



ITALY 2024-2025 SCENARIO

NORMALISATION AND TURBULENCE

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IN YOUR INTEREST



GROUP ECONOMIC RESEARCH

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SUMMARY

NORMALISATION AND TURBULENCE

Italian economic growth was sluggish in 2023 and should remain lacklustre in 2024. After the shocks experienced in 2022 (energy crisis following Russia's invasion of Ukraine), the deterioration of the economic environment weighed on the economic outlook. From the second quarter of 2023, the cumulative effects of inflation and the initial rate hikes pushed economic activity into negative territory. The story was the same in the third quarter, except that, by stimulating a recovery in consumption, the small gains made in purchasing power helped offset the negative consequences of monetary tightening on investment. The fourth quarter is unlikely to be any different. Signals from the industrial sector still point to a deteriorated environment, with a decline in production, surveys persistently reflecting lower order books and weak external demand. Against this backdrop, productive investment growth is expected to stay in the red, at least until summer, then recover once the first signs of monetary policy normalisation begin and demand picks up. In 2024, however, it is expected to be down sharply compared with 2023, i.e. -2.6%.

In the fourth quarter, production in construction is will remain contained. Including this slight growth in Q4, **housing investment should drop 6.8% in 2023 and nearly 3% in 2024.** Weak housing construction should nevertheless be offset by investments in public works, still benefiting from recovery plan.

Consumption is will likely remain the main driver of growth. Following two years of acute inflation, the inflation rate should near 2% in 2024. The resulting gains in purchasing power and persistently expanding labour market are likely to shore up activity. That said, although consumer spending is still climbing (at a rate of 1.2% expected in 2024), it should nevertheless slow compared to 2023 (which recorded an increase of 1.7%). Furthermore, **households are facing deteriorated financial conditions stemming from this inflationary episode.** Wage increases have not been sufficient to offset price rises, causing saving propensity to significantly erode along with the savings accumulated over the last two years. In addition, even if employment continues to grow, the slowdown in industry and expected

turnaround in the construction sector should see the unemployment rate start rising in H2 2024. Households will be able to rely, however, on the measures included in the Finance Act, particularly middle-income households, which have been hit hard by the increase in the CPI. Baskets of consumer goods should benefit more from tax cuts and targeted family allowances.

Finally, **the slowdown experienced by Italy's main trading partners is unlikely to contribute much to export recovery** early in the year, although they should get some help from a recovery in demand starting in H2. The decline in imports caused by the slowdown in investment and consumption of durable goods is expected to continue, promoting a temporary contribution of foreign trade and a recovery in current account surpluses.

In conclusion, **GDP growth is expected to slow from a timid 0.7% in 2023 to 0.6% in 2024.** As the effects of lower interest rates can only fully be appreciated at the end of the year, **the impact of monetary policy normalisation is not expected to translate into stronger growth until 2025.**

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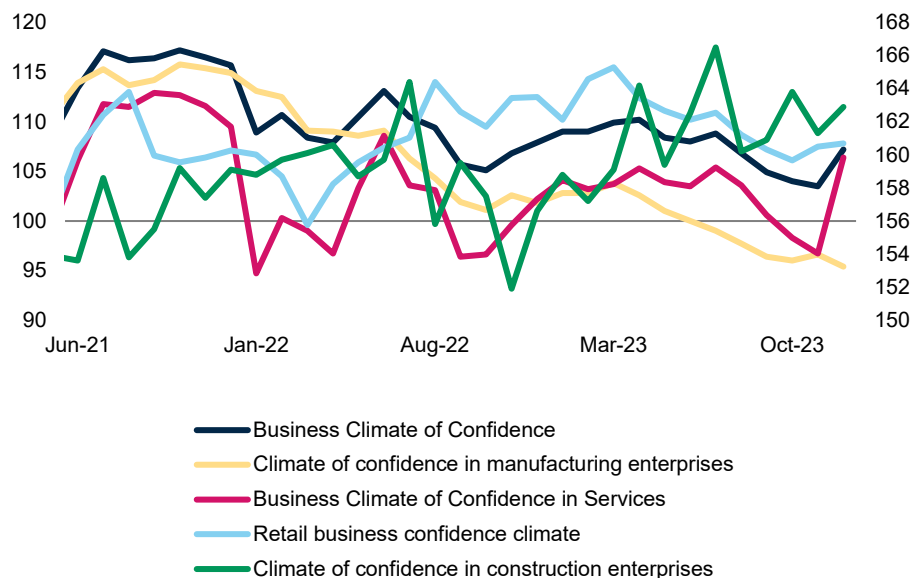
RECENT ECONOMIC TRENDS

CONFIDENCE UNEXPECTEDLY RECOVERES IN DECEMBER...

After sending mixed signals in November, data for December showed a sharp recovery in both business and household confidence. The improvement in business confidence was thus observed in all sectors except industry. While service companies expect stronger performance, retail companies expect higher sales in the coming months. Construction confidence indicators were still highly positive in December. Despite the reduction in subsidies granted to the sector, it continued to grow (+0.6% in October), although at a much slower pace compared to the first ten months of 2022 (-1.5%).

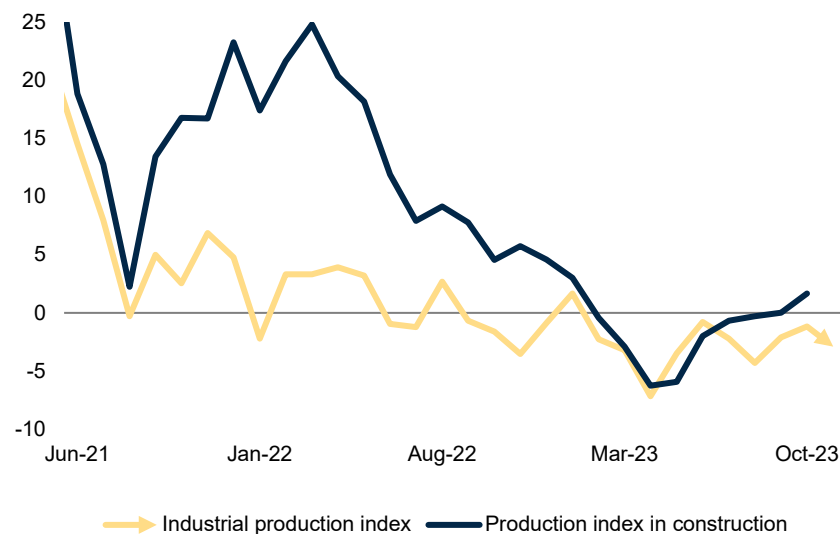
Finally, although on the decline, the confidence index for the manufacturing sector indicated stability in new orders but a sharp deterioration in the production outlook. The slowdown phase in industry is thus not over, despite an improvement in supply conditions. Industrial production prices fell 0.9% month-on-month in November and 12.6% year-on-year. At the same time, industrial sales continued to contract in October (-1.7% year-on-year), while the latest industrial production data continued to show a negative performance for the fourth quarter, with a gain of -1.1% vs. -1.5% in November.

Business sentiment



Sources: Istat, Crédit Agricole S.A./ECO

Production indices



Sources: Istat, Crédit Agricole S.A./ECO

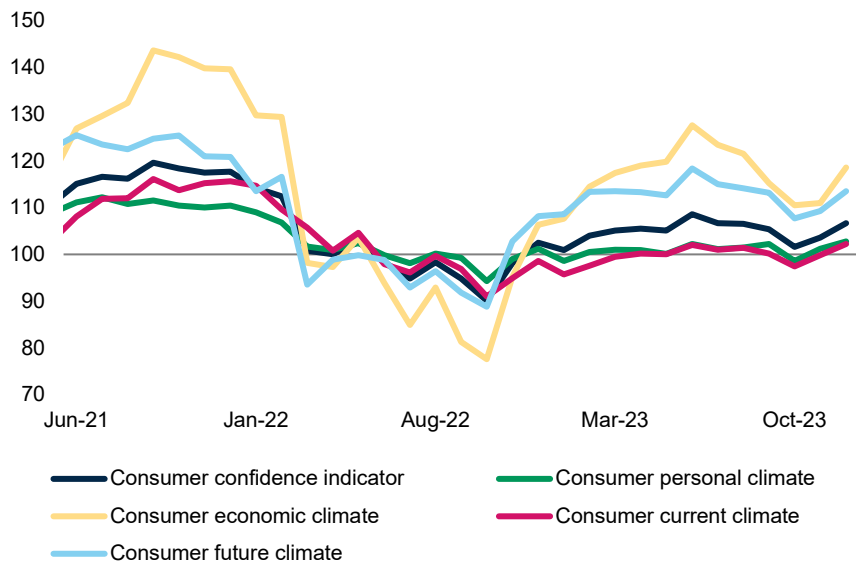
RECENT ECONOMIC TRENDS

... ESPECIALLY FOR HOUSEHOLDS

The consumer sentiment index, which rose for the second month in a row, returned to July 2023 levels thanks to a clear improvement in how households perceive their environment and, to a lesser extent, their personal situation. This renewed optimism can be attributed to the sharp slowdown in inflation and persistently resilient labour market. In the wake of 2022 and 2023 price rises, inflation became significantly more moderate in the last few months of the year. In November, inflation fell below the 1% threshold to 0.7% and continued sliding to

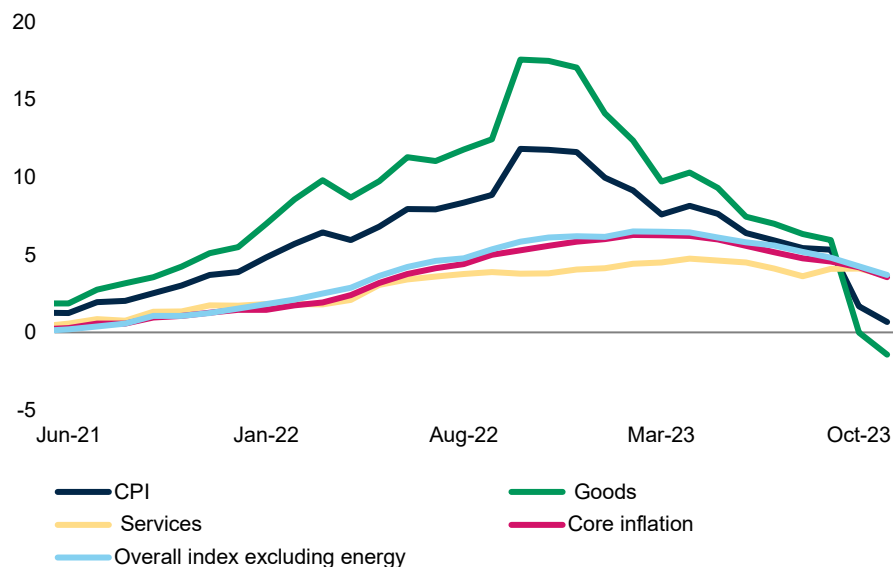
0.6% in December. In the fourth quarter, the inflation rate was 1% compared with 5.5% in Q3. In the fourth quarter of 2023, the slowdown in prices was further driven not only by the normalisation of energy prices (-23%), but also by the moderation in services and food (+6.1% vs. +9.7% in Q3). The slowing increase in property prices was also reflected in a recovery in retail sales volumes, which accumulated two month-on-month increases since October.

Consumer confidence index



Sources: Istat, Crédit Agricole S.A./ECO

Consumer price index



Sources: Istat, Crédit Agricole S.A./ECO

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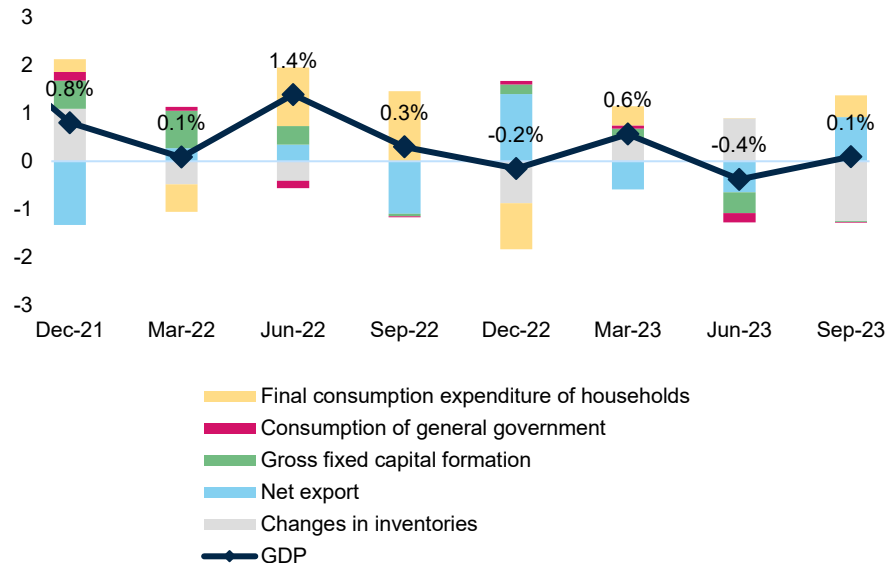
OUTLINE OF OUR SCENARIO

SLIGHT INCREASE IN GDP OVER THE SUMMER

After a negative performance in Q2 2023, growth picked up timidly during the summer months, increasing by 0.1%. Underlying this timid increase were still significant movements indicating that the post-inflationary shock adjustment cycle was not completely over. Domestic demand thus contributed +0.4 GDP points in Q3 2023, up sharply compared to Q2, when it reduced growth by -0.6 point. Meanwhile, external demand made a positive 1 percentage point contribution to GDP, stemming from a -2% contraction in imports and +0.6% recovery

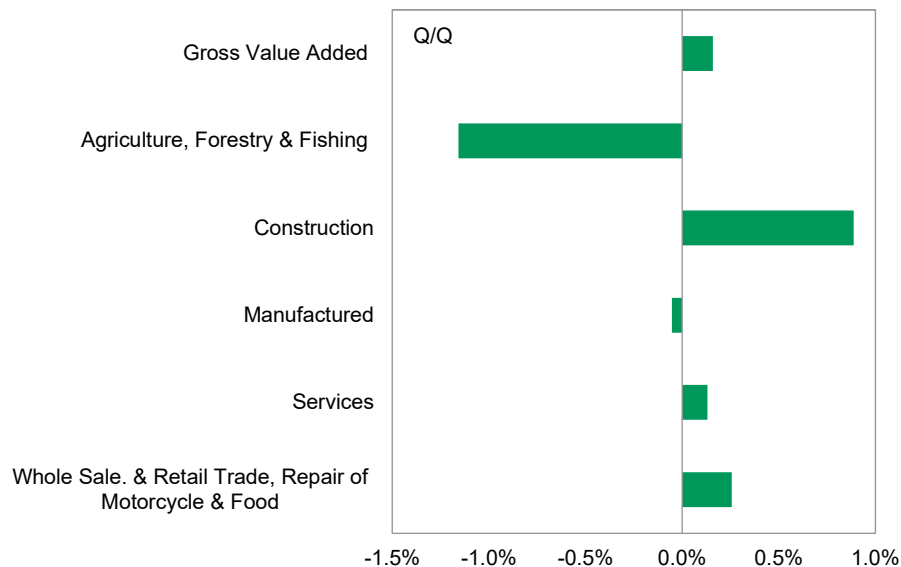
in exports. Finally, after two quarters of positive contributions, a significant inventory reduction movement shed 1.3 points off growth. The picture is brighter on the supply side of the equation. While activity in construction (+0.9%), industry (+0.2%) and services (+0.1%) rose after a second quarter in the red, in agriculture it continued to decline in Q3 (-1.3%).

Contributions to annual GDP growth



Sources: Istat, Crédit Agricole S.A./ECO

Added value by segment

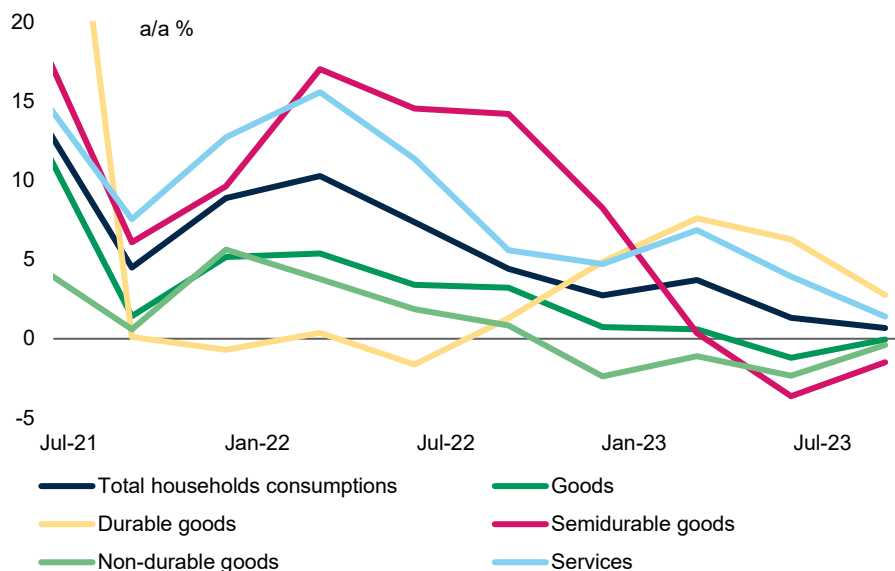


Sources: Istat, Crédit Agricole S.A./ECO

OUTLINE OF OUR SCENARIO

PARTIAL RECOVERY IN HOUSEHOLD SPENDING

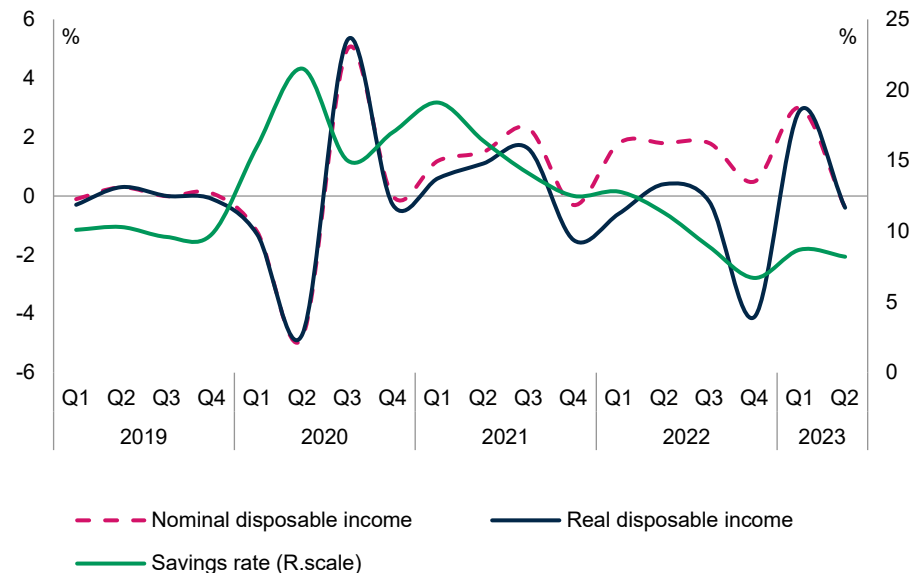
Household consumption



Sources: Istat, Crédit Agricole S.A./ECO

Consumer spending rose 0.6% in the third quarter, after falling 0.2% in Q4, dragged down by a decline in public consumption, which held steady at zero in Q3. Household consumption climbed 0.7%, driven first by a recovery in consumer spending on durable goods, i.e. + 2.7% (contributing 0.3%), and second by spending on services (+1.4%), with a contribution of 0.7%. It should be noted that consumption of services slowed compared to the previous, when it grew 2.4%.

Change in household disposable income



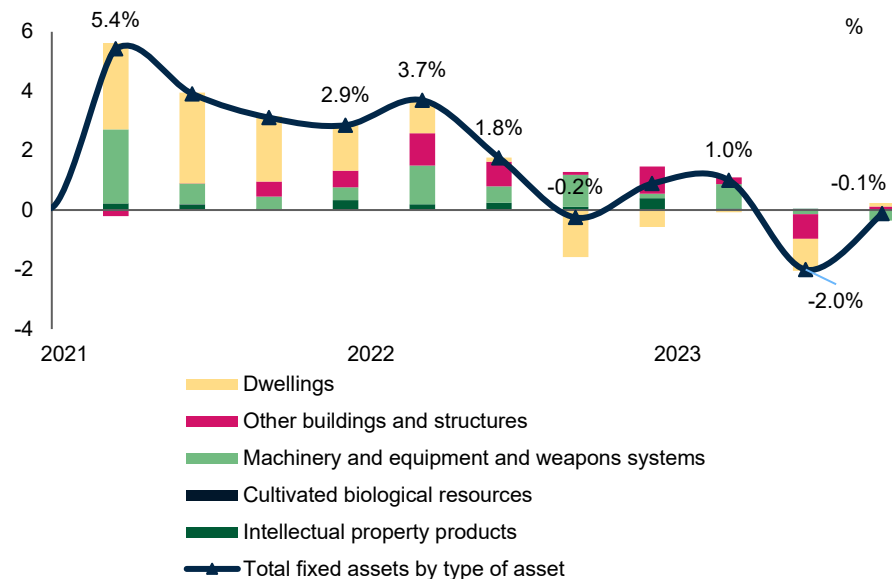
Sources: Istat, Crédit Agricole S.A./ECO

Finally, consumer spending on non-durable and semi-durable goods contracted for the second consecutive quarter (-0.4% and -1.5%, respectively). This recovery in consumption was driven by a positive trend in real household disposable income, which improved 1.4% compared to the previous quarter, while nominal disposable income increased 1.9%. The savings rate stabilised at 8.7%.

OUTLINE OF OUR SCENARIO

INVESTMENT FALLS AGAIN AS COMPANIES FIND THEMSELVES IN A VULNERABLE SITUATION

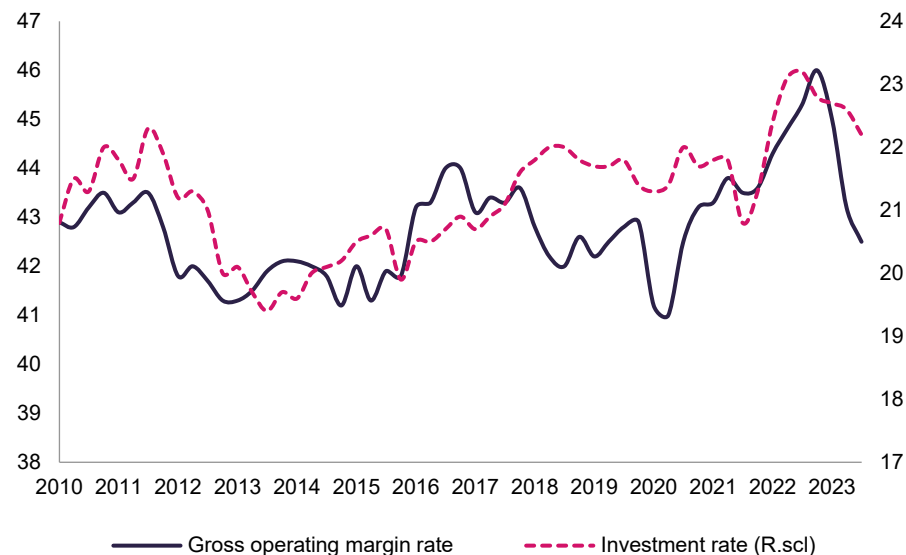
Components of investment



Sources: Istat, Crédit Agricole S.A./ECO

Investment continued to decline in Q3 but to a lesser extent than in Q2 (-2% in Q2 to -0.1% in Q3). The improvement in construction output also triggered a recovery in investment in housing (+0.4%) and construction (+0.6%). Productive investment fell 0.9% for the second consecutive quarter, partially offset by a persistently strong recovery

Profit margin rates



Sources: Istat, Crédit Agricole S.A./ECO

in transport, up 7% qoq. At the same time, the corporate investment rate fell 0.4 percentage points from the previous quarter to 22.2%. The NFC margin rate continued to dip, falling 0.7 percentage points, and is estimated at 42.5%, i.e. the level seen in November 2020.

OUTLINE OF OUR SCENARIO

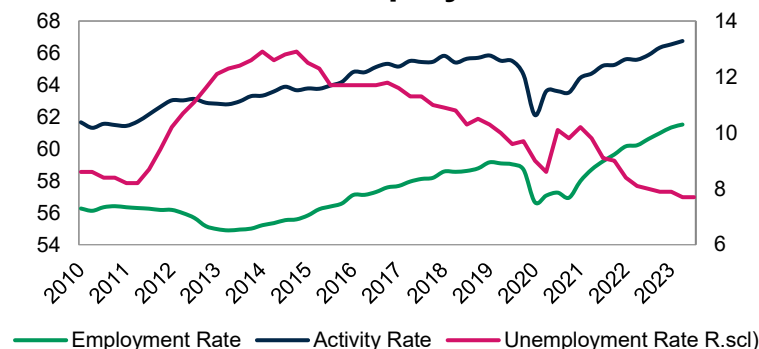
PERSISTENTLY ROBUST LABOUR MARKET FUNDAMENTALS

Despite the slowdown in activity, the labour market has been doing well. In the third quarter, employment was up 0.3%, driven by an increase in the number of employees on permanent contracts and self-employed persons. Employment growth also consolidated year-on-year at 2.1% and was accompanied by a 1.3 point increase in the employment rate compared to Q3 2022, i.e. 61.5%. Despite a slight increase in the number of unemployed persons (+2,000, +0.1% in three months) and a decrease in the number of people outside the workforce, the unemployment rate remained stable at 7.6%. Year-on-year, the number of people on long-term unemployment also fell 1.5 percentage points (people who have been looking for work for at least twelve months).

Corporate labour demand continued to grow, but at a slower pace than in previous quarters. The increase in the number of employees was driven by demand for full-time positions, mainly in services and to a lesser extent industry. The number of hours worked per employee also increased (+0.5%), while use of short-time work dropped to 6.1 hours per thousand hours worked due to a decrease in services. It did increase, in industry, however.

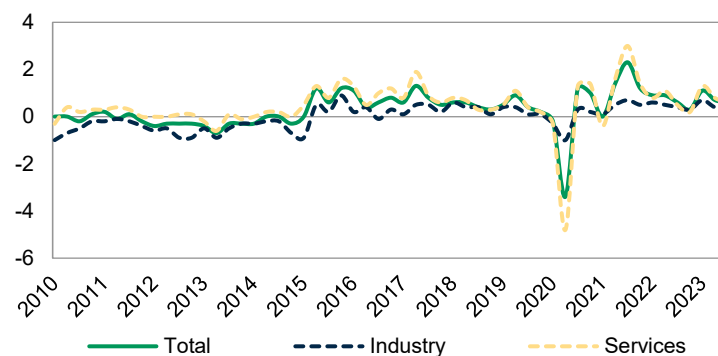
The job vacancy rate fell to 2.2% in industry but stabilised at 2.3% in services and at the national level. At the same time, wage costs per employee unit rose 0.7% qoq, fuelled by wage growth (+1.0%). Social Security contributions remained stable. Year-on-year, wage costs climbed 3.3%, driven by wage increases resulting from collective bargaining negotiations, particularly in industry.

Employment, activity and unemployment



Sources: Istat, Crédit Agricole S.A./ECO

Number of vacant positions

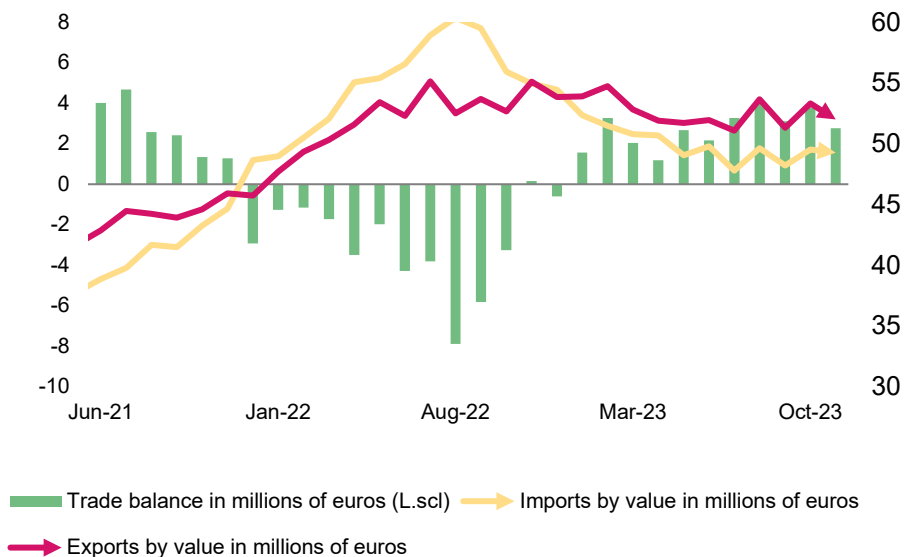


Sources: Istat, Crédit Agricole S.A./ECO

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TRADE SLOWDOWN CONCEALED BY POSITIVE FOREIGN TRADE CONTRIBUTION

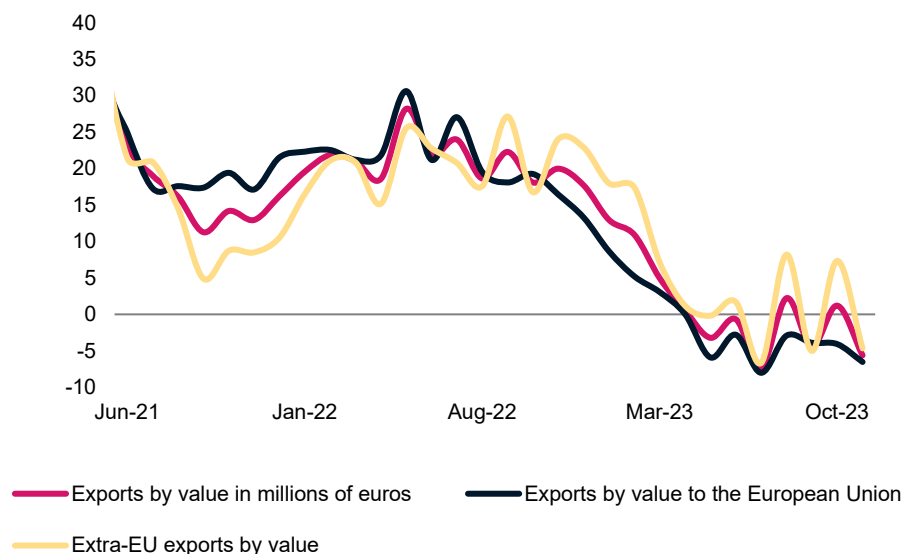
International trade



Sources: Istat, Crédit Agricole S.A./ECO

In the third quarter, net exports made a decidedly positive contribution, but this can mainly be attributed to a drop in imports (-2.0%) partially offset by a timid increase in exports (+0.6%). After two years of strong growth, the YTD decline in imports primarily reflected a shift in household spending on services. The slowdown in global trade was not without consequences for the Italian economy. As for exports, weak foreign sales resulted from an unfavourable international environment, marked by a slowdown in world trade and in European

Exports by partner zone over one year



Sources: Istat, Crédit Agricole S.A./ECO

countries (particularly Germany). Over the first nine months of the year, exports and imports of goods and services rose just 0.3% and 0.2%, respectively. On the plus side, this dual slowdown improved Italy's external accounts, which took a hit in 2022 due to the energy shock. Thus, the balance of goods and services improved in the third quarter to a surplus of 1.8%, versus a deficit of -3.7% in 2022, at the height of the energy crisis.

OUTLINE OF OUR SCENARIO

WEAK GROWTH ON THE HORIZON

Given the pressures still bearing down on the economy, GDP growth is expected to remain moderate, reaching 0.6% in 2024 versus 0.7% in 2023. Signals from industry point to a persistently challenging environment. Furthermore, because monetary easing is not expected to start until early autumn, these initial effects on productive investment should not be visible until summer 2025. After two years of record inflation, the inflation rate should near 2% in 2024, making consumer spending the main growth driver. Purchasing power gains, accompanying the disinflation process and still expanding labour market, should generate a 1.2% increase in consumer spending in 2024. Despite their adverse financial situation, households will benefit from support measures included in the Finance Act. Exports are expected to recover partially in H2

2024, while lower imports will help maintain current account surpluses.

This scenario is subject to downside risks, however, particularly with regard to the inflation profile. Inflation underwent a faster-than-expected decline in Q4 2023 due to comparison base effects involving energy, but also sluggish global demand making energy prices less sensitive to geopolitical uncertainties. However, the 2022 crisis has structurally changed the energy supply, making Italy permanently vulnerable to any further spike in energy prices. Any change in the inflation profile that jeopardises the monetary normalisation process could potentially delay the resumption of the growth cycle.

Italy	2023	2024	2025	2024				2025			
%				Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	0,7	0,6	0,9	0,2	0,2	0,3	0,4	0,2	0,2	0,0	0,2
Households consumption	1,7	1,2	0,9	0,2	0,2	0,3	0,3	0,3	0,1	0,1	0,2
Investment	0,4	-0,8	1,7	-0,3	-0,1	0,3	0,6	0,4	0,5	0,5	0,5
Change in inventories*	-0,3	-0,4	0,1	0,1	0,1	0,1	0,1	-0,1	0,1	-0,1	0,0
Net export*	0,1	0,5	0,1	0,0	0,0	-0,1	0,0	0,0	0,0	0,0	0,0
Unemployment	7,7	7,8	7,9	7,7	7,7	7,8	7,8	7,8	7,9	7,9	7,9
Government net lending	-5,3	-4,5	-3,6								

* Contributions to GDP growth

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PUBLIC FINANCES AND THE FINANCE ACT: A PRECARIOUS FINANCIAL YEAR

Approved on 30 December by Parliament, the 2024 Finance Act is based on a set of measures amounting to €28 billion, €20 billion of which will be deficit-financed. In line with the announcements made by the government this autumn, the move consolidates the lion's share of fiscal policy efforts targeting middle-income households, in particular via the tax cut. Embodied by two flagship measures, the tax cut is expected to represent nearly €15 billion, i.e. more than 50% of total spending under the Finance Act. Ten billion euros will thus be dedicated to reducing the tax wedge, with a 7% reduction for income up to €25,000 and 6% for income up to €35,000. This will be combined with a reform of the tax on natural persons, with the aim of reducing the number of tax brackets from four to three by merging the first two brackets up to €28,000. The rate would then be 23%. The tax threshold was also increased to €8,500. Both measures are expected to have a significant impact on the households concerned, with a tax gain of up to €1,298 per household. The Finance Act also includes specific measures for households with children. Nearly €1 billion has been allocated to measures aimed at encouraging birth rates, such as the exemption from social security contributions for female staff with two children until their second child reaches age 10 (until the last child reaches age 18 for families with three children), increase in the childcare bonus, the introduction of an additional month of parental leave (60% of salary covered) and facilitated use of benefits in kind.

Civil service and healthcare employees are also expected to receive pay rises in 2024. For private-sector employees, in addition to taxation, the government is keeping the levy on productivity bonuses at 5% instead of 10% and has confirmed that taxes on overtime and night work in tourist services activities have been eliminated.

Quota 103, a combination of retirement at age 62 and 41 years of retirement contributions, was also used to finance 2024 pensions with a new method for calculating contributions. The mechanism for indexing the lowest pensions to inflation has also been extended to 2024.

For businesses, support measures - mainly focused on employment - include a budget of €1.3 billion dedicated to increasing deductions (from 120% to 130%) for hiring members of vulnerable populations on permanent contracts, including young people, women and citizens' income beneficiaries. In addition, €1.8 billion has been allocated to tax credits for companies investing in southern Italy, and the New Sabatini fund (providing a subsidy for SMEs investing in low-impact machinery and equipment) and the Sustainable Growth Fund are being topped up. Finally, the 2024 Finance Act introduces a global minimum tax of 15% on large multinational groups, plus a 50% tax cut for companies reinvesting in Italy.

The final impact of these measures, reassessed by Istat, is expected to be similar to the impact presented in the update to the economic and financial document in September 2023, i.e. an increase of 0.2 growth points for 2024 and 0.1 percentage point in 2025. Although the overall impact is comparable, the considerable efforts made to aid households in a disinflationary environment should promote greater consumer spending, while the impact on business investment will be more mixed due to tighter monetary conditions and weak demand.

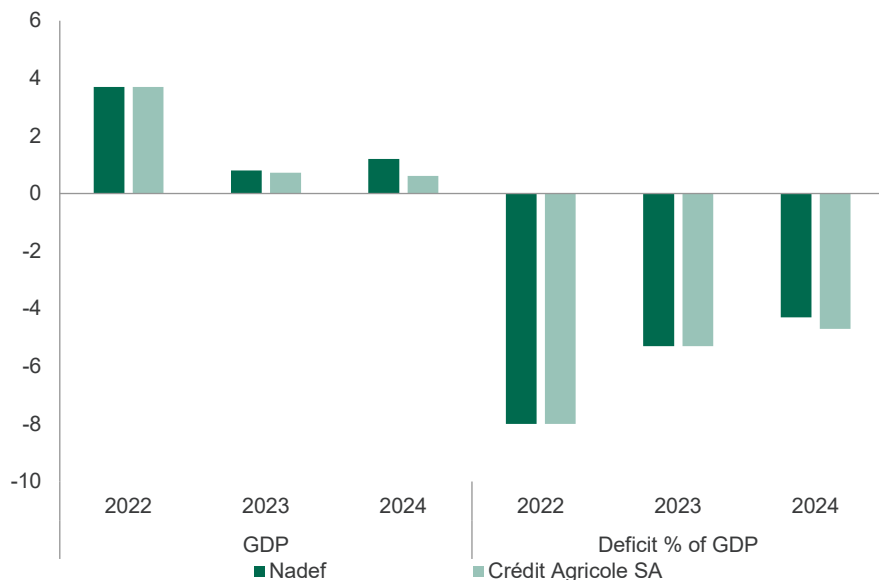
FOCUS: FINANCE ACT

PUBLIC FINANCES AND THE FINANCE ACT: A PRECARIOUS YEAR

Despite a funding requirement of €20 billion in 2024, the trajectory of public finances points to a slight decrease in the public deficit to 4.3% of GDP, compared with 5.3% in 2023. This decline is limited, however, compared to the goal of the stability programme, delaying the reduction of the public deficit below the 3% threshold and postponing the achievement of a primary surplus (necessary to reduce the public debt ratio) to 2025. The rise in sovereign bond yields, mitigated by the average maturity of Italian debt, is also expected to lead to a higher interest expense (from 4.2% in 2024 to 4.6% in 2026).

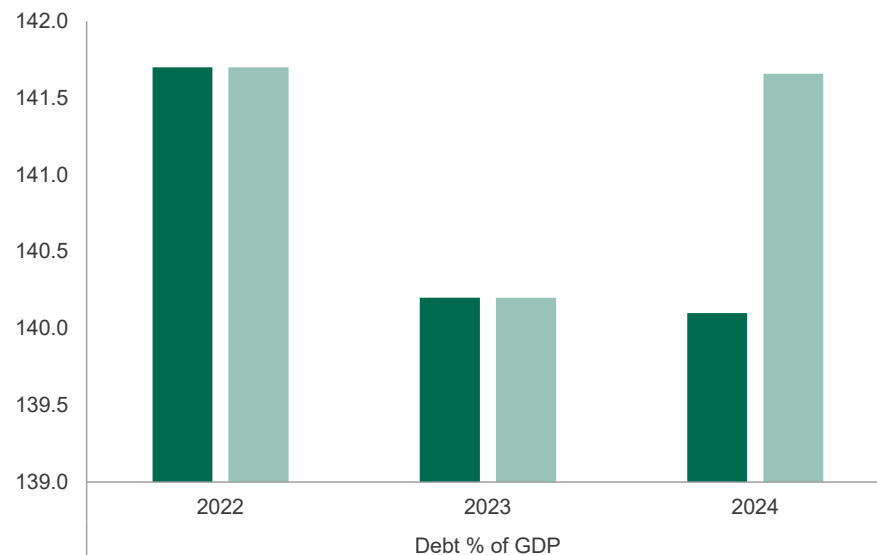
At the same time, the upward revision of the national accounts in 2021 and 2022 saw the public debt ratio drop from 144% of GDP to 141%. Nevertheless, the public debt ratio is expected to decline slightly to stabilise at 139% in 2026. There are some upside risks to this profile, as the trajectory of public finances is based on a scenario projecting growth of 1% in 2024, i.e. above the consensus. The deficit estimate based on the growth trajectory in our own scenario (0.6% in 2024) is slightly higher at 4.5%. Similarly, the public debt ratio is expected to stagnate rather than fall in 2024.

Trajectory of public finances



Sources: Ministry of Finance, Crédit Agricole SA/ECO

Public debt ratio



Sources: Ministry of Finance, Crédit Agricole SA/ECO

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