ITALY

THE SUMMER BREAK FOR THE ITALIAN ECONOMY

In Q3 24, real GDP remained unchanged. Domestic demand added 0.5 percentage points to the overall growth, while the net exports contribution was negative. The economic slowdown reflects the disappointing performance of manufacturing (-1.3%), while the services value added rose 6.5% above pre-crisis level. Italian exports have been declining in the last year and a half. The potential implementation of new measures to protect US production by the new US administration might have a significant impact on the Italian production system. The Italian trade surplus with the US in the first eight months of 2024 stood at EUR 26.5 bn, about 70% of the overall trade surplus.

DOMESTIC DEMAND REMAINS THE MAIN DRIVER OF ECONOMIC GROWTH

Over the summer, the recovery of the Italian economy came to a halt. In Q3, real GDP remained unchanged, after +0.3% q/q in Q1 and +0.2% in Q2. Domestic demand added 0.5 percentage points to the overall growth. The net exports contribution was negative (-0.7 pp), as exports posted their third consecutive decline (-0.9%), while imports rose by 1.2%. The contribution of inventories was +0.2 pp. In Q3, real GDP rose by 0.4% y/y and by 5.6% compared to Q4 2019.

In 2024, the Italian economy is expected to grow by 0.5% according to our forecasts. In 2025, real GDP should gradually accelerate, benefiting from the further implementation of the NRRP and the acceleration of consumption, while the fiscal stance should become less supportive.

GROWTH AND INFLATION

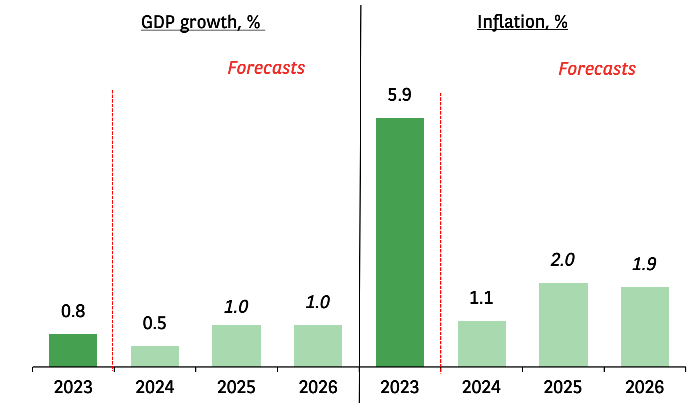

CHART 1

SOURCE: BNP PARIBAS GLOBAL MARKETS

INCREASING PURCHASING POWER SUPPORTS HOUSEHOLD CONSUMPTION

Labour market conditions have further improved. The number of people employed has risen above 24 million, with the employment rate at 62.5%, 3 percentage points more than in 2019. Nominal wage growth has accelerated: from January to September, hourly contractual wages rose by more than 3%.

After falling to 0.7% y/y in September, inflation picked up to 1.6% in November, remaining well below Euro area average (2.3%). The acceleration reflected the monthly increase of prices of food products (+3.2% y/y, from +2.5% in October) and energy (-5.4% y/y, from -9%). In 2024 as a whole, inflation is expected to be slightly above 1%. In the years ahead, the evolution of prices should remain moderate, except in the services where wages are expected to exert further upward pressure.

As nominal income has increased more than inflation, the purchasing power of Italian households has recovered, sustaining private consumption, which rose strongly by 1.4% q/q in Q3 (+0.2% in Q1 and +0.6% in Q2), adding 0.8 percentage points to the overall growth. Consumer confidence remains above long-term average, despite the persisting uncertainty surrounding the overall scenario. In 2025, consumption is expected to accelerate, as nominal income should continue to increase more than inflation.

DISAPPOINTING INVESTMENT

Economic conditions for Italian companies have slightly deteriorated, as higher costs partly eroded economic margins. Although the annual growth rate has fallen into negative territory, producer prices in the manufacturing sector are still about 20 percentage points higher than at the beginning of 2021. Labour costs of non-financial corporations rose to almost EUR 150 bn, more than 55% of the value added. The profitability of companies, measured by the ratio between the gross operating surplus and the value added, declined to 42.6%, slightly above the lowest level in the last twenty years. Although still above the long-term average, business confidence has deteriorated. As a result, the propensity to invest has declined, also reflecting the uncertainty about the implementation of new fiscal incentives to support expenditure on machinery and equipment. In Q3, gross fixed capital formation recorded its third consecutive decline (-1.2%), subtracting 0.3 percentage points from GDP growth.

A MIXED PERFORMANCE BY SECTOR

On the supply side, the slowdown of the Italian economy mainly reflects the disappointing performance of industry. In Q3 2024, manufacturing value added posted its eighth contraction in the last nine quarters (-1.3%). Production, which had increased by almost 3% in the first part of the recovery, has declined by 7% over the last two years, falling about 4.5 percentage points below pre-crisis level. The decline was stronger in more energy-intensive sectors, such as wood and paper, metals and chemical products. Production of textile products, clothes and leather items fell by more than a quarter compared to Q4 2019, also due to a long-term structural decline in activity.

The disappointing performance of the manufacturing sector reflects the slowdown of exports of goods, which have been declining in the last year and a half. In the twelve months ending in September, the value of Italian sales abroad fell to around EUR 620 bn, about EUR 20 bn below their value at the beginning of 2023. Italian companies are suffering as a result of the weakening of German economy, with total exports falling by 5.5% from January to September, with transport exports plummeting by more than 20% and metal products dropping by 12%.

The performance of the construction sector remains mixed. In Q3, the value added rose by 0.3% q/q, partly recovering from the previous decline (-0.7%). The residential sector is suffering as a result of both the phasing-out of fiscal incentives for housing renovation and the stubbornly high financing costs. Residential building permits have declined, signalling the risk of weakening activity in the coming quarters. Signs of resilience seem to come from non-residential buildings, which should be sustained by RRF-related spending.

Services are still the main driver of growth. In Q3 2024, value added increased by 0.2% q/q, after +0.6% in Q1 and +0.3% in Q2, rising to 6.5 percentage points above pre-crisis level. Services are benefiting from the recovery of tourism. From January to August, expenditure by foreigner travellers in Italy rose to EUR 38.5 billion, well above the same period in 2019, while the number of travellers increased to 62.8 million, 3.4 million more than in 2023.

A CAUTIOUS PUBLIC FINANCES STANCE

The EU Commission has approved the first Italian medium-term fiscal structural plan, based on a seven-year adjustment path, with a wide program of investments and structural reforms, ensuring continuity with those of the NRRP (judiciary, public administration, digitalization, competition and business environment). The Plan envisages a relatively rapid exit from the excessive deficit procedure launched by the EU Council in July 2024.

The public deficit is expected to drop below 4% of GDP in 2024, from 7.2% in 2023. The positive effect of the phasing-out of both measures to mitigate the impact of high energy prices and tax credits for housing renovations with the better-than-expected performance of tax revenues will be only partly offset by cuts to the labour tax wedge.

The draft budget for 2025-27, currently under discussion in the Italian Parliament, has a net expansionary effect of 0.4% of GDP in 2025, 0.6% in 2026 and 1.1% in 2027, when compared to the current legislation. The public deficit is expected to slightly decline in 2025 and then fall below 3% of GDP in 2026. Because of slower nominal growth, the debt-to-GDP ratio is expected to slightly increase, also reflecting the delayed impact of the tax credits for housing renovations, rising to 138% of GDP in 2026 and then falling in the years after.

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HIGH EXPOSURE OF ITALY TO HIKES IN US TARIFFS

The start of the new Trump presidency, and the potential implementation of new measures to protect US production, are expected to have a significant impact on the Italian production system, due to the strong commercial ties between the two countries.

The weighting of the United States in Italian foreign trade has been growing in recent years, and in 2022, the United States became the second destination for Italian exports, overtaking France. In the first eight months of 2024, 10.4% of Italian sales abroad went to the United States (for a value of EUR 43.3 bn). In the same period of time, the United States accounted for 4.5% of Italian imports (EUR 16.9 bn). The Italian trade surplus with the United States in the first eight months of 2024 therefore stood at EUR 26.5 bn, equivalent to approximately 71% of the overall Italian trade surplus.

On the US side, in 2023, Italy had the tenth largest trade deficit to the country. However, the deficit with Italy accounted for less than 1% of the US's overall trade deficit.

US multinationals also have a major presence in Italy. In 2022 (latest available data), they ranked second in number (2,603) but first in terms of employees (around 351,000), value added and turnover. In the manufacturing sector alone, US-controlled multinationals in Italy contributed 8.1% to the total value added. An analysis conducted by Istat shows that, in 2021, US multinationals in Italy in the pharmaceutical sector accounted for 46.1% of the sector's exports, while this same figure was 10.6% for the chemical sector. In terms of imports, in 2021, US multinationals generated over 54% of Italian imports of coke and refining products, and shares between 25 and 45% of imports of food, electrical equipment, machinery and furniture. With specific reference to Italy-US trade flows, in 2021, US-controlled multinationals in Italy were behind 11.7% of exports of transport (other than automobiles) to the US, as well as 8.9% of exports of machinery and 8.4% of exports of rubber and plastic.