PROMETEIA
BRIEF

ITALY IN THE GLOBAL ECONOMY

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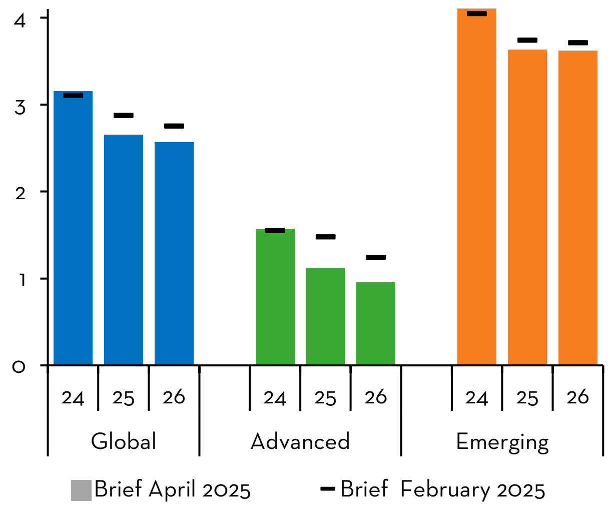
The worst is yet to come

- Economic indicators at the beginning of 2025 were mixed, pointing to a slowdown in the US and Europe and some signs of acceleration in China. It is against this backdrop that we need to assess the effects of the US administration's measures.
- US economic and trade policy developments, with daily news on tariffs, are a huge source of uncertainty. For our baseline assumptions see Table A of the InFocus at the end of this Brief.
- Beside the baseline, we also consider two alternative simulation exercises, discussed in the InFocus: one corresponding to the current situation after the suspension of the tariffs announced on April 2; a second, reflecting the tariff structure announced on April 2 and adding proportional retaliatory measures from trade partners.
- In our baseline, we expect a slowdown of global growth (Chart 1) with the US to experiencing more significant growth reduction, that would be more severe in the alternative exercises, -1.6% and –2% on the GDP level with respect to the baseline by the end of 2026.
- China's economic policy, which is especially targeting consumption and investment growth, along with a significant carry-over to 2025, have prompted us to upward revise growth for 2025 and 2026, but the escalation of the commercial war with the US could reduce growth between 1.1% to 2.6% by the end of 2026.

Moderate and uncertain growth in Italy

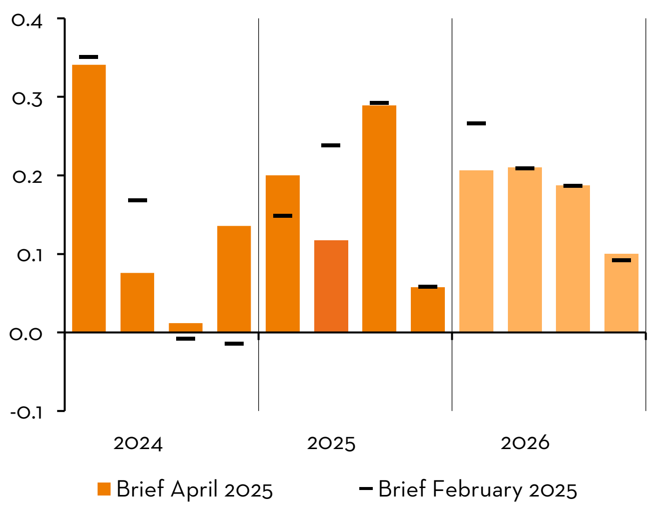
- In Q4-2024, Italy's GDP grew by 0.1% qoq, driven by domestic and external demand (respectively 0.5pp and 0.07pp) and hampered by inventories (-0.4pp). Annual growth in 2024 was 0.5%, in line with the February Brief, marking a slowdown from 0.8% in 2023.
- Increased domestic demand was mainly driven by investments, which grew across the board except for residential housing. Non-residential investments, supported by the NRRP, recorded their 6th consecutive rise, exceeding end-2022 levels by 34%.
- In 2024, household spending grew by 0.4%, which, compared to a 1.2% increase in disposable income, is an indication that the restraining effects of the inflationary shock on consumption have yet to fully subside.
- All the leading indicators in our nowcasting models suggest that, in the first part of 2025, GDP growth will continue at a still modest pace, but with some potential for a slight acceleration with respect to 2024H2 resulting in a growth around 0.6 in 2025. The developments in the commercial policy of the US introduces significant uncertainty around the forecast (see InFocus for an alternative scenario for Italy).
- Italy's public finances improved significantly in 2024, with the deficit more than halved (from 7.2% to 3.4% of GDP), a return to a primary surplus, a reduction in primary expenditure despite record public investment, and an increase in tax revenues due to higher labour income and better tax compliance.

Chart 1 **World: real GDP**
% change



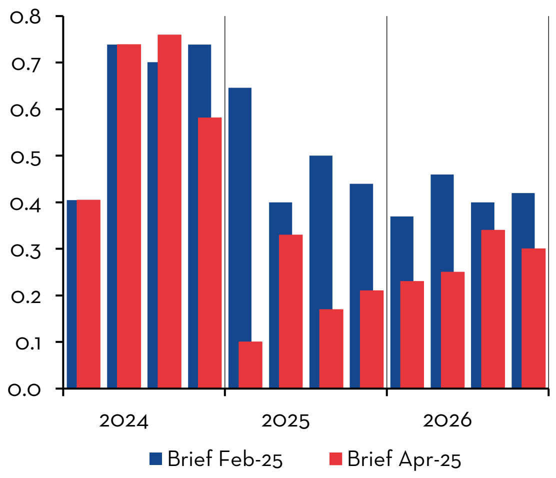
Source: Prometeia's forecast on IMF, World Bank, Eurostat, National Statistical Offices data.

Chart 2 **Italy: real GDP**
% change qoq



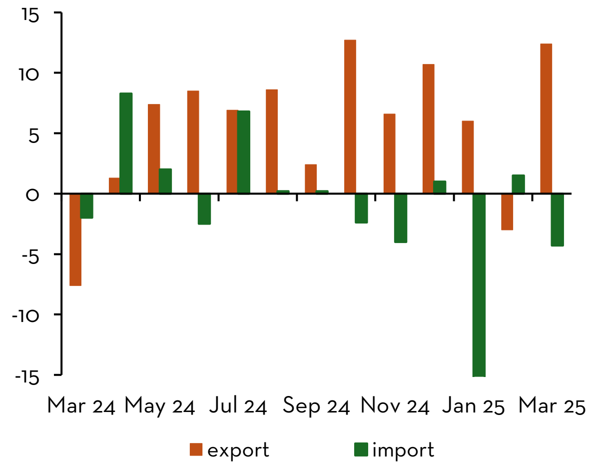
Source: Prometeia's forecast on Istat data.

Chart 3 **US: GDP**
% changes qoq



Source: Prometeia's forecast on Bureau of Economic Analysis.

Chart 4 **China: foreign trade, value**
monthly data, % changes yoy



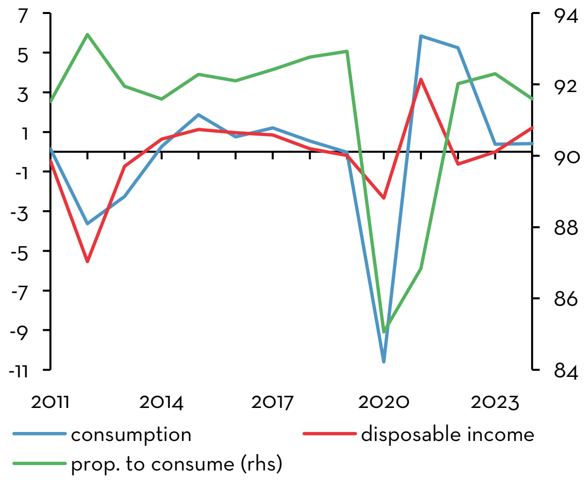
Source: China Custom data.

US economy hit by higher tariffs. In Q4- 2024, GDP grew by 0.6% qoq, with a carryover of 1pp in 2025. However, in the first months of 2025, household and business confidence has deteriorated sharply: the Trump administration's trade policy, and draconian interventions in the public sector, have created considerable uncertainty for both demand and prices. In the manufacturing sector, there has been a significant drop in new orders and a worsening in services is ongoing. Our expectation for the US economy to slow, (1.5% GDP growth in 2025, 3% inflation in our baseline scenario), could be significantly worsen in light of domestic and commercial policy. Uncertainty is expected to have negative effects on household consumption and, despite expectations about a weaker dollar, US exports are anticipated to decelerate. Uncertainty, risks of tariff-led inflation and weaker dollar are likely to encourage the Fed to maintain a cautious approach to reducing monetary policy rates, while increasing 10-year bond yields suggest some loss of confidence in the US economy. In our alternative exercises (see InFocus), the US would face larger growth reductions compared to its trading partners, as it would impose higher import tariffs – and, in case of retaliations, also export tariffs – towards most trading partners, while other countries would see mainly their trade with the US affected.

Euro area: some light at the end of the tunnel. 2024 ended with a slightly stronger-than-expected Q4 (0.2% GDP growth), resulting in a 0.4pp carry-over to 2025. Despite some timid signs of improvement, weak cyclical indicators suggest substantial stagnation in Q1-2025. Major uncertainty regarding the Trump administration's tariff policies (and related retaliations), in our baseline scenario translate into a negative contribution to growth of trade in 2025 partially offset by a larger one (0.4pp) from private consumption growth related to the ongoing recovery of household purchasing power. For all these factors the GDP is expected to grow by 0.8% in 2025. Starting in 2026, economic activity is expected to benefit from the stimulus provided by Germany's significant multi-year public investment plan, which should have positive spillovers for the eurozone countries, and from the possible increase in national defense spending promoted by the European Commission (€800 billion for the EU in the next four years). In our baseline, we foresee only partial use of the potential fiscal space without the achievement of defense spending target at 3% of GDP. We hence estimate annual 2026 GDP growth in the euro area to be around 1.1%. In our alternative exercises regarding the US administration tariff policy, the euro area could see a negative growth impact from -0.5% to -0.7% in 2026 compared to the baseline.

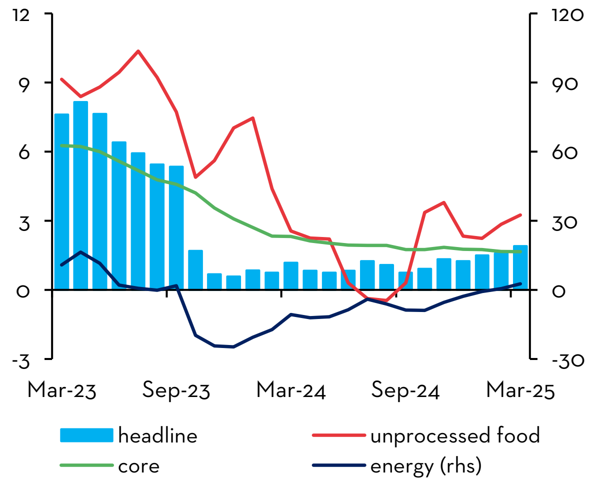
China: consumption, at last! Following the achievement of its growth target in 2024, in the first months of 2025, the Chinese economy grew 5.4% yoy due mainly to an increase of exports, to anticipate tariffs, around 12% in March. The outcome of the National People's Congress and the top political advisory body, the National Committee of the Chinese People's Political Consultative Conference (the 'two sessions'), seems finally to have shifted the economic policy focus towards supporting private consumption and domestic demand using other tools than liquidity interventions but the upward revision to Chinese growth in our baseline would take a significant hit in the alternative exercises. The scale of it will depend on the outcomes of the ongoing bilateral negotiations with trading partners, but if the level of bilateral tariffs remains at the current level, China growth could be reduced by 2.6% compared to our baseline in 2026.

Chart 5 **Consumption, disposable income** *(% change)* **and propensity to consume** *(%)*



Source: Prometeia's calculations on Istat data.

Chart 6 **Consumer prices**
% change yoy



Source: Prometeia's calculations on Istat data.

In Q4-2024, Italy's GDP grew by 0.1%, driven primarily by investment, particularly non-residential investment linked to the NRRP. Household spending and foreign demand also contributed, although to a lesser extent, while inventories had a negative impact. On the supply side, growth was led by the industrial sector, with positive signs across all segments, including manufacturing (+0.3%), which returned to growth after three consecutive quarters of decline.

Growth in Italian household consumption remained subdued in 2024, signalling continued caution. In Q4-2024, growth reached only 0.2%, with annual growth at only 0.4%, despite higher disposable income (Chart 5). This perhaps reflects a delayed response to inflation and a limited impact on spending of financial asset gains, which benefited mainly wealthier households.

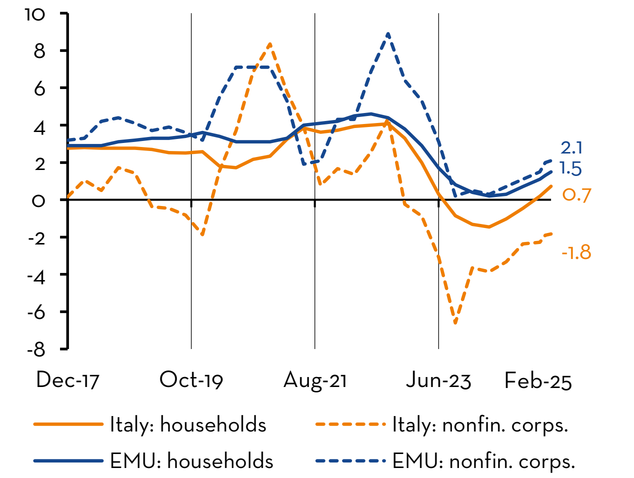
Inflation shows a mild recovery from 1.6% in February 2025 to 1.9% in March, following the 2024 low (Chart 6). This is due to the acceleration in almost all the components, from energy prices (0.6% in February to 2.6% yoy in March) to unprocessed food (from 2.9% to 3.3%), while the core component remains stable (1.7%). Services show a slight acceleration (from 2.4% to 2.5%). Nevertheless, we are forecasting that consumer inflation will remain anchored to the ECB's 2% target.

An exceptional labour market cycle with an all-time low unemployment rate of 6% in Q4-2024. Labour input growth is slowing but continues to be largely positive: on average in 2024, hours worked and the numbers of employees increased by 1.6%, full-time equivalents increased by 2.2% against GDP growth of 0.5%. There are several reasons behind these trends. After the ending of the Covid crisis, the composition of growth shifted towards construction, which is much more labour intensive than manufacturing. Also, rising energy costs and rising interest rates have meant that labour has become relatively less expensive than other inputs. Lastly, the demographic structure has been changing, with employment shifting towards older age groups with lower unemployment rates.

In Italy, the contraction of bank loans to the private sector has eased, with null growth yoy in February compared to the 2023 average and compared to the euro area average of +2.5% (Chart 7). The drop in interest rates supported a rise in the demand for credit from both households and non-financial corporations. At the end of 2024, loans to households returned to growth (+0.2% annually), supported by lower mortgage interest rates and a rise in property transactions. Loan growth intensified in the first two months of 2025 (0.7% yoy in February) and is expected to show an increase at the end of 2025 (+1.5%). In February, loans to non-financial corporations declined by about 1.8% annually (-2.3% in 2024), although there have been some signs of recovery, linked to increased investment in capital goods. Nevertheless, there are some persistent problems, such as the continuing high cost of credit and the repayment of the loans granted during the pandemic. Therefore, we expect a slight decline in 2025 (-0.3%), which could be amplified by the uncertainty of the global economy.

Italy

Chart 7 **Loans to households and non-financial corporations** - *% change yoy, latest data February 2025*



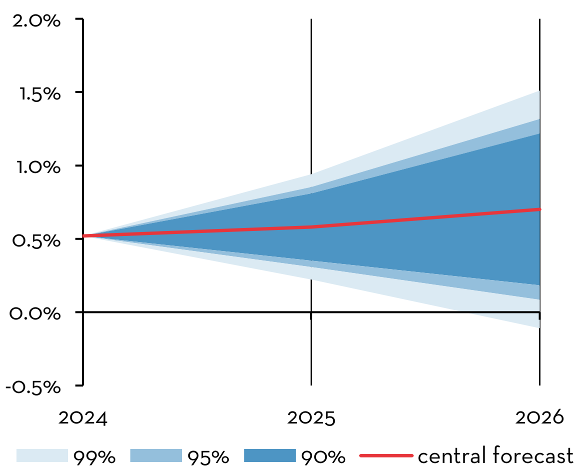
Source: Prometeia's calculations on Bank of Italy and ECB data.

In 2024, Italy's public finances showed significant improvements: the deficit-to-GDP ratio dropped to 3.4% (from 7.2% in 2023) and, after four years of deficit, the primary balance returned to surplus. Among the G7 countries, Italy has been the only country to achieve these improvements after the pandemic. Its success has been due, largely, to the ending of measures, such as the Superbonus 110% and some other temporary measures, which enabled a drop in spending, despite public investment reaching record levels. In 2025, the deficit is forecast to be 3.3%. The tax burden has increased to 42.6% of GDP, driven by structural improvements in tax collection and tax compliance.

Although public debt rose to 135.3% of GDP, this was lower than expected and financing pressures have remained minimal as a result of lower interest rates and strong demand for government bonds. Going forward, the government is expected to pursue a cautious fiscal policy, with targeted measures in the areas of taxation, healthcare and employment, but no expansive policies. Economic support will come mainly from investments linked to the NRRP.

Risks to the projection

Chart 8 **Italy: Prometeia's forecast of annual GDP growth** - *central value and the uncertainty based on past forecasting errors **



Source: Prometeia's calculation on Istat data.

- » If the current tariff tensions were to escalate into a full-blown trade war, with multiple rounds of retaliations, this is likely to result in a severe contraction in global trade. The impacts on different economies would vary and could lead to a significant sectoral redistribution (see InFocus).
- » Domestically, the US could face recession, triggered by a decline in consumption and investment as a result, primarily, of the impact of tariffs—particularly on prices, a drastic restructuring of the public sector (in terms of both employment and functionality) and immigration policies likely to restrict the supply of labour. These factors, combined with a collapse in consumer and business confidence and negative wealth effects from the stock market, could exacerbate the downturn.
- » A specific risk for the Italian economy lies in its (in)ability to effectively address structural transformations, such as demographic change and the climate and energy transitions, which leave it exposed to external shocks and internal constraints.

Table A **Baseline assumptions**
tariffs included in the baseline

baseline
20% China
25% Steel
25% Aluminium
10% Cars from EU
Reciprocal tariff for selected food EU products
25% Mexico except products in USMCA
25% Canada except products in USMCA

Source: Prometeia, March 2025

The current Brief is based on assumptions regarding US trade policy set in late March before "liberation day" and that aligned with measures already implemented and those reasonably anticipated, based on official statements and explicit threats from the US administration (see Table A). However, the tariffs announced on April 2 exceeded even the most pessimistic expectations, introducing sweeping duties calibrated to close bilateral trade deficits and affecting nearly all countries worldwide.

Within days, likely due to pressure from various industries and the severe repercussions on equity markets, long-term interest rates, and exchange rates, the administration reversed course.

A 90-day suspension was enacted for all tariffs exceeding 10%, establishing this rate as a universal minimum. The sole exception was an additional increase in tariffs on Chinese imports, following immediate retaliatory measures by China. This escalation led to successive rounds of reciprocal tariff hikes, culminating in a current US tariff of 145% on Chinese goods and a 125% Chinese tariff on US products.

Regrettably, the situation remains fluid. New exemptions (notably in electronics) have been introduced, alongside fresh threats of further tariffs in the same sector. Other previously exempted industries, such as pharmaceuticals, are now under scrutiny. While there have been openings in the automotive sector, the trajectory of potential bilateral negotiations between the US and individual partners remains uncertain. Outcomes could range from a comprehensive trade agreement to the reinstatement of the April 2 tariffs upon expiration of the suspension, or even a breakdown in negotiations accompanied by additional retaliatory measures.

Amid this climate of uncertainty, **we conducted simulations using Prometeia's models to assess the impact of these trade policies on key global aggregates and individual countries**. These exercises introduced shocks to our forecast baseline, **confined strictly to trade relations**. Specifically, we examined two alternatives:

1. Implementation of the tariff structure announced on April 2 accompanied by proportional retaliation from trade partners.
2. The post-suspension configuration: a universal 10% tariff (excluding China), with China-specific tariffs and corresponding retaliations (145% the US import tariff from China and 125% the China import from the US).

These two simulations held all other variables constant—such as business confidence, commodity prices, financial markets, exchange rates, and fiscal policies—to isolate the effects of relative price changes induced by tariffs, as modelled through the international trade matrix and historical elasticities.

The April 2 tariffs (first scenario) represented an approximate 14 percentage point increase in the average US tariff rate compared to our baseline hypotheses. Introducing retaliations exacerbates the overall outlook, particularly for the US, which would face a global competitiveness loss equivalent to a 15% increase in export prices. However, this impact is somewhat mitigated by the fact that exports constitute a relatively small share of US GDP—just over 11%.

1 *For exercise 2 we did not consider a situation involving full retaliation, as we deem it implausible. China has already implemented retaliatory measures, whereas the 10% tariffs are not perceived as a definitive endpoint warranting corresponding countermeasures. Should negotiations fail, the situation would revert to the April 2 scenario, at this point, with retaliations. Conversely, successful negotiations would likely result in either the elimination of tariffs or their reduction below the 10% threshold, without prompting further retaliations.*

Table B **Alternative simulation exercises**
percent difference from baseline levels

	April 2 with retaliation		universal 10% and China trade-war	
	2025	2026	2025	2026
US GDP	-0.6	-1.6	-0.8	-2.0
China GDP	-0.3	-1.1	-0.8	-2.6
EMU GDP	-0.2	-0.5	-0.2	-0.7
World GDP	-0.3	-1.0	-0.6	-1.9
World Trade	-0.7	-2.1	-0.7	-2.2

Source: *Prometeia calculations*

Under this hypothesis, our model indicates that the US would bear the most significant GDP cost—approximately 1.6 percentage points below the baseline in two years, with effects persisting into the medium term. Other countries would experience milder impacts: around a 1.1 percentage point decline for China and just over 0.5 percentage point for the Eurozone. Globally, these measures would result in a 1 percentage point reduction in GDP and a 2.1 percentage point decline in world trade (Table B)

The second scenario, representing a "status quo" simulation, with a universal 10% tariff and a trade war with China, suggests a stronger short-term deterioration in US GDP compared to first scenario, falling 2 percentage points below the baseline in 2026, mainly due to much higher US-China bilateral tariffs. Paradoxically, in the medium term, the magnitude of the tariffs would significantly discourage imports from China, thereby reducing the average tariff burden and associated inflation. In this exercise, China would suffer a notable GDP loss relative to the baseline (around 2.6 percentage points), primarily due to diminished market share in the US. Conversely, the impact on the Eurozone comes from weakened global activity (a 1.9 percentage point reduction in world GDP relative to the baseline), increasing its GDP loss to 0.7 percentage points relative to the baseline, even if under a more favourable tariff regime.

Finally, **building upon the results of the April 2 scenario**—which forecasts a decline in foreign demand for Italian exports and an increase in import prices—**we developed a more comprehensive scenario for the Italian economy (Table C).** This analysis considered additional factors, such as decreased business confidence, fluctuations in policy and market interest rates, and associated wealth effects. In the short term, policy interest rates in the euro area would decline to 1.75% by summer supporting the economy. Inflation is projected to be slightly higher than in the baseline scenario but is not expected to exceed 2%, while long-term rates would stay lower owing to anticipated slower growth, start rising only after 2026. The scenario would also be characterized by heightened uncertainty, leading to reduced disposable income formation, more cautious consumer spending, and a decline in financial wealth value. The decline in GDP relative to the baseline would be around 1 percentage point in 2026, as all the additional hypotheses add further decline with respect to the pure trade-related ones.

Table C **Alternative scenario for Italy**
percent difference from baseline levels

	2025	2026
GDP	-0.6	-1.0
Household consumption	-0.5	-0.9
Gross Fixed Capital Formation	-1.3	-3.1
Export	-0.8	-2.1
CPI	0.3	0.5

Source: *Prometeia calculations*

Table 1 ***The world economy main indicators*** *(% change)*

	2024	2025	2026
World real GDP	3.2	2.7	2.6
World Trade	2.2	2.6	1.8
Manufacturing prices $	-0.5	2.5	3.6
Brent oil price ($/brl, level)	79.9	68.8	68.2
GDP			
- United States	2.8	1.5	1.0
- Japan	-0.1	0.7	0.5
- EMU	0.8	0.8	1.1
- China	5.1	4.8	4.3
Consumer prices			
- United States	3.0	3.1	3.3
- Japan	2.7	3.3	2.0
- EMU	2.3	2.2	2.0
- China	0.5	2.3	2.4
$/€ exchange rate (level)	1.08	1.09	1.12
£/€ exchange rate (level)	0.847	0.843	0.866

Table 2 ***Italy: main indicators*** *(% change)*

	2024	2025	2026
GDP*	0.5	0.6	0.7
Imports of goods fob and services	-1.5	1.4	2.0
Private consumption	0.4	0.7	0.8
Government consumption	1.1	0.4	0.1
Gross fixed investment:	0.0	0.3	-0.8
- machinery, equipment, other products	-1.0	3.1	4.5
- construction	1.0	-2.1	-5.9
Exports of goods fob and services	-0.3	0.7	1.6
Domestic demand	0.2	0.8	0.8
Industrial production	-3.9	0.0	1.3
Trade balance (% of GDP)	2.8	2.5	2.7
Terms of trade	3.0	-0.5	0.7
Consumer prices	1.0	1.7	1.8
Per capita wages - manufacturing	3.1	3.3	2.7
Total employment	2.2	0.0	0.5
General government balance (% of GDP)	-3.4	-3.3	-2.8
General government debt (% of GDP)	135.3	137.4	138.8

* Chain-linked values (reference year 2020); data adjusted for seasonal and calendar effects.

Table 3 ***Exchange Rates and Interest Rates***

		25 Q1	25 Q2	25 Q3	25 Q4	26 Q1	26 Q2	26 Q3	26 Q4
Exchange rates vs euro	US dollar	1.05	1.09	1.10	1.11	1.12	1.12	1.12	1.12
	Yen	160.0	159.8	160.7	161.4	161.3	162.2	163.8	164.4
3 month interest rates %	US	4.29	4.23	4.02	3.75	3.51	3.35	3.33	3.32
	Euro area	2.55	2.13	2.00	2.00	2.00	2.00	2.01	2.04
10-year government bond yields %	US	4.45	4.29	4.27	4.24	4.23	4.23	4.24	4.24
	Germany	2.59	2.82	2.83	2.84	2.86	2.89	2.91	2.97
	Italy	3.66	3.92	4.04	4.14	4.16	4.19	4.21	4.26

Table 4 ***Real GDP: comparison of the forecast*** *– % qoq and annual % change – in bold historical data*

		24 Q1	24 Q2	24 Q3	24 Q4	2024	25 Q1	25 Q2	25 Q3	25 Q4	2025
United States	Brief February 2025	**0.4**	**0.7**	**0.7**	**0.6**	2.8	0.7	0.4	0.5	0.4	1.5
	Brief April 2025	**0.4**	**0.7**	**0.7**	**0.6**	**2.8**	0.1	0.3	0.2	0.2	1.5
EMU	Brief February 2025	**0.3**	**0.2**	**0.4**	**0.0**	0.8	0.1	0.2	0.2	0.2	0.8
	Brief April 2025	**0.3**	**0.2**	**0.4**	**0.2**	**0.8**	0.0	0.2	0.2	0.3	0.8
Italy	Brief February 2025	**0.3**	**0.2**	**0.0**	**0.0**	0.5	0.1	0.2	0.3	0.1	0.5
	Brief April 2025	**0.3**	**0.1**	**0.0**	**0.1**	**0.5**	0.2	0.1	0.3	0.1	0.6

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