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

INTEREST RATES, NRRP, SUPERBONUS, ENERGY: WHAT WILL HAPPEN TO ITALIAN GROWTH?

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INTRODUCTION AND SUMMARY

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Global growth prospects are improving In 2023, global trade in goods experienced a sharp contraction (-1.9%), wider than previously assumed in our October report (-1.0%). The several factors contributing to this decline are still present at the beginning of 2024: sluggish demand for manufactured goods and investment, interest rates at their highest levels, energy prices consistently higher than pre-pandemic levels and increasing geopolitical tensions and fragmentation. Additionally, the German recession weighs on Europe.

However, global growth prospects appear to be gradually improving. Declining inflation increases household purchasing power and consumer confidence, supporting consumption. Moreover, it brings interest rate cuts closer, stimulating investment. Industrial production is expected to gradually strengthen, driven by increased demand for goods, the need to adjust inventory levels and favorable industrial policies in some countries, such as the USA.

Global trade in goods is, therefore, expected to resume growth this year and next, albeit at modest rates (Table A): by the end of 2025, it will align with the pace of global GDP expansion.

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

	2023	2024	2025
World trade	-1,9	2,0	2,5
GDP- United States	2,5	2,2	2,0
GDP - Eurozone	0,5	0,5	1,1
GDP - Emerging markets	4,0	4,2	4,4
Oil price[1]	83	87	85
Gas price (Europe)	41	28	28
Dollar/euro exchange rate[2]	1,08	1,09	1,09
Effective FED rate[3]	5,02	5,21	4,25
ECB rate[3]	3,80	4,15	3,18

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

In the two-year forecast period, global GDP will continue to expand, albeit at moderate rates. Growth will be supported by: 1) the emerging economies which are expected to slightly accelerate, 2) the USA, which, although it does not seem to have been, overall, greatly affected by the high interest rates, is, however, expected to gradually slow down due to increased uncertainty associated with the presidential elections and 3) the Eurozone economy which is expected to accelerate, but only in 2025, after growing this year at the same rate as in 2023.

However, there are significant downside risks, including increased geopolitical tensions, the escalation of ongoing military conflicts and further disruptions in global supply chains, especially in international transportation. On the positive side, growth in the US could surprisingly keep its current sustained pace and the European economy could indeed experience a faster recovery, starting with Germany, especially in the case of a quicker-than-expected drop in interest rates.

It should also be noted that the price of oil has risen in recent months, driven by demand from emerging markets and production limitations by OPEC countries and Russia and it is expected to approach the $90 threshold this year. Additionally, the price of gas will remain roughly stable at current levels, which are low compared to 2022 but high compared to the pre-pandemic period.

Two powerful drivers for Italian growth Italian growth was surprisingly positive in 2023 and the economy rose by 0.9% annually despite high interest rates and

INTEREST RATE CUTS

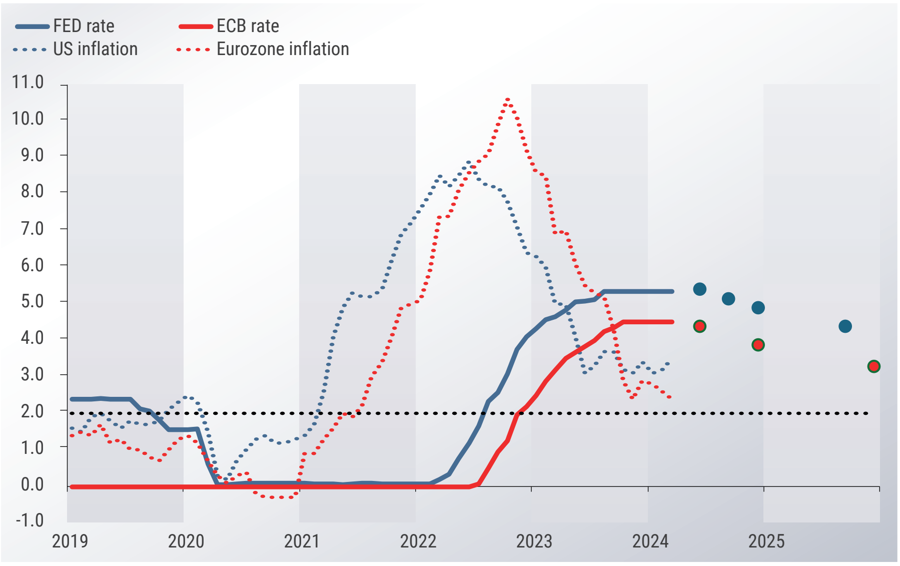
THE NRRP IMPLEMENTATION

inflation. Although decelerating from the very high rates of 2021-2022, which included the post-pandemic recovery, the Italian economy grew at a much higher pace compared to the modest pre-pandemic rates and twice as fast as the Eurozone average. Indeed, without the extraordinary destocking of inventories (-1.3% its contribution to GDP in 2023), Italian GDP growth would have actually reached 2.2%. This was possible thanks to various factors, especially the expansion of investments, still driven by construction incentives (see Focus no. 1), accompanied by the completion of the recovery in the services sector, which kept household spending high despite the contraction of real disposable income.

In the 2024-2025 forecast period, in addition to the improvement in global demand which will give new impetus to exports, two factors could further support Italian growth at significant rates.

The first is the cut in interest rates (Chart A). For several months now, the ECB has been waiting to see in hard data if the hikes that brought the official rate to 4.50% are indeed able to accompany European inflation to the +2.0% target. However, inflation has almost stopped declining in the last few months, standing at +2.4% in March (the same value as last November). Moreover, increases in the prices of goods and services excluding energy and food have so far slowed down only to +2.9%, still well above the target. In Italy, things are much better: total inflation is at +1.2% and the core at +2.3%. This is, indeed, the basis for the expected recovery in real household disposable income, an essential fuel for growth.

Graph A
The slow decline in inflation keeps rates high for longer
(Monthly data, % values and annual % changes)



Interest rates: from June 2024, values implicit in the future contracts.
Source: Centro Studi Confindustria elaborations based on Refinitiv, Eurostat and BLS data.

High interest rates dampen economic growth through their restrictive impact on domestic demand, namely consumption and investment. In recent official statements, it has become evident that the ECB is no longer considering further rate hikes and anticipates the beginning of a phase of cuts. According to the markets, rates will remain stable for another two months, before starting to decrease in June 2024 or, at the latest, by July. This timing has been informally supported by some members of the ECB Board. It represents a delay compared to expectations in the markets a few months ago, according to which the first rate cut was expected in May, or even earlier in April. The forecast scenario follows these indications, imagining an initial cut in June, followed by three more cuts by the end of the year, each by a quarter point, to reach a rate of 3.50%, one point lower than today. In 2025, three more cuts will follow, further reducing the rate down to 2.75%. At these levels, monetary policy will continue to be slightly restrictive until the end of the forecast horizon, but much less so than today. This could provide further impetus for investment and consumption.

Compared to this scenario, the risk of a rate hike can be considered minimal. However, it cannot be ruled out that a rate of inflation in Europe persistently above the 2% threshold may induce the ECB to further postpone the rate cut. This would be even more likely if the Fed were to wait longer, as it is currently implied by the *futures* (cut postponed to September) following the recent surprise increase in US inflation. For the Italian economy, this would act unfavorably, as it would prolong monetary tightening, which is already excessive given that Italian inflation has fallen well below +2% since October 2023.

The second growth driver is the implementation of the NRRP, which is picking up pace: in 2024 and 2025, in fact, the amount of resources to be spent on investments and reforms outlined in the Plan is 42 and 58 billion euros respectively, equivalent to over 2 percentage points of GDP per year. Although it is difficult to make precise assumptions about the overall impacts that NRRP resources will have on economic growth, partly due to the lack of information on various aspects of the recent revision of the Plan, the boost to GDP from its full implementation will be very strong, decisive to keep Italian growth high.

NRRP RESOURCES FOR ITALY

AMOUNT TO

100 BILLION

OF EURO IN 2024-2025

In terms of expenditure, the resources disbursed up to the first months of 2024 amounted to approximately 45 billion euros, less than a quarter of the total endowment of over 194 billion euros to be spent by 2026. This includes 72 billion in grants, i.e., European funds not to be repaid, and 123 billion in loans. There are still challenges in monitoring the Plan, but compared to other countries, the Italian NRRP is one of the most rapidly progressing, in terms of both conditions met and disbursed installments by Europe.

An important point is that, even though the resources so far disbursed amount to only a quarter of the overall allocation, those "committed", that is, those for which there is already a payment obligation, are over half of the total (about 100 billion euros; see Focus n. 6). And this bodes well, also because a significant portion of the resources subject to the recent restructuring will be disbursed through automatic mechanisms. This should promote faster spending and facilitate the achievement of targets. The revision of the Plan has also led to a greater concentration of resources for businesses: out of the total resources reallocated, around 12 billion are earmarked for them, including 6.3 billion for Transition 5.0 (for which the actual implementation is awaited) and 2.5 for green supply chains and net-zero technologies.

THE BRAKES ON ITALIAN GROWTH

THE COST OF ELECTRICITY

THE PHASING OUT OF THE SUPERBONUS

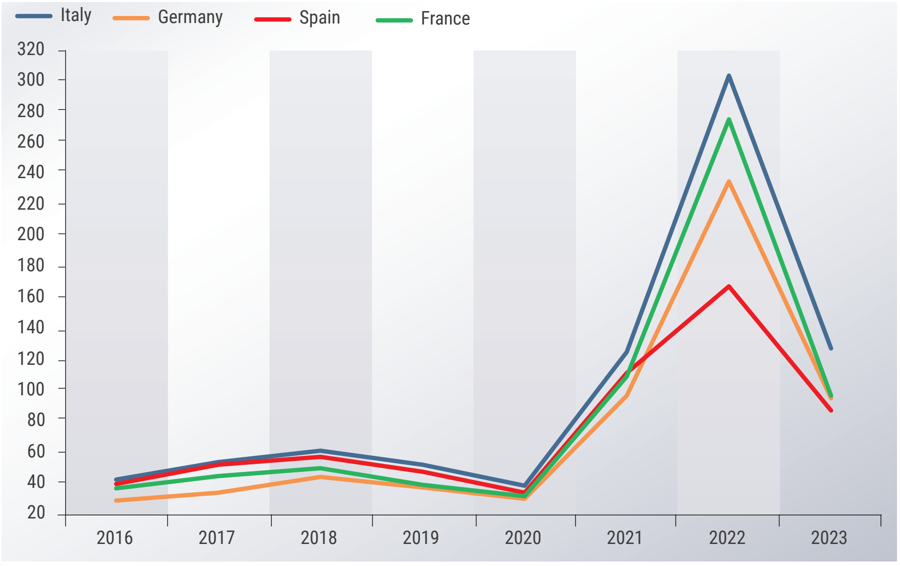
THE GLOBAL BOTTLENECKS IN TRANSPORTATION

Several factors restrain growth Alongside these two powerful factors that stimulate growth, there are, however, several other factors that will tend to curb Italian GDP over the next two-year period. In any case, the net effect is expected to be positive, with a clear possibility, therefore, that, in 2024-2025, there could also be room for even stronger economic growth than is currently predictable.

First, the cost of electricity paid by businesses remains higher in Italy compared to the other main EU countries as well as to major international competitors, such as the US and Japan (see Focus no. 4). With the surge in gas prices in 2021-2022, the gap has widened and remained large in 2023 (Graph B).

This depends, first of all, on the way in which the market price of electricity is formed in Italy (the so-called PUN, the wholesale reference price of electricity) and in Europe, where it is, in large part, still linked to natural gas thermoelectric generation but it's also affected by the mix of sources used for electricity. In Italy, the share of natural gas with respect to renewable sources continues to be high in comparison to other European countries where, instead, the renewable sources are utilized much more. Public policies also count and, with respect to the "wholesale" quotation, they are such that actual prices paid by companies in other EU countries are even lower than in Italy. All this creates a competitive disadvantage for Italian companies. A reform of the electricity market and a greater share of renewables in electricity generation, which today have lower costs than fossil fuels, could alleviate energy costs in Italy and reduce (although not eliminate) foreign dependence.

Graph B
In Italy the highest price for electricity
(€/MWh, yearly averages)



Source: Centro Studi Confindustria elaborations based on GME data.

The second braking factor is the gradual phasing out of the Superbonus, whose 110% rate already expired at the end of 2023, and of other incentives for construction. In terms of value added and, therefore, in terms of contribution to GDP growth, starting in 2024 and even more so in 2025, residential construction is expected to be significantly affected by this anticipated reduction in incentives. In 2023, instead, the greatest contribution to investment growth in Italy, although not the only one, came precisely from housing.

Another negative factor is global transportation bottlenecks and their impact on the Italian industry (see Focus no. 5). The issue of transportation security concerns not only the Red Sea, a crucial hub for the exchange of goods between Europe and Asia, but also numerous other vulnerabilities along international transportation routes, such as the Strait of Malacca (in Asia) and the Panama Canal (in America). In Italy, more than half of incoming volumes of goods arrive by sea, and ships transport 42% of exported quantities. There are also several critical points along regional transportation routes, mainly by land: they regard, in particular, Italy's connections with other EU countries across the Alps. Regarding the Red Sea crisis, the impact of recent increases in maritime transport costs, which more than doubled, on Italian industrial producer prices is estimated to be overall moderate, although quite strong in some specific sectors such as in the chemical, metallurgy, and paper sectors.

In addition to these three main restraining factors, there are some negative effects from two other ongoing structural trends. First, the demographic decline: the overall population in Italy is decreasing, particularly the working-age population (which has been contracting for over a decade), and this will increasingly act as a brake on economic growth in the coming years. Second, the reconfiguration of global goods trade which is increasingly occurring between "like-minded" countries and less with geopolitically "distant" countries: an analysis of cross-market shares between the EU, the US and China shows some signs of decoupling (see paragraph 2.2), which is not beneficial for global trade and, in particular, for the economic growth of a manufacturing and export-oriented country like Italy.

Investments slowdown, but Italy will continue to grow at high rates The performance of Italian GDP in 2024 is expected to continue in line with the positive trend recorded in 2023: an annual increase of +0.9% is forecasted (Table B), a figure 0.4 percentage points higher than the one projected in our last October's scenario. Growth in 2025 is expected to be slightly higher, at +1.1%.

Table B
The CSC forecast for Italy
(% changes)

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

[1] Percent of GDP.
FTEs = full-time equivalents.
Source: Centro Studi Confindustria elaborations and estimates based on Istat and Bank of Italy's data.

According to cyclical indicators, economic activity was substantially stagnant in the 1st quarter of 2024. However, on a quarterly basis, GDP is expected to start growing again at a stronger pace from the second half of 2024 and throughout 2025, thanks to the two drivers (interest rate cuts and implementation of the NRRP) mentioned earlier, the strengthening of global trade and the recovery of real disposable income.

From the supply side, in 2023, GDP was driven by construction and services, while industrial activity declined. At the beginning of 2024, growth in the services sector was still rather moderate but should gain strength in the course of the year sustained by the recovery of real disposable income and, especially in 2025, by easier access to credit. Over the two-year forecast period, industry will join services in sustaining Italian GDP, recovering from the losses incurred in 2022-2023, this thanks to the recovery of global trade, and hence of the export of goods, and the easing of monetary tightening.

The risks of the forecast scenario are predominantly to the downside, some interconnected: energy prices rising more than expected due to numerous outbreaks of geopolitical tensions; higher-than-expected inflation and Central Banks further postponing interest rate cuts; but also potential delays or incomplete implementation of the NRRP.

Private consumption is expected to be weak in 2024, picking up in 2025. Indeed, after the decline in the 4th quarter of 2023, Italian household spending is expected to recover moderately throughout 2024 (+0.2% on average for the year), while gaining momentum in 2025 (+1.2%). Low inflation and recovery of disposable income are the two driving factors behind the expected strengthening. In 2023, the overall favorable performance of consumption (+1.2% on average for the year), despite the decline in real disposable income (-0.5%), reflected the effort to maintain a higher propensity to consume compared to pre-pandemic levels. It is also true that last year, household investments (in housing) increased significantly, but these did not detract significant resources (accumulated extra-savings) from consumption. Indeed, the very generous government incentives (Superbonus at 110% and other building bonuses), have, in fact, "returned" or will return to households much of the resources spent in 2022 and 2023 for housing investments. Moreover, thanks to the tax credit transfer mechanism, part of the spending on building renovations has not even been disbursed.

Gross fixed capital formation is expected to grow modestly, +1.0% on average in 2024 and +0.7% in 2025, a much reduced pace compared to last year (+4.7%) and even more so compared to the post-pandemic two-year period (+20.3% in 2021 and +8.6% in 2022). The strong growth of Italian investment in the past few years has been *unique* compared to other major European countries. The slowdown comes as a result of the sharp drop expected in 2024 and especially in 2025 in residential construction investment, the spending component that had most driven the high rates of investment growth in recent years, as a consequence of the phasing out of the Superbonus and other construction incentives. In 2024-2025, however, several factors will support gross fixed capital formation growth: public investments will continue to grow at high rates thanks to the implementation of NRRP projects, which should also increase spending on non-residential buildings. Investments in machinery and equipment, in particular, will be boosted by interest rate cuts as well as by new incentive programs (Transition 5.0).

In the forecast scenario, Italian exports of goods and services, after the almost stagnant performance in 2023, will return to growth in the biennium at stronger rates (+2.2% and +2.5%), slightly above those expected for global trade, although still lower than those recorded in 2021 and 2022. Imports as well, which actually shrank in 2023, will reverse its trend and expand again (+1.3% in 2024 and +2.4% in 2025). The expectation of a relatively slow recovery in foreign sales is based on the still weak international environment at the beginning of 2024, due, in particular, to sluggish growth in the Eurozone, which is the main destination market for Italian goods, not compensated by stronger growth in the American market. However, Italian exporting firms quickly adapt to changing contexts: the speed of the re-composition of the manufacturing trade by destination market and by product has increased significantly over the past four years. On the import side, which is directly exposed to supply chain vulnerabilities, the re-composition is even more pronounced.

Employment, measured in terms of full-time equivalents (FTEs), will advance over the forecast horizon at a slightly slower pace than GDP: +0.7 percent in 2024 and +1.0 percent in 2025. This contrasts with the stronger-than-GDP growth of FTEs in 2023, which was, however, a temporary phenomenon that also reflected the fact that economic activity and labor input (in levels) were misaligned in the early stages of the energy crisis (labor input grew less than activity). The recent strong performance of employment has led to a drop in the unemployment rate, which fell to 7.4% at the beginning of 2024 from the peak of 10.2% in the spring of 2021. The unemployment rate is expected to decrease further, to 7.1%, in 2025, thanks to further employment growth and a labor force that will also continue to grow but at a modest pace.

A more-in-depth analysis of the employment changes that occurred during the post-pandemic recovery as well as over a broader time horizon spanning the last fifteen years shows an improvement in the Italian labor market, although the changes are not all uniformly positive (see Focus n. 2). On the one hand, the increase in the number of employed wage earners, especially those with permanent contracts, more than compensated for the decrease in self-employed workers. The employment rate has also risen, and especially so among young people in recent years (as a consequence, however, of an increase in employment as well as of a contraction in the population). On the other hand, the number of hours worked per capita has decreased and employment in industry has been lost in favour of sectors characterized, on average, by lower labour productivity.

In the two-year period 2024-2025, while, on the one hand, employment growth is expected to slow down, the rate of increase in nominal per capita wages is expected to accelerate. Higher wage growth accompanied by a pronounced decline in inflation, will allow for a partial recovery of real wages, which will increase by a cumulative 4.3% over the biennium. The recovery already began in 2023, driven by the private sector, as a result of the contractual wage adjustment mechanism agreed upon by social partners in 2009 and confirmed in 2018, which spreads out over several years the adjustments in purchasing power following “imported” inflationary spikes, such as the recent one.

The adjustment of public finances The estimate of the 2023 public deficit has recently been sharply revised upwards by Istat, to 7.2% of GDP from the 5.3% projected in the September NaDEF (the government’s Update of the Economic and Financial Document). The revision is linked to changes in the accounting treatment of resources mobilized by the Superbonus and Transition 4.0, which resulted in a sharp increase in capital spending. In the forecast scenario, deficit reduction will be substantial in 2024, reaching 4.4% of GDP, more contained in 2025 to 3.9%. This is due to a good revenue performance and the containment of expenditures, when measured net of the NRRP.

Overall, public sector consumption growth will provide a significant and positive contribution to GDP growth in 2024-2025, with its components expected to follow differentiated and somewhat opposing trends. Labor income will increase this year and especially next year (+1.2% and +3.0%, after -0.5% in 2023), due to rising wages and despite the expected decrease in public sector employment. Intermediate consumption, instead, will slow down this year (+1.0%, from +3.2% in 2023) and decrease next year (-0.6%), reflecting a more subdued price development.

Italian public debt is estimated to rise to 139.1% of GDP in 2024, an increase of 1.8 percentage points compared to 2023, and it is expected to continue to increase by approximately another 2.0 points, to 141.1% in 2025. This is due to two factors: first, the difference between the implicit interest rate on debt and nominal GDP growth will again be positive; second, there is an adverse effect of accounting reclassification related, as mentioned earlier, to certain tax incentives (Superbonus and Transition 4.0).

With regard to public finances, the rules of the Stability and Growth Pact come into effect again this year (see Focus n. 3). These rules, although largely modified and mostly for the better, will require Italy and several other EU countries to take measures to improve deficit and debt, in order to bring them back towards the established parameters which, in essence, require net borrowing to remain steady and significantly below 3%.

Full Report in Italian is available here