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EY Italian Macroeconomic Bulletin

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Index

Executive summary

- Global growth is expected at 3.2% in 2024 and 2025, according to the latest projections from the International Monetary Fund. Global inflation is expected to decline from 6.7% in 2023 to 4.3% in 2025.

- The international scenario remains complex and with significant downside risks, mainly due to geopolitical tensions. The world trade trend remains far from its long-term trajectory, considering the significant uncertainty driven by the geopolitical context and the outcome of the political elections in the United States. Furthermore, commodity prices remain above the levels experienced in the pre-pandemic period, although moving in a downward direction. Other factors to consider are the high interest rates environment and the heterogeneity of the economic performance of the main world economies (stronger growth in the United States, slower growth in China).

- After a 0.4% GDP growth in 2023, the Eurozone economy is expected to slightly accelerate (0.8% in 2024 and 1.2% in 2025). The industrial sector still faces significant complexities, particularly in Germany and Italy, and the short-term outlook for manufacturing is not positive.

- At its last meeting in December, the ECB reduced monetary policy interest rates by 25 basis points to support member countries' economies, coherently with a declining inflation (2.0% in October) and with operators' expectations anchored to the price stability objective. The labor market continues to show positive dynamics, but with a decelerating trend.

- In Italy, the industrial crisis is heterogeneous depending on the sectors considered, with the "energy-intensive" industries presenting the greatest complexities. Inflation remains contained, although rising in November 2024 (1.4%), driven mainly by the underlying component which is proving persistent (1.9% in November). The labor market is robust, with the number of employees at historical records (24 million) and the unemployment rate below 6%.

- In this context, it is interesting to focus on the automotive sector, given the crisis of the German industry (which is an important trading partner for this and other products), the competition from foreign producers (such as China) and the European regulation on emissions, which is leading to a significant transformation within the sector. All these factors pose several challenges for the automotive sector, adding uncertainty about the future trends.

- In this context, EY forecasts indicate a real GDP growth of 0.5% in 2024 and 0.8% in 2025 in Italy, while the inflation rate is expected to move from 1.0% in 2024 to 2.0% in 2025. The forecasts are subject to a high level of uncertainty, considering the mixed signals coming from the data currently available, as well as the latest geopolitical events.

- Two simulations carried out with the EY econometric model on possible scenarios of partial use of the PNRR funds underline their importance for growth. Specifically, a use of 90% of the total resources expected in 2025 would lead to a reduction in GDP growth in 2025 of approximately 0.2 percentage points compared to the complete use of these resources; a use of 70% of the planned resources would result in an even stronger reduction (0.7 percentage points).

Figure 1: Real GDP, Italy – % change

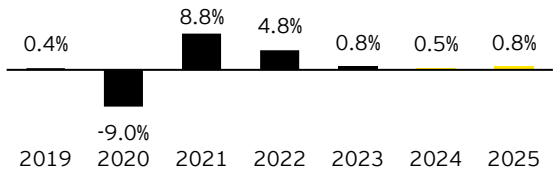
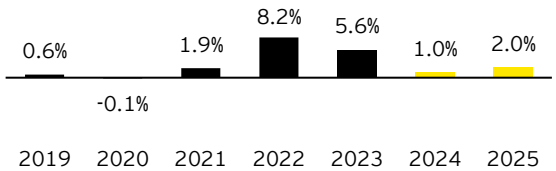


Figure 2: Consumer prices, Italy – % change



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

In its latest World Economic Outlook, the International Monetary Fund confirms global growth of 3.2% in 2024, close to what was experienced in 2023 (3.3%) and with what is expected for 2025 (3.2%).[1] The International Monetary Fund's (IMF) forecasts appear coherent with the Organisation for Economic Co-operation and Development (OECD) forecasts in its latest reports: in the December Economic Outlook, in fact, the OECD forecasts global growth of 3.2% for 2024, which was expected to be followed by similar growth in 2025 (3.2%).[2]

Although the global growth is in line with pre-pandemic values, the latest data and forecasts show a certain degree of heterogeneity among the world economies.

On the one hand, in fact, the United States showed robust growth in 2023 (2.9%) which is expected to be followed by equally high growth in 2024 (2.8%), but with a slight slowdown in 2025 (2.2%). The 2025 is expected to be less dynamic, according to estimates by the OECD, which estimated a GDP growth rate in the United States of 1.6%.

On the other side, the overall picture for the Eurozone appears different: after the low growth in 2023 (0.4%), the IMF forecasts a slight acceleration in 2024 and 2025, although growth is still expected to be weak (0.8% and 1.2% respectively). These forecasts are in line with those of the OECD, which forecasts a growth in 2024 and 2025 of 0.8% and 1.3% respectively.

In addition to the differing growth rates, another difference between the United States and the Eurozone lies in the recent forecast revisions by the IMF. These revisions offer insights into growth expectations based on the latest available information.

Figure 3: Real GDP – var. %

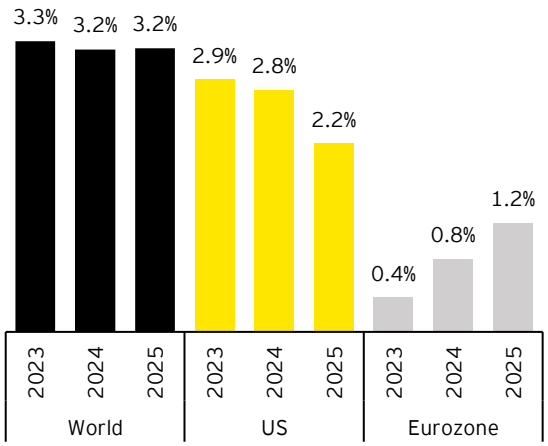
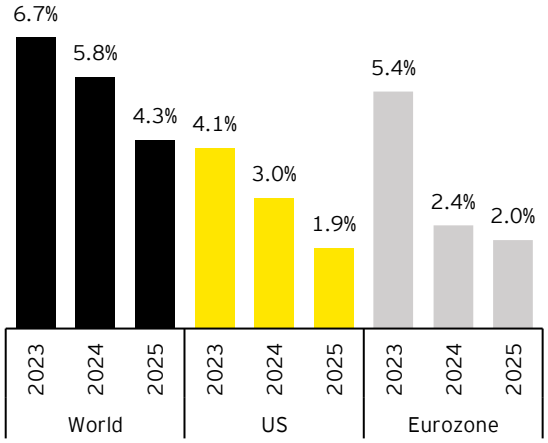


Figure 4: Consumer prices – % change



Source: EY elaborations on IMF World Economic Outlook data and forecasts, October 2024.

Specifically, while for the United States the revision of growth rates was positive, especially for 2025 (revision of 0.2 and 0.3 percentage points for 2024 and 2025 respectively), the Eurozone experienced a downward revision (-0.1 and -0.3 percentage points respectively).

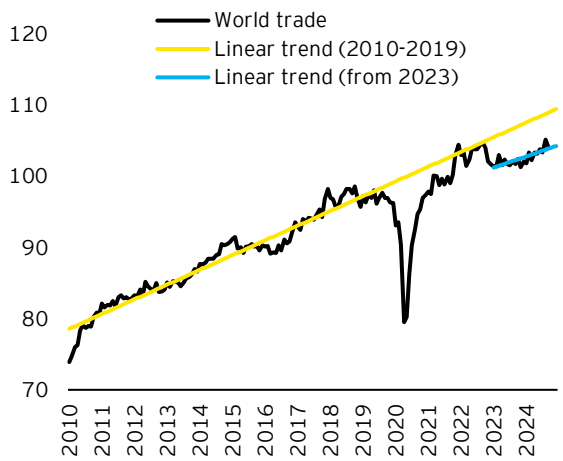
The subdued performance of some of the world's major economies, together with new or

[1]IMF World Economic Outlook, October 2024.

[2]OECD Economic Outlook, December 2024.

rekindled geopolitical risks[3] and specific environmental situations, continue to negatively affect international trade.

Figure 5: Trade in goods, volume, world – index, 2010=100



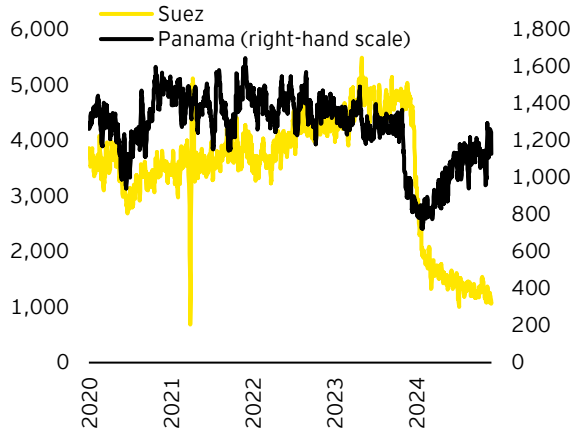
Source: EY elaborations on CPB data Netherlands Bureau for Economic Policy Analysis. Reference is made to trade in goods. Last observation: September 2024.

By analyzing the trend of trade in goods from 2010 to 2019, it is possible to identify a linear trend, which clearly shows the presence of factors slowing down the trade in goods in recent months and years. In addition to the reduction recorded in 2020 (linked to the pandemic), the index analyzed shows a significant gap from 2023 compared to what could have been expected from the trend previously described, potentially suggesting the presence of longer-term complexities and, potentially, of a "new normal" scenario.

The attacks on commercial vessels in the Red Sea, together with the disruptions caused by climate events in the Panama Canal, have indeed had a negative effect on maritime transit and freight rates.[4]

While on the one hand, trade in the Panama Canal, hampered by specific climatic issues, seems to be returning to values in line with historical values, on the other hand, trade transiting through the Suez Canal continues to show complexities, with volumes in transit significantly reduced compared to the values experienced before 2024.

Figure 6: Volume of trade through the Panama Canal and the Suez Canal – metric tonnes



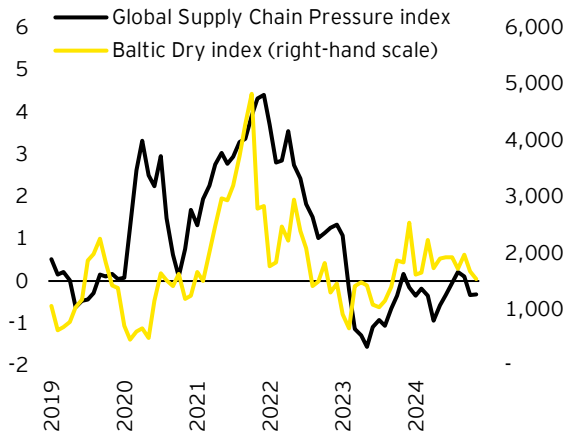
Source: EY calculations on IMF PortWatch data. Data is represented as a 7-day moving average of trade volume in thousands of metric tonnes. Last observation: 1 December 2024.

These events, however, have not yet translated into a significant increase in global supply chains pressures, as demonstrated by two of the representative indicators of these phenomena, namely the Global Supply Chain Pressure Index and the Baltic Dry Index.

The weakness in global trade is therefore linked not to supply chains complexities, as happened in the pandemic period and immediately after, but due to rising uncertainty on account of recent geopolitical events, including uncertainties preceding and following the elections in the United States (the risk of a protectionist trade policy by the future administration),[5] the introduction of several trade-distorting measures since 2022,[6] as well as the reconfiguration of supply chains to reduce dependence on specific suppliers, making trade more costly and less efficient.[7]

[3]Caldara, D., & Iacoviello, M. (2022). Measuring geopolitical risk. American Economic Review, 112(4), 1194-1225.
[4]Bogetic, Z., L. Zhao, H. Krambeck, E. A. Chamorro, S. Sarva, J. Matossian, and Y. Zhao. 2024. "Dire Strait: The Far-Reaching Impact of the Red Sea Shipping Crisis." MENA FCV Economic Series Brief, World Bank.
[5]Caldara, D., Iacoviello, M., Molligo, P., Prestipino, A., & Raffo, A. (2020). The economic effects of trade policy uncertainty. Journal of Monetary Economics, 109, 38-59.
[6]Freund, C., A. Mattoo, A. Mulabdic, and M. Ruta. 2023. "Is US Trade Policy Reshaping Global Supply Chains?" Policy Research Working Paper 10593, World Bank, Washington, DC.
[7]Grossman, G. M., E. Helpman, and S. J. Redding. 2024. "When Tariffs Disrupt Global Supply Chains." American Economic Review 114 (4): 988-1029.

Figure 7: Global Supply Chain Pressure index and Baltic Dry Index



Source: EY elaborations on Federal Reserve Bank of New York and Baltic Dry index data. The *Global Supply Chain Pressure Index* (GSCPI) – the index created by the NY FED to monitor pressures along supply chains – integrates a series of commonly used metrics with the aim of providing a summary of potential disruptions in the supply chain (for more information see https://www.newyorkfed.org/research/policy/gscpi#/overview). The Baltic Dry Index is an index of average prices paid for the transportation of materials on over 20 routes (for more information see https://www.balticexchange.com/en/index.html). Last observation: November 2024.

Despite the absence of significant complications along supply chains, it is important to underline how the ongoing geopolitical issues and worsening of specific fights may translate into a further slowdown in trade in the future. While geopolitical frictions are one of the reasons behind the current slowdown in trade, as widely described in several studies,[8] a widening of the "geopolitical distance" with blocs not "aligned" may further undermine trade. The worst economic spillovers, in this case, would be faced by the advanced economies, especially for what concerns imports, as advanced economies are more prone to trade-distorting policies than emerging countries and developing economies. Greater fragmentation could also make it even harder to address broader global challenges, such as the transition to a more sustainable economy, due to the lack of necessary resources.[9]

Finally, it is important to underline that, despite the important challenges for international trade, it is not possible to affirm that a real process of de-globalization is underway. In this regard, some fundamental aspects clarified by recent studies should be considered, which describe the current process as a process of reorganization of trade relations rather than deglobalization. It can, in fact, be described as a reconfiguration of trade along geopolitical lines, mainly driven by the weakening of specific trade relations.[10]

The United States, for example, has been reducing its trade relations with China since 2018, while the European Union only started a similar process in 2023, especially in relation to specific technological products. Overall, it is important to note that not all trade dependencies on China are decreasing: the United States and the European Union are importing, for example, more and more goods that are essential for the "green transition". It should also be considered that the United States' supply chains from China are becoming lengthier, with intermediate production stages being moved to third countries.

In addition to trade, geopolitical tensions also impact on the price dynamics of commodities, especially energy products such as natural gas and oil.

In November 2024, the Brent oil price was at 74.4 $/bbl,[11] in line with the previous two months (74.3 $/bbl and 75.7 $/bbl in September and October respectively), but down compared to the average of the first seven months of 2024, 84.2 $/bbl).

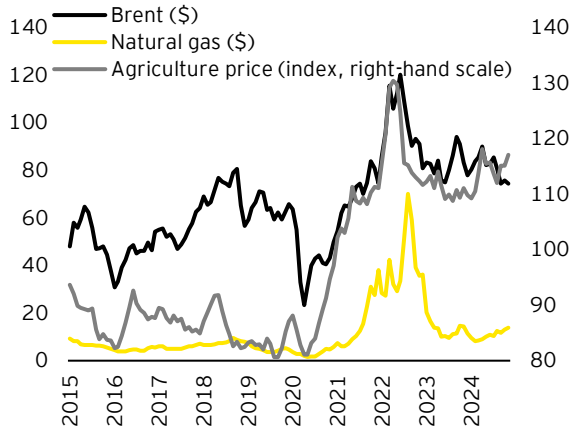
[8]Reference in this regard to Campos, R.G., Estefanía-Flores, J., Furceri, D., & Timini, J. (2023). Geopolitical fragmentation and trade. Journal of Comparative Economics, 51(4), 1289-1315; Jakubik, A., & Ruta, M. (2023). Trading with friends in uncertain times (No. 2023/124). International Monetary Fund; Aiyar, S., Malacrino, D., & Presbitero, A. F. (2024). Investing in friends: The role of geopolitical alignment in fdi flows. European Journal of Political Economy, 83, 102508; Gopinath, G., Gourinchas, P.-O., Pescatori, A., & Topalova, P. (2024). Changing global linkages: A new cold war? International Monetary Fund; Hakobyan, S., Meleshchuk, S., & Zymek, R. (in press). Divided we fall: differential exposure to geopolitical fragmentation in trade. (IMF Working Paper).

[9]Bosone, C., & Stamato, G. (2024). Beyond borders: How geopolitics is reshaping trade. ECB Working Paper Series.

[10]Conteduca, F. P., Giglioli, S., Giordano, C., Mancini, M., & Panon, L. (2024). *Trade fragmentation revealed: five facts on the reconfiguration of global, US and EU trade* (No. 881). Bank of Italy, Economic and Financial Issues (Occasional Papers).

[11]Dollars per barrel of oil. One barrel is equal to approximately 159 liters.

Figure 8: Energy commodity prices ($) and agricultural price index (2010=100)



Source: EY elaborations on World Bank data. Brent and natural gas prices are expressed in $/bbl and $/mmbtu, respectively. The price of natural gas refers to natural gas quoted in the Title Transfer Facility (TTF). The agricultural price index considers the price of various goods and derivatives related to agriculture at a global level (for example, the price of wheat). Last observation: November 2024.

Several factors influence oil prices. Firstly, it is notable that in 2024, prices have trended downward compared to 2023, driven by long-term underlying factors steering them lower. One such factor is the global slowdown in oil consumption, which aligns with a secular trend of reduced oil intensity in economic activities and significantly contributes to long-term price reductions. Additionally, the diversification of global oil supply, marked by a gradual increase in the market share of non-OPEC+ producers, further influences this downward trajectory.[12]

Furthermore, following successive cycles of production cuts, OPEC+ retains an unused oil capacity of slightly over 7% of current global production as of the end of October 2024. This represents a substantial buffer for potential increases in oil production capacity.[13]

Amid the current uncertainty in the international landscape, oil prices remain highly susceptible to significant fluctuations and volatility, largely influenced by developments in the geopolitical context. In this regard, the World Bank's October 2024 Commodity Market Outlook highlights two potential scenarios for future economic and geopolitical trends that could substantially impact oil prices.

In the first scenario, which anticipates an escalation of the conflict in the Middle East, a potential reduction in global oil supply by 2 million barrels per day (approximately 2% of global production) is projected. This would likely drive Brent prices to around 92 $/bbl by the end of 2024, subsequently stabilizing at approximately 84 $/bbl in 2025−15% higher than the baseline scenario without escalation. Such a reduction would be comparable to historical supply disruptions, such as those caused by the Iraq War in 2003 and the Libyan Civil War in 2011.

A second scenario envisions an increase in oil supply, assuming OPEC+ reverses its voluntary cuts of 2.2 million barrels per day (consistent with its announced policy but contrary to the World Bank's baseline assumptions). Under this scenario, global oil production could significantly outpace demand in 2025. If OPEC+ largely adheres to its stated policy and other oil exporters do not reduce production to counterbalance the additional supply, global oil production in 2025 would, on average, exceed the baseline by approximately 1.5 million barrels per day. Consequently, the Brent price is projected to average 66 $/bbl in 2025−10% lower than the baseline forecast and 18% below the average price forecast for 2024.

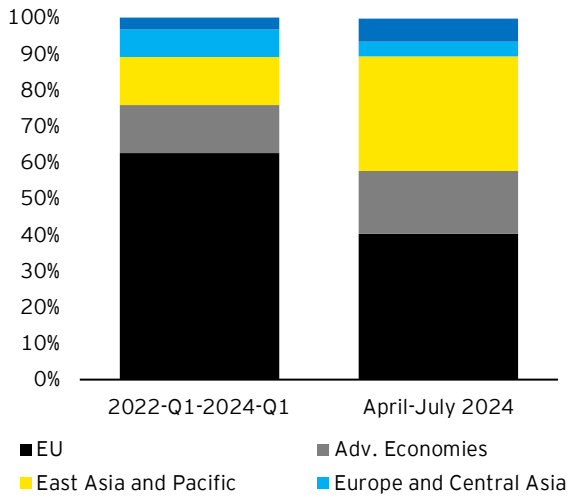
Moving on to other energy commodities, and specifically referring to natural gas listed in the European market, prices have increased significantly since mid-2024 (in the first three months an average price of 8.75 $/mmtbu was recorded[14], while between April and November an average price of 11.43 $/mmtbu was recorded; the price in November 2024 was 13.9 $/mmtbu) due to uncertainties regarding the availability of gas imports from Russia and increasing global competition for liquefied natural gas supplies.

[12]This refers to the group of oil exporting countries. The OPEC group consists of Algeria, Angola, Saudi Arabia, Congo, United Arab Emirates, Gabon, Equatorial Guinea, Iran, Iraq, Kuwait, Libya, Nigeria, Venezuela. The OPEC+ group It is composed of OPEC countries plus Azerbaijan, Bahrain, Brunei, Kazakhstan, Malaysia, Mexico, Oman, Russia, Sudan, South Sudan.

[13]World Bank, Commodity Markets Outlook, October 2024.

[14]Dollars per million British thermal units, a measure of the amount of gas.

Figure 9: Destination of U.S. Liquid Natural Gas Exports



Source: World Bank. Data is updated to July 2024.

Finally, regarding agricultural commodity prices of many crops, such as corn, soybeans, and wheat have generally experienced downward trends this year, largely due to abundant harvests. However, adverse weather conditions, specific plant diseases, and trade restrictions have driven the prices of commodities like cocoa, coffee, and rice to record highs during the year. This highlights the potential for supply volatility to become more frequent, driven by climate change and trade fragmentation.

Overall, lower commodity prices compared to the previous year are supporting central banks in achieving their inflation-containment mandate, especially in emerging and developing countries where food and energy products are relatively important components of consumer baskets.[15]

Furthermore, given the importance of energy and food prices within the consumer basket, the reduction in commodity prices could also translate into a reduction in inflation expectations, which could in turn lead to a reduction in inflationary pressures.[16]

Though the volatility of commodity prices has highlighted the role of geopolitical shocks and their effects on the real economy, [17] it is important to consider that adverse geopolitical events can have negative spillovers on the economy through other channels as well.

Specifically, two further channels can be identified: the first channel produces direct and tangible impacts by compromising infrastructure or industrial capacity,[18] but potentially also acting as a stimulus to the economy through increased military spending;[19] the second channel refers to the increased volatility and uncertainty generated, which potentially translates into an incentive to precautionary savings, with a consequent postponement of consumption and investments.

In relation to adverse geopolitical events, it is important to consider the presence of non-linear relationships between economic performance and prices. In this case, uncertainty plays a fundamental role, amplifying the overall impact of the negative event by causing, for example, a reduction in stock prices and private consumption. This effect generally occurs only in the case of large-scale shocks, while it is less evident in the case of smaller shocks.[20]

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

The international environment is characterized by some heterogeneity even in the shortest-term.

United States

In the third quarter of 2024, the United States experienced a growth rate of 0.7%, consistent with the 0.7% growth observed in the second quarter. This period saw a notable increase in private consumption, which rose from 0.7% in the second quarter to 0.9% in the third quarter. This

[15]Ha, J., M. A. Kose, and F. Ohnsorge, eds. 2019. Inflation in Emerging and Developing Economies: Evolution, Drivers and Policies. Washington, DC: World Bank.
[16]D'Acunto, F., U. Malmendier, J. Ospina, and M. Weber. 2019. "Exposure to Daily Price Changes and Inflation Expectations." NBER Working Paper 26237, National Bureau of Economic Research, Cambridge, MA.
[17]In this regard, refer to Caldara, D., Iacoviello, M., 2022. Measuring Geopolitical Risk. American Economic Review 112, 1194-1225. URL: https://ideas.repec.org/a/aea/aecrev/ v112y2022i4p1194-1225.html, doi:10.1257/aer.20191823; Caldara, D., Conlisk, S., Iacoviello, M., Penn, M., 2022. The Effect of the War in Ukraine on Global Activity and Inflation URL: https://ideas.repec.org/p/ fip/ fedgfn/2022-05-27-2.html, doi:10.17016/2380-7172.3141.
[18]Barro, RJ, Ursùa, JF, 2012. Rare Macroeconomic Disasters. Annual Review of Economics 4, 83-109. URL: https://ideas.repec.org/a/anr/reveco/v4y2012p83-109.html.
[19]Ramey, V.A., 2011. Identifying Government Spending Shocks: It's all in the Timing. The Quarterly Journal of Economics 126, 1-50. URL: https://ideas.repec.org/a/oup/qjecon/v126y2011i1p1-50.html.
[20]Brignone, D., Gambetti, L., & Ricci, M. (2024). *Geopolitical risk shocks: when the size matters* (No. 2972). ECB Working Paper Series.

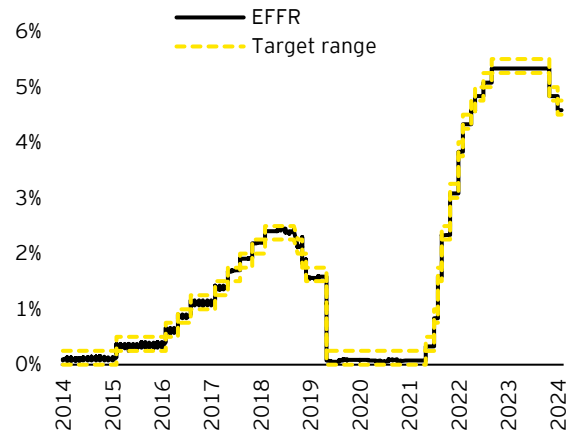
growth was primarily driven by a 1.4% increase in the consumption of goods and a more modest 0.6% rise in the purchase of services. Within the goods category, non-durable goods consumption grew by 1.1%, while durable goods consumption saw a more substantial increase of 1.8%.

Private investments saw a modest growth of 0.3% in the third quarter, following a substantial 2.0% increase in the fourth quarter. In terms of international trade, exports grew by 1.8% on a quarterly basis, while imports experienced a more significant growth of 2.5%. This resulted in a negative overall contribution from foreign demand to growth, amounting to -0.2 percentage points.[21]

Inflation in the United States appears to be stabilizing at more moderate levels, despite occasional increases in the consumer price index. For instance, in October 2024, inflation was at 2.6%, compared to 2.4% in September 2024, and similar to the inflation rate recorded in August. A similar pattern is observed in other price indices, such as the Harmonized Price Index and the Personal Consumer Expenditure Index.

Despite the uneven trajectory of inflation reduction, the American central bank (Federal Reserve) is gradually loosening the monetary tightening measures implemented since March 2022. During the November meeting, the Federal Reserve adjusted the upper and lower bounds of its rate corridor from 5.00%-4.75% to 4.75%-4.50%.[22]

Figure 10: Federal Reserve monetary policy benchmark rates, United States



Source: EY calculations based on Federal Reserve Bank of New York data. EFFR: Effective Federal Funds Rate; the EFFR is calculated as the volume-weighted median of reported overnight transactions. For more information, see https://www.newyorkfed.org/markets/reference-rates/effr.

Even with the reduction in interest rates, it is crucial to remember that their high levels can still have potential negative impacts on emerging economies, as extensively documented in the literature.[23] For instance, countries that incur debt in US dollars may face a greater financial burden due to rising interest rates. Additionally, there is the potential for capital flight from emerging markets, which are generally more profitable, to the more stable American market. Notably, in this cycle of rising interest rates, emerging markets have not experienced the expected negative effects. Although these economies have not been entirely immune to the US' restrictive monetary policies, the gradual reduction of macro-financial vulnerabilities over the past decades, coupled with more prudent monetary policy management, appears to have mitigated the overall impact of higher interest rates.[24]

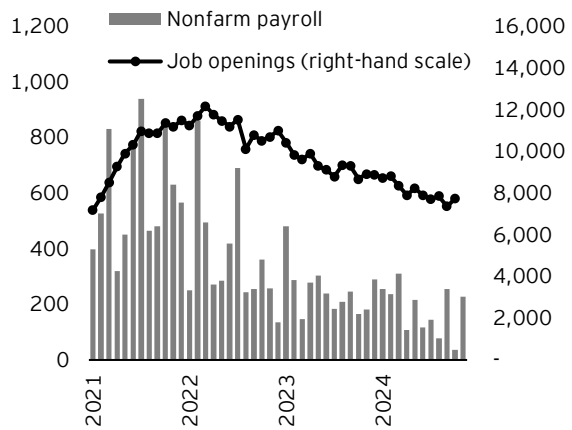
Regarding the recent performance of the US economy, the latest data indicates that consumer

[21]Gross Domestic Product, Third Quarter 2024 (Second Estimate) and Corporate Profits (Preliminary), https://www.bea.gov/news/2024/gross-domestic-product-third-quarter-2024-second-estimate-and- corporate-profits .
[22]Federal Reserve issues FOMC statement, 07 November 2024, https://www.federalreserve.gov/newsevents/pressreleases/monetary20241107a.htm .
[23]In this regard, Georgiadis, G. (2016) can be cited. Determinants of global spillovers from US monetary policy. Journal of International Money and Finance 67 (C), 41–61; Iacoviello, M. and G. Navarro (2019). Foreign effects of higher US interest rates. Journal of International Money and Finance 95, 232–250; Miranda-Agrippino, S. and H. Rey (2020). US Monetary Policy and the Global Financial Cycle. Review of Economic Studies 87 (6), 2754–2776; Ca' Zorzi, M., L. Dedola, G. Georgiadis, M. Jarocinski, L. Stracca, and G. Strasser (2020). Monetary policy and its transmission in a globalized world. International Journal of Central Banking 19 (2); Ahmed, S., O. Akinci, and A. Queralt´o (2021). US Monetary Policy Spillovers to Emerging Markets: Both Shocks and Vulnerabilities Matter. International Finance Discussion Papers 1321, Board of Governors of the Federal Reserve System.
[24]Andres Escayola, E., McQuade, P., Schroeder, C., & Tirpák, M. (2024). *What shapes spillovers from monetary policy shocks in the United States to emerging market economies?* (No. 2973). ECB Working Paper Series.

spending saw modest growth in October 2024, increasing by 0.1% compared to the previous month, compared with a 0.5% growth in September and a 0.1% increase in August.[25] The weak growth is primarily attributed to stagnant spending on goods, which remained flat at 0.0% in October, following a 1.1% increase in September and a 0.4% decline in August. In contrast, spending on services showed slightly more dynamism, growing by 0.2% in October, matching the 0.2% growth in September, and following a 0.3% increase in August. Within the goods category, durable goods consumption saw a monthly growth of 0.3%, while non-durable goods consumption contracted by 0.1%.

These figures are accompanied by a robust labor market, albeit at a slower pace compared to previous months. In November, the number of employed people in the United States increased by 227,000 compared to the previous month. However, this dynamism is likely temporary, considering the impact of recent natural disasters.[26] This becomes clear when analyzing the data over the past few months, which show a decline compared to the first half of the year and the end of 2023. Additionally, new job openings have been trending downward since their peak in 2022. Meanwhile, the unemployment rate has remained relatively stable, hovering just above 4% (4.2% in November).

Figure 11: Change in nonfarm payrolls and job openings – US



Source: EY calculations based on Bureau of Labor Statistics (BLS) data. Nonfarm payroll refers to the number of U.S. workers in the economy excluding business owners, household employees, unpaid volunteers, farm employees, and the unincorporated self-employed. This measure represents about 80% of workers who contribute to gross domestic product (GDP). For more information, https://fred.stlouisfed.org/series/PAYEMS .

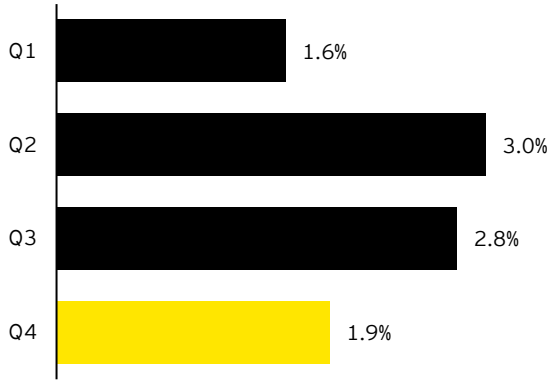
The industrial and manufacturing sectors are experiencing a contraction. In October 2024, industrial activity decreased by 0.3% compared to the previous month, following a 0.5% growth in August and a subsequent 0.5% decline in September. Similarly, the manufacturing sector saw a 0.5% reduction in October, after a 0.6% increase in August and a 0.3% decrease in September. On a year-on-year basis, both industrial and manufacturing production show a discouraging trend, with a 0.3% reduction in October for both sectors.[27]

Regarding expectations for the upcoming quarters, the latest projections from the Federal Reserve Bank of New York at the end of November 2024 suggest that average GDP growth over the next four quarters will range between -0.11% and +3.43%, with a median estimate of 1.75%,[28] This demonstrates a dynamic economy. Specifically, the short-term forecasts from the Federal Reserve Bank of New York for the US economy indicate an annualized growth rate[29] of 1.9% for

[25]Personal Income and Outlays, October 2024. For more information, https://www.bea.gov/news/2024/personal-income-and-outlays-october-2024 .
[26]EY, Employment report November 2024, Beneath the jobs rebound, cooling conditions and slower labor supply. For more information, https://www.ey.com/en_us/insights/strategy/macroeconomics/employment-report .
[27]Industrial Production and Capacity Utilization, November 2024. For more information, https://www.federalreserve.gov/releases/g17/current/default.htm .
[28]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 .
[29]For more information, https://www.bea.gov/help/faq/463 .

the fourth quarter of 2024, following a 2.8% growth in the third quarter.[30]

Figure 12: GDP 2024 – US, annualized QoQ % change



Source: EY elaborations on Federal Reserve Bank of New York data, US Bureau of Economic Analysis (BEA). The yellow bars represent the available forecasts for the next quarters (New York Fed Staff Nowcast). The rates of change are annualized. Last update: November 20, 2024.

When discussing the US economy, it is crucial to consider the recent election results from early November. The uncertainties surrounding political decisions and the vigor with which they will be executed adds another layer of unpredictability to both the US and global economies.

Key contentious issues include the trajectory of public spending and the implementation of new trade-distorting measures, such as tariffs. These measures could negatively impact specific countries and the global economy, especially if affected economies retaliate.

United Kingdom

The UK is projected to grow by 0.1% in the third quarter of 2024, following a 0.5% growth in the second quarter and a 0.7% growth in the first quarter. The performance in the third quarter is primarily influenced by a decline in investment (including inventories), which is offset by increases in net exports, private consumption, and government spending.[31]

Higher frequency data indicate a largely stable economic trend: in September, the services sector showed no growth month on month (0.0%), following slight increases in the previous two months (0.1% in both July and August).[32]

Conversely, the construction sector experienced weak growth of 0.1% in September, following a 0.6% increase in the previous month. Additionally, the industrial sector contracted by 0.5% compared to the previous month, continuing a downward trend with a 0.7% reduction in July and a 0.5% growth in August 2024.[33,34]

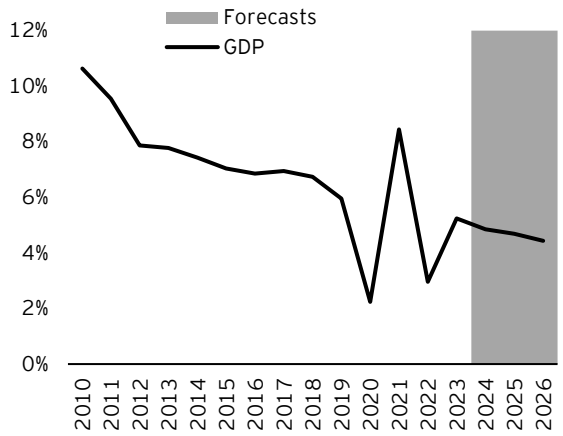
The inflation rate is nearing the target of 2%. In October, headline inflation rose significantly to 2.3%, up from 1.7% in September. Core inflation also remains persistent, reaching 3.3% in October, a slight increase from 3.2% in September.[35]

China

The Chinese economy is exhibiting signs of a slowdown. This trend is not only reflected in the GDP growth of recent years or the forecasts for 2025 (with the OECD's latest Economic Outlook predicting 4.9% growth for China in 2024, followed by a reduction to 4.7% in 2025), but also represents a long-term trend that has been ongoing since the period following the 2008 financial crisis.

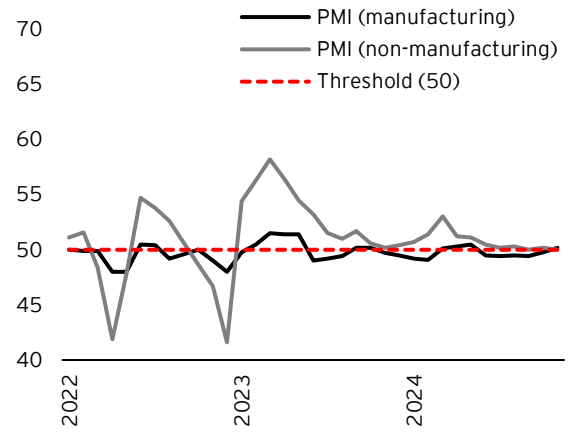
[30]For more information, https://www.newyorkfed.org/research/policy/nowcast#/overview .
[31]GDP first quarterly estimate, UK July to September 2024, https://www.ons.gov.uk/economy/grossdomesticproductgdp/bulletins/gdpfirstquarterlyestimateuk/julytoseptember2024 .
[32]Office for National Statistics, Index of Services, UK: September 2024, https://www.ons.gov.uk/economy/economicoutputandproductivity/output/bulletins/indexofservices/september2024 .
[33]Office for National Statistics, Construction output in Great Britain: September 2024, https://www.ons.gov.uk/businessindustryandtrade/constructionindustry/bulletins/constructionoutputingreatbritain/september2024newordersandconstructionoutputpriceindexjulytoseptember2024 .
[34]Office for National Statistics, Index of Production, UK: September 2024, https://www.ons.gov.uk/economy/economicoutputandproductivity/output/bulletins/indexofproduction/september2024 .
[35]Office for National Statistics, Consumer price inflation, UK: October 2024, https://www.ons.gov.uk/economy/inflationandpriceindexes/bulletins/consumerpriceinflation/october2024 .

Figure 13: GDP, China – % change



Source: EY elaborations on OECD data and forecasts.

Figure 14: Purchasing Managers Index (PMI), manufacturing and non-manufacturing activities, China



Source: EY elaborations on National Bureau of Statistics of China data. Last observation: November 2024.

According to the latest data, China's economy grew by 4.6% in the second quarter of 2024 compared to the same quarter of the previous year, following growth rates of 5.3% in the first quarter and 4.7% in the second quarter. On a quarter-over-quarter basis, the third quarter saw a growth rate of 0.9%, after increases of 1.5% in the first quarter and 0.5% in the second quarter.[36]

In October, the industrial sector's value added increased by 5.3%, following similar growth in September (5.2%) and more moderate growth in August (4.5%), indicating a partial acceleration compared to previous months. This performance is partly attributed to the growth in the value added of the manufacturing of computers and other electronic machinery (10.5%) and the pharmaceutical sector (7.8%).[37]

Regarding the expectations of operators in the manufacturing and non-manufacturing sectors, the PMI (Purchasing Manager Index) released by the National Bureau of Statistics of China indicates a slightly positive trend or is aligned with the expansion threshold of 50.[38]

The real estate sector remains in crisis, experiencing a contraction of 10.3% from January to October 2024 compared to the same period the previous year. This downward trend is further confirmed by data from previous months, highlighting the sector's significant difficulties.[39]

Expanding the analysis to encompass overall investments, growth in the first ten months of the year compared to the same period the previous year stands at 3.4%. Notable increases were observed in the energy production industry (24.1%), the processing of non-ferrous metals (25.9%), and the other transportation equipment industry (33.0%).[40]

Retail sales growth rate (year-on-year) has been progressively decreasing since the end of 2023, with a few exceptions, reaching 2.1% in August. However, September and October saw an acceleration in sales, with year-on-year growth of 3.2% in September and 4.8% in October 2024.[41]

Net exports have positively contributed to growth. In October 2024, exports saw a year-on-year increase of 11.2%, while imports decreased

[36]Preliminary Accounting Results of GDP for the Third Quarter of 2024, https://www.stats.gov.cn/english/PressRelease/202410/t20241025_1957137.html .
[37]Industrial Production Operation in October 2024, https://www.stats.gov.cn/english/PressRelease/202411/t20241127_1957585.html .
[38]Purchasing Managers' Index for November 2024, https://www.stats.gov.cn/english/PressRelease/202412/t20241204_1957641.html .
[39]Investment in Real Estate Development for Jan-Oct 2024, https://www.stats.gov.cn/english/PressRelease/202411/t20241128_1957593.html .
[40]Investment in Fixed Assets from January to October 2024, https://www.stats.gov.cn/english/PressRelease/202411/t20241127_1957586.html .
[41]Total Retail Sales of Consumer Goods in October 2024, https://www.stats.gov.cn/english/PressRelease/202411/t20241128_1957594.html .

by 3.7%.[42] The positive contribution of exports to growth is also evident in the analysis of the first ten months of 2024, with exports growing by 6.7% compared to a 3.2% increase in imports.

While the international landscape is generally showing signs of recovery, numerous uncertainties and vulnerabilities remain. These include a still complex geopolitical situation, further moderate growth in some economies compared to the pre-pandemic period, changes in the political structures of key countries in the global economy, and declining raw material prices that are marked by volatility.

[42]For more information, http://english.customs.gov.cn/statics/report/preliminary.html . The annual growth of exports stands at 12.7% when considering exports expressed in dollars, while that of imports stands at stands at -2.3%.

The European framework

The Eurozone economic framework and economic indicators

In the third quarter of 2024, the Eurozone experienced a quarterly growth of 0.4%, compared to the previous quarter. This follows a more moderate growth of 0.2% in the second quarter and a growth of 0.3% in the first quarter, which was similar to the growth in the current quarter. The positive trend in the third quarter is largely attributed to Spain's strong performance, with sustained growth of 0.8% in both the third and second quarters, and 0.9% in the first quarter. France and Germany showed modest growth at 0.4% and 0.1% respectively, while Italy remained stagnant with 0.0% growth.

Shifting from a cyclical to a year-on-year analysis (comparing to the same period of the previous year), Spain emerged as the fastest-growing country, with a GDP increase of 3.4% in the third quarter, following growth of 3.2% and 2.6% in the second and first quarters respectively. France also demonstrated a positive trend, albeit significantly lower than Spain's, with a GDP growth of 1.2% in the third quarter compared to the same period last year, after growth of 0.9% and 1.4% in the second and first quarters respectively. Italy's growth was more subdued, with a GDP increase of 0.4%, following growth of 0.7% and 0.3%. Germany continued its negative trend, recording a contraction of 0.3% in the third quarter, after reductions of 0.1% and 0.2% in the first and second quarters of this year. This marks the fifth consecutive quarter of recession for Germany on a trend basis. Overall, the Eurozone recorded a trend growth of 0.9% in the third quarter.

Figure 15: GDP and contributions by country, Eurozone – YoY % change

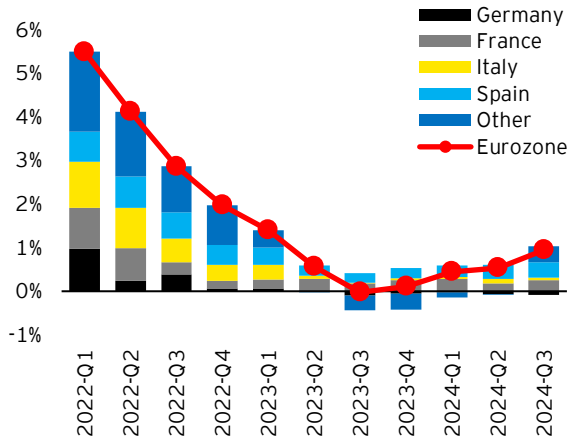
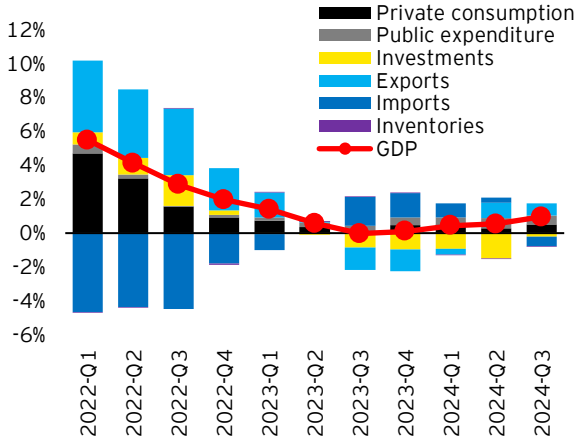


Figure 16: GDP and contributions by component, Eurozone – YoY % change



Source: EY elaborations on Eurostat data.

The trend in industrial production continues to indicate signs of weakness in the Eurozone economy. In September, industrial production decreased by 2.0% compared to the previous month, following a growth of 1.5% in the prior month and a contraction of 0.2% in July. On a year-on-year basis, the situation appears even more complex. In September, industrial production declined by 2.4%, marking the sixteenth month of trend contraction (excluding December 2023, which saw a modest growth of 0.2%). In July and August, contractions of 2.0% and 0.3% were recorded, respectively.

Examining the economic details of the main Eurozone countries, Germany's industrial sector shows the most pronounced signs of weakness, with a monthly contraction of 2.4% in September, following a contraction of 3.3% and subsequent growth of 3.2% in July and August. Italian and French industrial

production also declined, with reductions of 0.4% and 0.7% respectively in September 2024. In contrast, Spanish industrial production stood out with a growth of 1.0%.

Figure 17: Industrial production by main countries, Eurozone – index, 2021=100

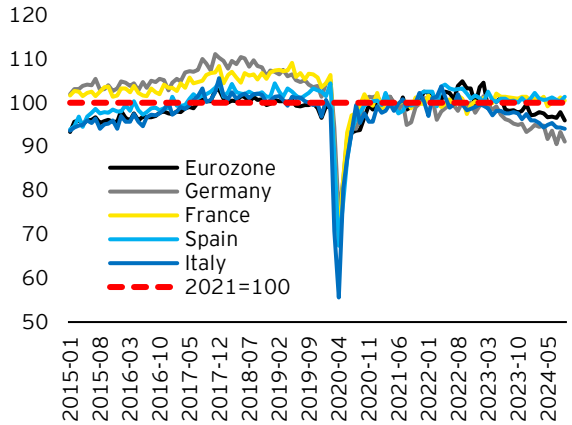
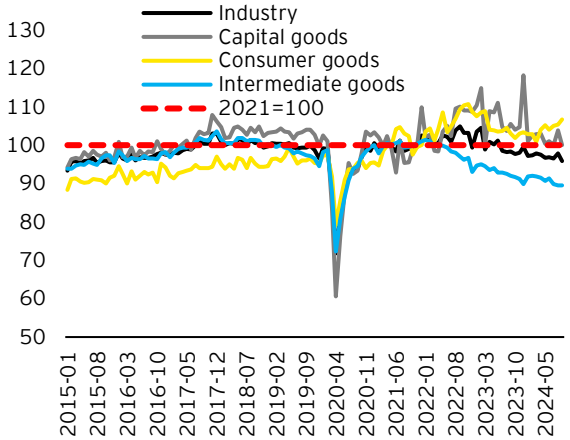


Figure 18: Industrial production by type of good, Eurozone – index, 2021=100



Source: EY elaborations on Eurostat data. For industrial production, we refer to NACE Rev. 2 *Mining* and *quarrying; manufacturing; electricity, gas, steam and air conditioning supply*. Last observation: September 2024.

Analyzing the main macro-categories of industrial goods, the production of intermediate goods remains the most critical category, continuing its negative trend since 2022. September 2024 marks the thirty-first consecutive month of year-on-year contraction, with a decline of 2.7%, following a reduction of 3.1% in August. From a month-over-month perspective, however, September saw zero growth after two months of contraction (-1.5% in July and -0.3% in August).

The analysis of the PMI indicator[43] for manufacturing and services provides insightful and timely details on the performance of the main sectors of the economy. The latest reading of the manufacturing PMI indicates an overall less optimistic climate, with mixed signals from the major economies. Spain is the only one of the four major Eurozone countries where the manufacturing PMI index recorded values above the expansion threshold (defined as a value of 50), although it has been declining in recent months. Italy, on the other hand, shows values below the expansion threshold and has been in strong decline recently. The situations in France and Germany appear more complex.

The perception of activity in the services sector is somewhat better, with Spain recording values above the expansion threshold, Italy and Germany slightly below, and France showing less encouraging values.

[43]The PMI (Purchasing Managers' Index) is one of the most popular economic indices, i.e. an index of the prevailing direction of economic trends in the manufacturing, construction and services sectors, obtained thanks to timely surveys conducted on the most representative companies in the reference sectors. Values above 50 indicate a growth trend in economic activity, values below 50 a decrease.

Figure 19: Purchasing Managers Index (PMI), manufacturing

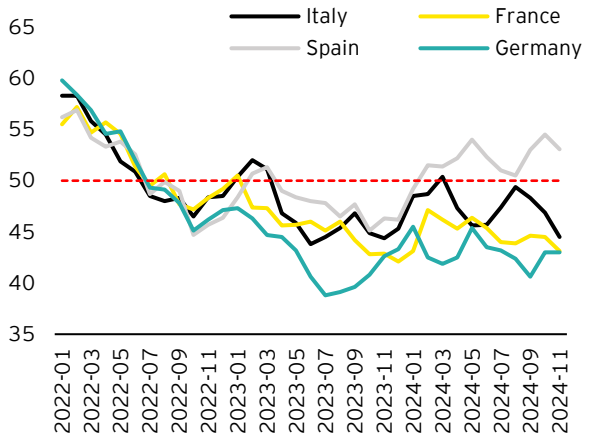
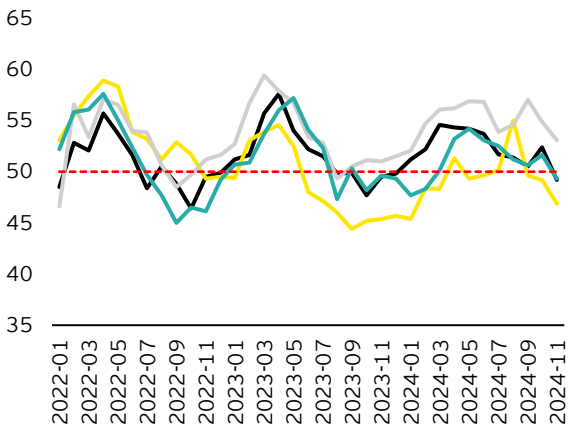


Figure 20: Purchasing Managers Index (PMI), services



Source: EY elaborations on S&P Global data. Last observation: November 2024.

Monetary Policy and Prices in the Eurozone

At the meeting on December 12, 2024, the European Central Bank implemented its fourth cut in the reference interest rates for monetary policy, following a previous cut in October 2024.[44] This decision is justified by the current inflation trend and projections for the coming years, with an inflation rate forecasted at 2.1% in 2025, 1.9% in 2026, and 2.1% in 2027.[45]

Figure 21: Reference interest rates of the European Central Bank's monetary policy

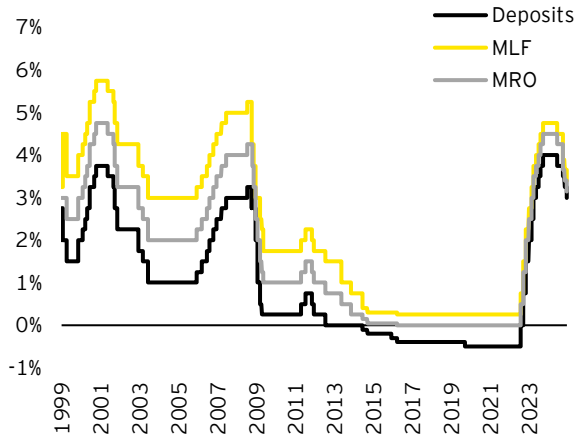
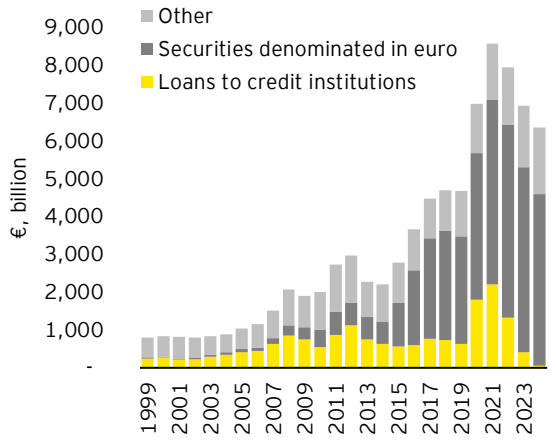


Figure 22: Main balance sheet items of the European Central Bank (€, billion)



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 December 6, 2024.

[44]ECB, Monetary policy decisions, 17 October 2024. For more information, https://www.ecb.europa.eu/press/pr/date/2024/html/ecb.mp241017~aa366eaf20.en.html .
[45]ECB, Monetary policy decisions, 12 December 2024. For more information, https://www.ecb.europa.eu/press/pr/date/2024/html/ecb.mp241212~2acab6e51e.en.html .

The interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility[46] therefore stand at 3.15%, 3.40% and 3.00% respectively.

The restrictive economic policy cycle in place since mid-2023, recently interrupted by the latest rate cuts, together with a slightly positive change of the external environment, led to a reduction in the growth of the price level.

Figure 23: Inflation rate, Eurozone – YoY % change

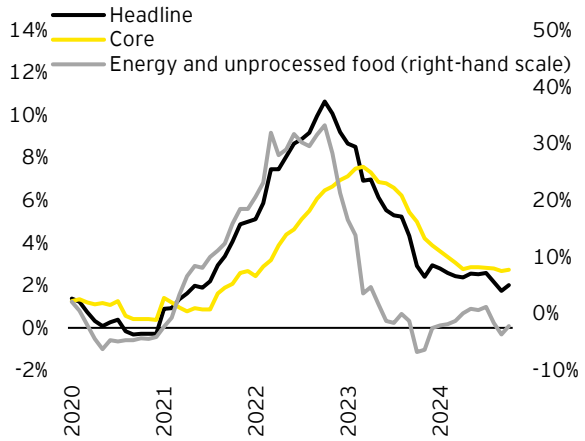
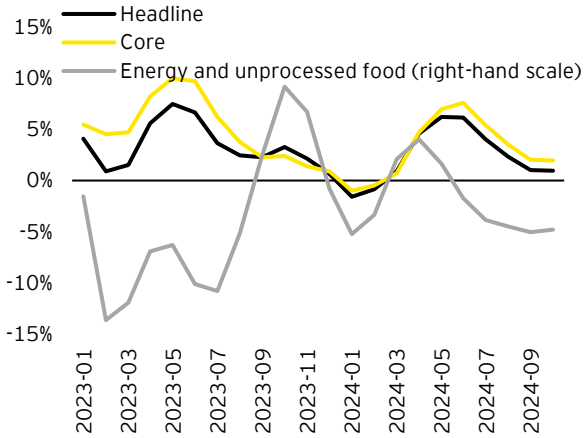


Figure 24: Inflation rate, Eurozone – 3-month on 3-month annualized % change



Source: EY elaborations on Eurostat data. The headline measure considers all goods in the basket used to calculate the price change; the core measure considers the goods in the headline basket excluding energy and unprocessed food. The rates refer to the harmonized rates. Last observation: October 2024.

Headline inflation (which includes all goods in the basket used to monitor price trends) stood at 2.0% in the Eurozone, down from the first half of the year (with an average of 2.5% between January and June). Meanwhile, core inflation (the underlying component)[47] continues to show higher values, at 2.7% in October, with a January-June average of 3.1%. A similar phenomenon occurred during the pandemic crisis when energy prices fell significantly due to the slowdown in global economic activity. A core inflation rate higher than the headline inflation rate indicates a faster rate of change in the underlying component compared to energy and fresh food products.

The downward trend in inflation is further confirmed by the quarterly analysis of the consumer price index. By calculating the annualized rate of change[48] of the quarterly average of the consumer price index compared to the previous quarterly average, it is evident that both headline and core inflation have progressively decreased in recent months. This decline is also attributed to the negative values recorded for energy products and fresh food.

Overall, it can be said that the European Central Bank's monetary policy has played a significant role in curbing the growth of the price level. However, it is important to note that not all cycles of monetary tightening in the past have successfully brought inflation back to the target of price stability. Achieving this goal is not guaranteed, both in terms of reaching the objective itself and the way it is achieved.

A soft landing—defined as reducing inflation without triggering a recession—is often challenging to achieve because it requires a delicate balance between two opposing forces: slowing down the economy to bring inflation back toward the target and avoiding the onset of a recession. Soft landings typically occur when inflation is at its lowest peak, especially when compared to core inflation (overall inflation excluding volatile

[46]The deposit facility rate is one of three key interest rates that the ECB sets every six weeks as part of its monetary policy decisions. This rate defines the interest that banks earn on their overnight (one working day) deposits with the central bank. The other two key interest rates are the main refinancing operations (MRO) rate and the marginal lending facility (MRO) rate. 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.en.html .

[47]Reference is made to the ISTAT definition of core inflation, which considers the consumer price index net of variations in energy products and fresh food products.

[48]The annualized rate of change is used to reflect the amount of change in a variable over a year if it had continued to grow at the specified rate. For more information, see https://www.dallasfed.org/research/basics/annualizing .

components such as food and energy). Other contributing factors include modest increases in unemployment, minor losses in the stock market, and anchored inflation expectations. In contrast, hard landings often coincide with a financial crisis, a prolonged slowdown in lending to businesses and households, and high unemployment, even when interest rates are quickly reduced. These rate cuts usually do not significantly impact inflation outcomes. In the current restrictive monetary cycle, elements within the trend of inflation and the Eurozone economy suggest that a hard landing will be avoided, provided there are no new negative shocks to the economy.[49]

With the reduction in the inflation rate and a still high, though decreasing, level of monetary policy interest rates, real interest rates have returned to positive values since the end of 2023. They have now reached levels similar to those experienced between 2013 and 2016.

Figure 25: Real interest rate, Eurozone – Households

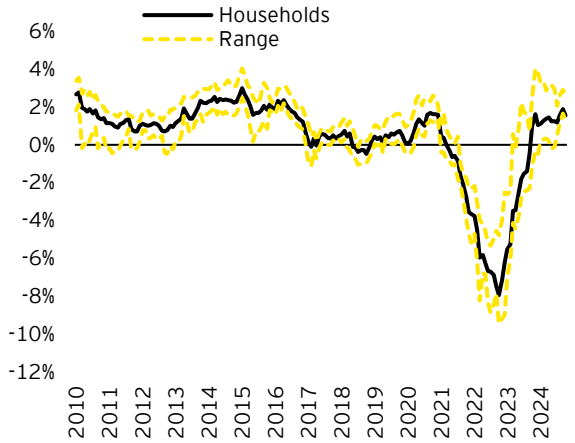
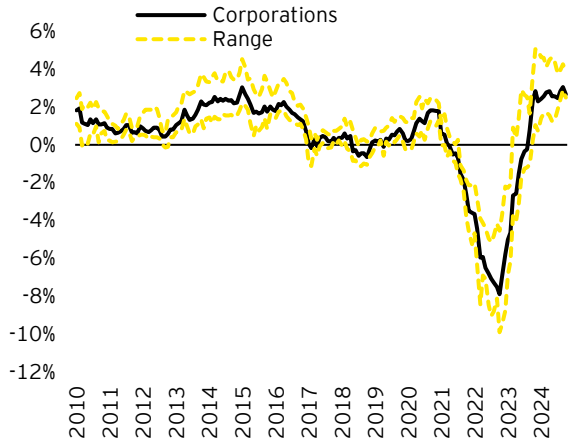


Figure 26: Real interest rate, Eurozone – Corporations



Source: EY elaborations on Eurostat, ECB data. Households data refer to the purchasing of a house. Last observation: October 2024.

In addition to the actual level of real interest rates, expectations about future real interest rates also significantly influence the investment and consumption decisions of businesses and households.[50] These expectations are shaped by various factors, including how economic agents adjust their outlook based on the trajectory of monetary policy. Data from the Consumer Expectations Survey[51] indicate that consumers with a high level of financial literacy adjust their expectations more rapidly than those with lower financial literacy. This suggests that a higher degree of financial literacy could potentially enhance the transmission mechanisms of monetary policy, encouraging consumers to act in alignment with the central bank's objectives.[52]

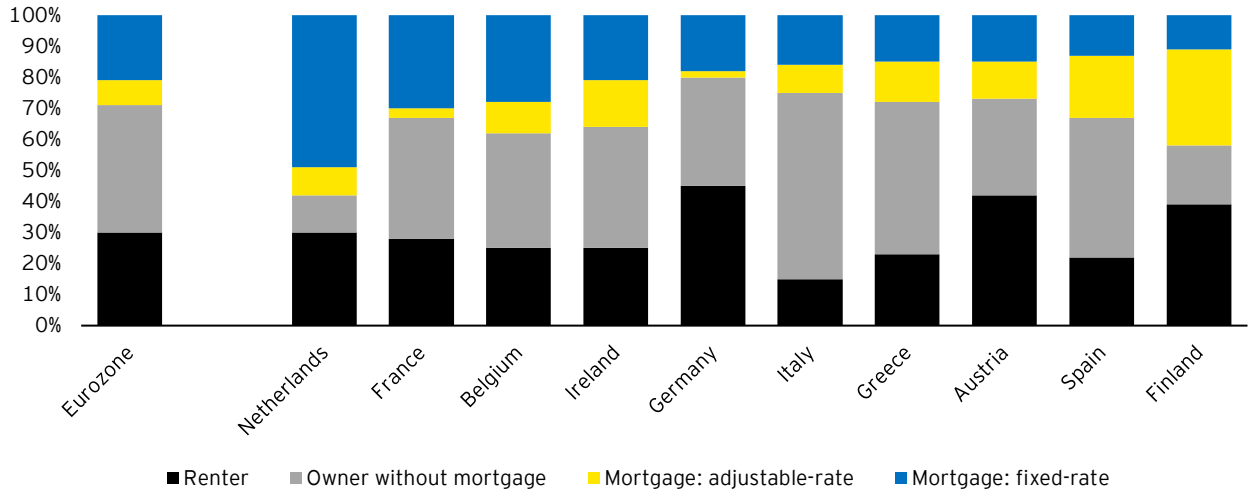
Among the various types of investments affected by interest rate trends, household real estate investments are particularly noteworthy. Lower interest rates can encourage households to consider purchasing and financing a home through a mortgage. Conversely, higher interest rates might prompt them to delay this decision. This underscores the significant role that consumers' expectations about interest rates play in the transmission of monetary policy, making it an important factor for the European Central Bank to consider.[53,54]

Focusing on the real estate market and household expectations, it is important to emphasize that the transmission of monetary policy is closely tied to the housing and mortgage status of households. In this

[49]The ECB Blog (2024) - Delivering a soft landing: a historical perspective of monetary policy cycles.
[50]The ECB Blog (2024) - Monetary policy transmission: why consumers' housing situations matter.
[51]The Consumer Expectations Survey (*CES*) collects high-frequency information on euro area consumers' perceptions and expectations about the economy, as well as on their economic and financial behaviour. The survey helps the European Central Bank pursue its price stability mandate by improving the analytical basis of the ECB's economic and monetary analysis. This, in turn, improves the understanding of the financial vulnerabilities of the household sector and the challenges to financial stability. For more information, see https://www.ecb.europa.eu/stats/ecb_surveys/consumer_exp_survey/html/index.en.html .
[52]The ECB Blog (2024) - Rate hikes: How financial knowledge affects people's reactions.
[53]Bernanke, B. S., & Gertler, M. (1995). Inside the black box: the credit channel of monetary policy transmission. Journal of Economic perspectives, 9(4), 27-48.
[54]Mishkin, F.S., (2007). Housing and the monetary transmission mechanism, NBER Working Paper 13518.

context, four potential categories of households or consumers can be identified: tenants, homeowners without a mortgage, homeowners with a fixed-rate mortgage, and homeowners with a variable-rate mortgage.

Figure 27: Housing and mortgage conditions of families – % over total



Source: Consumer Expectations Survey data, February 2024.

Due to variations in the composition of households in terms of housing and mortgage status across the Eurozone, the transmission of the European Central Bank's monetary policy has likely been quicker in countries with a higher proportion of homeowners with variable-rate mortgages and slower in those with a greater share of fixed-rate mortgages.[55]

Beyond the real estate channel, another important channel through which monetary policy impacts the real economy is the bank credit channel. A recent study has demonstrated that the increases in the ECB's key interest rates between July 2022 and September 2023 significantly dampened GDP growth and inflation, partly due to the response of the supply of bank credit.[56]

In this regard, the information provided by the latest edition of the Eurozone Bank Lending Survey[57] offers some interesting insights.[58]

[55]The ECB Blog (2024) - Monetary policy transmission: why consumers' housing situations matter.
[56]Conti, A. M., Neri, S., & Notarpietro, A. (2024). *Credit strikes back: the macroeconomic impact of the 2022-23 ECB monetary tightening and the role of lending rates* (No. 884). Bank of Italy, Economic and Financial Issues (Occasional Papers).
[57]The Bank Lending Survey (BLS) has been conducted since January 2003 by the national central banks of the countries that have adopted the single currency in collaboration with the European Central Bank. It is addressed to credit policy makers of the main banks in the area (about 150). The survey allows to highlight in a distinct manner, on the one hand, the factors that influence the supply of credit as well as the terms and conditions practiced to customers and, on the other, the trend of the demand for credit with the related determinants.
[58]The euro area bank lending survey - Second quarter of 2024.

Figure 28: Credit standards for bank loan supply to businesses, Eurozone – net percentage of respondents

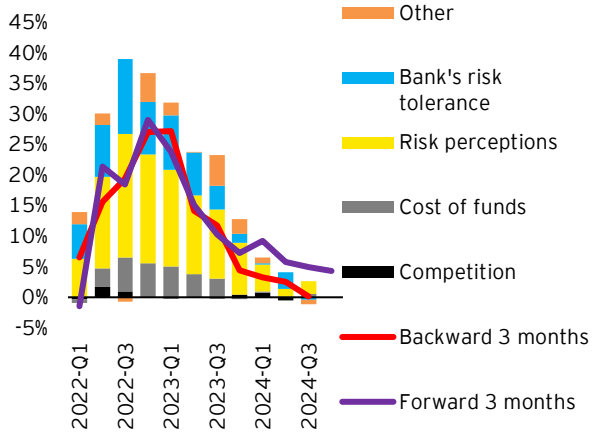
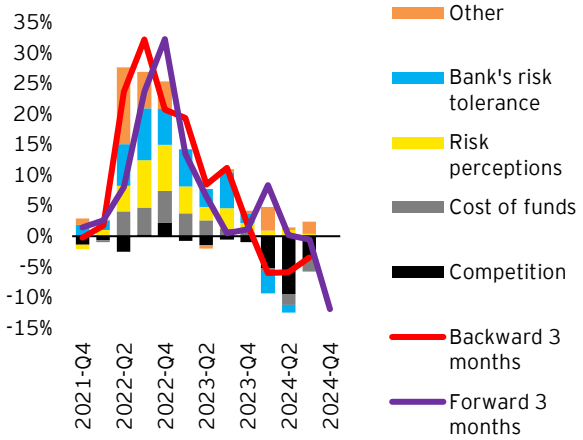


Figure 29: Credit standards for bank loan supply to households, Eurozone – net percentage of respondents



Source: EY elaborations based on European Central Bank data (Bank Lending Survey). For households, this refers to the supply conditions for home loans. Net percentages are defined as the difference between the sum of the percentages of banks responding, "significantly tightened" and "slightly tightened" and the sum of the percentages of banks responding 'slightly loosened' and "significantly loosened" in reference to the change in credit conditions. Net percentages for responses to questions on contributing factors are defined as the difference between the percentage of banks reporting that a particular factor contributed to tightening and the percentage of banks reporting that it contributed to loosening.

Regarding the provision of bank credit to businesses, Eurozone banks reported that they maintained their lending conditions unchanged in the third quarter of 2024 (net share of banks at 0%), following more than two years of tightening conditions.

Banks' risk perceptions related to the economic outlook and specific situations of firms continued to have a mildly restrictive impact. The cost of funds, banks' balance sheet constraints, their risk tolerance, and competition had a broadly neutral impact, similar to previous quarters. Notably, in some major economies, risk perceptions led to different outcomes: risk perception acted as a tightening factor in Germany and as an easing factor in Spain. In Q4 2024, Eurozone banks expect a moderate net tightening of corporate lending (net rate of 4%), affecting both loans to small and medium-sized enterprises and large companies, regardless of the loan duration (short or long term).

In relation to loans to households, specifically for house purchases, Eurozone banks reported a further net easing in lending conditions (net share of banks -3%). This marks the third consecutive net easing after credit conditions tightened in 2022-23. The net easing was slightly more pronounced than banks had anticipated in the previous quarter (-1%). This easing was almost exclusively driven by French banks, which reported strong easing, while German banks reported moderate net tightening, and banks in other Eurozone countries reported broadly unchanged overall conditions.

Additionally, it is worth noting that credit risk has gradually increased in recent quarters, although it has not reached the levels of deterioration suggested by the main measures of bank credit risk based on historical patterns in the face of a weak economic outlook for the Eurozone, higher interest rates, and a growing number of bankruptcies. Part of this containment of credit risk on bank balance sheets can be attributed to banks actively reallocating their portfolios towards safer assets since the beginning of the monetary tightening cycle, thereby reducing potential risks to their balance sheets.[59]

Regarding the labor market trend, it continues to show signs of robustness, albeit with a slight cooling. One tool that helps analyze its dynamics is the Beveridge curve, which examines the relationship between the unemployment rate and job vacancies (job vacancy rate).[60] This curve provides insights into the health

[59] Barbiero, F., & Dimou, M. (2024). Credit risk and bank lending conditions. Economic Bulletin Boxes, 4.
[60]The job vacancy rate is defined as the ratio of the number of vacancies to the sum of the number of occupied posts and the number of vacancies. A vacancy is defined as a paid post 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 undertaking concerned; and (ii) which the employer intends to fill immediately or within a specific period of time. For more information, see https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Glossary:Job_vacancy_rate_(JVR) .

of the economy and the characteristics of the labor market. Typically, there is an inverse relationship between the two variables: a higher unemployment rate is generally accompanied by a lower vacancy rate, and vice versa. By analyzing the dynamics of the Beveridge curve across three main periods over the last 15 years—namely, the period from 2010 to 2014 (following the financial crisis and including the sovereign debt crisis), the period from 2015 to 2020 (including the pandemic), and the period from 2021 to 2024 (post-pandemic period characterized by increased uncertainty due to adverse geopolitical events) we can obtain valuable insights.

The segment of the Beveridge curve for the period 2021-2024 initially exhibited a steeper slope compared to the two previous periods, indicating a labor market where companies faced greater difficulty in finding the necessary workforce. This situation translated into increased bargaining power for workers, potentially leading to higher wage increases during negotiations. In recent quarters, there has been a decline in the vacancy rate, signaling a partial cooling of the labor market, while the unemployment rate has remained at historic lows (around 6% at the end of 2024). This labor market trend in the Eurozone has a dual effect on the inflation rate. On one hand, the reduction in the vacancy rate results in less upward pressure on wages, which in turn diminishes the support that higher wages can provide to consumption and price increases. On the other hand, the decrease in the inflation rate leads to an increase in the real income of households, potentially boosting consumption and, consequently, contributing to a rise in prices.

Figure 30: Beveridge Curve, Eurozone

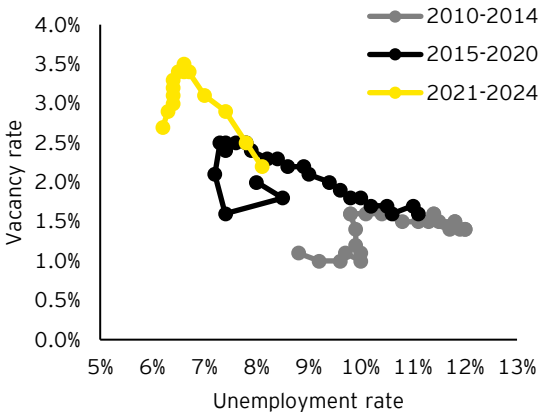
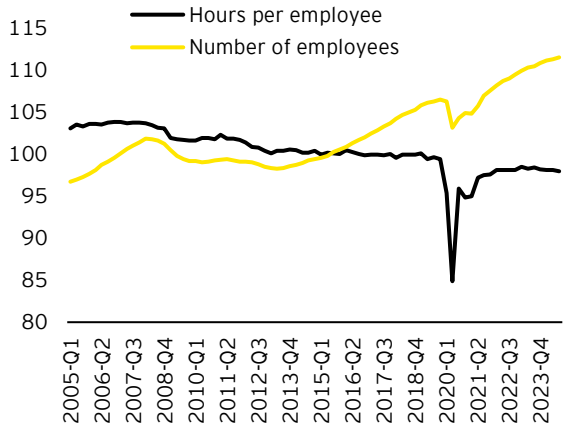


Figure 31: Hours per employee and number of employees, Eurozone – index, 2015=100



Source: EY elaborations on Eurostat data. Last observation: figure 30 – second quarter 2024; figure 31 – third quarter 2024.

Regarding the labor market, the number of employees continues to rise, reaching historical highs since 1995 (approximately 171 million people employed in the third quarter of 2024).[61] However, it is noteworthy that despite the increase in employment, the number of hours worked per employees is decreasing, indicating a transformation in the labor market.

This phenomenon is not limited to recent quarters, but represents a long-term structural trend,[62] as shown in Figure 31, and it does not only concern the Eurozone economies: average working hours in developed economies have been declining since the 19th century, halving for example between 1870 and 2000 in Germany.[63] Generally, the average number of hours worked in OECD countries decreased by about 0.5% per year between 1870 and the early 2000s, with the notable exception of the United States in the post-war period.[64] The structural reduction in the number of hours worked has also been explored in several

[61]Both employees and self-employed persons are considered. For more information, https://ec.europa.eu/eurostat/cache/metadata/en/namq_10_esms.htm .
[62]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.
[63]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 Labor Organization, Routledge, May 2007.
[64]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.

OECD reports;[65,66] studies have also found among the main factors supporting the decrease in average working hours over the last two hundred years not only the increase in workers' rights, but also technological progress.[67]

Regarding the labor market, an analysis of the latest available data in the Eurozone reveals that, compared to the pre-pandemic period (average values in 2019), real wages per hour worked in the third quarter of 2024 saw an average increase of 2.5%. This growth was primarily driven by a positive trend in the services sector (3.5%), in contrast to the industrial sector, which experienced essentially zero growth.

Figure 32: Real compensation by main branches of activity, Eurozone - % change 2019-2024-Q3

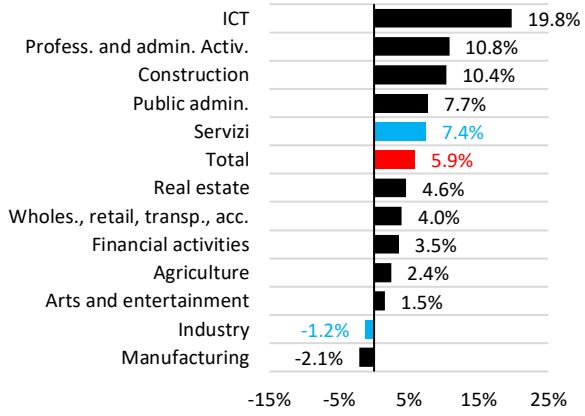
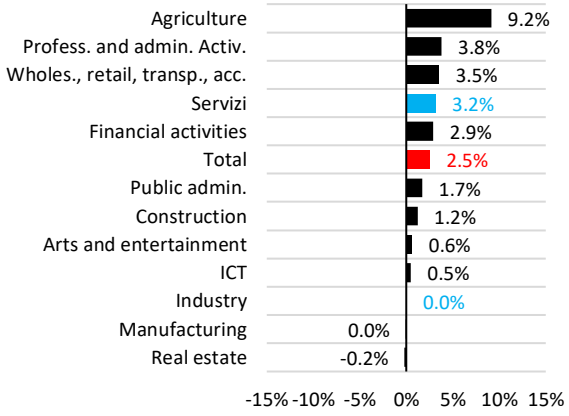


Figure 33: Real hourly earnings by main branches of activity, Eurozone – % change 2019-2024-Q3



Source: EY elaborations on Eurostat data.

Wage dynamics are anticipated to maintain positive momentum in 2024 and 2025, although at a slower pace than previously observed. While wage growth is expected to be a primary driver of inflation dynamics in 2024, a reduced contribution from profits to price level increases could lead to a more contained inflation trend. Specifically, by reducing demand and containing inflation expectations, the European Central Bank's restrictive monetary policy can limit the extent to which corporate costs are passed on to consumer prices.[68]

Overall, the situation in the Eurozone remains quite complex. On one hand, economic activity is largely stagnant, with the industrial sector continuing to exhibit signs of struggle. Restrictive monetary policy has significantly contributed to curbing the rise in price levels, but the process of reducing inflation has been progressing slowly in recent months, partly due to the positive dynamics in the labor market and wage growth.

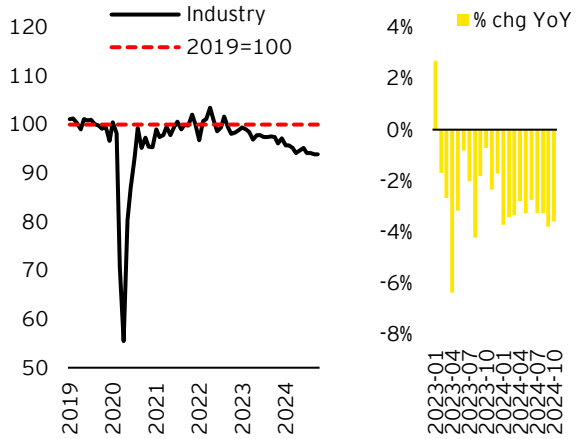
[65]OECD, "Working Hours: Latest Trends and Policy Initiatives," in "OECD Employment Outlook 1998: June" OECD Employment Outlook, Paris: Organization for Economic Co-operation and Development, 1998, pp. 153-188.
[66]OECD, "Working Time and Its Regulation in OECD Countries: How Much Do We Work and How?," in "OECD Employment Outlook 2021: Navigating the COVID-19 Crisis and Recovery" OECD Employment Outlook, Paris: Organization for Economic Co-operation and Development, July 2021.
[67]Greenwood, J., Vandenbroucke, G., (2005). Hours Worked: Long-Run Trends. NBER, Working Paper 11629.
[68]ECB (2024). "Monetary policy and the disinflation process", Speech by Philip R. Lane, Member of the Executive Board of the ECB, at the Banking & Payments Federation Ireland (BPFI) National Banking Conference.

The Italian economy

Real economic indicators

In recent months, Italian industrial production has continued its downward trend that began in the second half of 2022. In October 2024, the industrial production index stood at 93.9, more than 6 percentage points lower than in 2019. This marks a zero quarterly change compared to September 2024, following a contraction of 0.3% in September.

Figure 34: Industrial production index (average 2019=100) and % YoY change, Italy

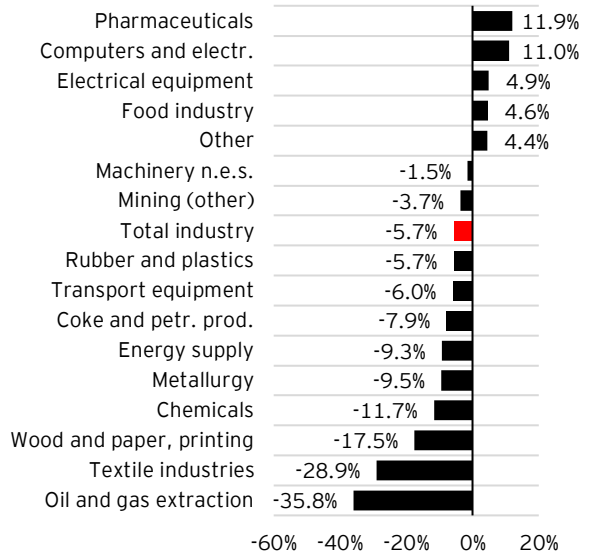


Source: EY elaborations on ISTAT data. The indices refer to the seasonally adjusted indices. Last observation: October 2024.

The negative trend in Italian industry is highlighted by analyzing the year-on-year growth, which compares the index's value to its value in the same month of the previous year. In October, industrial production contracted by 3.6% compared to October 2023, following a contraction of 3.8% in September and 3.3% in August. October marks the twenty-first consecutive month of negative year-on-year growth, dating back to February 2023.

Delving into the specifics of industrial production provides more precise information on which sectors continue to record lower production levels compared to the pre-pandemic period.

Figure 35: Industrial production index by industrial sector, Italy – average % change in the first ten months of 2024 compared to the average of the first ten months of 2019



Source: EY elaborations on ISTAT data. Machinery n.e.s.: Manufacture of machinery and equipment not elsewhere specified.

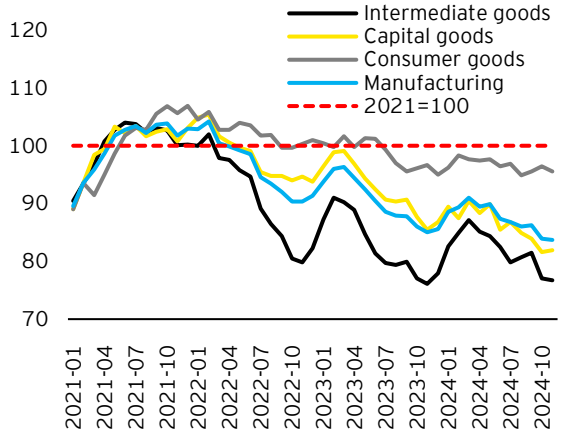
In this context, the pharmaceutical industry, computer and electronics manufacturing, and electrical equipment manufacturing are the top three sectors with positive performance in the first ten months of 2024 compared to the same period in 2019, with growth rates of 11.9%, 11.0%, and 4.9%, respectively.

Conversely, the oil and gas extraction sector, the textile industry, the wood and paper products industry, and the production of chemical products remain significantly below pre-crisis levels, with production down by 5.8%, 28.9%, 17.5%, and 11.7%, respectively.

The challenging situation of the Italian industrial sector is also reflected in the declining

business confidence, which has been on a downward trend since the end of 2021, as indicated by the latest results of the ISTAT survey on the confidence of manufacturing companies.[69]

Figure 36: Manufacturing business confidence, Italy – index, 2021=100



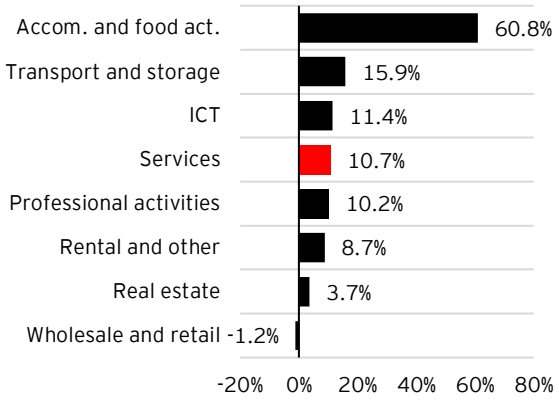
Source: EY elaborations on ISTAT data. Intermediate goods: goods used as input to a production process; Capital goods: goods used for the production of other goods (machines, means of transport, etc.), intended to be used for a period longer than one year; Consumer goods: goods used without further transformation for the direct satisfaction of individual or collective needs (based on their duration they are distinguished into durable consumer goods and non-durable consumer goods). For more information, https://www.istat.it/storage/IstatData/Coeweb/Glossario.pdf .

Analyzing the index in detail and considering some of its main components, it is evident that the confidence climate among manufacturing companies producing intermediate goods is experiencing a more pronounced decline compared to other components.

This trend is potentially linked to the overall weakness of the Eurozone industry, particularly in Germany, which is a major market for Italian intermediate products. A negative performance in the German industry translates into lower demand for intermediate goods, subsequently leading to a slowdown in the Italian sector.

Turning attention to the services sector, which accounts for more than 70% of the value added in Italy, there has been a substantial recovery in turnover volume. The first nine months of 2024 saw growth of approximately 11% compared to the same period in 2021. However, this data reveals some heterogeneity among the different components of the sector, despite the overall positive trend observed in the main sub-sectors.

Figure 37: Service turnover volume index, Italy – average % change in the first nine months of 2024 compared to the average in the first nine months of 2021



Source: EY elaborations on ISTAT data.

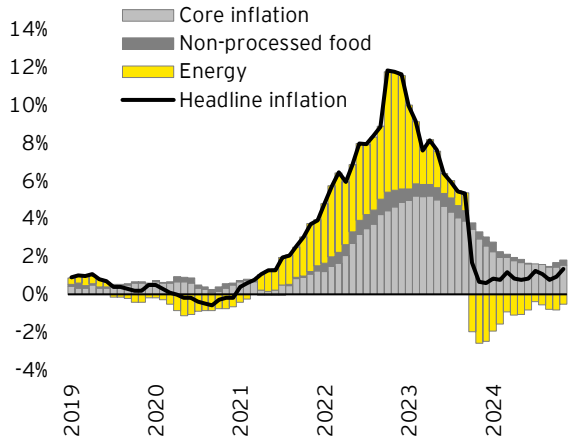
Specifically, it is noteworthy that the accommodation and food services sector is experiencing very high growth, with an increase of approximately 61% in the first nine months of 2024 compared to the same period in 2021. The growth rates for transport and storage services and ICT are more moderate, at around 16% and 11%, respectively. The only sector that has not yet recovered to 2021 levels is trade (retail and wholesale), which shows a turnover volume that is approximately 1.2% lower.

Price trends and the labor market in Italy

The growth of the consumer price index has remained subdued in recent months, continuing a trend that began at the end of 2023. In November 2024, overall inflation was 1.4%, up from the values recorded in the previous months (0.7% in September and 0.9% in October 2024). Despite the increase in inflation in November compared to the previous months, the values are still below the European Central Bank's target of 2%.

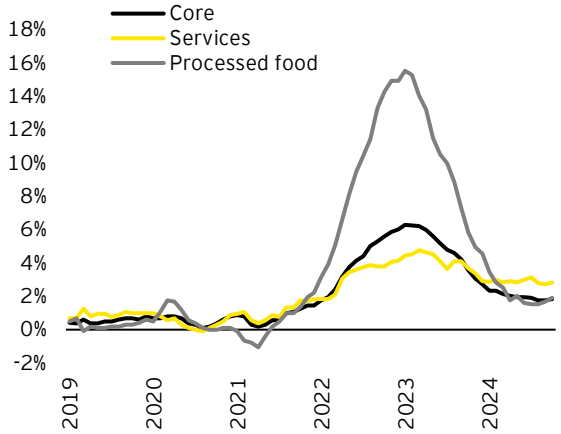
[69]The survey is aimed at detecting qualitative variables such as short-term (3 months) opinions and expectations of the main company variables (such as opinions and expectations on orders, production and liquidity; opinions on finished product inventories; expectations on employment and sales prices) and assessments of the general situation of the Italian economy. Further information is requested on a quarterly basis on various aspects of the company (such as production capacity, number of hours worked, new orders, raw material inventories, export volume, obstacles to production, duration of assured production and degree of plant utilization) and on the competitive position of the company. The unit of detection and analysis is the company.

Figure 38: Headline inflation and components, Italy – % YoY change and percentage points



Source: EY elaborations on ISTAT data. Last observation: November 2024.

Figure 39: Core inflation and components, Italy – YoY % change



Source: EY elaborations on ISTAT data. Last observation: November 2024.

The weak growth in the consumer price index is primarily due to energy products, which have continued to restrain price increases in recent months. Specifically, within the energy sector, the negative contribution comes from the prices of non-regulated goods, which recorded a contraction of 6.6% in November, following declines of 10.2% in October and 11% in September 2024.

Core inflation (which excludes unprocessed food and energy goods) stood at 1.9% in November, slightly higher than the 1.8% recorded in both September and October. This indicates a persistent trend in core inflation during the second half of the year. One of the main factors contributing to this persistence is the service price index, which showed a growth of 2.8% in November, following values just under 3% in the previous two months (2.7% in October and 2.8% in September). Conversely, inflation for processed food goods is on the rise, reaching 2.4% in November after 1.7% in October.

Recent studies confirm the significant role of the food and energy components in headline inflation.[70] This phenomenon is not unique to Italy: due to the international nature of the pandemic and the geopolitical shock from Russia's invasion of Ukraine,[71] the potential inflation triggers are largely common across all major Eurozone countries and beyond. These factors include substantial increases in energy and food prices, disruptions in supply chains, attempts by companies to increase profit margins, heightened short- and long-term inflation expectations, labor market tensions, and the rigidity of real wages.

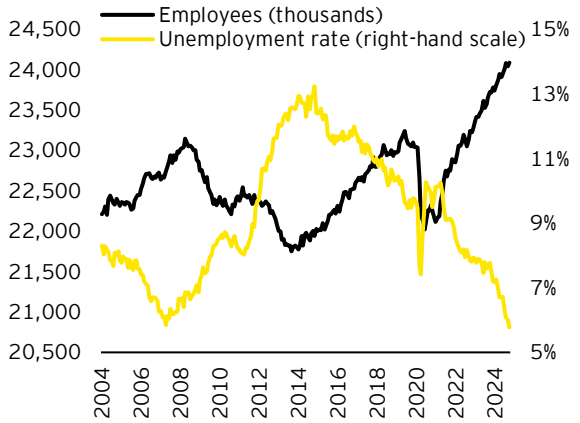
It is also important to note that in Italy, unlike the 1970s, the mechanism that could have triggered a wage-price spiral (where an initial supply shock leads to a price increase, which then propagates through wages and becomes entrenched in inflation expectations) has not materialized. Although the inflation increase due to commodity price shocks have been substantial, they have also been relatively short-lived.[72]

The rigidity of the labor market has not yet resulted in strong wage pressures. This indicates that the cooling of the labor market in Italy and the Eurozone does not seem to be the main driver of inflationary pressures.[73]

[70] Pisani, M., Tagliabracci, A. (2023). What Caused the Post-Pandemic Inflation in Italy? An Application of Bernanke and Blanchard (2023). An Application of Bernanke and Blanchard.
[71] Ropele, T., Tagliabracci, A. (2024). "Perceived economic effects of the war in Ukraine: survey-based evidence from Italian firms", Applied Economics Letters, vol. 31(4), pages 275-280, February.
[72] Corsello, F., Gomellini, M., Pellegrino, D. (2023). "Inflation and energy price shocks: lessons from the 1970s", Questioni di Economia e Finanza (Occasional Papers) 790, Bank of Italy, Economic Research and International Relations Area.
[73] Lo Bello, S., & Viviano, E. (2024). Some considerations on the Phillips Curve after the pandemic. Bank of Italy Occasional Paper, (842).

Regarding the labor market, the latest data indicate a high number of employees compared to historical figures (approximately 24.1 million in October, an increase from the previous month's figure), along with an unemployment rate of 5.8%.

Figure 40: Employees and unemployment rate, Italy



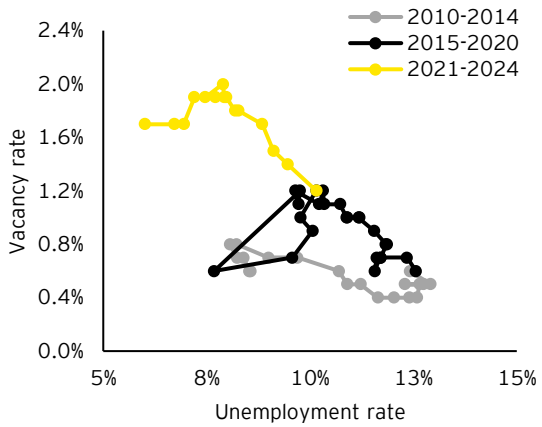
Source: EY elaborations on ISTAT data. Last observation: October 2024.

It is also important to highlight that, since the beginning of 2022, the majority of new hires have been on permanent contracts (over 1.2 million), which is a positive factor for supporting consumption and growth.

As observed in the analysis of the Eurozone labor market, the Beveridge curve provides valuable insights into the current state of the labor market in Italy as well. When breaking down the dynamics of the Beveridge curve into three reference periods—2010-2014, 2015-2020, and 2021-2024—we see that in the third period, the vacancy rate reached unprecedented levels, while the unemployment rate approached and then fell below the 2010 level (around 6% at the end of 2024).

What distinguishes the Beveridge curve segment for the period 2021-2024 from the other two periods is not only the declining unemployment rate but also the high vacancy rate. This indicates a labor market where employers are struggling to find the necessary employees to sustain economic activity.

Figure 41: Beveridge Curve, Italy

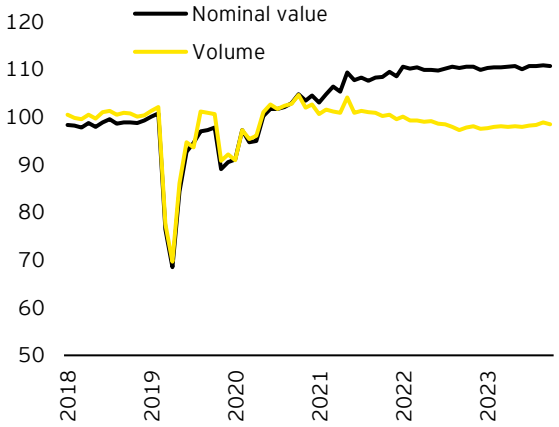


Source: EY elaborations on ISTAT data. Last observation: third quarter 2024.

It is also noteworthy that in the final quarters of 2024, the slope of the Beveridge curve has substantially reversed, indicating a simultaneous reduction in both the vacancy rate and the unemployment rate.

The positive trend in employment is also reflected in the trends of retail sales and household consumption expenditure.

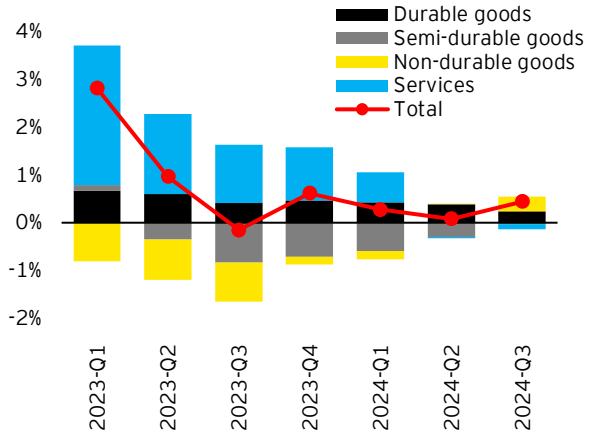
Figure 42: Retail trade turnover, Italy - index, 2021=100



Source: EY elaborations on Eurostat data. Last observation: October 2024.

Although a significant gap remains between nominal and turnover volume in retail trade (due to the inflation), the decline in turnover volume appears to have halted and partially reversed since the beginning of 2024.

Figure 43: Final consumption of households by category of goods, Italy – % change YoY and percentage points



Source: EY elaborations on ISTAT data.

The positive trend in the labor market is also reflected in household final consumption expenditure, which recorded a year-on-year growth of 0.4% in the third quarter (equivalent to a quarterly growth of 1.3%). This growth was mainly driven by an increase in the consumption of durable and non-durable goods, the latter of which had been decreasing or stagnant for several quarters.

Overall, the Italian economy remains characterized by substantial weaknesses, including high interest rates and a struggling industrial sector, while the service sector demonstrates greater dynamism. However, signals from the labor market are encouraging, with the number of employees at historic highs and a slight recovery in household consumption. Additionally, inflation remains contained.

Focus: the automotive sector in the Italian industry

Main messages:

1. *The automotive sector[74] accounts for approximately 1% of the value added of the Italian economy, or about 4.5% of the value added of the industrial sector. When considering the extensive and complex production chain, the automotive sector represents around 3.4% of the national GDP.*
2. *The current crisis in the automotive sector can be examined from the perspectives of foreign and domestic demand. Regarding foreign demand, between 2008 and 2022, about 40% of the sector's turnover was generated by exports, with this percentage increasing in recent years. This has made the sector more vulnerable to changes in external market conditions.*
3. *In terms of domestic demand, the decline in households' intentions to purchase new cars, coupled with an increase in the purchase of used cars, high interest rates, and greater pressure from foreign competitors, has negatively impacted the production performance of the automotive sector.*
4. *The automotive sector faces significant future challenges, including the transition to lower-emission mobility, increased foreign competition, the economic slowdown of some of its main markets (and related industries), and the introduction of new potential measures that could distort free trade.*

Recent data on the performance of Italy's industrial sector indicates a severe crisis. Although there is some variability in the performance of different industrial sectors, with some expanding compared to pre-pandemic levels (2019), the overall trend is negative. In this context, the automotive sector is particularly noteworthy, not only for its recent dynamics but also for the profound transformation it is undergoing and is expected to undergo in the future. Additionally, the sector's complex interconnections with other Eurozone countries significantly influence its performance.

A deeper analysis of the automotive sector within Italian industry is especially relevant given its role in the broader Italian economy. The value added generated by the automotive sector, divided into its three main sub-sectors (manufacturing of motor vehicles, manufacturing of bodies for motor vehicles, trailers and semi-trailers, and manufacturing of parts and accessories for motor vehicles and their engines), accounted for approximately 1% of the country's total value added in 2022, or about 4.5% of the total value added of the industrial sector (excluding construction). However, when considering the entire automotive production chain (identified here as the ATECO sector [29], manufacturing of motor vehicles, trailers, and semi-trailers), this figure becomes even more significant, representing approximately 3.4% of GDP.[75] The automotive industry supply chain is important not only for its size but also for its breadth, encompassing sectors such as metal product manufacturing, machinery and equipment manufacturing, metallurgical activities, rubber and plastics manufacturing, wholesale trade, and many others.

For these reasons, examining the recent dynamics characterizing the automotive sector holds significant value at this historical moment. By adopting a long-term perspective, it is also possible to identify the structural factors underlying these recent dynamics, enabling a more comprehensive analysis.

[74] In this study, reference is made only to the ATECO sector [29], Manufacture of motor vehicles, trailers and semi-trailers. The ATECO sector [45], Wholesale and retail trade and repair of motor vehicles and motorcycles, has not been taken into account.
[75] The data was calculated using the Input-Output tables provided by ISTAT.

Figure 44: Industrial production and automotive production index, Italy – 2001=100

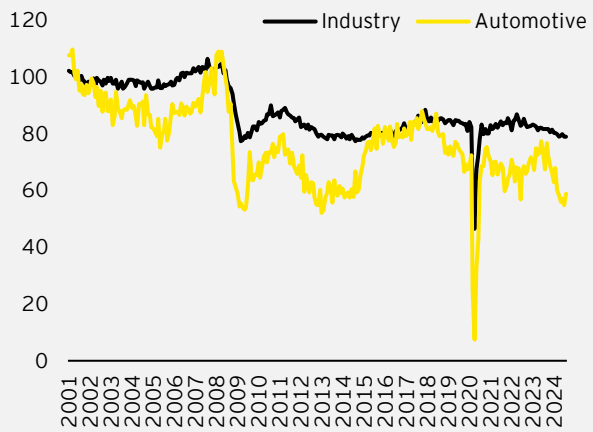
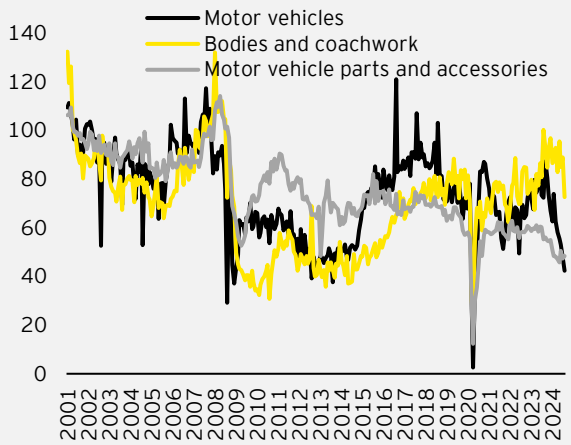


Figure 45: Detail of the automotive production index, Italy – 2001=100



Source: EY elaborations on ISTAT data. Last observation: October 2024.

Let's begin by examining the performance of the automotive industry production. After peaking around 2008, the industry experienced a collapse, followed by a period of substantial stabilization in production levels until 2015. This was then followed by a recovery (initially rapid, then slower), which eventually halted, giving way to a significant decline in production in recent years. Delving into the details of automotive industrial production, we can observe differences in the trends of the index components. The parts and accessories component, for instance, has seen a substantial reduction since the period post the financial crisis. In contrast, the automotive manufacturing component showed a partial recovery from 2014 to 2019, regaining some of the losses incurred during the financial crisis and subsequent sovereign debt crisis. Meanwhile, the production of bodies, trailers, and semi-trailers experienced a different trend, with a steady increase following the collapse in 2009, except for a dip during the pandemic crisis. It is important to note that, in terms of production value, the manufacture of motor vehicles and the manufacture of parts and accessories for motor vehicles and their engines represent approximately 94% of the total (56% and 38% respectively in 2022), thus largely determining the direction of industrial production in the automotive sector.

To understand the main drivers behind these dynamics, one possible approach is to consider the roles of domestic and foreign demand for automotive products, specifically for the manufacturing of motor vehicles and related parts and accessories.

Firstly, it is important to highlight that the turnover generated by motor vehicle exports averaged around 40% of the total turnover between 2008 and 2022, with an increase in recent years (averaging 52% between 2019 and 2022). In contrast, the turnover from the manufacturing of parts and accessories saw just under 30% generated by exports during the same period.

Focusing on the manufacturing of motor vehicles and analyzing the trends in production and exports, we can identify some interesting dynamics. For example, between 2009 and 2014, a stable level of motor vehicle production corresponded with an increase in motor vehicle exports. This is reflected in the rise in the percentage of turnover from the sale of motor vehicle manufacturing products abroad (about 44% in 2015 compared to 37% in 2008). The increase in foreign demand for this category of products allowed for a stable level of production during those years.

Figure 46: Export volume and production, motor vehicle, Italy – index, 2001=100

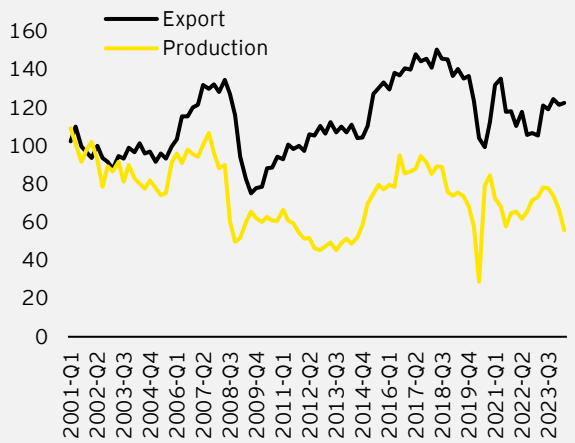
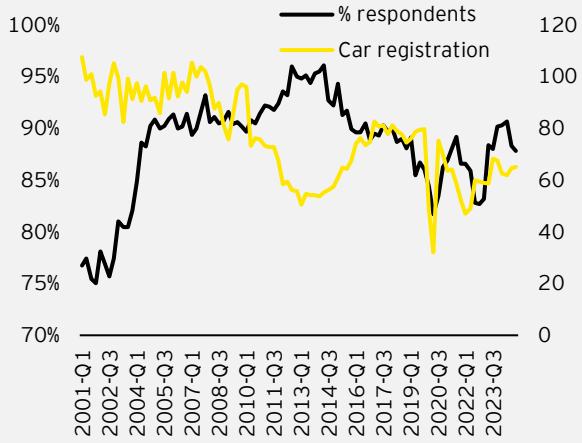


Figure 47: % of respondents declaring that they do not intend to buy a vehicle in the next 12 months and car registrations (index, 2001=100), Italy



Source: EY elaborations on ISTAT data, Oxford Economics. The percentage of respondents refers to families who answered "certainly not" or "probably not" to the question on their intentions to purchase a car within the next 12 months.

As the "dependence" on foreign demand increased, the trend in car production closely followed the trend in exports. However, recent quarters have shown a different dynamic, where despite an increase or stable maintenance of exports, industrial production has suffered a significant decline. This decline can be partly attributed to a reduction in the number of families intending to purchase a car during the recent period under analysis.

When discussing the latest car production data, it is also important to consider the growing used car market, which recorded a growth of 7.5% between January and September 2024 compared to the same period in the previous year.[76]

Figure 48: % change in the volume of motor vehicle exports by geographical area between 2018 and 2023, Italy – percentage points

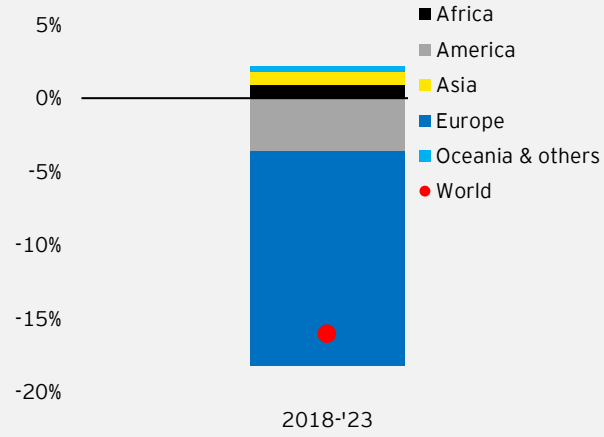
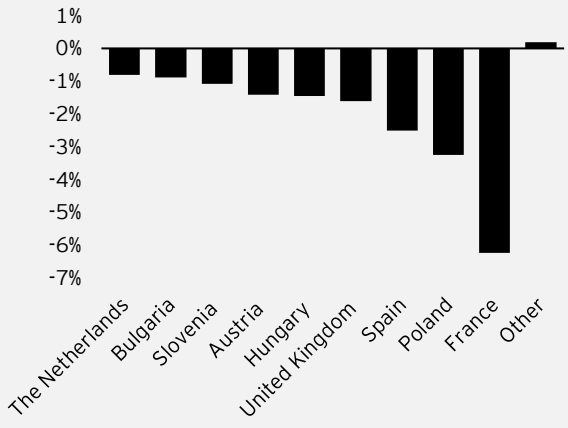


Figure 49: Contribution to the % change in the volume of motor vehicle exports to Europe between 2018 and 2023, Italy – percentage points



Source: EY elaborations on ISTAT data.

Another factor to consider is consumer credit, and the data shows lower flows in the second quarter of 2024 compared to previous quarters (approximately 3 billion euros in the second quarter of 2024,

[76]UNRAE, November 25, 2024. For more information, https://unrae.it/sala-stampa/autovetture/6937/dopo-il-calo-di-agosto-lauto-usata-torna-in-positivo-settembre-a-06 .

compared to an average of around 8 billion euros between the first quarter of 2022 and the first quarter of 2024). This reduction in consumer credit could potentially influence the purchase of new cars.

Regarding the decline in the volume of motor vehicle exports between 2018 and 2023, it is important to note that the European market experienced the greatest contraction during this period (-19%). Within Europe, the most significant declines were observed in France, Poland, and Spain.

In addition to exports, another factor to consider is the import of automotive products. While the overall volume of automotive imports decreased between 2018 and 2023, this reduction is the result of varying dynamics across different geographical areas. The decrease in imports is primarily attributable to a reduction in imports from Europe, whereas imports from Asia increased during the same period. Specifically, the increase in imports is mainly linked to a rise in imports from China, which, unlike the period before 2018, has been exporting more and more cars.

Figure 50: % change in the volume of imports of automotive products by geographical area in the selected years, Italy – percentage points

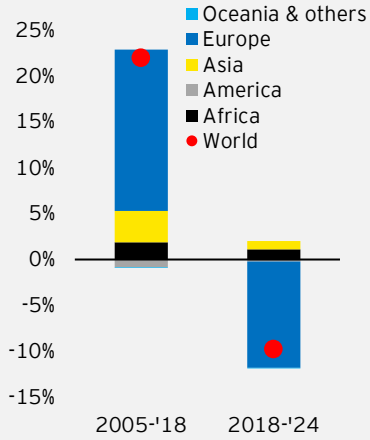


Figure 51: % change in the volume of imports of automotive products from Asia in the selected years, Italy – percentage points

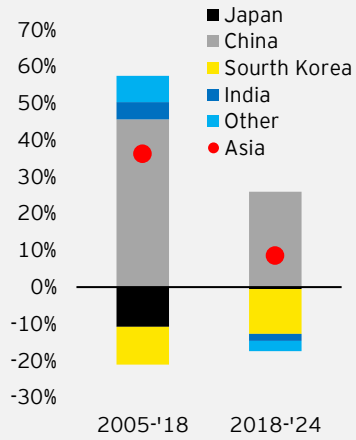
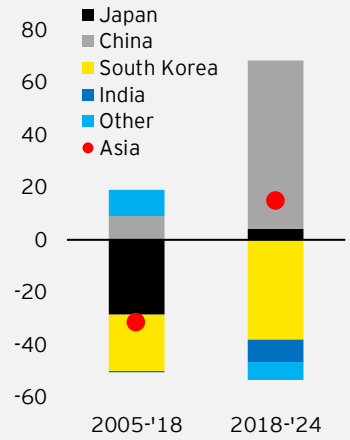


Figure 52: % change in the volume of imports of passenger cars from Asia in the selected years, Italy – percentage points



Source: EY elaborations on ISTAT data.

Asian competition, particularly from China, is a key factor to consider when examining the potential future developments of the automotive sector in Italy, especially in the context of transitioning towards low-emission mobility.

To achieve the goal of climate neutrality by 2050, the European Union is implementing measures to reduce emissions from cars, as road transport accounts for one-fifth of the EU's CO2 emissions. The objective is to reduce car emissions by 55% and van emissions by 50% by 2030, compared to 2021 levels, with the ultimate goal of achieving zero emissions for new cars and vans by 2035.[77]

In this context, China emerges as a significant competitor in the production of cars for future mobility. The country possesses the necessary raw materials for producing key components of electric vehicles, as well as advanced know-how.

Additionally, there are further complexities related to the weakness of the German industry, which is the primary market for intermediate goods produced by the Italian automotive sector. In 2023, Germany accounted for approximately 19% of Italy's automotive product exports. However, in the first nine months of 2024 (January-September), the volume of exports to the German market decreased by about 13% compared to the same period in 2018.

[77]For more information, https://www.europarl.europa.eu/topics/it/article/20180920STO14027/cars-vans-and-pollution-the-new-targets-for-emissions.

Additional risk factors for the Italian automotive industry include potential new US protectionist measures (noting that the United States accounts for about 13% of Italy's automotive product exports), as well as uncertainties regarding the persistence of high interest rates, which increase the cost of consumer credit for purchasing items such as cars.

The Italian Economy: GDP and EY Forecasts

In the third quarter of 2024, GDP growth was flat (0.0%), resulting in a year-on-year growth rate of 0.4%. GDP was primarily supported by domestic demand, particularly household consumption, which saw a quarter-on-quarter increase of 1.4%. Conversely, investments contributed negatively, with a contraction of 1.2%. Foreign demand also had a negative impact on growth, due to a decline in exports (-0.9%) and an increase in imports (1.2%).

The positive trend in household consumption can be partly attributed to the favorable labor market conditions, the recovery of real incomes, and the steady, albeit slow, growth in consumer confidence. This increase in consumption was also reflected in the rise in imports, which grew by 1.2% in the third quarter of 2024.

Figure 53: GDP components, Italy – contributions to growth, percentage points

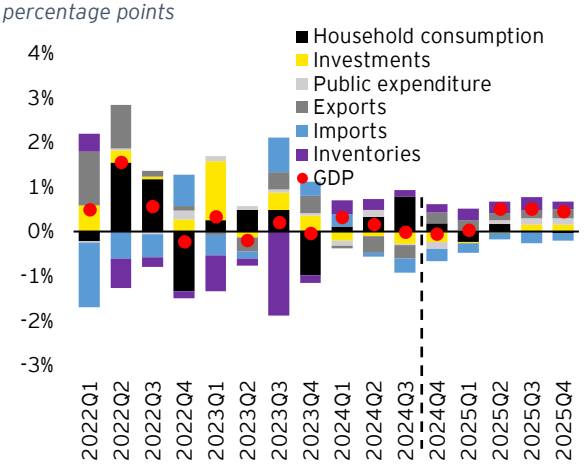
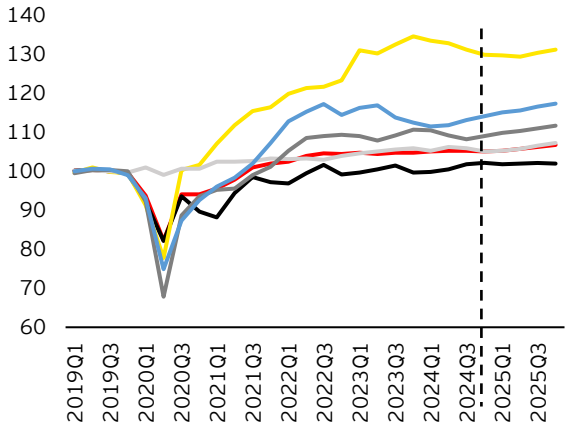


Figure 54: GDP components, Italy – index, quarterly average 2019 = 100



Source: EY elaborations on Eurostat data and EY forecasts. EY forecasts start from the third quarter of 2024. "Investments" refers to public and private investments, and includes gross fixed investments, acquisitions less disposals of valuables and depreciation.

Based on the information presented in the previous sections and the latest available data, EY's outlook for the Italian economy can be outlined. Following the essentially zero growth recorded in the third quarter of 2024, another quarter of nearly flat growth is anticipated. This is primarily due to a contraction in investments, minimal growth in household consumption, and a negligible contribution from foreign demand. Consequently, 2024 is expected to close with a GDP growth of 0.5%, mainly driven by an increase in private consumption (0.7%) and a contribution from foreign demand, which benefits from a contraction in imports (-2.0%) despite stagnant export growth.

In 2025, GDP growth is expected to slightly accelerate to 0.8%, driven by domestic demand components. While overall investments are projected to contract by 1.2%, largely due to a significant decline in housing investments (-10.9%) following the expiration of benefits from previous fiscal policies (e.g., "Superbonus 110%"). However, investments in machinery and intangible assets are expected to grow by 5.4% and 1.6%, respectively, partly due to a reduction in interest rates. The growth in private investments in machinery and household consumption (0.9%) will lead to an increase in imports (3.1%). Despite a recovery in exports (1.4%), the strong growth in imports will result in a negative contribution from foreign demand to GDP growth in 2025 (-0.4 percentage points).

Table 1: Economic forecasts for the Italian economy

	2020	2021	2022	2023	2024	2025
GDP, % change	-9.0%	8.8%	4.8%	0.8%	0.5%	0.8%
Household consumption, % change	-10.6%	5.8%	5.0%	1.0%	0.7%	0.9%
Investments, % change	-7.3%	21.5%	7.9%	8.7%	-0.2%	-1.2%
Exports, % change	-14.4%	14.2%	10.5%	1.1%	0.0%	1.4%
Imports, % change	-13.0%	16.0%	13.8%	0.0%	-2.0%	3.1%
Unemployment rate	9.3%	9.5%	8.1%	7.7%	6.7%	7.5%
Consumer price index, % change	-0.1%	1.9%	8.2%	5.6%	1.0%	2.0%
Deficit, % of GDP	-9.4%	-8.9%	-8.1%	-7.1%	-4.4%	-3.7%
Public debt, % of GDP	154.4%	146.0%	138.4%	134.7%	137.3%	137.1%

Source: forecasts from the EY Italy Macroeconometric Model, "HEY-MoM". The grey area represents the forecast horizon. The changes in GDP and its components are calculated on values in real terms. The item "Investments" refers to public and private investments, and includes gross fixed investments, acquisitions less disposals of valuables and depreciation. Historical growth rates may not coincide with ISTAT communications; this is due to statistical effects of aggregation of quarterly data (used in the HEY-MoM model) which led to possible discrepancies with annual values.

The labor market appears robust, with an unemployment rate of 6.7% in 2024, although it is expected to rise to 7.5% in 2025. Inflation estimates are improving, with inflation projected to increase from 1.0% in 2024 to 2.0% in 2025, aligning with the European Central Bank's target values.

The public deficit is expected at 4.4% in 2024 and 3.7% in 2025, while the public debt-to-GDP ratio is anticipated to slightly decrease, reaching 137.1% in 2025. These forecasts remain subject to significant uncertainty and present substantial risks, both downside and upside, primarily linked to the global macroeconomic context.

In a context of reduced investments in 2024 and 2025, with a contraction driven by the private investment component (-3.6% in 2024 and -2.3% in 2025), particularly due to a decline in housing investments, the role of public investments becomes even more crucial in supporting the growth of the Italian economy. In this regard, it is important to highlight the significance of the National Recovery and Resilience Plan (PNRR) not just for medium-to-long term growth, due to an increase in potential growth partly resulting from the complex reform program included in the Plan, but also in the short term, as it represents an important driving force in a context of declining private investments.

It is important to remember that the forecasts presented assume the actual implementation of the PNRR reforms and projects, based on the information available in the Court of Auditors' report on the state of implementation of the PNRR as of December 2024.[78] The report indicates a total expenditure of approximately 57.7 billion euros between 2020 and the third quarter of 2024 (September 2024),[79] out of the roughly 90 billion euros planned in the timetable outlined in the document. Based on this information, it can be assumed that the difference between the amount actually spent, and the amount planned by the end of 2024 will be utilized in the subsequent semesters (from the first semester of 2025 to the second semester of 2026).

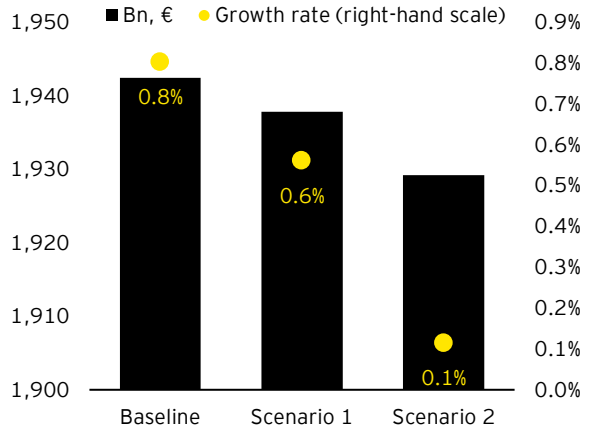
Considering the context described, econometric estimates were conducted on two alternative scenarios to identify the potential repercussions on growth from a partial implementation of the plan in 2025.

[78]Court of Auditors, Half-yearly Report on the PNRR (first and second half of 2024), December 2024. For more information, https://www.corteconti.it/HOME/StampaMedia/ComunicatiStampa/DettaglioComunicati?Id=4599c2da-38b4-443b-aca5-73ccfecea712 .
[79]Fifth report on the implementation status of the National Recovery and Resilience Plan. For more information, https://www.italiadomani.gov.it/content/sogei-ng/it/it/strumenti/documenti/archivio-documenti/quinta-relazione-al-parlamento-sullo-stato-di-adempimento-del-pia.html .

Specifically, the analysis of the PNRR's impact on growth under these possible implementation scenarios was carried out as follows:

1. Starting with the actual expenditure incurred, as quantified in the semestral report on the implementation of the PNRR of December 2024 (57.7 billion euros), the remaining amount to be spent (approximately 30.2 billion euros) to align with the spending plan outlined in the report (approximately 90 billion euros) by the end of 2024 was calculated.
2. The difference was then evenly distributed across the four remaining semesters (from the first semester of 2025 to the second semester of 2026). Additionally, for 2025 and 2026, the investments reported in the spending schedule in the Court of Auditors' report were included.
3. The estimated values were then allocated into spending categories, considering the expenses already incurred. For this purpose, we referred to the Fourth Report on the state of implementation of the PNRR.[80] Specifically, the following distribution of resources is assumed: 25% of total spending for the purchase of goods and services; 39% for public investments; 11% for social benefits; 24% for incentive grants to production units; and 1% for other spending purposes.
4. A delay of approximately one quarter in the actual spending of public investments ("time to spend") was assumed, considering the necessary bureaucratic formalities. This period is shorter than the four quarters assumed in a study by the European Commission (Pfeiffer et al., 2021),[81] based on the assumption that there are now established and efficient procedures for utilizing the resources.
5. Keeping a conservative approach, this exercise only considered the effects generated on public investments, leaving the related private investments unchanged.
6. The forecasts mentioned above (baseline scenario with full implementation of the plan) are complemented with two additional scenarios that assume a partial implementation of the PNRR. Specifically:
    a. *Scenario 1*: implementation of the plan at 90% of the resources estimated for 2025;
    b. *Scenario 2*: implementation of the plan at 70% of the resources estimated for 2025.

Figure 55: Real GDP (millions of €) and growth rate in the two implementation scenarios, Italy, 2025



Source: Elaborations from the Macroeconometric Model of EY Italy, "HEY-MoM".

Considering these two scenarios, in Scenario 1 (implementation of the plan at 90% of the estimated resources planned for 2025), GDP growth is estimated at 0.6%, which is 0.2 percentage points lower than the baseline scenario of full implementation.

In Scenario 2 (implementation of the plan at 70% by 2025), the Italian economy would experience growth of 0.1% in 2025, which is 0.7 percentage points lower than the baseline scenario. As previously mentioned,

[80]For more information, https://www.italiadomani.gov.it/content/sogei-ng/it/it/strumenti/documenti/archivio-documenti/quarta-relazione-al-parlamento-sullo-stato-di-adempimento-del-pia.html , table 27.
[81]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 work 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.

the resources from the PNRR represent a crucial lever for the growth of the Italian GDP in the coming year, especially in a context of still high interest rates that discourage private consumption and investment. The key element is that these resources are spent so to stimulate growth in the medium to long term as well.

Assumptions to forecasts

Forecasts and analyses are based on data available as of December 10, 2024.

The forecasts described above are based on a series of assumptions that outline the reference scenario. Specifically, the following hypotheses are considered:

- **Foreign demand for Italian goods**: overall growth of around 2% is expected in 2024, followed by a more dynamic growth in 2025 (growth of around 3%);
- **Natural gas**: the price of natural gas (referred to the Dutch Title Transfer Facility) in the last quarter of 2024 is assumed to be around 13.3 $/mmbtu; an average price of 13.0 $/mmbtu is assumed for 2025;
- **Oil**: Oil price is assumed to be around $75 per barrel at the end of 2024,[82] and to remain substantially stable in 2025 ($74 per barrel);
- **Exchange rate**: the euro/dollar exchange rate is assumed at 1.06 in the forecast horizon;
- **Public spending:** the projections contained in the 2025 Budget Program Document and the latest data on the public sector from ISTAT national accounting were considered;[83]
- **Monetary policy and interest rates**: A reduction in interest rates of 0.25 percentage points is assumed at the end of 2024, followed by a further reduction of 0.75 points in 2025. The long-term interest rate (10 years) is also expected to follow a similar path, but with a progressively increasing differential with the short-term rate.

Finally, considering the current scenario of strong uncertainty, downside and upside risks are listed below.

Upside risks

- Reduction of geopolitical tensions: Tensions related to ongoing conflicts, specifically the Russian-Ukrainian and Israeli-Palestinian conflicts, as well as recent events in Syria, could decrease in the short to medium term. This reduction in tensions could lead to greater stability in the macroeconomic framework, potentially resulting in positive effects on the prices of energy goods (mainly oil) and other commodities;
- Labor market: Reduced pressure from wages on the price level, thereby lowering the risk of sustained inflation;
- Monetary policy: Accelerated easing of monetary policy by the European Central Bank and reduced pressure on domestic demand;
- Readjustment of supply chains: A quicker realignment of value chains at the European and global levels would reduce pressure along these chains, resulting in greater supply security and enhanced global trade;

[82] Reference is made to the price of Brent.
[83] Budget Programming Document 2025. For more information, https://www.rgs.mef.gov.it/VERSIONE-I/attivita_istituzionali/previsione/contabilita_e_finanza_pubblica/documento_programmatico_di_bilancio/ .

- Increase in foreign demand for Italian goods and services: Increased economic growth in key trading partners such as China, Germany, and the United States, which would lead to a greater contribution of foreign trade to Italian growth;
- New European legislature: The policy decisions of the new European legislature could support the growth of European Union countries through targeted interventions, benefiting various economies.

Downside risks

- Increased geopolitical tensions: The Russia-Ukraine conflict may not find a resolution in the short to medium term, perpetuating geopolitical instability. This could be exacerbated by a worsening of the Israeli-Palestinian situation and the conflict in Syria. If additional countries become involved, there could be significant humanitarian and economic repercussions, potentially leading to negative impacts 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 might maintain a restrictive monetary policy for longer than anticipated if inflation persists in various economies. This could result in prolonged low growth due to reduced consumption and investment, discouraged by high interest rates.
- Stress in the financial system: High interest rates could lead to increased stress for financial institutions, impacting savers and tightening credit conditions in both the United States and the Eurozone.
- High public debt: The post-pandemic increase in public debt, combined with current high interest rates, poses new challenges to its sustainability in Eurozone economies, particularly in highly indebted countries like Italy. This could ultimately lead to higher risks of financial market stress.
- PNRR: Failure to fully achieve the PNRR objectives and its partial implementation could slow down the growth rate of investments, and consequently, the Italian economy as a whole. This issue could also affect potential GDP and medium to long-term growth prospects.
- Monetary policy transmission channels: Structural factors such as a high percentage of households with fixed-rate debt or an economy dominated by the service sector can hinder the transmission mechanisms of monetary policy, requiring more time for their effects to materialize;[84]
- Greater distress in the real estate sector: Sustained high interest rates may exert additional pressure on the real estate market, discouraging home and property purchases.
- Lower growth for China, Germany, and the United States: Slower future growth in China, Germany, and the United States could lead to reduced foreign demand for Italian goods.
- New Administration in the United States: The installation of a new US government could introduce increased uncertainties related to non-cooperative trade policies, potentially resulting in trade-distorting measures.
- New European legislature: The new European legislature may face challenges in implementing its political agenda, which could have negative effects on the economies of European Union countries.

[84]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[85]

The construction of a new macro-econometric model required the optimization of an inevitable trade-off between building a model that emphasizes the information of the data (such as the ARIMA and VAR models, which do not make any use of economic theory) or a model that is attentive only to the foundations on which its relationships are based (in the extreme case, the calibrated RBC-DSGE models that do not pay attention to the data of their variables). [86]This trade-off has been underlined several times in the literature, see for example the reflections in Granger (1999) and Pagan (2003).

In building HEY-MOM, we tried not to neglect either of the two ingredients mentioned above (economic theory and data), in an attempt to produce a hybrid model with a careful balance in the specification of relationships (a) based on micro-founded economic behaviors and at the same time (b) careful in the application of rigorous techniques for evaluating statistical information. 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 structure of macroeconomics in EY. To do this, the model refers to the main aggregates of the Italian economy, based on empirical data, of a non-monetary nature, with explicit long-term relationships between the variables it studies, and mainly oriented to the definition of short-term forecasts (over a two-year horizon).

The economic foundations

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

Long-run output (the economy's potential) depends on the combined effect of trends in total factor productivity, labor supply and hours, and capital stock. These factors are combined by a "Cobb-Douglas" technology with constant returns to scale. The demand for inputs is that which minimizes cost given a planned level of output in the context of an oligopolistic competitive economy, where firms are free to set prices based on a markup over labor costs and, at those prices, are willing to collectively meet any level of market demand. Wages are set on a "Phillips curve" driven by the inertia of the inflation rate, labor productivity, and the gap between the actual and natural unemployment rates (defined by the long-run state of the labor market). Actual output is composed of the following items of domestic and foreign demand: private (household) and public consumption; private and public investments by type of asset (residential and non-residential buildings, machinery and equipment, and research and development expenditure); imports and exports.

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

[85]The model was created in collaboration with the Department of Economics of the University of Bologna.
[86]"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 with which the economic dynamics outlined above evolve over time is estimated with 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 approaches of the London School of Economics and Fair's (2004) revision of the Yale Cowles Commission approach. The synthesis realized 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), interpretable in the light of economic theory and identified by state relations whose parameters are estimated on the basis of error correction models (Hendry et al., 1984, and Pesaran et al., 2001). In the absence of exogeneity of some explanatory variables of the model, the relationships are first inspected following the instrumental variables estimation approach, and then definitively estimated in three stages (Hsiao, 1997).

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

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