EY Italian Macroeconomic Bulletin

N°7 | June 2024

EY

Building a better
working world

Index

Executive summary

▸ World growth is projected at 3.1% in 2024, accelerating moderately to 3.2% in 2025. This outlook comes alongside a projected decline in global inflation. Peaking at 6.8% in 2023, inflation is expected to fall to 5.9% in 2024 and further down to 4.5% in 2025.

▸ The international scenario remains characterized by substantial uncertainty: energy and commodity prices are still affected by geopolitical tensions, growth in the world's major economies is uneven, and the major central banks' path on monetary policy is turning hard to predict, creating uncertainty for businesses and investors.

▸ The Eurozone is characterized by weak economic growth (+0.3% growth in the first quarter of 2024), after two quarters of no or slightly negative growth. Industrial production is still subdued with PMI indicators show manufacturing activity below the expansion threshold. On the other side, the services sector is characterized by better outlook (above the expansion threshold).

▸ In a context of weak economic activity and declining inflation rates in the Eurozone (inflation expected at 2.4% in 2024), the ECB cut key interest rates by 25 basis points. This marks the first reduction since July 2022

▸ In Italy, inflation is lower than the Eurozone average (0.8% in May 2024, confirming a scenario of inflation below 2% from October 2023). This is due to the negative contribution of the energy goods component. Low inflation rates translate into higher real interest rates, which tend to discourage consumption and investment.

▸ EY expects real GDP growth of 0.8% in 2024 and 1.3% in 2025 for Italy, while the inflation rate will move from 5.6% in 2023 to 1.4% in 2024 and 2.0% in 2025. However, these projections come with a significant caveat: mixed economic data and recent geopolitical events create a high degree of uncertainty. Two simulations, carried out with EY's econometric model on possible scenarios of a partial utilization of the PNRR (National Recovery and Resilience Plan) funds underline their importance for growth. Specifically, a utilization of 70% and 90% of the planned resources in 2024 and 2025 respectively would result in a cumulative reduction in growth in 2025 of about 0.5 percentage points compared to the full utilization of these resources; a utilization of 50% and 70% of the resources in the two years of analysis would result in an even more pronounced reduction (1.2 percentage points).
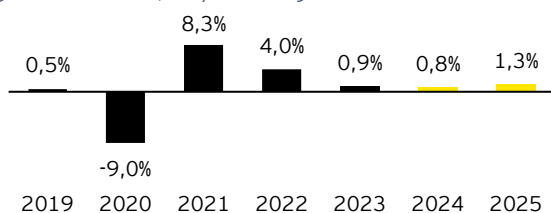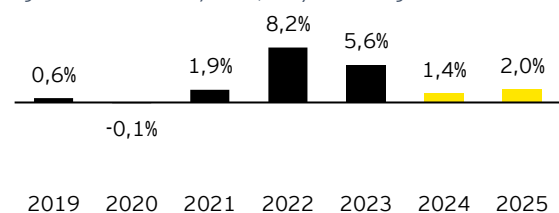
Figure 1: Real GDP, Italy - % change

2019	2020	2021	2022	2023	2024	2025
0,5%	-9,0%	8,3%	4,0%	0,9%	0,8%	1,3%

Figure 2: Consumer prices, Italy - % change

2019	2020	2021	2022	2023	2024	2025
0,6%	-0,1%	1,9%	8,2%	5,6%	1,4%	2,0%

Source: ISTAT and forecasts from EY Italy's Macroeconometric Model, 'HEY-MoM' (see Technical Appendix for details). The yellow bars represent the forecast horizon.

The Global Scenario

The World Economy

The latest projections of the Organisation for Economic Co-operation and Development (OECD) in May 2024 show a global growth in line with the values experienced in 2023 (around 3.1%), which is expected to be followed by 3.2% growth in 2025.[1] This is consistent with the expectations of the International Monetary Fund, which in April 2024 expected global GDP growth in 2024 and 2025 at 3.1% and 3.2%.[2]

The latest forecasts reflect some signs of improvement in the international scenario, considering that in the previous Economic Outlook of February 2024 the OECD estimated world growth to be 0.2 percentage points (p.p.) lower for the two years analyzed, at 2.9% for 2024 and 3.0% for 2025.[3]

Going into detail, it is possible to identify a strong heterogeneity among the major countries and regions of the world. Specifically, the US showed robust growth in 2023 (2.5%), which is expected to be followed by similarly dynamic growth in 2024 (2.6%) and a slight slowdown in 2025 (1.8%). The resilience and strength of the US economy is higher even when compared to previous growth expectations, especially for 2024, where a 2.1% growth was expected. The forecast for 2025 also improved (from 1.7% to 1.8%).

However, the picture is different for the Eurozone, which continues to show an overall economic weakness. According to the OECD, GDP growth in the Eurozone will be 0.7% in 2024, after a 0.5% growth in 2023. Only in 2025 will the Monetary Union countries show more dynamism, with growth of 1.5%.
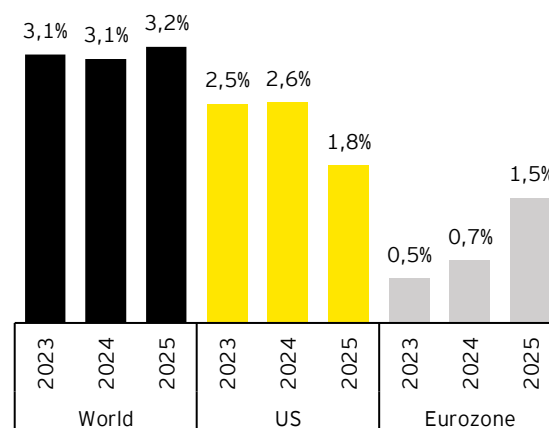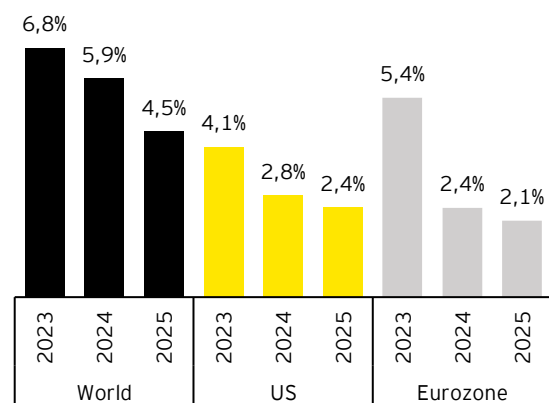
Figure 3: Real GDP - % change

Figure 4: Consumer prices - % change

Source: For GDP data, EY elaborations on data and forecasts from OECD Economic Outlook, May 2024. For consumer prices, EY elaborations on data and forecasts from IMF World Economic Outlook, April 2024.

Although these values are far from those expected for the United States, it is important to emphasize that a slight optimism is also perceived for the Eurozone, which translates into an upward revision of growth by 0.1 and 0.2

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[1] OECD Economic Outlook, May 2024.
[2] IMF World Economic Outlook, April 2024.

[3] OECD Economic Outlook, Interim Report February 2024.

percentage points for 2024 and 2025 (previously the forecasts were 0.6% and 1.3%).

This improvement is potentially due to the slowdown in inflation in recent months, which would translate into a slight pick-up in business confidence and a consequent increase in economic activity.

The global inflation picture is one of expected decline but rather at a gradual pace. While inflation is projected to fall from the peaks reached in 2022, it will likely remain above the average experienced in the past two decades (3.9% between 2000 and 2019). This suggests a period of gradual moderation in inflation, but one that may take some time to reach pre-pandemic levels. Overall, the inflation rate in 2023 averaged slightly below 7%, and is expected to fall to 5.9% in 2024 followed by a further decline of 1.4 percentage points in 2025 (to 4.5%).

In US, inflation in 2023 stood at 4.1%, followed by a decrease to 2.8% in 2024 and 2.4% in 2025, which is more in line with the Federal Reserve's (Fed) price stability target (2%). A similar trajectory is expected for the eurozone (5.4% in 2023, followed by a decrease to 2.4% in 2024 and 2.1% in 2025).

Although world economic growth is estimated to be steadily above 3% over the forecast period, this figure remains lower than that experienced in the two decades before the pandemic (2000-2019, where the world growth rate was around 3.7% on average per year). The lower demand is one of the factors behind the slowdown in world trade, which is reflected in a deviation from the trend derived from the data between 2000 and 2019.[4]

Figure 5: Trade in volume, world - index, 2010=100
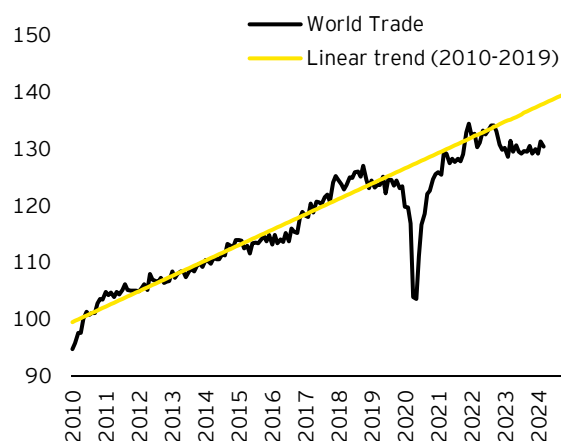
Source: EY elaborations on CPB Netherlands Bureau for Economic Policy Analysis data. Trade refers to trade in goods. Last observation: March 2024.

Another element behind the international trade dynamics is the evolution of geopolitical events in recent years,[5] as well as specific environmental issues.

For the former, after the attacks on commercial ships in the Red Sea as a result of the tensions in the Middle East, part of global trade was diverted to other routes, e.g., to the Cape of Good Hope. This redirection, which affected about 9% of the world's maritime trade and about 18% of the volumes of ocean-going long-haul ships, with a consequent increase in journey times between Northern Europe and Asia of about 30%, seems, however, to have had only a marginal negative effect on price level, due to the moderate growth in world demand.

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[4] Attinasi, M. G., Boeckelmann, L., Hespert, L., Linzenich, J., Meunier, B. (2024). Global trade in the post-pandemic environment. ECB Issue 1, 2024. Box 1.

[5] Caldara, D., & Iacoviello, M. (2022). Measuring geopolitical risk. American Economic Review, 112(4), 1194-1225.

Figure 6: Volume of trade transiting the Panama Canal and Cape of Good Hope – metric tonnes
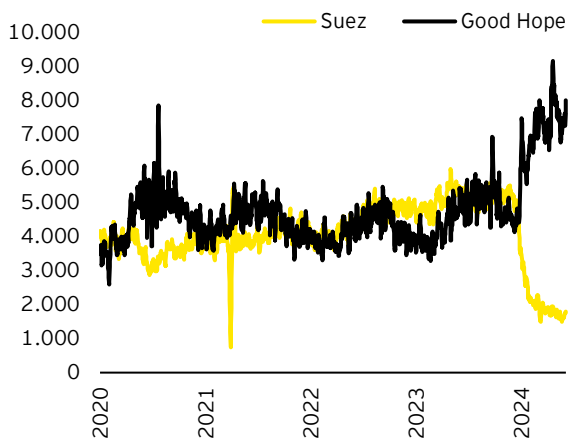
Source: EY calculations on IMF PortWatch data. Data are represented as an index of the 7-day moving average of trade volume expressed in thousands of metric tonnes. Last observation: 04 June 2024.

Therefore, the complexities in the Suez Canal are geopolitical in nature, triggered by a partial escalation of the conflict between Hamas and Israel. Consider that 90% of global trade volume takes place by sea and 12% of this transited the Suez Canal before the crisis.[6] On the other hand, the complexities in the Panama Canal have a different nature: the drought caused by insufficient rainfall on Lake Gatún, which feeds the canal, has reduced trade flows significantly (around 30%) compared to the average values recorded in 2022.[7]

Returning to recent geopolitical dynamics, these do not only influence international trade developments, but also commodity prices, representing a factor of potential uncertainty.

The first two months of 2024 marked a continuation of the reduction in the price of natural gas quoted on the European market, a reduction that continues since October 2023, until it reached a price of $8.15/mmbtu[8]. March, April and May were, on the contrary, characterized by an increase in the cost of gas,

bringing prices back to around $10.1/mmbtu, a higher value than that recorded in the previous months but significantly lower than that experienced in 2023. A similar dynamic was recorded for the price of gas on the US market[9] ($2.13/mmbtu in May 2024, compared to $1.50/mmbtu in March 2024).

On the other hand, the oil price trend was different, with Brent oil reaching $90.1/bbl in April,[10] after rising since December 2023 ($77.9/mmtbu), and then returning to $82/bbl in May 2024. When discussing oil price trends, it is important to consider various factors influencing their dynamics.

Figure 7: Energy commodity prices ($)
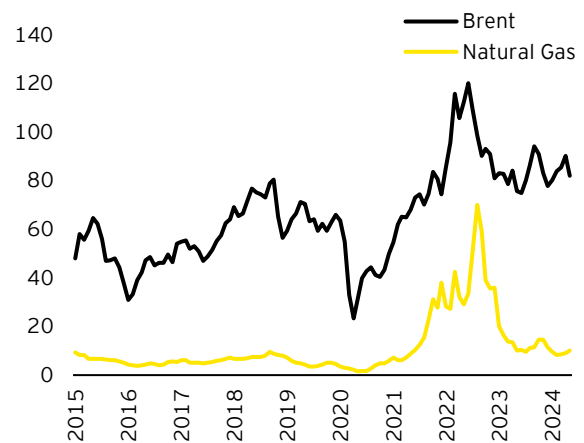
Source: EY elaborations on World Bank data. Brent and natural gas prices are expressed in $/bbl and $/mmbtu, respectively. Natural gas prices refer to natural gas quoted in the Title Transfer Facility (TTF). Last observation: May 2024.

On the one hand, the prolonged supply cuts by OPEC+ are supporting the increase in oil prices,[11] leading the US Energy Information Administration (EIA) to expect a supply deficit for the first part of 2024, which will lead to an average Brent price in the second quarter of 2024 at around $88/bbl.[12] These effects are partly balanced by the increase in supply by non-OPEC+ countries, especially the US.[13]

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[6] Confindustria, Congiuntura Flash, January 2024.
[7] Arslanalp, S., Koepke, R., Sozzi, A., Verschuur, J. (2023). Climate Change is Disrupting Global Trade, IMF Blog, November 2023.
[8] Dollars for one million British thermal units, which is a measure of the amount of gas.
[9] For the European figure, reference is made to natural gas quoted in the Title Transfer Facility (TTF). For the American figure, reference is made to the spot price at the Henry Hub, Louisiana.
[10] Dollars per barrel of oil. One barrel is equivalent to about 159 litres.
[11] Organisation of the Petroleum Exporting Countries (OPEC). It is the grouping of oil exporting countries, whose aim is to coordinate and unify oil policies among member countries in order to ensure fair and

stable prices for oil producers, an efficient, cheap and regular supply of oil to consumer countries and a fair return on capital for those who invest in the sector. OPEC's current member countries are Algeria, Angola, Congo, Equatorial Guinea, Gabon, Iran, Iraq, Kuwait, Libya, Nigeria, Saudi Arabia, United Arab Emirates, and Venezuela. For more information, https://www.opec.org/opec_web/en/about_us/24.htm. OPEC+ is the group formed by the OPEC countries and other oil exporting countries, of which Russia is one of the main exponents.
[12] U.S. Energy Information Administration, short-term energy outlook, March 2024. For more information, https://www.eia.gov/outlooks/steo/archives/mar24.pdf.
[13] IMF World Economic Outlook, April 2024.

Figure 8: Change in oil supply by OPEC+ and non-OPEC+ countries - million barrels per day
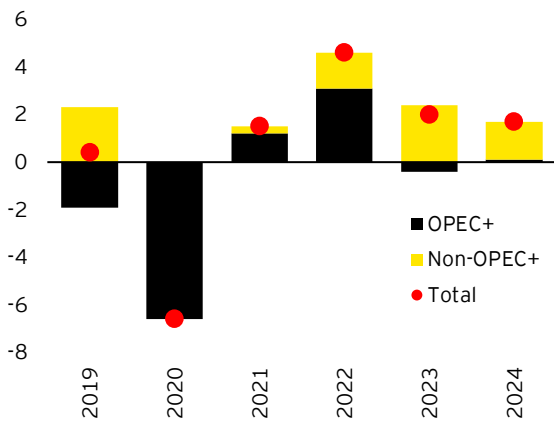

Source: EY elaborations on International Energy Agency (IEA) data.

On the other hand, the widening of the Middle East conflict is likely to pose new challenges. Consider, for example, that about 30% of the world's oil trade and 20% of natural gas trade transit through the Strait of Hormuz (located between the Persian Gulf and the Gulf of Oman). Although the possibility of complications in the strait is remote at the moment, even short-term adverse events could have a very significant effect on energy prices and, consequently, on world growth. For example, the OECD estimates that in the event of a shock resulting in a 25% increase in oil prices in the first year, followed by a 10% increase in the following year, world growth would reduce by 0.4 percentage points in the first year, with the greatest effect in advanced economies. This would be coupled with a one percentage point increase in global inflation and a potential increase in monetary policy interest rates by 50 basis points in several economies.[14]

For what concern agricultural prices, after the substantial stagnation experienced between December and February 2024, there was a significant increase between March and April in the representative index provided by the World Bank, which was only partially reversed in May.[15] Given the composition of the index, the increase can be attributed to an exponential rise in the

price of beverages, which in turn was driven by a rise in the price of cocoa (which accounts for about 40% of the index, according to the World Bank's methodology). The increase in the price of cocoa is linked to a lower-than-expected production of the raw material in Côte d'Ivoire, which is the world's main supplier of this commodity, due to heavy rainfall related to the natural phenomenon El Niño.[16]

Figure 9: Beverage price index (2010=100) and component prices ($/Kg)
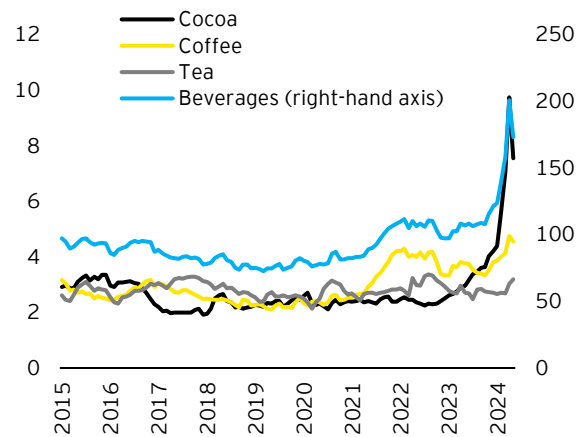
Source: EY elaborations on World Bank data. Last observation: May 2024.

The rise in recent months has brought the agricultural price index back to the levels experienced in mid-2022 and, although far from the peaks of early 2022, they still remain well above the levels recorded in the period between 2015 and the start of the pandemic crisis, creating potential instability for global inflation and food security.[17,18] The overall improvement in global supply conditions is, however, having a positive effect on price levels.[19]

While there are many geopolitical uncertainties and natural phenomena influencing commodity price, inflation is expected to reduce over the coming years.

The current and expected reduction in price level growth is driven by a double reduction in the supply and demand factors that characterized price developments in previous periods. This becomes clear using widely used

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[14] OECD Economic Outlook, May 2024.
[15] For more information, https://www.worldbank.org/en/research/commodity-markets.
[16] World Bank Blogs, 'Beverage prices surge amid supply shortfalls', March 2024.

[17] Vos, R., Glauber, J., Hernandez, M., Laborde D. (2022). COVID-19 and Rising Global Food Prices: What's Really Happening? IFPRI. Washington, DC.
[18] WFP & FAO. 2022. Hunger Hotspots: FAO-WFP early warnings on acute food insecurity. October 2022 to January 2023 Outlook.
[19] World Bank Global Economic Prospects, January 2024.

econometric approaches to assess the contributions to inflation by demand and supply factors,[20,21] suggesting that both supply- and demand-driven price changes contributed positively to inflation in many advanced economies until the fourth quarter of 2023. However, compared to 2022, supply factors contributed more than demand factors.[22]

Growth in the world's major economies: the latest data

As anticipated, the revised forecast for global growth from the Organisation for Economic Co-operation and Development shows important heterogeneities among the world's major economies, especially to 2024.

Figure 10: Revisions of OECD GDP growth forecasts to 2024 in May 2024 compared to February 2024 (percentage points)
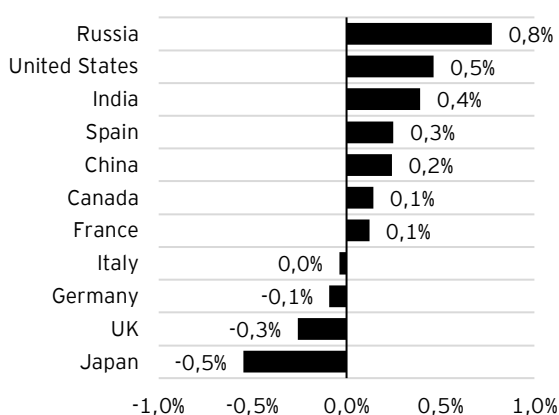
Source: EY elaborations on OECD Economic Outlook data and forecasts February 2024, May 2024.

The revisions shown in figure 10 highlight an articulated scenario: on the one hand, as mentioned above, the OECD presents a major upward revision for US growth in 2024 (0.5 percentage points); a positive revision is also presented for Spain (0.3 percentage points) and France (0.1 percentage points). On the other side, a downward revision is presented for

Germany (-0.1 percentage points) and the United Kingdom (-0.3 percentage points).

United States

In the first quarter of 2024 the US recorded a growth of 0.3% compared to the previous quarter, following a growth of 0.8% in the fourth quarter of 2023. More specifically, the first quarter of 2024 was characterized by strong growth in private consumption (from 0.8% growth in the fourth quarter of 2023 to 0.5% growth in the first quarter of 2024), reflecting different dynamics in consumption of goods and services (-0.5% and 1.0%, respectively). For what concern the consumption of goods, a 0.2% decrease in the consumption of non-durable goods and a larger decrease in the consumption of durable goods (-1.0%) is recorded, probably due to high interest rates on consumer credit. On the other hand, there was sustained growth in private investment (0.8%), after a quarter of modest growth (0.2%). Further, exports experienced a quarter-on-quarter growth of 0.3%, together with a stronger growth in imports (1.9%).[23]

The latest data also show that consumer spending in April 2024 contracted slightly compared to the previous month (-0.1% compared to 0.4% in March and 0.3% in February). [24]

When analyzing consumption trends, it is also interesting to note that credit card defaults have increased in recent quarters. The Quarterly Report on Household Debt and Credit for the first quarter of 2024 shows that, for all debts different from student loans, delinquency has been rising steadily since the fourth quarter of 2021, after the all-time lows recorded during the pandemic. Credit card delinquencies, in particular, have exceeded pre-pandemic levels and are likely to increase in the coming quarters.[25]

These data come together with a dynamic labor market: total nonfarm payroll employment increased by 272,000 in May compared to the

[20] Shapiro, A. (2022), 'A Simple Framework to Monitor Inflation', FRBSF Economic Letters, 2022-15.
[21] OECD Economic Outlook, Interim Report February 2024.
[22] OECD Economic Outlook, May 2024.
[23] Gross Domestic Product, First Quarter 2024 (Second Estimate) and Corporate Profits (Preliminary), https://www.bea.gov/news/2024/gross-domestic-product-first-quarter-2024-second-estimate-and-corporate-profits.

[24] Bureau of Economic Analysis (BEA), Personal Income and Outlays, April 2024. For more information, https://www.bea.gov/news/2024/personal-income-and-outlays-april-2024.
[25] Haughwout, A., F., Donghoon L., Mangrum, D., Scally, J., van der Klaauw, W., Wang, C. (2024). Delinquency Is Increasingly in the Cards for MaxedOut -Borrowers. Federal reserve Bank of New York, Liberty Street Economics.

previous month, and unemployment rate kept stable at around 4%.[26]

While the data show a dynamic growth of the US labor market, it is important to consider that this phenomenon is not homogenous across country. There are several reasons for this: the composition of economic activity, for example, played an important role (e.g., the local economies where tourism activity was preponderant experienced a major hit from the restrictions of the pandemic period), as did the moment when pandemic spread (the first places affected by the pandemic experienced greater economic damage).

Other factors underlying this lack of homogeneity in labor market recovery is related to pre-pandemic dynamism. Many of the economies that have not yet recovered to pre-pandemic employment levels were, for example, characterized by low employment growth even before the pandemic. For example, metropolitan areas that currently show an 'employment deficit' compared to the pre-pandemic period experienced an annual employment growth of 0.5% on average in the five years prior to the pandemic, compared to 1.5%, on average in areas that have recovered to pre-pandemic employment levels.

Finally, many locations that have not yet recovered to previous levels of employment are also characterized by a lack of employees: with the persistent shortage of employees across the country after the pandemic, finding employees has become increasingly difficult, particularly in locations that still experience a gap from pre-pandemic employment levels.[27]

US industrial and manufacturing activity is stable or contracting, with the former registering essentially no growth in April 2024 compared to the previous month, and the latter contracting by 0.3%. Both industrial and manufacturing production are contracting when considering

year-on-year growth, falling by 0.4% and 0.5% respectively in April 2024.[28]

For what concern growth expectations for the coming quarters, the Federal Reserve Bank of New York's latest projections for May 2024 indicate average GDP growth over the next four quarters in a range of -0.49% to +3.41%, with a median of 1.53%,[29] showing high uncertainty on the future economic activity.

Also, the Federal Reserve Bank of New York the short-term forecast for the US economy shows an annualized growth rate[30] of 1.90% for the second quarter of 2024 and 2.04% for the third quarter.[31]

Figure 11: GDP 2024 - US, % QoQ change, annualized
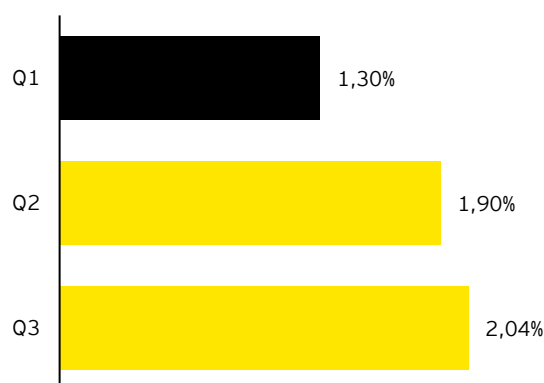
Source: EY calculations on Federal Reserve Bank of New York, U.S. Bureau of Economic Analysis (BEA) data. The bars in yellow represent the available forecasts for the coming quarters (New York Fed Staff Nowcast). Growth rates are annualized. Last update: 7 June 2024.

United Kingdom

In the UK, GDP grew by 0.6% in the first quarter 2024, followed by a contraction of 0.3% in the fourth quarter of 2023 and modest growth of 0.1% in the third quarter of the same year. The first quarter performance is due to growth in private consumption (0.2%), public consumption (0.3%), and investment (1.4%).[32]

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[26] U.S. Bureau of Labor Statistics, Employment Situation Summary. For more information, https://www.bls.gov/bls/news-release/empsit.htm#2024.
[27] Jaison R. A., Deitz, R., Hastings, J., Scally, J., (2024). Many Places Still Have Not Recovered from the Pandemic Recession. Federal reserve Bank of New York, Liberty Street Economics.
[28] Industrial Production and Capacity Utilisation, May 2024. For more information,
https://www.federalreserve.gov/releases/g17/current/default.htm.
[29] Federal Reserve Bank of New York, Outlook-at-Risk: Real GDP Growth, Unemployment, and Inflation,

https://www.newyorkfed.org/research/policy/outlook-at-risk#root:growth-at-risk.
[30] For more information, https://www.bea.gov/help/faq/463.
[31] For more information,
https://www.newyorkfed.org/research/policy/nowcast#/overview.
[32] Office for National Statistics (ONS), GDP first quarterly estimate, UK: January to March 2024,
https://www.ons.gov.uk/economy/grossdomesticproductgdp/bulletins/gdpfirstquarterlyestimateuk/januarytomarch2024.

Higher-frequency data show signs of improvement: in March, the services sector grew by 0.5% compared to previous month, which was followed by a further, albeit modest, growth of 0.2% in April compared to the previous month. [33]

The construction sector, on the other hand, followed a different trend, with a 1.4% drop in production in April 2024; industrial production also fell in April, albeit to a lesser extent than construction (-0.9%) and following a 0.2% growth in the previous month. [34, 35]

The inflation rate reached the 2% inflation target in May, 0.3 percentage points lower than the previous month's figure (2.3%). Core inflation also reduced, from 3.9% in April to 3.5% in May. [36]

China

Moving to Asian, the Chinese economy grew by 5.3% in the first quarter of 2024 compared to the same quarter of the previous year, which corresponds to an economic growth (compared to the previous quarter) of 1.6%. [37]

With regard to the industrial sector, industrial production grew by 6.7% in April, after a growth of 4.5% in March. This performance was partly due to the significant growth in the automotive industry (16.3%), the manufacturing of computers and electronic equipment (15.6%), the chemical industry (12.3%), and the plastics and rubber industry (10.5%). [38]

On the other hand, a significant contraction is recorded for investments in the real estate sector, with a -9.8% cumulative growth from January to April 2024 compared to the same period of the previous year. This downward trend is also confirmed by the data for the previous months, demonstrating a complex scenario in the sector. [39] Broadening the spectrum of analysis to total investments, growth in the first four months of the year compared to the same period of the previous year stands at 4.2%, with a growth mainly in the energy production industry (26.2%), mining (21.3%) and manufacturing (9.7%). [40]

With reference to retail sales, after the peak recorded in November 2023, the year-on-year growth gradually decreased (10.1% growth rate in November, steadily decreasing to 2.3% in April). [41]

It is important to emphasize, in this regard, that to support economic activity, People's Bank of China (China's central bank) has put in place an expansionary monetary policy through a reduction in benchmark interest rates. The one- and five-year Loan Prime Rate (LPR, i.e., the rate used by commercial banks to define the cost of lending to customers with the highest credit standards) stood at 3.45% and 3.95% respectively in May 2024. The five-year LPR was reduced by 25 basis points in February 2024, a reduction that follows a cut of 10 basis points in June 2023. By contrast, the MLF (Medium-term policy loan rate, i.e., the rate at which commercial banks and other banks - such as the China Development Bank - borrow from the central bank in the medium term) remains constant at 2.50%. [42]

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[33] Office for National Statistics, Index of Services, UK: April 2024, https://www.ons.gov.uk/economy/economicoutputandproductivity/output/bulletins/indexofservices/april2024.

[34] Office for National Statistics, Construction output in Great Britain: April 2024, https://www.ons.gov.uk/businessindustryandtrade/constructionindustry/bulletins/constructionoutputingreatbritain/april2024.

[35] Office for National Statistics, Index of Production, UK: April 2024, https://www.ons.gov.uk/economy/economicoutputandproductivity/output/bulletins/indexofproduction/april2024.

[36] Office for National Statistics, Consumer price inflation, UK: May 2024, https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/may2024.

[37] National Economy Made a Good Start in the First Quarter, https://www.stats.gov.cn/english/PressRelease/202404/t20240416_1948543.html.

[38] Industrial Production Operation in April 2024, https://www.stats.gov.cn/english/PressRelease/202406/t20240603_1954231.html.

[39] Investment in Real Estate Development in 2023, https://www.stats.gov.cn/english/PressRelease/202402/t20240201_1947107.html.

[40] Investment in Fixed Assets from January to April 2024. For more information, https://www.stats.gov.cn/english/PressRelease/202406/t20240604_1954251.html.

[41] Total Retail Sales of Consumer Goods in April 2024. For more information, https://www.stats.gov.cn/english/PressRelease/202406/t20240603_1954214.html.

[42] For more information, http://www.pbc.gov.cn/en/3688229/3688335/3883798/index.html.

Figure 12: 1- and 5-year Loan Prime Rate (LPR), China
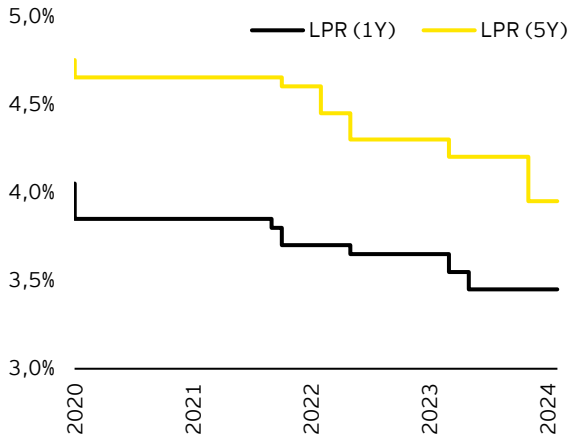
Source: EY calculations on People Bank of China data. Last observation: May 2024.

A positive contribution to growth comes from net exports. Exports recorded an YoY growth of 11.2% in May 2024, while imports grew by 5.2%.[43] The positive contribution of exports (higher than imports by about 30% in May) to growth is also confirmed when analyzing the trend for the first five months of 2024, despite slightly higher import growth than export growth (6.4% and 6.1% respectively).

Overall, therefore, a recovering international scenario is emerging, but with some significant elements of uncertainty that will characterize the global economic landscape in the short to medium term.

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[43] For more information, http://english.customs.gov.cn/statics/report/preliminary.html. Export growth stands at 7.6% when considering exports expressed in dollars, while import growth stands at 1.8%.

The European Framework

The Eurozone economic framework and economic indicators

In the first quarter of 2024, Eurozone GDP grew by 0.3% compared to the previous quarter, after a quarter of contraction (-0.1 in the fourth quarter of 2023) and one of stagnation (third quarter of 2023). The acceleration in the first quarter of 2024 is mainly due to a positive performance of Spain, which recorded a quarter-on-quarter growth of 0.7%, and modest growth in the other main economies of the Monetary Union (specifically, 0.2% in France and Germany, and 0.3% in Italy).

Fron and year-on-year point of view, Spain and France emerged as the two most dynamic countries (with growth of 2.4% and 1.3% respectively), followed by Italy (0.7%). On the other side, German economic activity contracted, marking the third consecutive quarter of negative growth (-0.2% in the first quarter of 2024, after negative growth of 0.1% and 0.2% in the third and fourth quarter of 2023, respectively). Overall, the Eurozone marks a YoY growth of 0.4% in the first quarter of 2024.

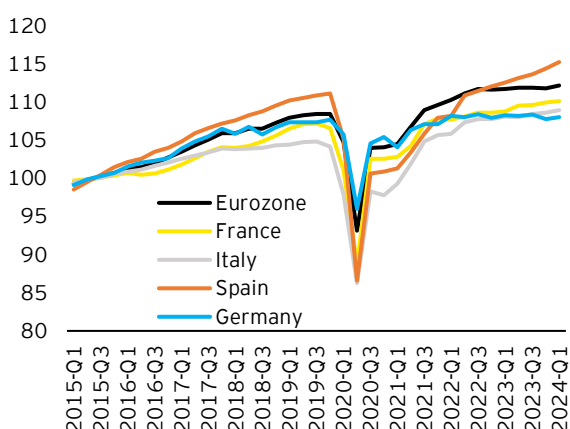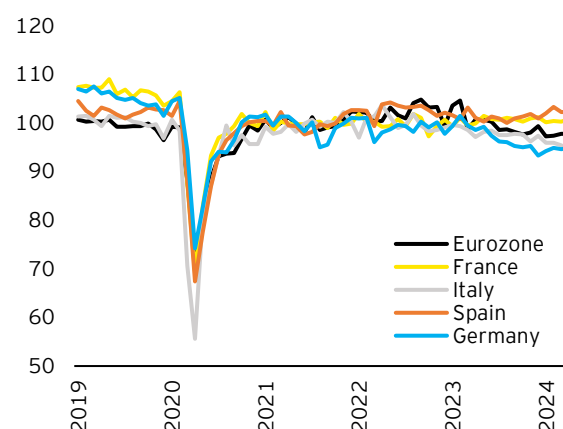*Figure 13: GDP - index, 2015=100*

Figure 14: Industrial production - index, 2021=100

Source: EY elaborations on data from Eurostat, European Commission (*Business and consumer surveys*). For industrial production, reference is made to NACE Rev. 2 B-D codes (*Mining* and *quarrying; manufacturing; electricity, gas, steam and air conditioning supply*). Last observation for GDP: 2024-Q1; for industrial production: April 2024.

With reference to industrial production, after the positive figures in February and March (respectively 0.6% and 1.0% compared to the previous months), the Eurozone recorded a cyclical contraction of 0.1% in April. The figure was mainly influenced by the contraction experienced in Italy (-1.0%, after -0.5% in March), which was compounded by the non-positive performance of Spain (1.1% contraction in March and stagnation in April) and Germany (-0.3% in March and a modest recovery in April with 0.3% growth).

The weakness of economic and industrial activity is also manifested in the three-month production expectations[44] and in the orders of industry sector. With regard to the former, after the recovery following the pandemic crisis, the indicator representing production expectations has fallen to a level of stability in recent months. The trend in domestic orders continues its downward trajectory, demonstrating a weak domestic demand, while external orders, despite following the direction of domestic orders overall, show some slight signs of recovery in recent months.

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[44] For more information on the methodology supporting the indicators, https://economy-finance.ec.europa.eu/document/download/4f162b92-e654-4cef-beed-38960dae1b09_en?filename=bcs_user_guide.pdf.

As previously mentioned, the 'demand' factor is identified by Eurozone industrial firms as the main obstacle to production activity, while complications on the supply side (availability of skilled labor and materials and equipment needed to carry out the activity) have subsided.

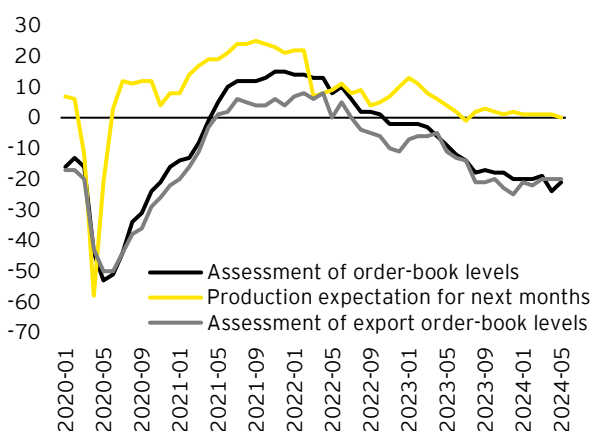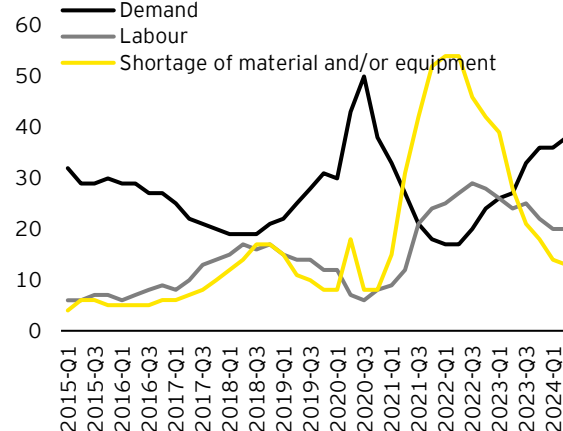Figure 15: *Orders and production expectations for industry in the next three months, Eurozone*

Figure 16: *Factors hindering industry activity, Eurozone - % of respondents*

Source: EY elaborations on European Commission data (Business and Consumer Surveys). Last observation for Figure 15: May 2024; Figure 16: 2024-Q2.

The analysis of the PMI (Purchasing Manager Index) indicator[45] for manufacturing and services shows interesting and more timely details of the development of the two main sectors of the economy. The latest findings of the manufacturing PMI do not an optimistic climate broadly, although in an improving phase compared to the early months of 2024. Spain is the only one of the four major Eurozone countries where the manufacturing PMI index recorded values indicating an expansion of activity (above 50). Overall, therefore, the general perception is still that of a general complexity in the performance of economic activity in the industrial sector.

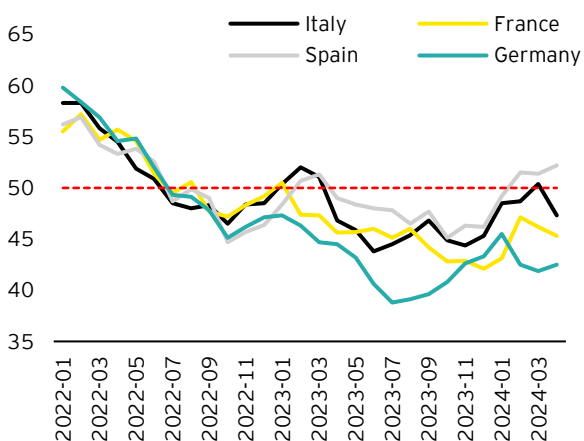Figure 17: *Purchasing Managers Index (PMI), manufacturing*

Figure 18: *Purchasing Managers Index (PMI), services*
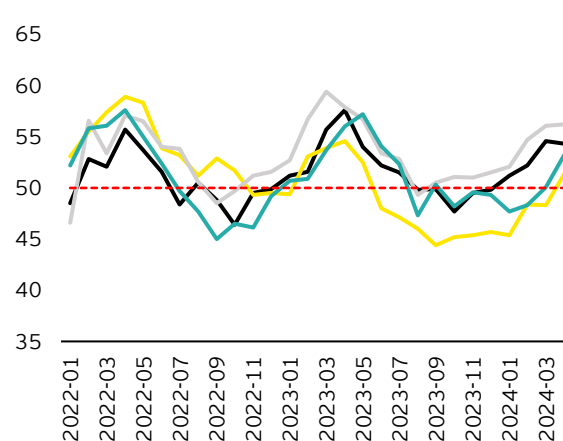
Source: EY calculations based on S&P Global data. Last observation: April 2024.

On the other hand, the perception in the services sector is positive, showing values above the expansion threshold for the four major European countries. This bodes well for growth prospects, the services sector being by far the one with the highest contribution to GDP.

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[45] The Purchasing Managers' Index (PMI) is one of the most popular business cycle indices, i.e., an index of the prevailing direction of economic trends in the manufacturing, construction and service sectors, obtained through timely surveys of the most representative companies in the relevant sectors. Values above 50 indicate an upward trend in economic activity, values below 50 a downward trend.

Monetary policy and prices in the Eurozone

The meeting of the European Central Bank on 6 June 2024 represents an important moment for the monetary policy of the Eurozone. Indeed, in line with market expectations, the ECB decided to reduce its key interest rates by 25 basis points. This was the first reduction in rates since July 2022. Thus, the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and on deposits with the central bank[46] stand at 4.25 %, 4.50 % and 3.75 % respectively.[47]

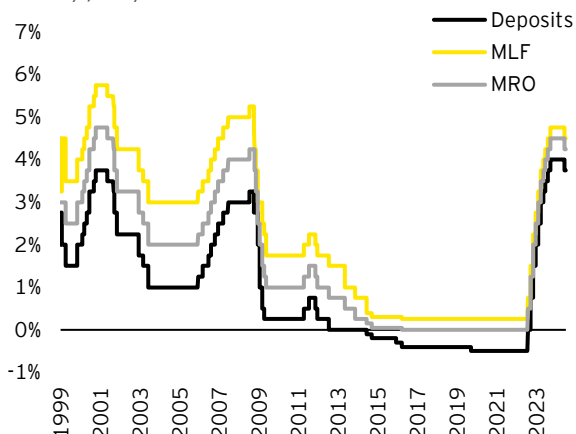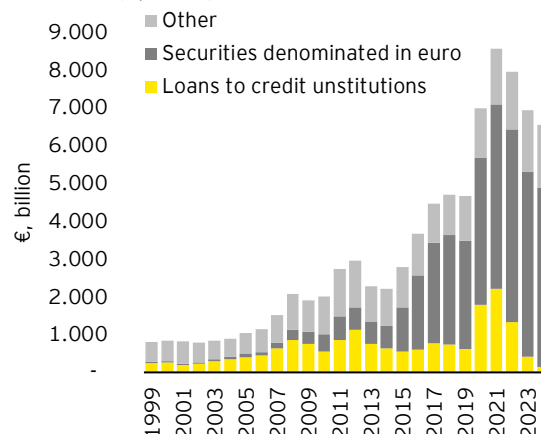*Figure 19: Reference interest rates of the European Central Bank's monetary policy*

Figure 20: Main balance sheet items of the European Central Bank (€, billion)

Source: EY elaborations on European Central Bank (ECB) data. MLF = marginal lending facility; MRO = main refinancing operation. The deposit rate refers to deposits at the central bank. Balance sheet items - loans to credit institutions: it refers to loans to Eurozone credit institutions related to monetary policy operations denominated in euro (the different items include main refinancing operations and LTROs); securities denominated in euro: it refers to Eurozone residents' securities denominated in euro (the different items include assets acquired for monetary policy purposes); other: the different items include gold and claims denominated in foreign currency on Eurozone residents and non- Eurozone residents. The last observation for 2024 refers to the *weekly financial statement* of 7 June 2024.

Although in the European Central Bank's latest projections, inflation estimates have been revised downwards (in particular for 2024) mainly due to a lower contribution of energy prices. As such, the ECB expects inflation in the Eurozone at 2.3% in 2024, still slightly above the price stability target (2%). This is expected to be followed by inflation rates of 2.0% and 1.9% in 2025 and 2026, respectively. Although most components of core inflation are slowing down, price pressures remain high, in part due to real wages growth[48] (with nominal trend growth in the fourth quarter of 2023 of 6.4%). Caution in lowering interest rates and, consequently, maintaining restrictive financing conditions, is therefore justified in order to keep inflation on its current downward trajectory and avoid a potential new acceleration in the price level.

Consistent with the European Central Bank's projections of declining inflation in the first half of 2024, interest rates have been reduced, and according to the latest surveys of professional forecasters, the main refinancing operations is expected at 3.5% in the fourth quarter of the year, 3% in 2025 and 2.5% in 2026.[49] Although these are the operators' expectations, it is important to emphasize that it is not given that the European Central Bank will follow this path, considering that, as the ECB governor stated, "Interest rates will therefore have to remain restrictive for as long as necessary to ensure price stability

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[46] The interest rate on deposits with the central bank is one of three reference rates that the ECB sets every six weeks as part of its monetary policy decisions. This rate defines the interest that banks receive on their overnight deposits (for the duration of one business day) with the central bank. The other two reference rates are the rate on the main refinancing operations (MRO) and the rate on the marginal lending operations (MRO). The MRO rate defines the cost at which banks can obtain credit from the central bank with a maturity of one week. If banks need overnight liquidity, they can use the marginal lending facility at a higher rate. For more information, see
https://www.ecb.europa.eu/stats/policy_and_exchange_rates/key_ecb_interest_rates/html/index.it.html.
[47] ECB, Monetary policy decisions, 6 June 2024. For more information,
https://www.ecb.europa.eu/press/pr/date/2024/html/ecb.mp240606~2148ecdb3c.en.html.
[48] ECB staff macroeconomic projections for the euro area, March 2024. For more information,
https://www.ecb.europa.eu/pub/projections/html/ecb.projections202403_ecbstaff~f2f2d34d5a.en.html.
[49] ECB Survey of Professional Forecasters, second quarter of 2024. For more information,
https://www.ecb.europa.eu/stats/ecb_surveys/survey_of_professional_forecasters/html/ecb.spf2024q2~804a80b66b.en.html.

on a lasting basis. In other words, we still need to have our foot on the brake for a while, even if we are not pressing down as hard as before." Monetary policy choices, in fact, will essentially depend on three factors, namely (i) a decline in the inflation rate towards levels consistent with the price stability objective, (ii) an easing of price pressures and (iii) confirmation of the effectiveness of monetary policy in containing inflation.[50]

As already announced in previous meetings, the ECB is flanking an increase in key interest rates with a reduction in assets on its balance sheet. Regarding the APP,[51] the size of the portfolio is decreasing at a measured and predictable pace, with the Eurosystem no longer reinvesting principal payments on maturing securities. With reference to the PEPP,[52] the Governing Council intends to continue reinvesting principal payments of maturing securities purchased under the PEPP in the first half of 2024. In the second half of the year, it intends to reduce the PEPP portfolio by an average of €7.5 billion per month (currently the cumulative value of purchases under the PEPP programme amounts to around €1.7 trillion), discontinuing reinvestments at the end of 2024. A reduction of this magnitude and pace translates into a reduction of reinvestments of about €45 billion in the second half of the year.

Looking at the net purchases between July 2022 (when the first monetary policy interest rate hike took place) up to May 2024, it is possible to rank the intensity of the central bank's purchase of public debt through the two main programmes (PSPP and PEPP) for the Eurozone countries. On the one hand, Germany, Italy and Portugal represent the three main countries in terms of amount of sales of public debt securities by the ECB, as a percentage of GDP (respectively 2.4%, 2.8% and 3.3% of GDP), while on the other hand, countries such as Slovenia, Estonia, Cyprus and Malta still benefit from the public debt purchase programme, with positive net purchases, albeit less than 1% of their GDP.

Figure 21: Net purchases of government debt from July 2022 to May 2024 (% of GDP 2023)
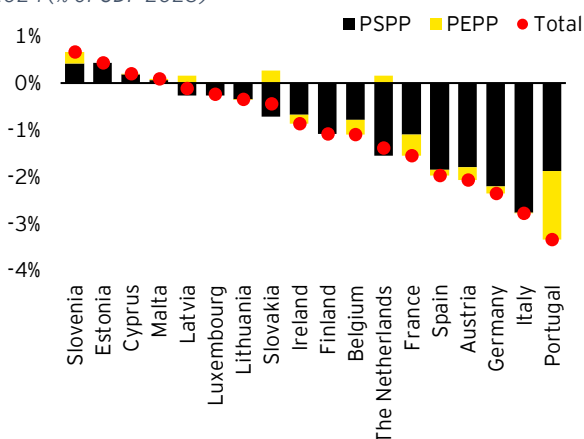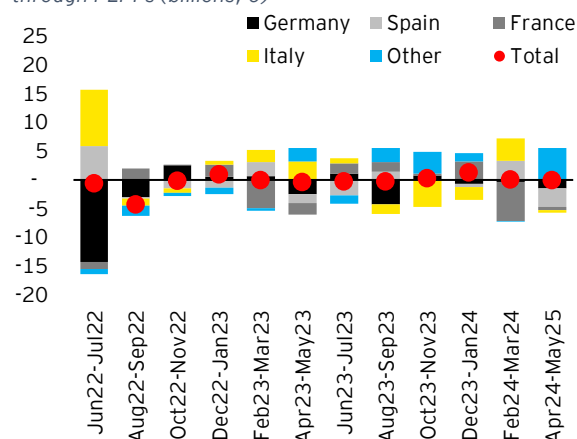

Figure 22: Net purchases of government debt securities through PEPPs (billions, €)

Source: EY elaborations on data from Eurostat, European Central Bank.

While the rise in interest rates certainly had an effect in curbing consumption and investment in the Eurozone, with the consequent effect of lowering inflation rates, at the same time it is important to consider that the strong negative effects of monetary policy on growth expected by many at the beginning of the monetary tightening cycle did not materialize. This was possible due to several elements: firstly, the major central banks, including the Fed and the ECB, raised nominal interest rates after inflation

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[50] Why we adjusted interest rates, Christine Lagarde, 8 June 2024. For more information, https://www.ecb.europa.eu/press/blog/date/2024/html/ecb.blog240608~aa46b5f2a0.en.html.

[51] The ECB's Asset Purchase Programme (APP) is part of a package of unconventional monetary policy measures that also includes targeted longer-term refinancing operations and was launched in mid-2014 to support the monetary policy transmission mechanism and provide the amount of accommodation needed to ensure price stability. The programme consists of: Corporate Sector Purchase Programme (CSPP), Public Sector Purchase Programme (PSPP), Asset-Backed Securities Purchase Programme (ABSPP), third Covered Bond Purchase Programme (CBPP3). For more information, see https://www.ecb.europa.eu/mopo/implement/app/html/index.it.html.

[52] The ECB's Pandemic Emergency Purchase Programme (PEPP) is a non-standard monetary policy measure launched in March 2020 to counter potential risks to the proper functioning of the monetary policy transmission mechanism following the outbreak of the pandemic. The PEPP is a temporary programme to purchase private and public sector assets. For more information, https://www.ecb.europa.eu/mopo/implement/pepp/html/index.en.html.

expectations started to rise, resulting in lower real rates thereby supporting economic activity; secondly, households were supported by the savings accumulated during the pandemic, which limited the impact of the higher interest rates; thirdly, the characteristics of the mortgage and housing markets during the decade prior to the pandemic (characterized by lower interest rates) limited the effect of the interest rate increase.[53]

With reference to this last factor, some elements may have reduced the intensity of the pass-through of the increase in monetary policy interest rates to the real economy through the housing market, such as the prevalence of variable-rate or fixed-rate mortgages and the share of households with mortgages. Specifically, monetary policy has the greater effect on economic activity the lower the share of fixed-rate mortgages. This is due to the fact that homeowners see their monthly payments increase with monetary policy rates if their mortgage rates adjust. In contrast, households with fixed-rate mortgages experience no immediate difference in their monthly payments when monetary policy rates change. The effects of monetary policy are also more pronounced in countries where the total value of mortgages relative to property values is higher, and in countries where household debt is high relative to GDP. In such contexts, more households will be exposed to changes in rates, and the effects will be stronger if their debt is higher than their assets. The characteristics of the housing market are also important: the transmission of monetary policy is more effective where the supply of real estate is limited. For example, lower interest rates reduce the cost of borrowing and tend to increase the demand for real estate. Where supply is limited, this can lead to an increase in real estate prices. This will result in increased household wealth, potentially increasing consumption, especially if the value of the property can be used as collateral for new loans. [54]

The restrictive monetary policy put in place by the European Central Bank to slow growth in the price level resulted in an increase in the cost of bank loans to households and companies (non-financial corporations). After a steady reduction in the cost of loans in the period between 2012 (sovereign debt crisis) and early 2022 (the pandemic aftermath), the interest rate applied to the main economic players experienced unprecedented growth.

Specifically, as of April 2024, the cost of bank loans for non-financial corporations is above 5%, although it has been falling slowly in recent months. Despite the peak in October 2023 (5.3%), the costs are still lower than the levels experienced in the second half of 2008, when the cost of loans had reached around 6%. Growth in the cost of loans for households was less pronounced, which remained at lower levels in 2023 compared to 2008, although high when compared to the recent past. With regard to households, the highest interest rate is recorded for consumer credit (7.9% in April 2024), followed by other purposes (5.3%) and house purchase (3.8%).

[53] IMF World Economic Outlook, April 2024.
[54] Andaloussi, M. B., Biljanovska, N., De Stefani, A., Mano, R. C. (2024). Housing is One Reason Not All Countries Feel Same Pinch of Higher Interest Rates. IMF Blog, April 2024.

Figure 23: Cost of bank loans to non-financial corporations and households, Eurozone
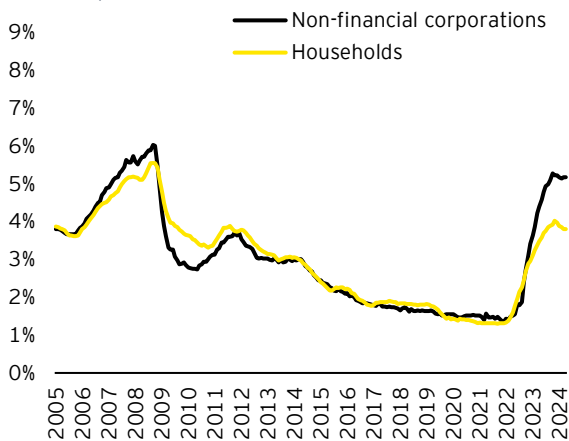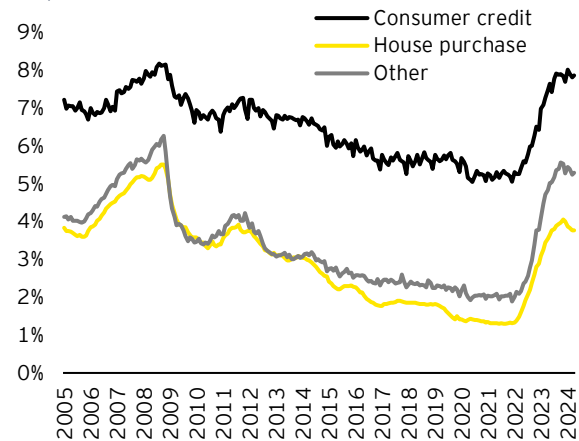

Figure 24: Cost of bank loans to households by type of use, Eurozone

Source: EY calculations based on European Central Bank data. Last observation: April 2024.

With regard to credit developments, the latest Bank Lending Survey shows that Eurozone banks reported a slight net tightening of credit standards for loans or lines of credit to businesses in the first quarter of 2024 (net percentage of banks of 3%).[55] This is lower than what banks had expected in the previous quarter's survey (9%).[56] The net tightening is mainly a reflection of what was recorded in Germany and some other countries, while the other economies reported no change in the credit standard. Banks' risk perception was the main driver of the net tightening, while the cost of funds and balance sheet constraints, competition and risk tolerance had a basically a neutral impact. The perception of risk mainly referred to a general weakness in the economic situation and outlook, together with the credit risk for companies due to their financial situation.

With regard to household credit, Eurozone banks reported a moderate net loosening of credit standards on loans to households for house purchases for the first time since the fourth quarter of 2021 (banks' net percentage of -6%). The net loosening came after banks had reported a slight tightening of credit standards in the previous quarter (2%) and is in contrast to the tightening that banks had expected (8%) in the previous quarter. On the one hand, competition and banks' risk tolerance were the main factors behind the net loosening of credit standards for house purchasing loans; on the other hand, risk perception, cost of funds and balance sheet constraints had a neutral impact.

The labor market is still robust, even if cooling slightly. A framework to analyses its dynamics is the Beveridge curve, which investigates the relationship between the unemployment rate and job vacancies in the economy[57], thus providing information on the health of the economy itself and the characteristics of the labor market.

The relationship between the two variables analyzed is generally inverse: a higher unemployment rate is accompanied by a lower vacancy rate, and vice versa. By analyzing the dynamics of the Beveridge curve in the three main periods over the last 15 years, i.e., the period between 2010 and 2014 (post-financial crisis and including the sovereign debt crisis), the period between 2015 and 2020 (including the pandemic) and the period between 2021 and 2023 (post-pandemic period and characterized by increased uncertainty due to adverse geopolitical events), it is possible to get some interesting information.

In fact, the segment of the Beveridge curve for the period 2021-2023 is characterized by a steeper slope than that of the two previous periods, indicating more difficult for companies to find people needed

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[55] Euro area bank lending survey - First quarter of 2024.
[56] Euro area bank lending survey - Fourth quarter of 2023.
[57] The job vacancy rate is defined as the ratio between the number of vacancies and the sum of the number of filled positions and the number of vacancies. A vacancy is defined as a paid position that is newly created, unfilled or about to become vacant (i) for which the employer is taking active steps and is prepared to take further steps to find a suitable candidate outside the company concerned; and (ii) that the employer intends to fill immediately or within a specific period of time. For more information, https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Glossary:Job_vacancy_rate_(JVR).

to carry out their activities. This, in turn, translates into greater bargaining power for workers, which can lead to higher wages in negotiations. The last few quarters have also witnessed a decline in the vacancy rate, a sign of a partial cooling of the labor market, which, however, remains characterized by an unemployment rate at an all-time low (close to 6% at the end of 2023). The described development of the labor market in the Eurozone has a twofold potential effect on the inflation rate: on the one hand, the reduction in the vacancy rate translates into less upward pressure on wages, which in turn reduces the support that the latter can give to consumption and thus to price increases; on the other hand, the decrease in the inflation rate translates into an increase in real household income, with potential positive impacts on consumption and thus on price increases.

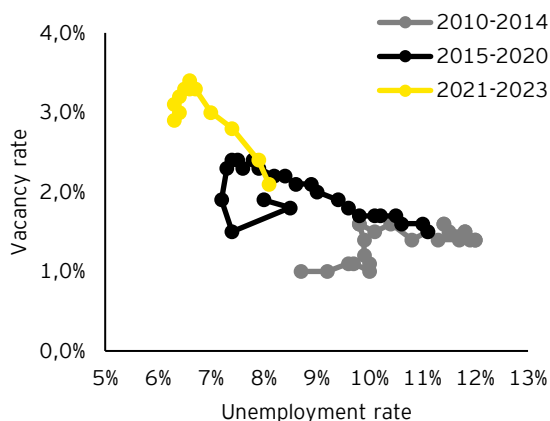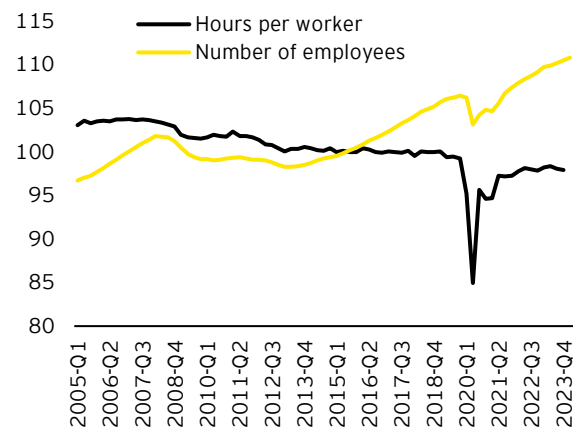Figure 25: Beveridge curve, Eurozone

Figure 26: Hours per worker and number of employed, Eurozone - index, 2015=100

Source: EY elaborations on Eurostat data.

Still talking about the labor market, the number of employees also continues to increase, reaching an all-time high since 1995 (around 170 million employed in the first quarter of 2024[58]). Interestingly, however, despite the increase in the number of employees, the number of hours worked per employees is falling, indicating a transformation of the labor market.

This phenomenon does not only focus on the last few quarters, but represents a long-term structural trend,[59] as shown in Figure 26, and does not only affect the Eurozone economies: average working hours in developed economies have been declining over the long term since the 19th century, for example halving between 1870 and 2000 in Germany.[60] More generally, average working hours in OECD countries decreased by about 0.5% per year between 1870 and the early 2000s, with the post-war United States being an important exception.[61] The structural reduction in the number of hours worked has also been discussed in detail in several OECD reports;[62,63] several studies have found technological progress to be one of the main factors supporting the decrease in average working hours over the past two hundred years, in addition to increased labor rights.[64]

The dynamics of consumer prices remain positive, with inflation falling, albeit at a slower pace than recorded after peaking in the second half of 2022 (in April 2024 there was an increase in the price level of

[58] Both employed and self-employed persons are considered. For more information, https://ec.europa.eu/eurostat/cache/metadata/en/namq_10_esms.htm.
[59] Astinova, D., Duval, R., Hansen, N. J., Park, B., Shibata, I., Toscani, F. (2024). Dissecting the Decline in Average Hours Worked in Europe. International Monetary Fund, Working Paper, WP/24/2, January 2024.
[60] Messenger, J. C., Sangheon, L., McCann, D., (2007). Working Time Around the World: Trends in Working Hours, Laws, and Policies in a Global Comparative Perspective, International Labour Organization, Routledge, May 2007.
[61] Boppart, T., Krusell, P., (2020). Labor Supply in the Past, Present, and Future: A Balanced-Growth Perspective. The University of Chicago Press, January 2020, 128 (1), 118-157.
[62] OECD, 'Working Hours: Latest Trends and Policy Initiatives,' in 'OECD Employment Outlook 1998: June' OECD Employment Outlook, Paris: Organisation for Economic Co-operation and Development, 1998, pp. 153-188.
[63] OECD, "Working Time and Its Regulation in OECD Countries: How Much Do We Work and How?," in "OECD Employment Outlook 2021: Navigating the COVID-19 Crisis and Recovery" OECD Employment Outlook, Paris: Organisation for Economic Co-operation and Development, July 2021.
[64] Greenwood, J., Vandenbroucke, G., (2005). Hours Worked: Long-Run Trends. NBER, Working Paper 11629.

2.4% compared to the same month of the previous year, similar to the figure recorded in March and 0.2 percentage points lower than the figure recorded in February).
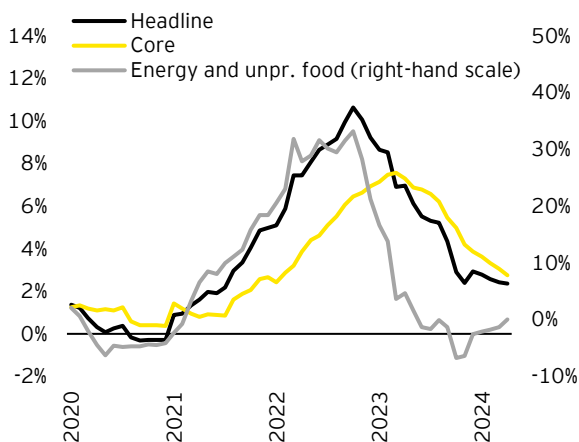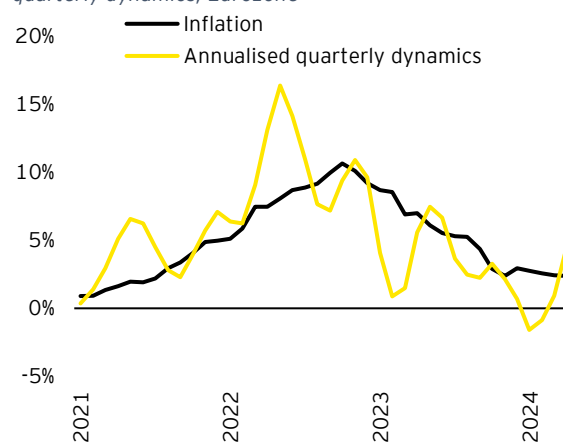
Source: EY calculations on Eurostat data. The headline measure considers all goods in the basket for calculating the price change; the core measure considers goods in the headline basket net of energy and fresh food. The rates refer to the harmonised rates. Annualized quarterly dynamics is calculated as the annualized three-months on three-months rate of change. Last observation: April 2024.

Core inflation in the Eurozone (i.e., the underlying component)[65] continues to be higher than headline inflation (inflation that considers all goods in the basket used to monitor price developments). A similar phenomenon occurred during the pandemic crisis, when the price of energy fell significantly as a result of the slowdown in global economic activity: a core inflation rate higher than the headline inflation rate indicates a higher rate of change in the core component than in energy and unprocessed food. In April 2024, annual core inflation stood at 2.8%, compared to 3.0% in the previous month and 3.3% in February.

Another indicator of inflation dynamics, namely the annualised quarterly rate of change, also shows positive signs, with values in line with what was experienced in 2021. Although inflation analysis typically looks at an annual frequency (the price level of a specific month compared to that of a previous year), in order to try to better understand inflation dynamics it is also worth examining what is often referred to as *momentum*. On the one hand, annual analysis necessarily implies a certain inertia in the measurement of inflation itself, given the high overlap on a monthly basis in annual inflation calculations.

At the same time, shifting the focus to the highest available frequency, i.e., monthly, runs the risk of increasing the 'noise' of the analysed series, given the role of seasonal and idiosyncratic factors in the monthly data. The proposed analysis, therefore, lies somewhere in between these two possibilities.[66]

Talking about inflation rates, it is important to keep in mind that the Eurozone figure basically represents an average of the dynamics of the Monetary Union member states. Consequently, there is a certain heterogeneity in the inflation rates between the different states: in May 2024, for example, the inflation rate (compared to the same month of the previous year) calculated on the harmonised indices in Italy was 0.8%, compared to 3.8% in Spain. The different dynamics can be attributed to multiple underlying factors. Analysing the contributions to inflation of the main Eurozone member countries, in fact, important differences can be noted: in Italy, for example, the energy component continues to contribute to the reduction in inflation (negative contribution of -1.1 percentage points), unlike in France and Spain (with a positive contribution of 0.5 and 0.8 percentage points, respectively).

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[65] Reference is made to ISTAT's definition of core inflation, which considers the consumer price index net of changes in energy goods and unprocessed food.
[66] Underlying inflation, Lecture by Philip R. Lane, Member of the Executive Board of the ECB, Trinity College Dublin.

In Germany, on the other hand, the contribution of energy goods was essentially nil in May, while the contribution of services was substantial (2.1 percentage points).

Alongside a reduction in the inflation rate in recent months, there has also been a reduction in the core inflation rate, albeit at a slower pace. However, it is important to consider the possibility that some of the underlying elements may show different dynamics than expected in the short to medium term, such as a faster growth in labor costs or a higher level of corporate profit margins.

In conclusion, despite a not particularly dynamic trend in the first quarter, the activity of the Eurozone economy is expected to improve in 2024: a reduction in inflation is expected to be accompanied by a growth in wages for a recovery of the real income lost in recent years, thus supporting private consumption. The positive dynamics in the labor market are also supporting consumption. While the reduction in the vacancy rate leads to a potential easing of wage pressures, thus in turn providing lower boost to consumption, low unemployment is acting as a support to the consumption itself. The latter phenomenon, however, could push for and increase in price, with a potential pick-up in inflation, hence the caution of central banks in outlining the downward trajectory of interest rates.

The Italian economy

Real economic activity in Italy

The weakness of industrial activity in Italy persists during first months of 2024. Overall, industrial production remains below the level recorded before the pandemic (2019) and maintains its downward trajectory. Specifically, in April 2024, industrial production is about 6 percentage points lower than in 2019, with a monthly change of -1.0%.

April also marks the fifteenth month of year-on-year contraction, with a reduction of 2.9% compared to April 2023.[67] This negative trend is mainly due to higher energy prices compared to the pre-pandemic period and a weakness in the main trading partners to which Italy exports manufactured goods (such as Germany).

Figure 29: Industrial production index, Italy - index (average 2019=100) and % change YoY
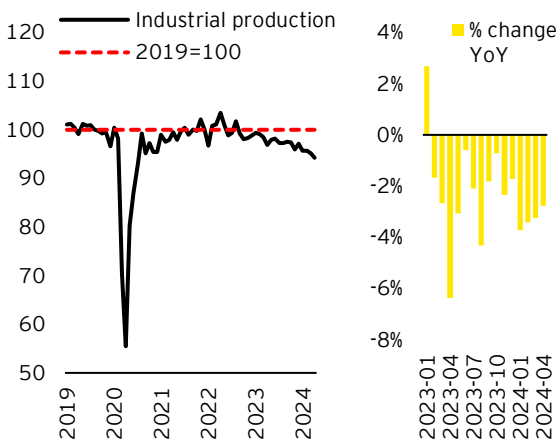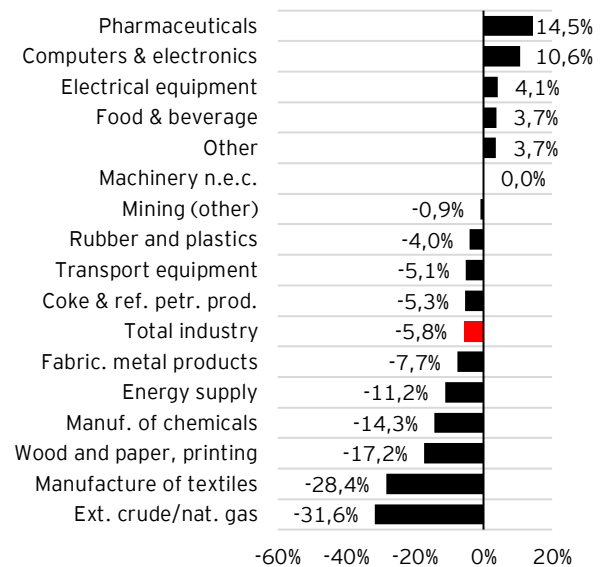

Source: EY elaborations on ISTAT data. Indices refer to seasonally adjusted indices. Last observation: April 2024.

Looking in detail at the industrial sectors, it is possible to identify which ones are still facing complexities in carrying out their activities (reflected in a lower level of industrial production than in 2019) and which ones, on the other hand, have managed to recover and possibly exceed pre-crisis pandemic production levels.

Figure 30: Industrial production index by industry, Italy - % change April 2024 compared to average 2019

Source: EY elaborations on ISTAT data.

In this respect, the manufacture of basic pharmaceutical products, the manufacture of computers and electronic products, and the manufacture of electrical equipment represent the top three industries by positive performance in April 2024 compared to the average output in 2019, with growth of 14.5%, 10.6% and 4.1% respectively.

On the other hand, the extraction of crude oil and natural gas industry, together with the textile industry, the wood and paper products industry, and the production of chemical products are still far from their pre-crisis levels (with output below by 31.6%, 28.4%, 17.2% and 14.3% respectively).

Moving to the service sector, which accounts for around 72% of the value added in Italy, an

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[67] ISTAT, industrial production April 2024. For more information, https://www.istat.it/it/archivio/298098.

upturn in turnover volume has been recorded in recent years, with a growth of around 9% from 2021.

This figure shows some heterogeneity between sub-sectors.

Figure 31: Services turnover volume index, Italy - % change March 2024 vs. average 2021
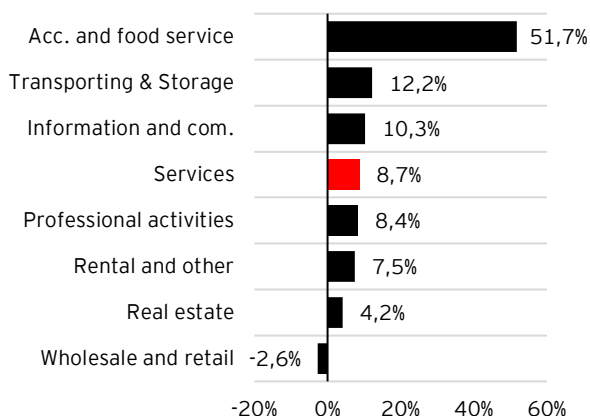
Source: EY elaborations on ISTAT data. Accommodation and food service: Accommodation and food service activities; Professional activities: Professional activities: Professional, scientific and technical activities; Information and com.: Information and communication services; Rental and other: Rental, travel agencies, business support services; Real estate: Real estate activities; Wholesale and trade: Wholesale and retail trade, repair of motor vehicles and motorbikes.

Specifically, it is interesting to note that the accommodation and food services are growing at a high rate, with a growth in March 2024 compared to the average values of 2021 of about 52%. By contrast, the growth rates of transporting and storage services and information and communication services are lower (12.2% and 10.3% respectively). The only sector that has not yet recovered the level recorded in 2021 is the wholesale and retail sector, which shows a turnover volume that is about 2.6% lower.

Price trends in Italy

After a period of stability and slight reversal in January 2024 compared to the downward trend in the last months of 2023, the inflation rate in May 2024 was once again below 1% (0.8%).

While the moderate acceleration in the pace of growth of the price level was a reflection of the dynamics of the prices of regulated energy goods, whose annual reduction in January was mitigated due to the statistical effect of the comparison with January 2023,[68] in May 2024 an important contribution to the reduction of the inflation rate came from a reduction in the unregulated energy component (regulated energy goods showed an annual growth of 0.7%).

Figure 32: Inflation and components, Italy - % change YoY
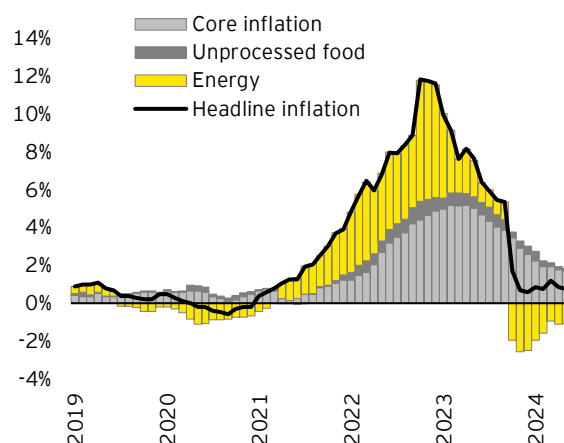
Source: EY elaborations on ISTAT data. Last observation: May 2024.

In May 2024, core inflation decreased from 2.1% in the previous month to 2.0%, mainly due to a reduction in the processed food component, which continues on the downward trajectory outlined in the first half of 2023 (consider that since January 2024, inflation of the processed food component stood at 4.5%, whereas in May it fell to 1.8%).

The services component is persistent at around 3% since the beginning of the year (2.9% in May, similar in April).

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[68] Consumer prices, January 2024, ISTAT. For more information, https://www.istat.it/it/files//2024/02/CS_Prezzi-al-consumo_Prov_Gennaio2024.pdf.

Figure 33: Core inflation and components, Italy - % change YoY
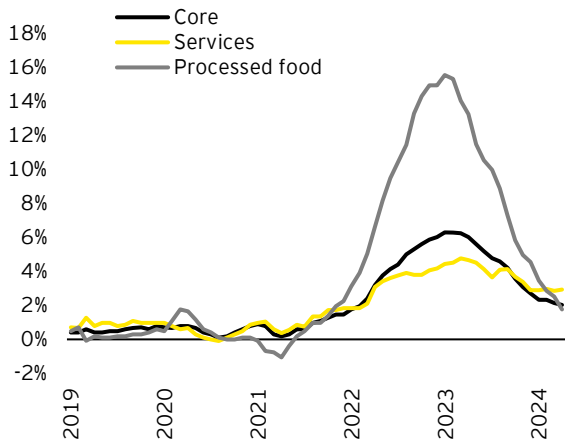
Source: EY elaborations on ISTAT data. Last observation: May 2024.

While the inflation trend looks encouraging and in line with a normalization process, it is important to consider that the current geopolitical situation poses upside risks to this inflation trend in Italy.

Specifically, the longer routes needed for ships in order to avoid potential risks related to the difficult geopolitical situation may lead to higher transport costs, which in turn translate into higher import costs. In order to quantify these effects, two scenarios were outlined in the 2024 Italian Economic and Financial Document (*Documento di Economia e Finanza*): a first scenario in which the increase in container freight prices for the East Asia/China-Mediterranean route increases for a limited period (between March and June 2024), and a second scenario in which the shock is more persistent (until the end of 2024). Overall, freight rates in these two scenarios are expected to increase by a value within a range of 62% to 125%, with a maximum negative effect on GDP of -0.2%, mainly as a result of a drop in consumption (-0.3 p.p.), and an increase in the consumption deflator of 0.2% (mainly due to an increase in the import deflator of 0.8%).[69]

The development of the consumer price index could also be partly explained by the dynamics in the producer price index. In fact, the producer price index for industry has been negative since April 2023, mainly driven by the development of energy-related producer prices.

Analyzing the producer prices index by product destination, the change in the index substantially reflects the dynamics in the producer prices index of industrial products sold on the domestic market, which is supporting a reduction in consumer price in Italy. The change in the index referring to the foreign market is also in negative territory, although with different intensity (since September 2023).

Figure 34: Producer price index - Italy, % change YoY
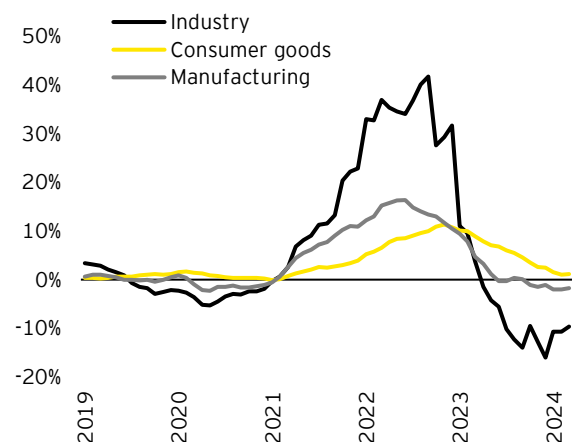
Source: EY elaborations on ISTAT data. Last observation: March 2024.

Price dynamics are also influenced by labor market dynamics, and vice versa: for example, an increase in the price level generally results in a demand for wage adjustments, which in turn results in a potential increase in household consumption, with the risk of further pressure on the price level if the mechanism is not offset by the negative price effect on demand.

As seen for the analysis of the labor market in the Eurozone, the Beveridge curve offers interesting insights into the current state of the labor market in Italy. Breaking down the dynamics of the Beveridge curve into three periods, i.e., 2010-2014, 2015-2020, and 2021-2023, we can see how in the third period the vacancy rate reached values never experienced before, while the unemployment rate approached, and then fell below, the 2010

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[69] Economic and Financial Document, 2024. Focus: An estimate of the impact of the recent tensions in the Red Sea.

level (at the end of 2023 the unemployment rate was around 7.3%).

The difference between the Beveridge curve segment in the 2021-2023 period and the ones on the other two periods is mainly in the higher vacancy rate, demonstrating a labor market in which employers are struggling to find the employees and skill needed to carry out their business activity.

Figure 35: Beveridge curve, Italy

Source: EY elaborations on ISTAT data.

It is also interesting to note that in the last quarters of 2023, the slope of the Beveridge curve has substantially reduced, thus maintaining a broadly constant vacancy rate and a declining unemployment rate.

The positive labor market factors seem to not be easily explained by the country's current economic condition, the latter being not particular dynamic. As of April 2024, in fact, the number of employees was around 24 million, the highest value since 2004 and growing steadily since 2021.[70] The Business and Consumer Surveys published by the European Commission also show expectations in both the industrial and service sectors of an increase in the level of employment, albeit at a slower pace than in previous quarters.

One of the possible explanations for the performance of the labor market and the economy overall can be found in the labor hoarding, i.e., the phenomenon whereby companies, although experiencing a slowdown in

demand, revise production and hours worked before reducing the number of employees.

Also in this regard, the Business and Consumer Surveys published by the European Commission offer an interesting picture of this phenomenon for Italy, especially when compared to the remaining major Eurozone countries.

Figure 36: Labour Hoarding - Percentage of companies expecting a reduction in production and a maintenance/increase in employment levels
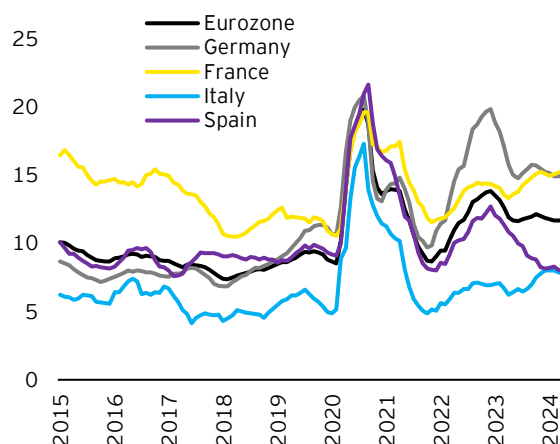
Source: EY elaborations on European Commission data. Values shown refer to the entire economy. Last observation: May 2024.

Since 2022, Italy shows an increasing percentage of companies experiencing a reduction in production together with a flat or increasing employment levels. The percentage is, however, not significantly different from the historical trend of the last ten years. It is also interesting to note that Italy has the lowest values among the main Eurozone countries, with France and Germany significantly above the Eurozone average.

While finding the right labor skills hamper the economic activity in the Eurozone more than in the period immediately prior to the pandemic crisis, it is important to consider that there are differences between member countries, which do not seem to clearly explain the heterogeneities in labor market dynamics between Eurozone countries.

In fact, most of the employees are in the service sector (around 80% in Italy and Germany, and around 85% in Spain and France), a sector that shows the same difficulties in finding the

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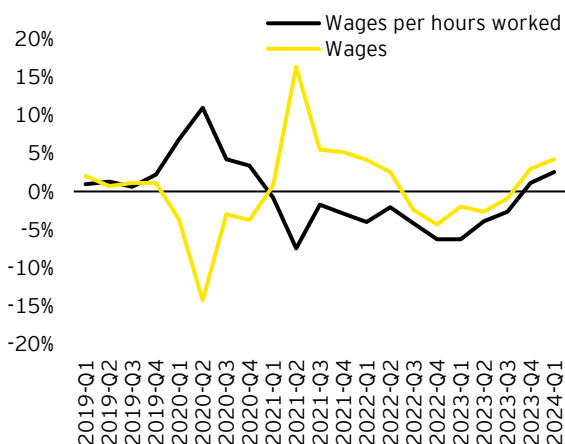[70] For more information, https://www.istat.it/it/archivio/297661.

right labor skills in Italy and Germany. What one would have expected from the joint analysis of the data would have been that the service sector in Germany (and France) would have had greater difficulty in finding the necessary labor, but this is not supported by the data.

The higher number of employees is reflected in an increase in the overall wage in Italy. If, on the one hand, higher inflation rates resulted in a reduction of the real wages, with a consequent reduction of workers' purchasing power, at the same time, the positive dynamics of the labor market partially reduced the negative effects of inflation thanks to an increase in the number of employees and, consequently, an increase in aggregate wages distributed.

Therefore, the negative effect of inflation was less pronounced than the one experienced for each employee. The dynamics of real wages per hour worked clearly point this out, showing a reduction since 2021 with a following growth starting from the fourth quarter of 2023.

Analyzing the growth of real wages and real wages per hours worked since 2019, it is possible to analyses what the effects of the pandemic crisis and inflation have been on the labor market. The pandemic crisis led to a reduction in the number of employees in Italy, resulting in a reduction in real wages; subsequently, the increase in the overall inflation reduced wages per hour worked, an effect that was partially reduced in aggregate by the increase in the number of employed persons.

The effect of inflation on real wages led to a reduction in household consumption of goods and services, which, after the decline recorded after the pandemic crisis, returned to 2019 levels between 2022 and 2023. It is interesting in this regard to point out how consumption developed differently depending on the expenditure destination, with some items recovering the loss recorded in 2020 faster than others.

Specifically, the analysis of data on household final consumption expenditure in Italy shows that the consumption of goods returned to pre-pandemic levels about one year (in the third quarter of 2021) after reaching a minimum (in the second quarter of 2020), unlike what was experienced for services, which returned to the average levels of 2019 in the third quarter of 2023 (and then declined again).

Looking at the goods and services in detail, there is heterogeneity within the different expenditure items. On the one hand, in fact, expenditure on communication, recreation and culture, and health are those that have shown a faster growth than the other categories (18%, 11% and 7% respectively in the last quarter of 2023 compared to 2019); on the other hand, items such as clothing and footwear, hotels and restaurants, and food and non-alcoholic beverages are still relatively far from their pre-crisis values (by 8%, 5% and 3% respectively).

Figure 37: Real wages per hour worked and real wages, Italy - % change YoY

Figure 38: Household final consumption expenditure, Italy - index, 2019=100
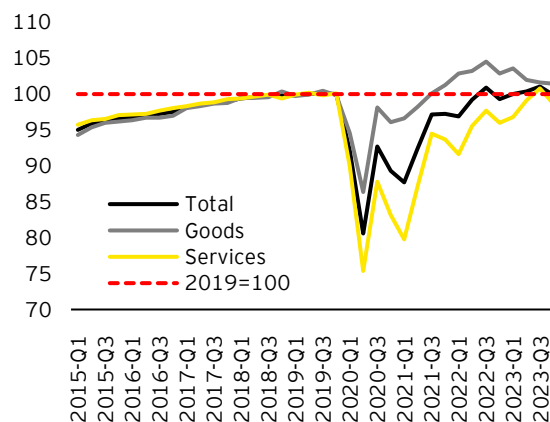
Source: EY elaborations on ISTAT data. Real values are calculated by deflating nominal values with the consumption deflator for household and non-profit institutions.

Source: EY elaborations on ISTAT data. Last observation: 2023-Q4.

It is also important to keep in mind that in the post-pandemic period, consumption was partly sustained by the extra-savings accumulated during the pandemic crisis, when the uncertainty and physical impossibility of maintaining pre-2020 consumption levels resulted in an accumulation of resources by Italian households.

A further element to be considered when analyzing consumption trends and investments, is the dynamic of real interest rates (i.e., interest rates adjusted for inflation). The low inflation recorded in Italy in recent months, in fact, has led to an increase in real interest rates compared to the Eurozone as a whole, making credit cost more expensive. Such high interest rates may result in a slowdown of consumption and investments in the coming quarters.

Figure 39: Differential of real interest rate for households and corporations in Italy compared to the Eurozone
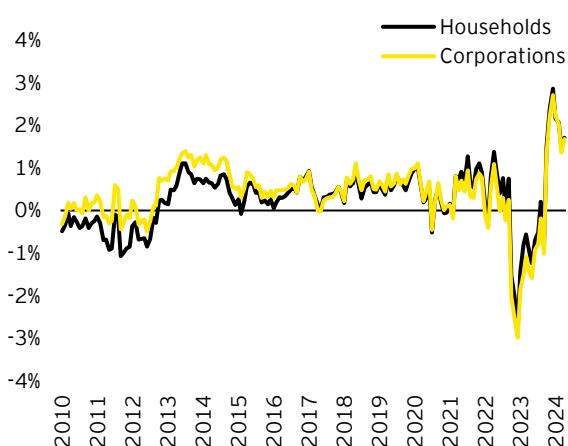
Source: EY calculations on Eurostat data. Real interest rates were calculated using harmonized inflation rates. Interest rates for households refer to the purchase of a house. Last observation: April 2024.

Overall, the Italian economic activity remains substantially weak, with a struggling industrial sector and a more dynamic services sector. The robustness of the labor market could support consumption, although this might be hampered by the weak recovery in real wages and, according to various estimates, by the reduction of the extra-savings accumulated during the pandemic period. Consumption is therefore still expected to stay weak.

Focus: investment and productivity

Main messages:

1. *Labor productivity in Italy is a crucial issue for the country's growth. There are many elements behind its dynamics, one of which are investments. Labor productivity growth in Italy was higher compared to the US in the period when overall investment, expressed as a percentage of GDP, was higher than in the US.*

2. *In Italy, productive investments, i.e., investments net of residential investments, fell between 2008 and 2014 as percentage of GDP, only to recover in the coming years. A significant gap is recorded compared to the US.*

3. *Productivity investments include those in technology, a key factor in productivity development. In recent years, investments in artificial intelligence in the United States have been on a totally different scale to those in other major world countries, the European Union and Italy. Italy must not miss this opportunity, although the effects of this technology on productivity growth and the economy in the long term appear to be less significant than might be expected.*

4. *Other factors, such as the institutional sector of the investor and the size of companies, can play an important role in defining the positive effects of investments on productivity.*

In a context of high interest rates, investment dynamics plays a central role, as it is one of the main elements in the economy influenced by the higher cost of money. At the same time, investment is a key factor for productivity growth and thus for the economic growth of the country as a whole. The positive relationship between investment and productivity growth has been extensively studied and is rooted in an extensive economic[71] and institutional literature.[72]

The comparison of historical investment trends between Italy and the United States is one interesting element to investigate in order to shed some lights on the relation between investments and labor productivity, also adding some insights into the dynamics behind the weak trend of productivity growth (here expressed as GDP per hour worked) in Italy. The reason behind the comparison between Italy and the United States is mainly related to the fact that the United States is a country with a particularly dynamic productivity growth: from 1995 to 2022, in fact, labor productivity increased by around 56%, compared to a growth in Italy of around 9%. This makes the United States a reference point in trying to investigate some of the potential underlying causes of productivity trends in Italy.

Between the 1960s and the early 1990s, Italy recorded a significantly higher share of investment in GDP than the United States, as shown in Figure 40. This share, close to 30% for Italy in the 1960s, declined progressively over the years, aligning around the end of the 20th century to US levels. On the other hand, an analysis of labor productivity trends shows how, in the period between 1970 and the first half of the 1990s, labor productivity grew in Italy faster than in US, almost catching up its levels.

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[71] Refer, in this regard, to Solow, R. M. (1962). Technical progress, capital formation, and economic growth. The American Economic Review, 52(2), 76-86.; Romer, P. M. (1990). Capital, labour, and productivity. Brookings papers on economic activity. Microeconomics, 1990, 337-367; Stiroh, K. J. (2001). What drives productivity growth?. Economic Policy Review, 7(1).
[72] Refer, in this regard, to recent sources such as OECD Compendium of Productivity Indicators 2024, OECD Compendium of Productivity Indicators 2023.
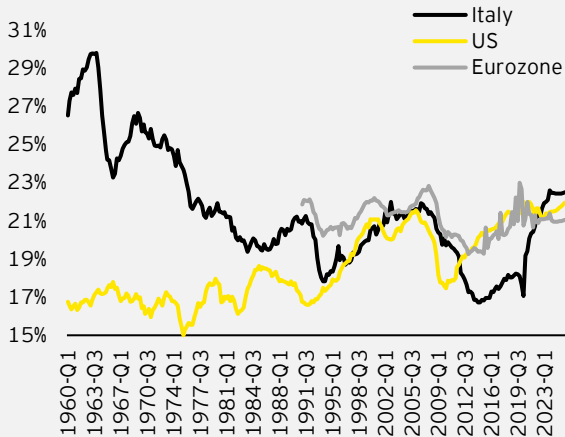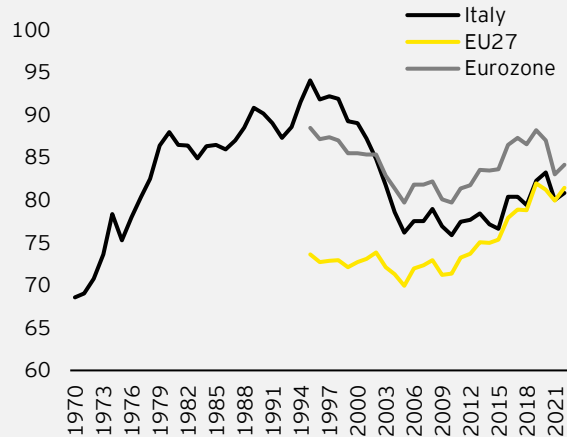
Figure 40: Investment - % of GDP

Legend: Italy, US, Eurozone

Figure 41: GDP per hour worked (USA=100)

Legend: Italy, EU27, Eurozone

Source: EY elaborations on OECD data, Eurostat.

The following years, however, were characterized by a widening of the gap in hourly productivity between the two countries. As such, between 2005 and 2015, the gap of hourly productivity in Italy and the US remained roughly similar and reduced in more recent years.

Comparing the dynamics of productivity and investment, it can be stated that, when Italy had a higher investment share of GDP than the US, the productivity gap narrowed, i.e., productivity per hour grew faster in Italy than in the US; then, when the investment share of GDP in Italy moved closer to that of the US, productivity growth relative to that of the US stabilized and then declined, and accelerated again when the investment share of GDP for Italy increased again.

With reference to investments, a further element to consider for productivity purposes is the type of investments made. The main categories are cultivated biological resources, intellectual property products, construction (housing and other buildings and structures) and machinery and equipment. These categories can also be grouped into two macro-categories, namely residential investment (investment in housing) and productive investment (within which all other categories fall).

Figure 42: Gross fixed capital formation and components, Italy - % change YoY

Legend: Biological resources, Intellectual Property, Other Buildings and Structures, Machinery and equipment, Dwellings, Gross investments
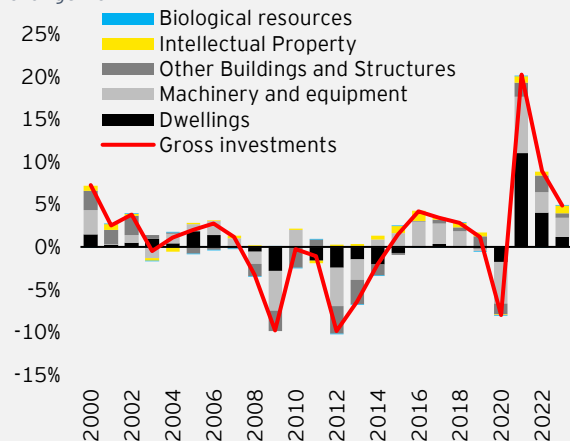
Figure 43: Productive investment - % of GDP

Legend: Eurozone, Italy, US
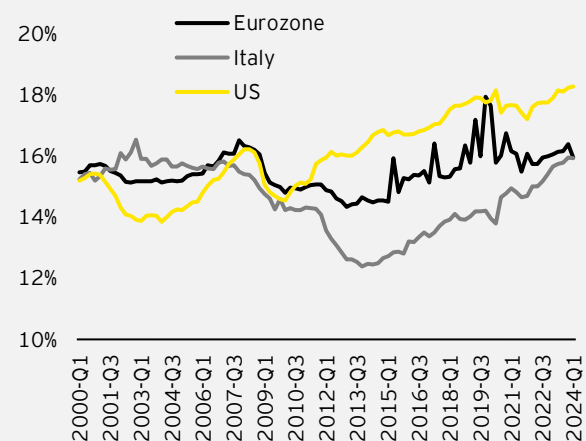
Source: EY elaborations on OECD data.

Analyzing the trend in productive investments as a percentage of GDP, a comparison between the United States and the Eurozone provides further information on investment trends. In fact, since the great

financial crisis of 2007, productive investment in Italy, as a percentage of GDP, has always been lower than in the United States. The importance of the type of investment in the analysis of productivity is testified to by several studies: consider, for example, investments in technology, which has been shown to have a positive effect on productivity growth.[73] This factor could therefore represent a further element behind the difficulties in catching up the hourly productivity gap between the US and Italy.

Turning to investments in technology, the United States recorded significant investments in artificial intelligence in recent years. The comparison with the European Union and Italy appears meaningful: according to Stanford University's Artificial Intelligence Index Report 2024, in 2023 private investments in artificial intelligence in the United States reached $67 billion, compared to investments in the European Union of around $6 billion.[74] Italy does not compare in the ranking by size of private investments, suggesting a low amount of investment compared to the other countries listed. A similar ranking is also shown for venture capital investments in artificial intelligence: the United States shows a clear gap compared to other major economies, with an investment to 2023 of around $55 billion compared to an investment in the European Union of around $8 billion ($0.1 billion for Italy).

Figure 44: Private investment in artificial intelligence - billions, $, 2023
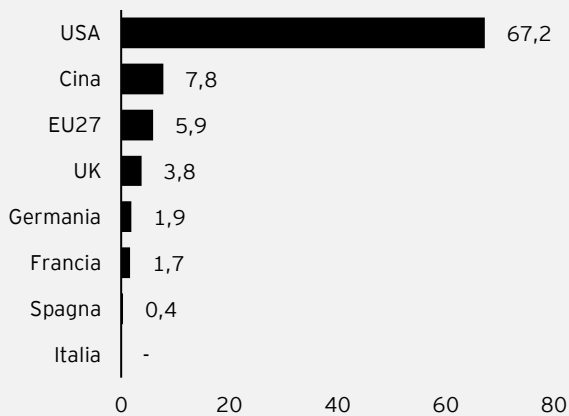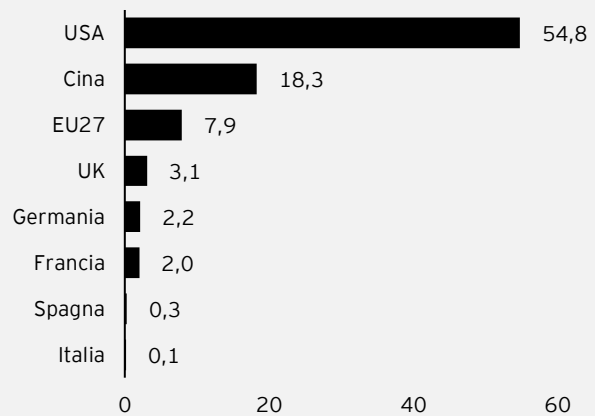
Figure 45: Venture capital investments in artificial intelligence - billions, $, 2023

Source: EY elaborations on Artificial Intelligence Index Report 2024 (Stanford), OECD data.

Speaking of artificial intelligence and productivity, it is important to emphasize that although expectations are of a real revolution in the way many activities will be performed in the future, some recent studies have shown that the effects of AI on labor productivity in the long run could be limited overall (a recent estimate by one of the world's leading economists describes an impact on the growth of *total factor productivity*[75] of between 0.55% and 0.71% over 10 years, with a consequent increase in GDP of around 1%).[76] It should also be considered that the study refers to the US economy, which, as seen, is the leading country for investments in this area.

A further important element to consider in the relationship between investment and productivity concerns the institutional sector which is making the investment. In this respect, however, the economic literature shows conflicting evidence: on the one hand, a positive role of public investment on business

[73] As an example, refer to Dedrick, J., Gurbaxani, V., & Kraemer, K. L. (2003). Information technology and economic performance: A critical review of the empirical evidence. ACM Computing Surveys (CSUR), 35(1), 1-28; Biagi, F. (2013). ICT and Productivity: A Review of the Literature, Institute for Prospective Technological Studies Digital Economy Working Paper, No. 2013/09, ISBN 978-92-79-33678-2, European Commission, Joint Research Centre (JRC); Zolas, N., Kroff, Z., Brynjolfsson, E., McElheran, K., Beede, D. N., Buffington, C., Goldschlag, N., Foster, L., Dinlersoz, E. (2021). Advanced technologies adoption and use by us firms: Evidence from the annual business survey (No. w28290). National Bureau of Economic Research.
[74] Artificial Intelligence Index Report 2024, Stanford University.
[75] TFP reflects the output per unit of a certain set of inputs: an increase in TFP reflects a gain in the quantity of output that does not result from an increase in the use of inputs. Consequently, TFP reveals the joint effects of many factors, including new technologies, efficiency gains, economies of scale, managerial skill and changes in the organisation of production. For more information, https://agridata.ec.europa.eu/Qlik_Downloads/InfoSheetSectorial/infoC27.html.
[76] Acemoglu, D. (2024). The Simple Macroeconomics of AI (No. w32487). National Bureau of Economic Research.

productivity is observed,[77] on the other hand, this relationship does not always seem to be verified.[78] Other studies assess the positive relationship between public investment and productivity, which would be conditioned to the type of investment made: this is the case of military and non-military investments. The second one have, in fact, a direct and indirect positive effect on productivity growth: the former linked to the greater availability of public capital to support private activity; the latter referring to the complementarity between public and private capital in productive activity, since an increase in the stock of public capital would increase the economic return on private capital, which, in turn, would stimulate an increase in private investment.[79]

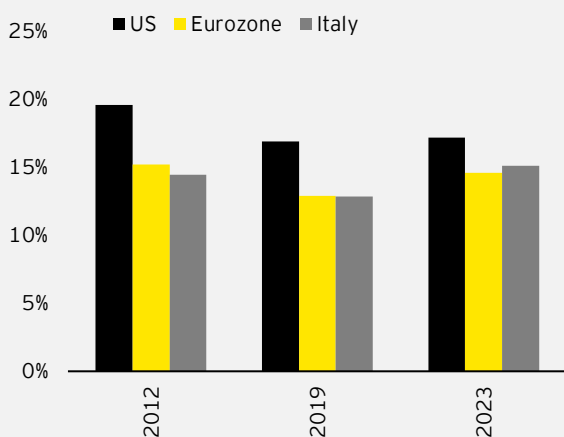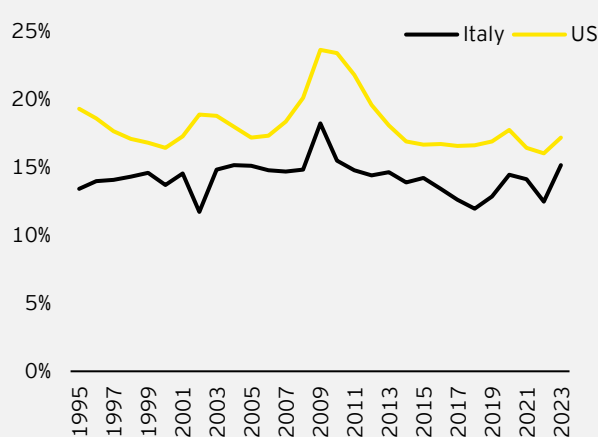*Figure 46: Share of public investment on total investment*

Figure 47: Share of public investment in the total

Source: EY elaborations on OECD data, Eurostat.

In any case, it is important to emphasize that when analyzing investment trends by institutional sector in Italy and the US, the latter has maintained a higher share of public investment than Italy and the Eurozone as a whole.

Table 1: Productivity per employee by enterprise size

	Austria	Belgium	Germany	Spain	EU27	France	Italy	The Netherlands	Poland
0-9	62.3	95.2	84.7	41.0	55.6	72.5	48.7	98.9	20.5
10-49	96.8	126.1	81.9	61.7	74.2	85.1	78.5	143.7	36.6
50-249	119.4	134.8	95.6	79.4	96.9	98.3	106.3	253.1	48.2
>250	131.9	144.1	126.4	85.3	116.0	121.2	125.2	128.3	65.4
Total	102.4	124.7	103.6	64.8	87.0	100.0	81.1	142.0	41.3

Lower productivity   Higher productivity

Source: EY elaborations on OECD data. The color scale is based on a single-country analysis, thus not making the colors comparable between different countries.

A further issue to be addressed with regard to the relation between investment and productivity concerns the size of enterprises. Analyzing labor productivity (here expressed as GDP per person employed) by firm size, greater size corresponds to greater productivity on average.

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[77] Refer, for example, to Munnell, A. H. (1990). Why has productivity growth declined? Productivity and public investment. New England economic review, (Jan), 3-22; Bom, P. R., & Ligthart, J. E. (2014). What have we learned from three decades of research on the productivity of public capital?. Journal of economic surveys, 28(5), 889-916.
[78] Holtz-Eakin, D. (1992). Public-sector capital and the productivity puzzle. NBER Working Paper Series, Working Paper No. 4122.
[79] Aschauer, D. A. (1989). Public investment and productivity growth in the Group of Seven. Economic perspectives, 13(5), 17-25.

There can be several explanations for this phenomenon. However, keeping the focus on investment, it is important to consider that small companies experience greater difficulties in accessing credit, which can translate into a greater barrier to investment, making small companies less capital-intensive.[80]

Table 2: Enterprises by size, percentage on total

	Austria	Belgium	Germany	Spain	EU27	France	Italy	The Netherlands	Poland
0-9	29%	32%	19%	34%	30%	27%	43%	29%	38%
10-49	20%	14%	21%	19%	19%	15%	19%	16%	16%
50-249	17%	15%	17%	13%	15%	12%	13%	16%	14%
>250	34%	39%	42%	33%	36%	46%	25%	40%	32%
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%

◻ Lower value   ◻ Higher values

Source: EY elaborations on Eurostat data. The color scale is based on a single-country analysis, thus not making the colors comparable between different countries.

The lower productivity can therefore be partly explained by the structure of the Italian economic system, mainly composed of small enterprises, which generally have lower productivity than large enterprises.[81,82]

In any case, the phenomenon for which small enterprises are on average less productive than medium-sized and large enterprises is not always verified: in some cases, especially in the service sector, small enterprises may show higher productivity than larger enterprises, thanks to their flexibility, tendency to be more innovative,[83] and thanks to other positive elements especially in terms of human capital - e.g., managerial skills.[84] However, it should be noted that it has been verified that the return on productivity of managerial skills increases with increasing firm size.[85]

In conclusion, therefore, it can be said that investment is one of the factors behind productivity growth. In addition, there are many elements to consider when investigating the link between investment and productivity, including the type of investment, the institutional sector investing, and the size of the firm. A future reduction in interest rates may result in a stimulus to investment, with potential positive effects on the recovery of productivity in Italy and, consequently, on economic growth in the medium and long term.

[80] Refer in this regard to Gerlach-Kristen, P., O'Connell, B., & O'Toole, C. (2015). Do credit constraints affect SME investment and employment?. The Economic and Social Review, 46(1, Spring), 51-86; Kuntchev, V., Ramalho, R., Rodríguez-Meza, J., & Yang, J. S. (2013). What have we learned from the enterprise surveys regarding access to credit by SMEs?. World Bank Policy Research Working Paper, (6670).
[81] Chen, S., & Lee, D. (2023). Small and vulnerable: SME productivity in the great productivity slowdown. Journal of Financial Economics, 147(1), 49-74.
[82] Marchese, M., Giuliani, E., Salazar-Elena, J. C., & Stone, I. (2019). Enhancing SME productivity: Policy highlights on the role of managerial skills, workforce skills and business linkages.
[83] Andrews, D., Criscuolo, C. and Gal, P. (2015), 'Frontier Firms, Technology Diffusion and Public Policy', OECD Productivity Working Papers, No. 2, OECD Publishing, Paris, https://doi.org/10.1787/5jrql2q2jj7b-en.
[84] Criscuolo, C., Gal, P., Leidecker, T. and Nicoletti, G. (2021), 'The human side of productivity: Uncovering the role of skills and diversity for firm productivity', OECD Productivity Working Papers, No. 29, OECD Publishing, Paris, https://doi.org/10.1787/5f391ba9-en.
[85] Baker, G. P., & Hall, B. J. (2004). CEO incentives and firm size. Journal of Labor Economics, 22(4), 767-798.

The Italian economy: GDP and EY forecasts

The first quarter of 2024 recorded a quarter-on-quarter growth of 0.3%, which translates into a year-on-year growth of 0.7%. The quarter-on-quarter growth is the result of similar growth (0.3%) in household consumption, growth in investment (0.5%), growth in exports (0.6%) and a significant reduction in imports (-1.7%). From a year-on-year perspective, household consumption remained essentially unchanged (0.1%), while investments and exports experienced stronger growth rates (4.0% and 1.9% respectively). Imports reduced compared to the same period the previous year (-3.4%).[86]

Private consumption experienced a tepid growth, after the -1.4% in the fourth quarter of 2023. The slowdown in consumption is mainly due to the reduction in households' purchasing power in recent years as a result of high inflation, high interest rates, and a reduction in the "extra savings" generated during the pandemic period, which partly supported consumption in previous quarters.

Figure 48: GDP components, Italy - contributions to growth, percentage points
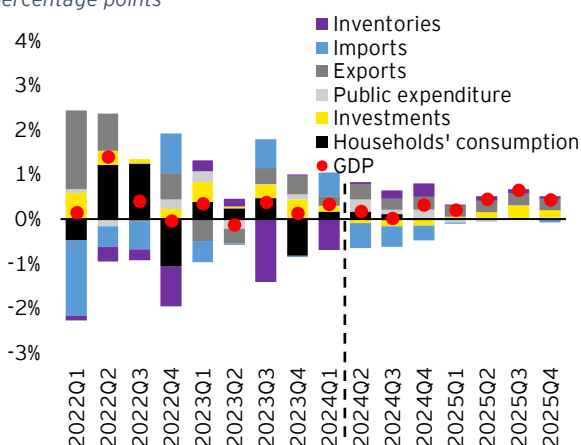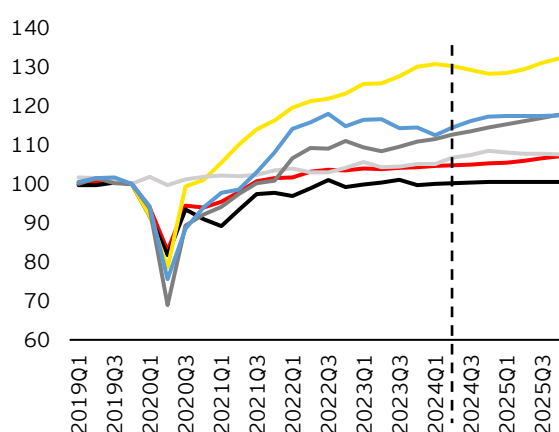
Figure 49: GDP components, Italy - index, 2019-Q4 = 100

Source: EY elaborations on Eurostat data and EY forecasts. EY forecasts start from 2024-Q1. Investment refers to public and private investment, and includes gross fixed capital formation, acquisitions less disposals of valuables and depreciation. Household consumption also consider the consumption of non-profit institutions serving households.

The weak growth in private consumption is also reflected in imports, which experienced a negative growth, thus making a positive contribution to GDP growth. Meanwhile, high interest rates and general uncertainty continue to weigh on investments dynamics, although they continue to experience a positive growth. Exports, on the other hand, benefit from a recovery in international trade.

Based on the information shared so far and the latest data available, it is possible to outline EY's outlook for the Italian economy. After the growth in the first quarter of 2024, a modest GDP growth is expected in the second quarter of 2024, followed by a stagnation and recovery by the end of the year, with an overall growth rate of 0.8% in 2024. 2025 will then be characterized by a slight acceleration (1.3%).

The 2024 performance will be mainly related to a flat growth in private consumption and a positive dynamic in investments (1.8%), together with a significant positive contribution from net exports (around 1.2 percentage points). On the other hand, 2025 will be characterized by a slight acceleration in private consumption (0.3% estimated growth compared to the previous year) and a slowdown in investment

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[86] ISTAT, Quarterly Economic Accounts, Q1 2024. For more information, https://www.istat.it/it/files//2024/05/CET-24q1.pdf.

(0.5%), mainly due to the marked reduction of the positive effects of fiscal measures (e.g., superbonus 110%) and high real interest rates.

Table 3: Economic forecasts for the Italian economy

	2020	2021	2022	2023	2024	2025
GDP, % change	-9.0%	8.3%	4.0%	0.9%	0.8%	1.3%
Household consumption, % change	-10.4%	5.5%	4.9%	1.2%	0.0%	0.3%
Total investments, % change	-8.0%	20.3%	8.9%	4.9%	1.8%	0.5%
Exports, var. %	-14.3%	14.1%	11.0%	0.5%	3.2%	3.1%
Imports, % change	-12.7%	15.6%	13.5%	-0.2%	-0.3%	2.0%
Unemployment rate	9.3%	9.5%	8.1%	7.7%	7.1%	6.9%
Consumer price index, % change	-0.1%	1.9%	8.2%	5.6%	1.4%	2.0%
Deficit, % of GDP	-9.3%	-8.7%	-8.3%	-7.2%	-3.7%	-2.7%
Public debt, % of GDP	155.1%	147.3%	140.4%	137.1%	136.8%	134.7%

Source: Forecasts from EY Italy's Macroeconometric Model, 'HEY-MoM'. The area in grey represents the forecast horizon. Changes in GDP and its components are calculated on values expressed in real terms. Investments refers to public and private investment, and includes gross fixed capital formation, acquisitions less disposals of valuables and depreciation. Household consumption also consider the consumption of non-profit institutions serving households.

The labor market is robust and shows an unemployment rate closer to around 7% between 2024 and 2025. Inflation rate is also expected to improve, moving from 5.6% in 2023 to 1.4% in 2024 and then to accelerate slightly to 2.0% in 2025.

The public deficit is expected at 3.7% in 2024 and 2.7% in 2025, while the public debt-to-GDP ratio will be affected by low nominal GDP growth, standing at around 134.7% in 2025. The forecasts remain subject to a scenario of high uncertainty and therefore present downside and upside risks due to the global macroeconomic environment.

Going into more details, high interest rates are compounded with a reduction of the positive effects of fiscal measures, thus affecting private investments. Specifically, investments in dwellings are expected to grow in 2024 before experiencing a sharp contraction in 2025 (2.9% and -13.5% respectively); different dynamics for investments in non-residential buildings and structures (2.9% and 4.8% respectively) and for machinery (-1.6% in 2024 followed by a 5.0% growth in 2025). A different trend can be observed for intangible assets, which increasingly represent a key element for those companies that want to stay competitive in the market. Indeed, these investments (which include, for example, investments in research and development, software) continue to grow, even though the total amount is still small compared to total investments, so that their contribution is not very significant on the overall investments' performance. It has to be noticed, however, that their role is fundamental for the economic system (e.g., for productivity).[87] In a scenario of contracting private investments in 2025, public investments, which is expected to grow by 10.5% in 2025, is therefore the real driver of national investments.

In this regard, it is important to emphasize the role of the National Recovery and Resilience Plan (PNRR) for growth in the medium-to-long term, thanks to an increase in potential growth due in part to the complex program of reforms. The PNRR is an important driver for economic growth in a context of private investment hampered by high interest rates and weak consumption.

The forecasts presented assume the actual implementation of the reforms and projects of the PNRR according to the information available in the latest report on the implementation of the National Recovery

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[87] Greco, R. (2023). A structural analysis of productivity in Italy: a cross-industry, cross-country perspective. Questioni di Economia e Finanza, Occasional Paper, Number 825, December 2023.

and Resilience Plan of May 2024[88] and in the fourth report on the implementation of the PNRR of February 2024.[89] The latter shows a total expenditure between 2020 and 2023 of approximately €43 billion against the approximately €46.6 billion according to the latest timetable available in the document shared by the Court of Auditors (*Corte dei Conti*). Based on this information, it is possible to assume that the difference between what has been spent and the resources available up to 2023 shown in the latest timetable will be allocated in the following years.
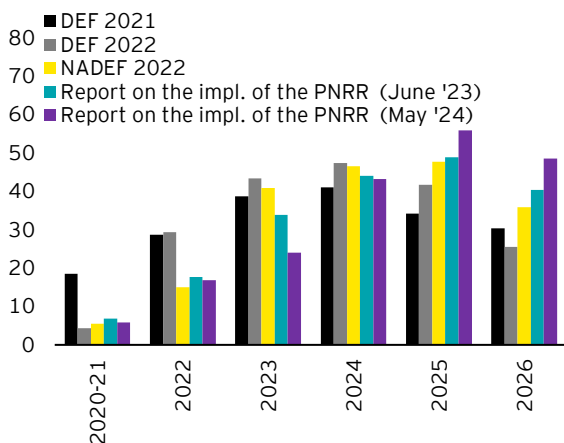
Figure 50: PNRR timetable (billions, €)

Table 4: PNRR timetable (billions, €)

	DEF 2021	DEF 2022	NADEF 2022	Report 06/23	Report 05/24
2020-21	18.5	4.3	5.5	6.8	5.8
2022	28.7	29.4	15.0	17.7	16.8
2023	38.7	43.3	40.9	33.8	24.1
2024	41.0	47.4	46.5	44.0	43.2
2025	34.2	41.7	47.7	48.8	56.0
2026	30.4	25.5	35.9	40.4	48.6
Total	191.5	191.5	191.5	191.5	194.4

Source: EY elaborations on institutional sources.

Considering the context described, we outline different scenarios to identify the potential impacts on economic growth of a partial implementation of the PNRR in the coming years. Specifically, the analysis of the impacts of the PNRR on growth according to different implementation scenarios was carried out considering the following steps:

1. The difference between the resources accruing in 2023 and those planned according to the last timetable (difference of about 3.6 billion) was assumed to be equally distributed over the next years (2024 to 2026).
2. The resources were broken down considering different spending categories, as described in fourth report on the implementation of the PNRR of February 2024. Specifically, the following distribution of resources is assumed: 33% purchase of goods and services; 46% public investments; 1% for social benefits; 19% incentives to production; 1% in other spending purposes.
3. We assumed a delay (four quarters) in the actual spending of public investments ('time to spend'), considering the necessary bureaucratic requirements, in line with the assumption shared in a work of the European Commission (Pfeiffer et al., 2021).[90]
4. This baseline scenario is complemented by two further scenarios in which a partial implementation of the PNRR is assumed. Specifically:
   a. *Scenario 1*: Implementation at 70% of the planned resource estimate in 2024 and 90% in 2025;
   b. *Scenario 2*: Implementation at 50% of the planned resource estimate in 2024 and 70% in 2025.

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[88] Relazione sullo Stato di Attuazione del Piano Nazionale di Ripresa e Resilienza. For more information, https://www.corteconti.it/Download?id=7c438424-a7db-4a5f-99a0-3e55c2875447.
[89] Quarta Relazione sullo Stato di Attuazione del Piano Nazionale di Ripresa e Resilienza. For more information, https://www.italiadomani.gov.it/content/sogei-ng/it/it/strumenti/documenti/archivio-documenti/quarta-relazione-al-parlamento-sullo-stato-di-attuazione-del-pia.html.
[90] Pfeiffer, P., & Varga, J. (2021). Quantifying spillovers of next generation EU investment (No. 144). Directorate General Economic and Financial Affairs (DG ECFIN), European Commission. This paper in turn refers to Leeper, E.M., T.B. Walker, and S-C.S. Yang, 2010, Government Investment and Fiscal Stimulus, Journal of Monetary Economics, 57, 1000-12.

	2024	2025
Baseline	0.8%	1.3%
Scenario 1	0.4%	1.2%
Scenario 2	0.1%	0.9%

Source: EY Italy's Macroeconometric Model, 'HEY-MoM'. The percentage points represent the deviation in the two scenarios from the baseline scenario (0.5% in Scenario 1; 1.2% in Scenario 2).

Taking these two scenarios into account, we estimate that in Scenario 1 GDP would grow by 0.4% in 2024 and 1.2% in 2025. This would result in a cumulative growth in 2025 that is 0.5 percentage points lower than the baseline.

In Scenario 2, the Italian economy would experience essentially flat growth (0.1%) in 2024 and 0.9 % in 2025. This would translate into a 1.2 percentage points lower growth in 2025 compared to the baseline. As already mentioned, therefore, the PNRR resources represent an important lever of Italian GDP growth in 2024 and 2025, in a context of high interest rates that discourage private consumption and investment. What is crucial is that these resources are also spent productively to stimulate medium- to long-term growth.

Assumptions to Forecasts

The forecasts described above are based on several assumptions outlining the baseline scenario. Specifically, the following assumptions are considered:

▸ **Foreign demand for Italian goods**: foreign demand for Italian goods is assumed to recover in 2024, with a further acceleration in 2025 to roughly 3% growth;

▸ **Natural gas**: the price of natural gas (referred to the Dutch Title Transfer Facility) is assumed to be around $10.0/mmbtu by the end of 2024, and around $11.0/mmbtu by the end of 2025;

▸ **Oil**: the price of oil is assumed to be around $84 per barrel at the end of 2024,[91] and to decline gradually in 2025 to $78 per barrel;

▸ **Exchange rate**: the euro/dollar exchange rate is assumed at 1.09;

▸ **Public expenditure**: we consider the projections in the latest Update Note of the Ministry of Economy and Finance's Economic and Financial Document as our starting point.[92] Some changes were applied to to take into account our estimates on the allocation of PNRR resources;

▸ **Monetary policy and interest rates**: we assume a path of interest rate reductions that will lead to a 0.50 percentage point reduction in key interest rates by the end of 2024, and a further 0.75 point reduction in 2025. It is also expected that the long-term interest rate (10 years) will follow a similar trend but showing a gradually increasing differential with the short-term rate.

Assumptions are made on the basis of data available as of 14th June 2024. The data in the analysis are updated to 14th June 2024.

Finally, considering the current scenario and the very high uncertainty, some downside and upside risks are listed below.

Upside risks

▸ **Reduction of geopolitical tensions**: tensions related to the ongoing conflicts, specifically the Russian-Ukrainian and Israeli-Palestinian ones, could ease in the short/medium term, thus reducing instability in the macroeconomic framework, with potential positive repercussions on the prices of energy goods (mainly oil) and other commodities;

▸ **Labor market**: low pressure of wages on price level, reducing the risk of inflation rate persistence;

▸ **Monetary policy**: acceleration of monetary policy easing by the European Central Bank with lower pressure on domestic demand;

▸ **Readjustment of supply chains**: a faster readjustment of European and global value chains would lead to lower complexities resulting in greater security of supply and world trade acceleration;

▸ **Acceleration of foreign demand**: higher economic growth for important trading partners such as China and the US, which would result in a higher contribution of foreign trade to Italian growth.

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[91] Reference is made to the price of Brent.
[92] Economic and Financial Document, Update Note, 2023.

Downside risks

‣ **Increased geopolitical tensions**: the Russia-Ukraine conflict may not ease in the short/medium term, perpetuating geopolitical insecurity and instability. In addition, a worsening of the Israeli-Palestinian issue, which, if other countries were to be involved, would have even more significant humanitarian and economic repercussions, with potential negative consequences on the prices of energy goods (mainly oil) and other commodities;

‣ **Stronger-than-expected impact of restrictive monetary policy on the real economy**: the ECB and other global central banks may maintain a restrictive monetary policy for longer than expected if inflation persists. This may translate into a risk of prolonged low growth, due to lower consumption and investment discouraged by high interest rates;

‣ **Stress in the financial system**: high interest rates can translate into increased stress for financial institutions, with a consequent impact on savers and a tightening of credit conditions, both in the US and in the Eurozone;

‣ **High public debt**: the post-pandemic increase in public debt, together with the current high interest rates, poses new challenges to its sustainability in Eurozone economies, especially in the most indebted ones such as Italy. This could ultimately translate into higher risks of stress in financial markets;

‣ **National Recovery Plan (PNRR)**: failing to fully achieve the objectives of the PNRR and its partial implementation could slow down the pace of growth of investments, and thus of the Italian economy as a whole; the issue could also have repercussions on potential GDP and thus on medium- to long-term growth prospects;

‣ **Emerging economies**: rising global interest rates may impact emerging economies through several channels (low US growth; depreciation of emerging country currencies, potentially leading to higher interest rates to avoid excessive depreciation; increased financial fragility);

‣ **Monetary policy transmission channels**: some structural factors such as the presence of a high proportion of households with fixed-rate debt, or an economy where the service sector is predominant, may hamper the transmission mechanisms of monetary policy, thus requiring more time for its effects to be felt; [93]

‣ **Increased distress in the real estate sector**: maintaining interest rates at a high level may add further pressure on the real estate market, discouraging home and property purchases;

‣ **Lower international growth**: less sustained growth in China and the US could result in reduced growth in foreign demand for Italian goods;

‣ **US elections**: the November 2024 US elections increase uncertainty about potential future developments and expectations on major geopolitical issues.

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[93] ECB, the risks of a stubborn inflation, June 2023, https://www.ecb.europa.eu/press/key/date/2023/html/ecb.sp230619_1~2c0bdf2422.en.html.

Technical Appendix

HEY-MOM: Hybrid EY MOdel for the Macroeconomy[94]

The construction of a new macro-econometric model required the optimisation of an inevitable trade-off between building a model that emphasises data information (such as the ARIMA and VAR models, which make no use of economic theory) or a model that only pays attention to the foundations on which its relationships are based (in the extreme case, the calibrated RBC-DSGE models that pay no attention to the data of their variables).[95] This trade-off has been emphasised several times in the literature, see for example the reflections in Granger (1999) and Pagan (2003).

In the construction of HEY-MOM, an attempt was made not to neglect either of the above two ingredients (economic theory and data), in an attempt to produce a hybrid model with a careful balance in specifying relationships (a) based on micro-founded economic behaviour and at the same time (b) careful in the application of rigorous statistical information evaluation techniques. An example of a hybrid model is MARTIN, the model currently in use at the Australian Central Bank (see Cusbert and Kendall, 2018).

In a nutshell, the role of HEY-MOM is to unify the analytical framework of macroeconomics in EY. In order to do so, the model refers to the main aggregates of the Italian economy, based on empirical data, non-monetary in nature, with explicit long-run relations between the variables it studies, and mainly oriented towards the definition of short-term forecasts (over a two-year horizon).

Economic foundations

Rigidity in the movement of prices and wages implies rigidity in the speed with which macroeconomic systems adjust to unexpected shocks. Thus, in the model, market demand drives short-term fluctuations, as outlined by Keynesian theories, while in the long run, supply determinants drive the state of the economy.

The long-run output (the potential of the economy) depends on the combined effect of trends in total factor productivity, labour supply and duration in hours and, finally, the capital stock. These factors are combined by a Cobb-Douglas-type technology with constant returns to scale. The demand for factors of production is that which minimises the cost given a planned level of output in the context of an economy in which oligopolistic forms of competition prevail, in which firms are free to set prices on the basis of a margin over labour costs and, at those prices, are prepared to collectively meet any level of market demand. Wages are defined on the basis of a 'Phillips curve' driven by the inertia of the inflation rate, labour productivity, and the distance between actual and natural unemployment rates (defined by the long-run state of the labour market). Actual output is composed of the following domestic and foreign demand items: private (household) and public consumption; private and public investment by type of asset (residential and non-residential buildings, machinery and equipment, and expenditure on research and development); imports and exports.

In each period, the gap between actual and potential output affects prices (through changes in margins) which, in turn, interact with the demand components. In this way, an equilibrium between supply and demand is achieved.

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[94] The model was developed in collaboration with the Department of Economic Sciences of the University of Bologna.
[95] "ARIMA" stands for "Autoregressive integrated moving average", "VAR" for "Vector autoregression", "RBC-DSGE" for "Real Business Cycle - Dynamic. Stochastic General Equilibrium'.

Data evaluation techniques

The speed at which the economic dynamics outlined above evolve over time is estimated using econometric methods based on the actual time series of the variables of interest in the model.

To this end, the model uses a combination of the London School of Economics approaches and Fair's (2004) review of the Yale Cowles Commission approach. The synthesis carried out in HEY-MOM uses cointegration methods (Engle and Granger, 1987, and Johansen, 1995) to estimate long-run relationships between non-stationary variables (Dickey and Fuller, 1979), which can be interpreted in light of economic theory and identified by state relationships whose parameters are estimated on the basis of error-corrected models (Hendry et al., 1984, and Pesaran et al., 2001). In the absence of exogeneity of some explanatory variables in the model, the relationships are first inspected following the instrumental variables estimation approach, and then definitively estimated at three stages (Hsiao, 1997).

The overall result is a model composed of 74 equations, of which 29 are stochastic and 45 are accounting identities. The forecasts and analyses performed are conditional on the delineation of scenarios for 65 exogenous variables that can be classified as: fiscal and monetary policy instruments, foreign bloc, and economic indicators.

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Contact

Mario Rocco
Partner, Valuation, Modelling and Economics Leader, EY
mario.rocco@it.ey.com

Alberto Caruso
Senior Manager, EY
alberto.caruso@it.ey.com

Luca Butiniello
Senior Analyst, EY
luca.butiniello@it.ey.com