% respectively, while the unemployment rate fell by 0.3 pp to 6.1%. From January to September 2025, contractual hourly wages rose by 3.3% y/y.

The unemployment rate is expected to stabilise at current levels in 2025 and to decline in 2026. In this context, employment growth in 2025 is expected to exceed GDP growth before slowing in 2026. As a result, labour productivity, which is declining in industry in particular, is projected to decrease in 2025 and then resume growth in 2026-2027.

INFLATION CONTINUES ITS DOWNWARD TREND

Inflation remains moderate in Italy. In November, the HICP slowed significantly to 1.1% y/y. Food inflation decreased from 2.5% in October to 2.3% in November, while energy prices continued to show deflation at -4.2% y/y. Core inflation also fell slightly to 1.8%, down from 1.9% in October.

Throughout 2025, inflation has remained below 2%, with the exception of March. Italy therefore continues to be one of the countries with the lowest inflation rates in the Eurozone, largely due to substantial deflation in energy prices. In Q2, household purchasing power continued to grow (+0.3% q/q, following +0.7% q/q in Q1). Despite this, the savings rate reached 9.5% in April-May, continuing its upward trajectory after hitting a low of 8.8% in Q4 2024.

For 2025 as a whole, inflation is expected to average 1.7%. Due to uncertainty and a higher savings rate – which offset the positive impact of income growth – private consumption is expected to rise moderately (less than 1%) before picking up pace in 2026.

PUBLIC FINANCES: INDICATORS OF CONFIDENCE AND STRUCTURAL IMPROVEMENT

Italian public finances continue to benefit from positive revisions by rating agencies and European institutions. In November 2025, Moody's upgraded Italy to Baa2 (stable outlook), marking the first upgrade in over twenty years, following similar decisions by Fitch and S&P. At the same time, the European Commission has revised its budget projections upward, anticipating improved fiscal metrics, and has indicated that Italy could exit the Excessive Deficit Procedure as early as 2026, one year ahead of schedule, pending verification of the Spring data.

Market sentiment has also improved: the BTP-Bund spread has fallen by around 100 basis points over the past two years, returning to its pre-sovereign crisis levels (75 bp in December 2025, with a 10-year rate of 3.5%). Foreign demand has increased, with the share of public debt held by non-residents reaching 33.7% in August 2025, marking a rise of nearly EUR 124 billion in just eight months, thereby confirming the reversal of the trend observed since 2023.

The 2025 Public Finance Planning Document (PFPD) indicates a more favourable path for fiscal consolidation: the deficit is projected to fall to 3% of GDP in 2025 (one year ahead of the earlier forecast made in the Spring), and is expected to gradually shrink in 2026-2028 (-2.8% in 2026, -2.6% in 2027, -2.3% in 2028). This downward trajectory, which aligns with the European Commission's forecasts, complies with the new net expenditure rule that is central to the EU's revised fiscal governance.

Nevertheless, Italian public debt remains high and is expected to reach 137.4% of GDP in 2026 due to stock-flow adjustments associated with the "Superbonus" scheme, before beginning to fall from 2027 onwards (136.4% in 2028 as per government estimates). The long-term sustainability of this debt will depend on the relationship between the average cost of debt and nominal GDP growth, particularly in a scenario where refinancing costs are expected to be less favourable than those in the previous decade.

PHARMACEUTICALS ARE DRIVING ITALIAN EXPORTS

During the first nine months of the year, trade dynamics were positive (resulting in a trade surplus of approximately EUR 35.4 bn; +0.9% y/y). Exports experienced a nominal growth of 3.5% y/y, mainly driven by pharmaceuticals (+35%), basic metals (+6.7%) and food products (+5%), while imports increased by 3.7%. The growth in exports was particularly strong towards EU countries (+4.5% y/y, compared to an increase of just 2.4% for countries outside the EU). Notably, exports to Spain surged by 11.8% y/y (accounting for 5.5% of total exports), while Switzerland also saw an increase of 11.8% (representing 4.8% of total exports).

Despite ongoing trade tensions and the introduction of US tariffs in August, exports to the United States grew by 9% y/y in the first nine months of the year, with pharmaceutical exports being the main contributor (+58.3%). However, the performance of Italian exports to the US was slightly below the EU average (+10% y/y between January and September 2025).

The US-EU trade agreement, although disadvantageous for the EU, has helped to reduce uncertainty, but the outlook for Italian exports to the US remains weak. On the other hand, the ratification of the EU-Mercosur agreement is expected to open up significant alternative markets that would be advantageous for Italian companies. In summary, Italian exports are projected to experience only marginal growth in 2025 before entering a phase of stronger growth in 2026, while imports are expected to rise more markedly in 2025-2026, driven by domestic demand.

PRODUCTIVITY AND COMPETITIVENESS: ITALY'S STRUCTURAL CHALLENGES

Italy continues to exhibit a growth in labour productivity that is significantly lower than that of its European counterparts: according to Eurostat data, the average annual productivity growth from 1995 to 2024 was a mere 0.2% in Italy compared with 1.2% in the EU. Following a brief recovery from 2009 to 2014 (+0.6% per year), productivity has stagnated once more – or is nearly stagnant – at +0.1% annually for around a decade. Undoubtedly, in the last five years, employment has seen considerable growth (+4.4%, in line with the EU average), but this increase has primarily occurred in low-productivity sectors. The rising costs of capital have also led companies to prioritise labour over investment, especially in intangible assets – an area where Italy lags behind its main competitors. From 1995 to 2023, intangible investment as a share of GDP increased only slightly, from 7% to 8.4%, compared to sharper increases in France (from 11% to 16%) and Germany (from 7% to 10%). The adoption of digital technologies is impeded by the low level of digital skills among the workforce: only 16% have advanced information and communication technology (ICT) skills (compared to around 30% in Germany and France), and graduates in science, technology, engineering and mathematics (STEM) account for only 15% of the total (EU average: 26%).

ITALY : PUBLIC DEBT BY HOLDER (%)

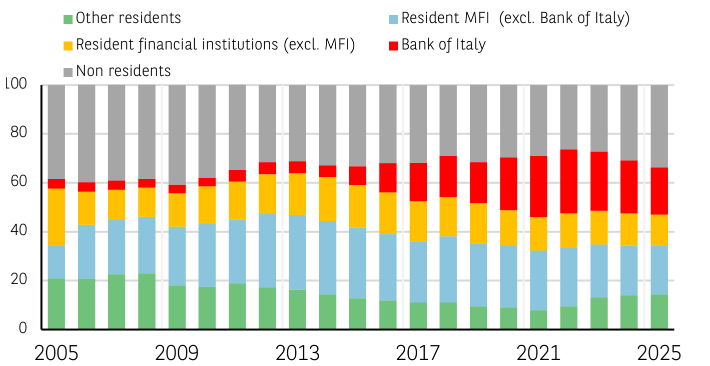

CHART 2 SOURCE: BANCA D'ITALIA, BNL ECONOMIC RESEARCH

ITALY: REAL LABOUR PROUCTIVITY PER HOUR WORKED

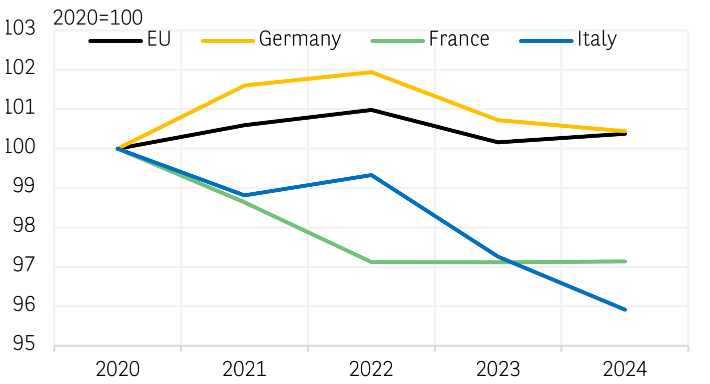

CHART 3 SOURCE: BANCA D'ITALIA, BNL ECONOMIC RESEARCH

The productive system is highly fragmented, primarily consisting of micro-enterprises, which restricts export potential, digitalisation and innovation – all of which are linked to significant productivity gains (15-30% for digital technologies and around 20% for innovation).

Boosting productivity will require greater investment in human and intangible capital, support for company-size growth, and full implementation of the NRRP reforms. In this regard, the government has taken concrete measures: under NRRP mission No.1 (digitalisation, innovation, competitiveness, culture and tourism), over EUR 16.9 bn has been allocated, with around EUR 6.1 billion earmarked for "digitalisation, innovation and security in public administration" and around EUR 6.9 bn for "digitalisation, innovation and competitiveness of the production system". In addition, over the last three years of the current administration, around EUR 6.3 bn has been allocated specifically to facilitate the digital and energy transformation of businesses.

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