Italian Economic Outlook 2024-2025, Introduction – Centro Studi Confindustria

ITALY'S GROWTH AMIDST GLOBAL TENSIONS, INTEREST RATES AND THE NRRP

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INTRODUCTION AND SUMMARY

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Global GDP will continue to expand moderately, slightly decelerating in 2025. The global growth scenario outlined in this forecast report takes into account a slowdown in the US, which is almost entirely offset by an improved performance in the Eurozone and continued high growth in emerging markets (Table A). Specifically, a soft landing scenario is expected for the US, with growth slowing from +2.5% in 2023 to +2.3% in 2024 and +1.5% in 2025. Growth in emerging markets is revised slightly upwards in 2024 compared to our April's expectations, thanks to better performances of some economies, including Argentina, Turkey, Poland and Russia. However, if we look at the top five emerging economies, and primarily at China and India, there has been a slightly downwards trend since 2023.

Table A
International exogenous variables of the forecast
(% changes)

	2023	2024	2025
World trade	-1,1	1,6	2,8
GDP - United States	2,5	2,3	1,5
GDP - Eurozone	0,5	0,7	1,0
GDP - Emerging markets	4,4	4,3	4,4
Oil prices[1]	83	83	84
Gas price (Europe)	41	33	37
Dollar/euro exchange rate[2]	1,08	1,09	1,10
Effective FED rate[3]	5,02	5,14	3,39
ECB dep rate[3]	3,30	3,70	2,38

[1] Brent, dollars per barrel; [2] levels; [3] % values.
Source: Centro Studi Confindustria elaborations based on Refinitiv, IMF, CPB data.

The growth gap between the Eurozone and the other two major global players is significant: From the pre-pandemic period (end of 2019) to mid-2024, the Euro Area GDP increased by +3.9% compared to +10.7% in the US and +22.8% in China. Even in the current year, the European growth rate (+0.2% in the second quarter with respect to the first) remains markedly lower than that of the US and China (+0.7% each). The old continent, in fact, is grappling with a sharp decline in investments and a slowdown in household consumption, both linked to high interest rates. The industrial business confidence indicator has been in a recessionary mode for 19 months, reaching its lowest point since August 2020. Only in the second half of next year will the easing of monetary policy, which is expected to return to neutral at the end of 2025 (-200 basis points from last June to the end of 2025), have a significant impact on growth, along with the recovery of household purchasing power.

Global trade in goods has resumed expansion in the first seven months of 2024, following a setback in 2023, and is expected to progressively strengthen, returning to pre-pandemic growth rates. This recovery is driven by stronger demand fueled by declining inflation which supports household purchasing power and confidence, as well as by falling interest rates in major economies, allowing for a gradual increase in credit and higher investments. Global demand is primarily driven by US imports (the world's largest importer) and China's exports (the world's largest exporter).

Signs of decoupling continue. In China, a gradual decline in imports is underway despite robust growth in exports and industrial activity. This suggests weak domestic demand on the one hand, and, on the other hand, a shift to relocating production processes upstream within national borders, thus reducing reliance on foreign inputs. Moreover, signs of decoupling between China and the US are increasing (shown by diminished cross-purchasing operations) and more recently between China and the European Union. At the same time, trade connections between the EU and the US are strengthening.

Various factors continue to fuel global tensions and negatively impact commodity prices and trade: persisting high interest rates, energy prices above pre-2022 levels, ongoing wars in Ukraine and the Middle East (with shipping costs for Asia-Europe and Asia-US routes significantly above 2023 levels and more than doubled for transatlantic routes) and a rise in protectionist measures (at rates more than double those implemented before 2020). Additionally, uncertainty in multilateral relations is heightened by the approaching presidential elections in the US. In Europe, the automotive crisis is further complicating the landscape, weakening industrial activity, particularly in Germany.

Several factors are expected to positively influence the Italian economy over the next two years: the recovery of international trade, in the second half of 2024 and especially in 2025; the easing of monetary policy, which will have increasingly positive effects on investment decisions by businesses and household consumption, especially in 2025; a moderate strengthening of growth in the Eurozone, which is largely in line with the projections for the Italian economy; an improvement in household real disposable income due to further job expansion, declining inflation and a gradual recovery of real wages. Finally, further stimulus will be provided by the implementation of the National Recovery and Resilience Plan (NRRP), with €9.5 billion spent so far this year out of the €42.2 billion planned. Although it is assumed that only part of the allocated resources will be spent (half this year and two-thirds next year, for a total of around €60 billion out of over €100 billion planned), the Plan's contribution to growth is expected to be significant. However, the persistent fragility of the German economy, Italy's primary export market (-5.4% the drop in Italian exports during the first seven months of 2024), global tensions and the diminishing impact of building renovation incentives, particularly next year, will act as headwinds.

Lower growth in Italy following the National Accounts revision. The Confindustria Economic Research Department's forecast for the Italian economy has been revised downward by a couple of tenths of a percentage point per year compared to the projections presented last April: GDP is expected to grow by +0.8% in 2024 and +0.9% in 2025 (Table B). These growth rates are, however, higher than those recorded, on average, by Italy in the pre-pandemic decades.

Table B
The CSC forecast for Italy
(% changes)

	2023	2024	2025
Gross domestic product	0,7	0,8	0,9
Household consumption	1,0	-0,1	0,9
Public consumption	1,9	0,0	1,3
Gross fixed capital formation	8,5	0,5	-1,3
Exports of goods and services	0,8	0,6	2,0
Imports of goods and services	-0,4	-2,9	1,9
Employment (FTEs)	2,3	1,4	0,5
Total employment (headcount)	2,1	1,7	0,9
Consumer price index	5,7	1,1	1,8
Per capita wages	2,3	4,2	3,1
Government net borrowing[1]	7,2	3,9	3,1

[1] Percent of GDP.
FTEs = full-time equivalent work units.
Source: Centro Studi Confindustria elaborations and estimates based on Istat data.

According to the recent comprehensive revision of national accounting data by Istat, Italy's growth in 2023 was +0.7%, down from the previously estimated +0.9%. Furthermore, although GDP growth rates remained unchanged in the first two quarters of 2024, the weaker outcome at the end of 2023 implies the elimination of the statistical carry-over effect for 2024, which had previously been estimated at +0.2%.

This year, on the supply side, GDP growth is only driven by the services sector (+0.6% in the second quarter, following a strong increase of +0.8% in the first); **all other sectors are declining**. Activity in the services sector has slowed in the third quarter of 2024 but should pick up momentum in the latter part of the year and into 2025, sustained by moderate inflation, rising real household disposable income and improved access to consumer credit. In 2024, the residential construction sector is being heavily affected by the reduction of incentives and will be even more penalized in 2025 when other tax benefits will expire. In contrast, non-residential construction should benefit from NRRP resources and more favorable bank lending conditions. Nonetheless, over the two-year period, the negative impact of the decline in residential construction will prevail.

Industrial production decreased by 2.4% in 2023 and fell by an additional 3.2% in the first eight months of 2024 (compared to the same months in 2023). It remained negative in the third quarter, given the already negative carry-over effect of 0.5 percent implied by last August's outcome. Sector performance varied considerably, with growth in other means of transportation, repairs and installations (+8.0% and +5.3% in the first eight months of the year compared to the same period in 2023) as well as in food and paper industries (+2.7% and +1.9%). However, the automotive sector contracted heavily (-17.9%), along with leather goods (-15%) and clothing. Value added in industry excluding construction is expected to recover next year (-0.8% in 2024, the level reached at mid-year, and +1.0% in 2025), driven by a modest recovery in both domestic and external demand between the end of this year and the beginning of 2025.

Investments are expected to stabilize in 2024 (+0.5%) and decline in 2025 (-1.3%), following robust growth in recent years (+21.5% in 2021, +7.5% in 2022, and +8.5% in 2023). In the first half of 2024, investment growth was restrained by the zero contribution provided by residential investments, also compounded by a negative contribution from investments in plant and machinery. In the second part of the year, the growth rate is expected to turn negative due to the decline in residential construction, which will worsen in 2025 when additional construction incentives expire or revert to standard rates, despite the positive impact of interest rate cuts. The expected fall (-15%) will bring residential investments back to levels between those of 2021 and 2022, corresponding to 2008 values. Spending related to the implementation of the National Recovery and Resilience Plan (NRRP), which will boost investments in non-residential buildings, will partially offset this decline, along with a rebound in investments in plant and machinery which are expected to start increasing again from as early as the second half of 2024. These include investment spending which firms had postponed waiting to see the access criteria to Transition 5.0 incentives clarified. Indeed, these criteria (finally defined in August) are not without some implementation difficulties (such as the need for firms to quantify and demonstrate energy savings, unclear guidelines for combining these incentives with other measures funded by European resources and the exclusion of part of the production system in compliance with the Do No Significant Harm principle). Furthermore, both the cuts in interest rates and the improved economic outlook are likely to positively impact all investment components.

Real disposable income is rising, but consumption remains constrained as households seek to rebuild savings spent in previous years. Household spending on goods and services has returned to pre-COVID levels, bolstered by robust growth in 2023 (+1.0% on average for the year). In the first half of

2024, spending continued to increase, albeit at very modest rates (averaging +0.2% per quarter). Spending on goods, which declined last year (-1.3% on average), is also gradually recovering.

Real household disposable income decreased slightly in 2023 (-0.2% year-on-year), but it started growing again in the first half of 2024 (+2.2% with respect to 2023, if the second quarter level remains unchanged throughout the year), driven by ongoing employment expansion, stronger wage growth and moderate inflation. The high savings rate, which has risen significantly above "normal" levels (10.2% in the second quarter, compared to a 7.9% average during the 2015-2019 period), is restraining consumption and reflects households' intentions to replenish savings depleted in previous years (due to high inflation) amid an uncertain geopolitical context. Looking ahead, households are expected to gradually normalize their savings rate, increasing consumption. Furthermore, the reduction in interest rates which has already begun and is expected to continue will both favor loans and reduce costs for households, with positive effects which will be more evident especially in 2025.

The annual consumer price increase in Italy (0.7% year-on-year in September, expected to average +1.1% in 2024) is the lowest among major European economies and remains well below the ECB's target of +2.0%. For this reason, the still high interest rates are, in real terms, more restrictive in Italy than in other countries. In 2025, inflation in Italy is expected to partially increase, trending closer to core inflation values, which are just below +2.0%.

A decline in hours worked per employee is expected, reflecting a partial reversal of the sharp increase in working hours observed in recent years and in light of a series of factors, both cyclical (slowdown in construction activity and weakness in the industrial sector) and structural (a shift of production activity and employment towards services, characterized by shorter working hours). Indeed, this will lead to a modest improvement in labor productivity, with a projected increase of +0.6% in value added per hour worked in 2025, following declines in previous years (-0.6% in 2024 and -1.5% in 2023). This improvement is particularly notable in the industrial sector, where the phenomenon of job growth without corresponding output growth, observed since 2022, appears to have come to an end (alongside an increase of workers benefiting from CIG, the Italian Wage Supplementation Fund). The same is happening in the services sector, where a shift towards higher productivity areas such as information and communication, as well as professional, scientific, technical activities and support services has been taking place since 2022. On average for the year, as in 2023, employment, measured in terms of full-time equivalent units (FTEs), is expected to increase in 2024 at a faster rate than economic activity (+1.4% compared to a +0.8% growth in GDP). However, starting from mid-year this year and into 2025, employment (in FTEs) is expected to increase at a slower pace than GDP. **The total number of employed people, on the contrary, will continue to rise in line with GDP growth**.

Nominal wage growth, along with declining inflation, will lead to a gradual recovery in real wages, which are expected to increase by +4.3% in the 2024-2025 period, following a decline of -6.7% in 2022-2023. This rebound has already begun in 2023, driven by the private sector, where in the second quarter of 2024 real wages per FTE had recovered 40% of the purchasing power lost due to the inflation surge (-5.0% compared to the first quarter of 2021, from a low of -8.3% at the end of 2022). This was possible thanks to the rapid increase in contractual wages, which occurred earlier and was more pronounced in the industrial sector where, in the 2022-2023 two-year period, nearly all employees were covered by national collective labor agreements. Furthermore, the renewal followed the virtuous mechanism for adjusting contractual (base) wages established by social partners in 2009, which allowed for a quicker downturn in inflation compared to other European countries. In contrast, in

the public sector, where two rounds of collective labor contract renewals were significantly delayed, real per capita wages fell even more with the price surge (-13.2% in the first quarter of 2023 compared to the first quarter of 2021). Wages only began to recover in the second half of 2023, remaining nearly 9 percentage points lower than at the beginning of 2021 by mid-2024.

Unit labor cost in the Italian manufacturing sector continues to rise, driven by wage increases accompanied by declining labor productivity: +5.6% in the first half of 2024 compared to the same period in 2023, following an average annual increase of +5.9% in 2023. Improvements in labor productivity in 2025 are expected to moderate ULC growth, which, however, will still expand by about 3 percentage points due to strong wage increases.

Exports of goods remained stagnant in the first seven months of 2024 (-0.1% compared to the same period in 2023, following -1.2% last year) **due to the decline in European demand** which absorbs 52% of Italian exports. This was the result, in fact, of an increase in sales in non-EU markets (+1.8 percent), partly due to a +3.3 percent in exports to the United States (the second largest destination country for Italian sales), and a decrease in EU markets (-1.6 percent), with a -5.4 percent decline in exports to Germany, Italy's first export market. **Nevertheless, Italian exports have performed better than their potential demand**, gaining market share in their target markets.

Italian imports of goods, however, are significantly declining this year, reflecting weak domestic demand for both consumption and, in particular, investment, especially in machinery, as well as stagnant exports. As a result, **net export is making a strong contribution to GDP growth** this year (+1.2 percentage points) and is expected to remain marginally positive next year (+0.1 percentage points) when both exports and imports of goods are expected to start increasing again at moderate rates, favored by an improvement in global manufacturing activity, especially in Europe (although, at slower rhythms than global trade). Foreign purchases of energy products (gas and oil, accounting for 11% of Italian imports in 2023) have significantly contracted this year dropping by over one-fifth in real terms compared to the same period in 2023, thanks to previous stockpiling and mild winter temperatures, contributing to more than half of the total import decline.

The impressive performance of exports stems from a series of adjustments made over the past 10 to 15 years. Notably, the production base contracted by 16% (equivalent to 67,000 businesses) between 2011 and 2022, primarily impacting micro and small enterprises, while the number of medium and large firms has increased since 2015. Additionally, there has been a catching-up of productivity relative to other European companies, largely driven by small and medium-sized enterprises (those with 10 to 249 employees), which have consistently improved their efficiency compared to their German and French counterparts (the group of "best" producers is made up of just under 20% of Italian manufacturing firms, which employ more than 50% of the workforce and generate about 50% of value added). Furthermore, the share of exporting companies has risen from below 21% in 2011 to over 22% in 2022, as the number of exporting firms declined less compared to other businesses, accompanied by an increase in average exports per company, regardless of size.

The competitiveness issues. In the coming years, several factors pose risks to the country's ability to grow.

The demographic decline will increase the shortage of workers, which is already a problem: before the pandemic firms reported recruitment difficulties for 26 percent of projected hires (1.2 million positions), while by 2023 the share had exceeded 45 percent (nearly 2.5 million positions). Factors such as low internal mobility, brain drain, shortage of non-EU workers tend to exacerbate the problem. According to Istat demographic projections, the natural

balance of Italy's resident population is expected to decline by 1.5 million units between the beginning of this year and the end of 2028. Despite the expected positive foreign migration balance of 1.2 million, the working-age population will shrink by 850 thousand units. If the employment rate remains unchanged, the labor supply is projected to shrink by 520,000 units within five years. A modest economic growth of 4.9% cumulative in 2024-2028 would imply an additional employment needs of about 815 thousand units. This means that the labor mismatch could widen by 1.3 million units by 2028. Regionally, it will be less severe in the North, remaining below the national average in the Center, while it will be more pronounced and challenging in the South. It is difficult to think of compensating for such a large mismatch by just increasing the employment rate, which would need to rise by 3.7 percentage points. Assuming a two-point increase in the employment rate (a more likely target over a five-year period), there would still be a shortfall of 610,000 work units, which would have to be filled by increasing the number of foreign workers by about 120 thousand more per year to avoid harming economic growth.

Excessively high housing costs, relative to productivity and wage differences across regions, hinder worker mobility. Housing costs are a key factor in the decision to relocate to another geographic area for work. In an ideal market, housing costs should be proportional to the region's productivity level and consequentially to average wages. When housing prices are too high relative to productivity, even in areas with high labor demand, they create a barrier for workers who might consider moving to such areas. In Italy, this issue is particularly evident in certain provinces like Milan, Como, Venice, Bologna, Florence, and Rome, as well as the North-West generally and Central Italy. The paradox is that some regions with high labor demand experience staff shortages, while other areas with lower productivity and fewer job opportunities suffer from high unemployment rates. Supportive measures for rental prices and a comprehensive plan aimed at promoting the construction or refurbishment of properties at controlled prices could help reduce these imbalances and increase worker mobility.

Gas and electricity prices are still higher in Italy, both compared to other large European countries such as France and Germany, and to the US, penalizing the competitiveness of Italian companies vis-à-vis their main western partners. In addition to the initiatives already underway, a useful contribution could come from reforming the electricity market by separating electricity prices from gas prices, as well as, in the long term, developing nuclear energy.

The collapse of the auto sector, where production has fallen back to approximately the early 2013 level, poses a significant risk to Italy's growth, due to its importance, in both the short and medium-to-long term. In July 2024, automotive production fell by 26.1% compared to July 2023, as compared to a 3.8% decrease in overall industrial production. In the subsector excluding the production of auto parts and components, the decline was even deeper (-34.7%). This phenomenon, while linked to weak demand, is not solely cyclical (imports of vehicles to Italy have actually increased slightly by 2.0% year-on-year). Shifting consumer habits are also affecting demand: younger generations show less interest in car ownership compared to previous ones and vehicle-sharing is experiencing significant growth. However, costs remain a critical factor. In Europe, the most affordable electric vehicle in 2023 was 92% more expensive than the cheapest internal combustion engine model, primarily due to battery costs, which account for around 40% of total costs. Price disparities widen as vehicle size decreases. When comparing two alternative engines for the same small car over a 10-year span, including all costs, switching to an electric vehicle results in an additional burden of approximately €5,700 for Italian drivers, an additional 15%. Furthermore, electric vehicles entail longer charging times, significantly reduced driving ranges, limited avail-

ability of charging infrastructure, and declining battery performance. The correlation between ongoing transformations and the collapse of production in the automotive sector appears to be more than coincidental. Nevertheless, this sector is too vital for both the Italian and European economies: the core automotive industry alone accounts for 13% of European manufacturing revenues, 6.3% of Italian manufacturing production, with a value added of €15 billion and 170,000 jobs in Italy. This does not even account for the extensive domestic supply chain (when included, the sector contributes 5.6% to total value added according to Anfia). This encompasses not just metal products but also rubber and plastics, metallurgical activities, machinery manufacturing, and electrical equipment.

The increasingly stringent EU regulations, the ETS (Emissions Trading System), combined with the operational CBAM (Carbon Border Adjustment Mechanism), heightens the risk of certain regulated manufacturing activities, representing 9% of manufacturing value added in both Italy and, on average, in Europe, being relocated outside the EU. The EU has set a maximum limit on total emissions allowances, which is revised and reduced annually, aiming for a 62% reduction by 2030 compared to 2005 levels. The significant reduction in available allowances, combined with the possibility for external operators to purchase EU allowances on the market has led to a substantial increase in allowance purchase prices: since early 2021, prices have surged by 42%, creating a competitive disadvantage for European companies. This disadvantage was already evident in 2021, when carbon prices applied to the production of steel, aluminum, and cement in EU countries were generally higher, often substantially, than those available in import and export markets, while they were lower for countries outside the system, like the United States. According to a simple simulation conducted by the Confindustria Research Department (CSC), the elimination of free allowances used by Italian companies within the ETS, scheduled for 2034, will result in an average direct production cost increase of 3% for regulated companies. The average increase will exceed 5 percent for firms producing petroleum refining derivatives and products from the processing of nonmetallic minerals (such as refractory products, cement, concrete, gypsum, glass, ceramics, etc.), and 7% for the 25% of firms most exposed to these changes. Furthermore, considering the already existing impact of the ETS on electricity costs, which creates a competitive disadvantage for the entire EU, it becomes clear that this mechanism poses significant challenges and may adversely affect firms' willingness to invest in Europe.

The introduction of the CBAM (Carbon Border Adjustment Mechanism) in 2026, which will impose a carbon tax on imports of a group of high-emission products such as pig iron, iron, steel, aluminum, cement, fertilizers, electricity, and hydrogen from non-EU countries, will raise similar risks. EU imports from non-EU countries in sectors affected by the CBAM tax exceed 4% of total imports outside the single market, contributing to a trade deficit of approximately €15 billion. Italy is the most heavily exposed of the main European manufacturing countries, with 7.5% of total imports affected, and has an extra-EU trade deficit of -5.0 billion in these products, although it has a surplus when considering trade within the single market. Since European companies compete in markets where carbon is not priced (e.g., in various US states) or is cheaper (e.g., in China), a loss of competitiveness in those markets is likely. Moreover, applying the tax upstream in the production chain penalizes goods that are often semi-finished or raw materials rather than finished products, effectively to the detriment of the European industry, primarily a manufacturing and transformation industry. Finally, in addition to being easy to circumvent, its implementation demands extensive information, increasing the administrative burden along the entire production chain, particularly for small and medium-sized enterprises. At the same time, the lack of a uniform method for calculating emissions further heightens the risk of penalties for companies that fail to meet the requirements.