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Address
Via Nazionale 91 – 00184 Roma – Italia

Telephone
+39 06 47921

Website
http://www.bancaditalia.it

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SYMBOLS AND CONVENTIONS

Unless otherwise specified, Banca d'Italia calculations; for Banca d'Italia data, the source is omitted.

In the tables:

–	the phenomenon does not exist;
....	the phenomenon exists but its value is not known;
..	the value is nil or less than half of the final digit shown;
::	not statistically significant;
()	provisional.

In the figures with different right- and left-hand scales, the right-hand scale is identified in the notes.

For the abbreviations of the names of countries used in this publication please refer to the EU's Interinstitutional Style Guide (https://publications.europa.eu/code/en/en-5000600.htm).

OVERVIEW

The resumption of hostilities between the United States and Iran has sparked renewed tensions on energy markets. *Energy commodity prices rose again in July, after the announcement of a memorandum of understanding on 14 June had helped ease the upward pressures in the markets. Oil and natural gas prices have declined compared with the peaks reached in March and April, but remain higher than in the weeks prior to the outbreak of the conflict. Since mid-April, equity prices have recouped the losses recorded in previous weeks, driven above all by AI-related sectors, while sovereign yields have risen in anticipation of a tightening of monetary policy. The dollar has appreciated against the main currencies.*

Global growth continues, but remains exposed to significant risk factors*. In the United States, economic activity continues to be supported by investment in AI-related technologies and by private consumption, despite higher input cost pressures and deteriorating household confidence. In China, exports continue to drive growth, while domestic demand remains weak. World trade grew faster than expected in the first quarter, buoyed by demand for AI-related goods; it is expected to slow in the second half of the year, affected by the supply chain tensions linked to the conflict in the Middle East. Uncertainty over the content, timing and implementation of a deal between the United States and Iran continues to weigh on the global growth outlook and on international trade.*

Rising energy prices are putting upward pressure on inflation in the main economies. The Federal Reserve and the Bank of England have kept their policy rates unchanged, while the Bank of Japan has raised them. There are still risks of financial market corrections, stemming from an underestimation of the consequences of higher energy prices, from tighter financial conditions and from overly optimistic expectations for profitability in the technology sector.

The Middle East crisis has worsened the outlook for growth and inflation in the euro area*. In the first three months of the year, euro-area GDP grew at the moderate pace of the previous quarters (0.3 per cent), net of the exceptional fluctuations in economic activity in Ireland. Hostilities in the Persian Gulf had a negative impact on GDP in the spring months, resulting in modest growth according to our estimates. The contribution of the service sector to growth appears to have slackened considerably, while that of manufacturing activity appears to be positive. The June Eurosystem staff projections revised euro-area GDP growth downwards, to 0.8 per cent in 2026, 1.2 per cent in 2027 and 1.5 per cent in 2028, while still contemplating alternative scenarios. The projections were revised upwards for consumer price inflation, which is estimated to rise to 3.0 per cent in 2026, then fall to 2.3 per cent in 2027 and return to the target of 2.0 per cent in 2028.*

The ECB has raised its key interest rates*. At its June meeting, the ECB Governing Council increased its key interest rates by 25 basis points in response to the inflationary pressures generated by the crisis in the Middle East. Between February and May, the cost of new loans to firms and of new mortgage loans increased slightly. Growth in lending to firms strengthened, driven by short- and medium-term loans. Growth in lending to households remained stable.*

The Italian economy grows in the first quarter, but appears to have slowed in the second. *During the winter months, GDP continued to expand at a moderate pace (0.3 per cent), exports of goods and services rose, investment increased further and consumption accelerated. However, capital formation appears to have softened and household consumption to have slowed in the spring, amid the conflict in the Middle East. According to our June projections, GDP growth will remain muted in the baseline scenario: adjusting for calendar effects, GDP is estimated to rise by 0.5 per cent in 2026, 0.4 per cent in 2027 and 0.9 per cent in 2028.*

Taking into account the better-than-expected growth in the first quarter, GDP is estimated to rise by 0.6 per cent this year. These projections reflect surging energy prices and high geopolitical uncertainty.

According to our estimates, goods export volumes held broadly stable in April and May, despite falling sales in the Middle East. The surge in energy prices will cause Italy's energy deficit to widen.

Labour market conditions remain positive overall. *Employment rose in the first quarter of the year and over the April-May period. The unemployment rate fell further, hitting a new all-time low, while the participation rate was practically unchanged. Contractual wage growth remained moderate.*

Rising energy prices have fuelled inflationary pressures. *Inflation reached 3 per cent in the second quarter. The surge in energy prices caused by the Middle East crisis has had a limited impact on electricity and gas bills in Italy. The Government has repeatedly stepped in to counter the pressures on energy prices by temporarily cutting excise duties on fuels.*

The short-term inflation expectations of households and firms have increased, though they remain below the levels observed in March 2022, following Russia's invasion of Ukraine. According to our June projections, consumer price inflation will rise to 3.1 per cent on average this year, largely reflecting the higher energy prices, before returning to 2 per cent over the next two years.

Lending to firms continues to expand. *Between February and May, lending to firms accelerated, while growth in loans to households remained stable. Interest rates rose on new loans to firms and, to a lesser extent, on new mortgage loans. Credit standards were virtually unchanged in the first quarter. Net bond issuance by non-financial corporations increased in a high-yield environment.*

The Italian Government's public finance estimates confirm that the deficit will trend down over the coming years. *Based on the estimates contained in the Public Finance Document 2026 published last April, net borrowing will decline over the four years 2026-29. The net expenditure growth rates will be in line with what has been agreed at European level, except for 2027. The debt-to-GDP ratio will grow in 2026 and then decline in the following years. The European Commission gave an overall positive assessment of the state of progress of Italy's corrective path under the excessive deficit procedure.*

1 THE WORLD ECONOMY

1.1 THE GLOBAL CYCLE

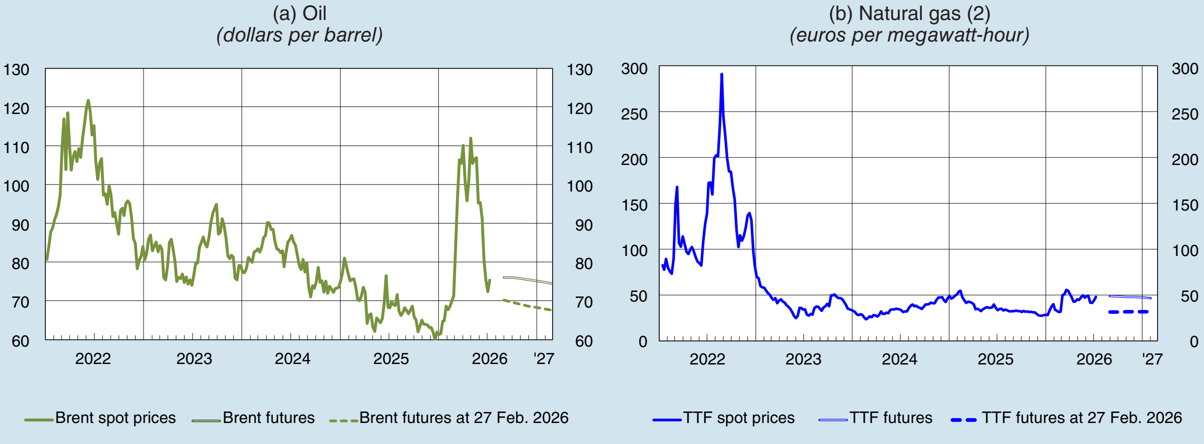
The resumption of hostilities between the United States and Iran has sparked tensions on energy markets. Rising oil and natural gas prices have exerted upward pressure on inflation in the major economies. Considerable uncertainty about the timing of the reopening of the Strait of Hormuz is weighting on global trade and growth. Sovereign bond yields have risen, while equity prices continue to benefit from the strong performance of artificial intelligence (AI) infrastructure companies.

The situation in the Middle East remains highly uncertain. The revival of the conflict between the United States and Iran has once again driven up oil and natural gas prices; this comes after the announcement in mid-June of a memorandum of understanding which had helped to alleviate market tensions. Looking ahead, energy commodity prices and financial market developments will be affected by how long it takes to normalize trade flows and restore the energy infrastructure in the Persian Gulf area.

Oil prices rise after the renewal of hostilities. In the second week of July, crude oil prices stood at around $75 per barrel, falling sharply from the peaks reached in April but still higher than those prior to the outbreak of the conflict (Figure 1.a). They rose further in the third week, reabsorbing most of the decline that followed the memorandum of understanding. Since March, the decline in oil supply from the Gulf has been offset by a contraction in demand, an increase in exports from the United States and reliance on inventories. According

Figure 1

Commodity prices (1)
(average weekly data)



Source: LSEG.
(1) For spot prices, weekly averages up to 10 July 2026. For futures, the prices are updated to 10 July 2026, for the curve relating to the latest available data. The dashed line refers to prices as at 27 February 2026, the day prior to the start of the conflict in the Middle East. – (2) Price of natural gas traded on the Dutch TTF market.

to estimates by the International Energy Agency (IEA), inventories have fallen at an exceptionally fast pace (3.8 million barrels per day on average since the beginning of the war).[1] The reopening of the Strait of Hormuz to traffic after the signing of the memorandum eased tensions in the oil market; however, the renewal of hostilities has reinforced the still considerable uncertainty about when trade flows will return to pre-conflict levels. The prices of refined products remain significantly higher than before the outbreak of the hostilities, reflecting: structurally lower levels of stocks relative to crude oil, the damage to Gulf refineries, and the increase in transport, insurance and procurement costs for refineries in the rest of the world, especially in Asia.

Gas prices remain high. The European reference price for natural gas is still considerably higher year on year (Figure 1.b), buoyed by the need to replenish stocks, currently at historically low levels. The outlook for the supply of gas from the Middle East continues to be affected by the damage that occurred to some of the area's infrastructure, such as Ras Laffan Industrial City in Qatar. Higher gas prices have led to an increase in prices for other hydrocarbon-derived products; higher fertilizer prices, in particular, could have repercussions on food security in low-income countries, sub-Saharan Africa and some Asian economies.

Following a strong start to the year, global trade growth appears to have slowed in the second quarter. In the first three months of 2026, world trade grew faster than expected, driven by demand for AI-related goods. However, the data for April and May point to modest signs of a slowdown, following the reduction in trade flows with the Persian Gulf economies and the increase in transport and insurance costs connected with the conflict. Since April, there have been heightened tensions on global supply chains, adding to those that started to appear at the end of last year in the electronics sector in response to the strong demand for AI components. Uncertainty about the path of US tariff policy, which is still being redesigned after the Supreme Court's decision of February 2026, is also dampening international trade (see the box: 'US tariffs following the Supreme Court's decision', in *Economic Bulletin*, 2, 2026).

Economic activity in the United States continues to expand at a rapid pace. In the first quarter, US GDP growth was driven by AI-related investment, by consumption and by a rebound in government spending following the end of the shutdown between October and November 2025 (Table 1). Partial

Table 1

GDP growth and macroeconomic projections
(percentage changes)

	Growth			Forecasts		Revisions (2)	
	2025	2025 Q4 (1)	2026 Q1 (1)	2026	2027	2026	2027
World	**3.5**	**–**	**–**	**3.0**	**3.4**	**-0.1**	**0.2**
Japan	1.1	0.7	1.8	0.6	0.7	-0.1	0.1
United Kingdom	1.3	0.2	2.5	1.0	1.3	0.2	0.0
United States	2.1	0.5	2.1	2.3	2.2	0.0	0.1
Brazil	2.3	1.8	1.8	2.4	2.2	0.5	0.2
China	5.0	4.5	5.0	4.6	4.1	0.2	0.1
India (3)	7.7	8.0	7.8	6.4	6.7	-0.1	0.2
Russia	1.0	1.0	-0.2	1.1	1.1	0.0	0.0

Sources: National statistics, for data on growth; IMF, *World Economic Outlook*, July 2026, for world GDP and forecasts.
(1) Quarterly data. For Japan, the United Kingdom and the United States, annualized and seasonally adjusted percentage changes on the previous quarter; for the other countries, year-on-year percentage changes. – (2) Percentage points; revisions compared with IMF, *World Economic Outlook. Global Economy in the Shadow of War*, April 2026. – (3) The actual data and the forecasts refer to the fiscal year starting in April.

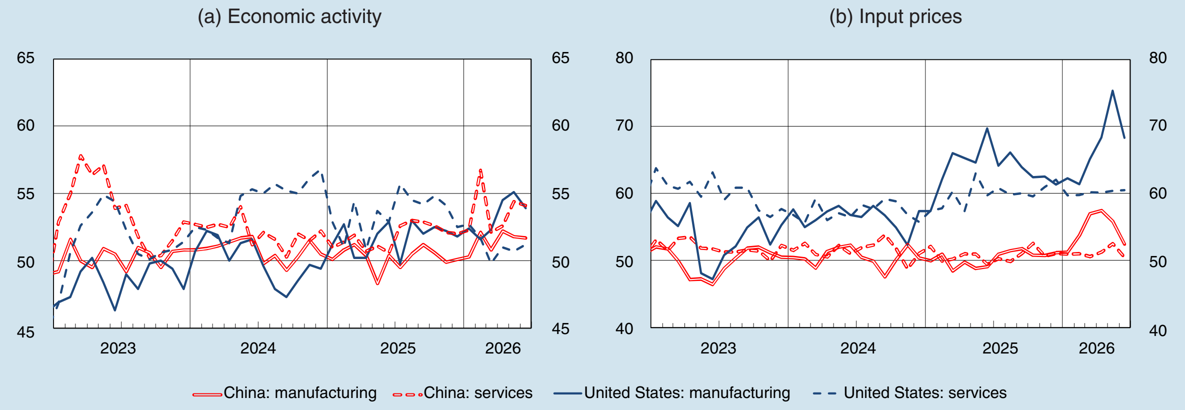
1 IEA, *Oil Market Report*, June 2026.

data for the second quarter confirm this trend. Private consumption also grew in April and May, although consumer confidence remains historically low. Headcount employment continues to grow, while the unemployment rate remains stable.

The purchasing managers' indices (PMIs) for the manufacturing sector continued to signal an expansion in economic activity in June as well (Figure 2.a), supported by the output and new orders components. However, pressures on intermediate goods prices have intensified considerably, especially in manufacturing (Figure 2.b), and they have climbed to their highest levels since 2022 as a result of rising energy prices.

Figure 2

PMIs in China and in the United States (1)
(per cent; diffusion indices)



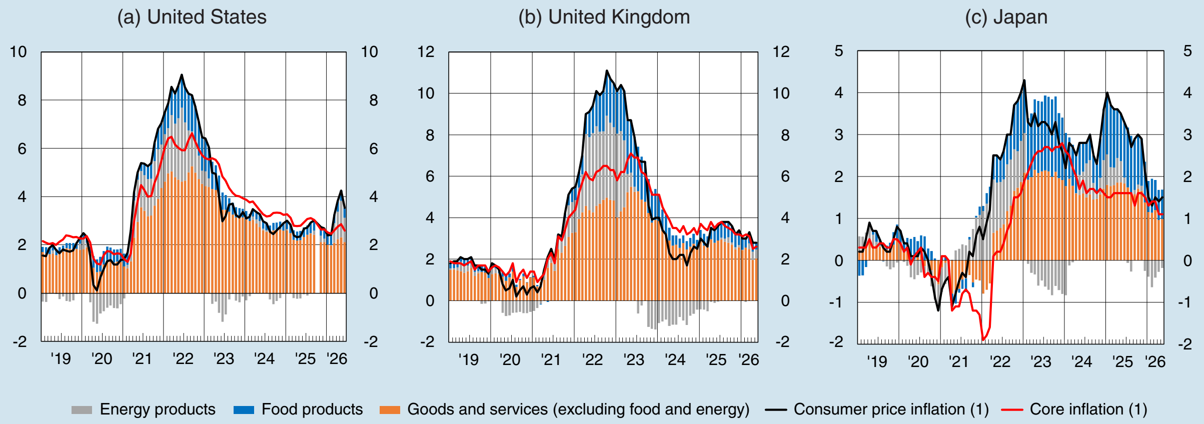
Source: Standard & Poor's Global Ratings.
(1) Diffusion indices for economic activity in the manufacturing and service sectors. Each index is obtained by adding half of the percentage of responses of 'stable' to the percentage of responses of 'increasing'. For economic activity, values greater than 50 are compatible with expansion in the sector; for input prices, they indicate an increase in perceived costs.

In China, exports continue to support growth, while domestic demand remains weak. China's GDP rose less than expected in the second quarter, to 4.3 per cent; in the same period, sales of Chinese products abroad continued to grow robustly, especially exports of AI-related goods, which rose considerably to other Asian countries in particular. Moreover, exports of products linked to the energy transition continue to increase to all the key export areas except the United States. Retail sales slowed markedly in the second quarter; the withdrawal of government incentives for the purchase of durable goods and the persistent weakness in the housing market are exacerbating the fragility of private consumption.

Rising energy prices are putting upward pressure on inflation across the major economies. Cross-country inflation dynamics reflect not only differences in the degree of foreign energy dependence, but also market structure and fiscal support measures (see the box 'The blockade of the Strait of Hormuz and the pass-through of higher energy prices in the main advanced economies'). In June, consumer price inflation was equal to 3.5 per cent on an annual basis in the United States, after reaching a peak of 4.2 per cent in May (Figure 3.a), driven by the rise in energy prices; core inflation rose only slightly, to 2.6 per cent. Inflation instead fell in the United Kingdom in May compared with March, while it remained stable in Japan (Figures 3.b and 3.c). The effect of the increase in energy prices on inflation was offset in the UK by a temporary reduction in the core component and it was cushioned in Japan by price mitigation measures. In China, higher energy prices pushed producer prices back into positive territory in the second quarter, interrupting the deflationary phase under way since the end of 2022. However, consumer price inflation has remained low.

Figure 3

Consumer price inflation, contributions of its components, and core inflation in the main advanced economies
(monthly data; percentage changes and points)



Source: Based on national statistics.
(1) 12-month percentage changes; core inflation excludes food and energy products.

THE BLOCKADE OF THE STRAIT OF HORMUZ AND THE PASS-THROUGH OF HIGHER ENERGY PRICES IN THE MAIN ADVANCED ECONOMIES

The conflict in the Middle East and the restrictions on traffic through the Strait of Hormuz led to a sharp rise in energy commodity prices. The increase in crude oil prices was rapidly transmitted worldwide, reflecting the high degree of integration of the oil market. By contrast, the rise in natural gas prices had different effects across the major economic areas, owing to the more segmented nature of that market. From the outbreak of the conflict to the peaks reached at the end of April, the price of Brent crude increased by around 60 per cent, before declining as a result of the optimism surrounding negotiations between the United States and Iran, which culminated in the announcement of a memorandum of understanding on 14 June. The effects were even more pronounced in the European and Asian natural gas markets, where price rises peaked at more than 90 per cent, while the US Henry Hub price remained broadly stable.

Direct exposure to a disruption of traffic through the Strait of Hormuz varies considerably across the main advanced economies. The United States is the least vulnerable, owing to its sizeable domestic production of oil and natural gas. The United Kingdom has an intermediate exposure, especially for imported gas and oil products. Japan depends almost entirely on imports of crude oil and liquefied natural gas (LNG): while its LNG supplies are highly diversified geographically, more than 90 per cent of its crude oil imports come from Persian Gulf countries. In the euro area, exposure is limited for oil and LNG (at around 10 and 5 per cent, respectively), but it is more significant for refined petroleum products (30 per cent).

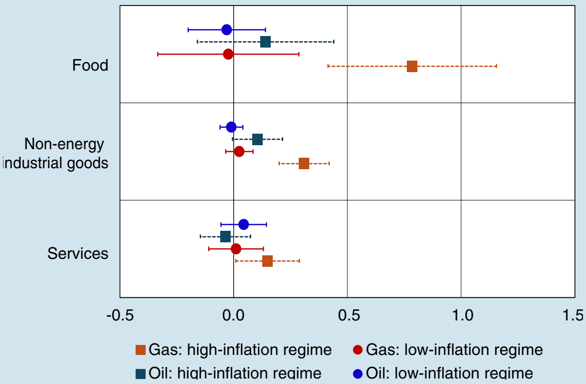
These differences only partly explain the varying responses of inflation to higher energy commodity prices across the main advanced economies; in addition to the degree of direct exposure, this reflects the interplay between energy mixes, market structures and fiscal support measures.

Our analyses indicate that Japan's significant exposure to oil imports from the Strait of Hormuz was offset by ample strategic reserves, a substantial domestic refining capacity and the imposition of a cap on fuel prices. The pass-through to domestic gas and electricity prices was partly mitigated by long-term LNG supply contracts and tariff schemes with indexation lags. In the United Kingdom, the oil price shock was rapidly transmitted to the energy component of consumer prices, while the pass-through of the shock to natural gas prices was temporarily held back by the schedule for revising gas and electricity tariffs. In the United States, energy self-sufficiency limits the risk of physical shortages, but did not prevent higher oil prices from feeding through to domestic prices, reflecting the lack of price-mitigation measures, and the larger share of motor fuels in the consumer price index basket (around 3 per cent). In the euro area, the increase in energy inflation was driven mainly by motor fuels, on which the impact of the shock was almost immediate, although partly mitigated by the fiscal measures adopted across countries. The pass-through to gas and electricity prices has been slower than that to petrol prices and has so far made a smaller contribution to the overall increase in consumer energy prices.

Historical regularities for the main advanced economies suggest that the impact on inflation depends crucially on the nature of the shocks. For the euro area (Figure A), analyses based on granular data for consumer prices between 1996 and 2024[1] show that the pass-through of oil price shocks is rapid but more short-lived, mainly affecting motor fuels, while gas supply shocks have more gradual, persistent and widespread effects, partly owing to the role of gas in electricity price formation and in production input costs. Moreover, energy shocks have a greater impact when energy prices and inflation are already high, particularly in the case of gas and electricity.[2]

Figure A

Indirect effects of energy shocks on HICP special aggregates in the euro area (1)
(per cent)



Sources: Based on ECB and Eurostat data.
(1) Response of HICP special aggregates in the euro area after 18 months to oil and gas supply shocks, under low- and high-inflation regimes. The shocks are normalized to have an immediate 1 per cent impact on energy inflation. The whiskers indicate a 68 per cent confidence interval. Estimates made for the 1996-2024 period.

Econometric estimates indicate that, over the last few decades, oil and natural gas supply shocks have been transmitted to inflation in different ways also in the United States, the United Kingdom and Japan (Figure B). In all three economies, the pass-through of oil shocks is concentrated largely within the first year. Moreover, for a given change in oil prices, the response of consumer prices is stronger in the United States and the United Kingdom than in Japan. By contrast, the impact of gas supply shocks is more uneven across countries: in the

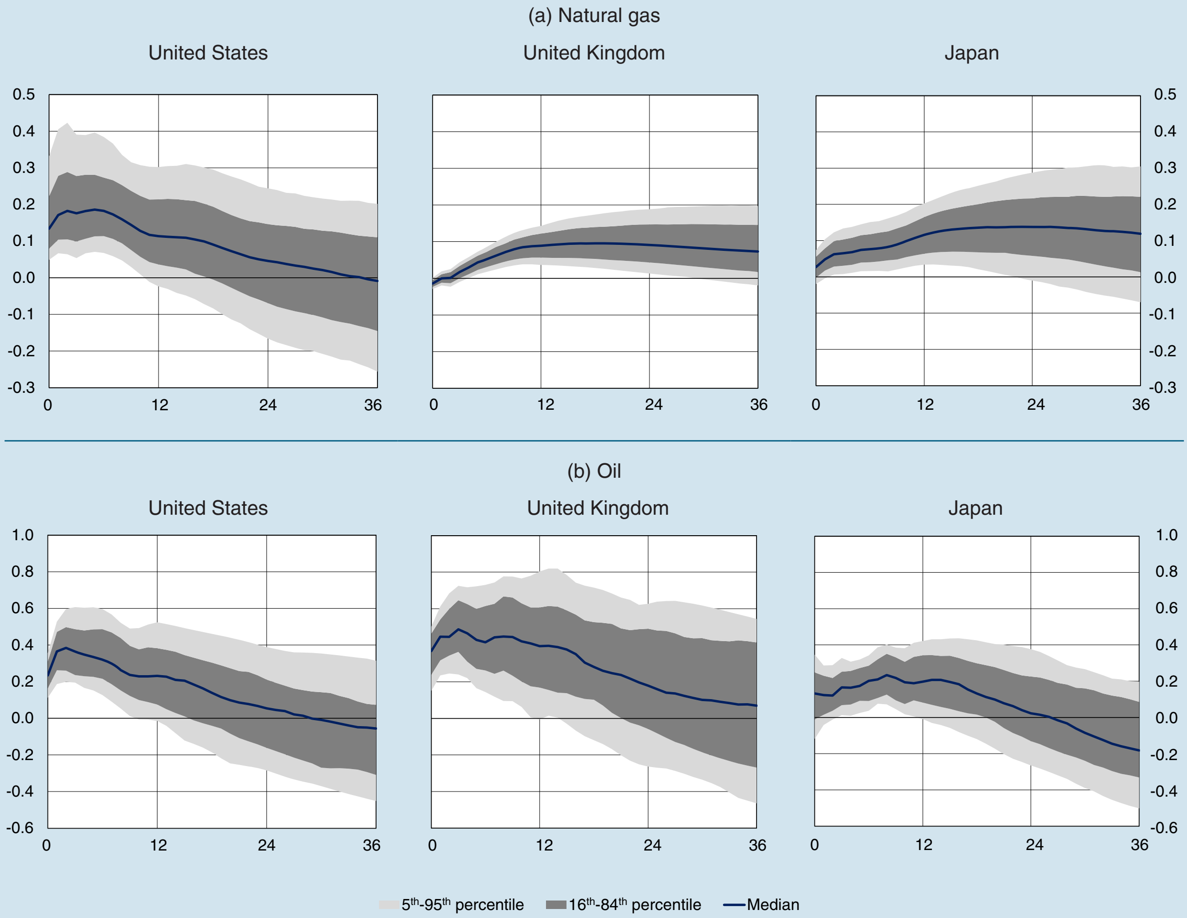
1 F. Corsello and A. Foschi, 'The different effects of oil and gas supply shocks on euro-area inflation', Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers), 1024, 2026; S. Neri, 'Energy prices, inflation and the ECB's monetary policy during the 2021-22 energy crisis', Banca d'Italia, Temi di Discussione (Working Papers), 1481, 2025, also in *European Economic Review*, forthcoming.

2 Analyses based on Italian data point to a non-linear relationship between wholesale and consumer prices: when the European gas price exceeds €50 per megawatt-hour, the pass-through to gas bills becomes about four times faster than during periods of low prices, while the pass-through to electricity prices only becomes statistically significant when prices are high (see J. Tozzo, 'Gas and electricity prices pass-through: possible scenarios for Italian inflation', Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers), forthcoming). These findings suggest that, when tensions in energy markets persist, the indirect effects on the non-energy components of inflation may be more significant, especially for food products and industrial goods.

United Kingdom and Japan, the pass-through lasts several years and results in a larger overall impact on price levels than in the United States, where its time frame is instead similar to that of oil shocks.

Figure B

Propagation of an energy shock to consumer prices in the United States, the United Kingdom and Japan (1)
(per cent)



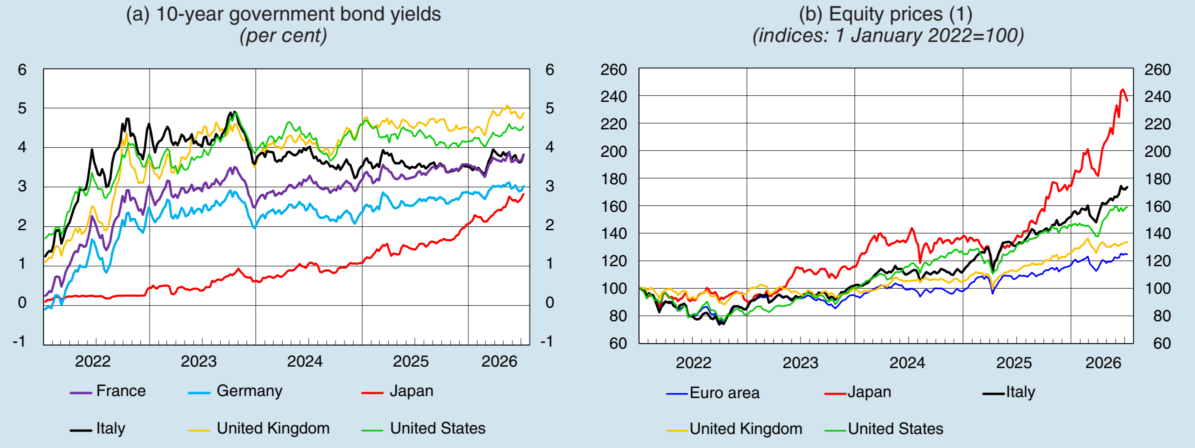
Sources: Based on Bureau of Labor Statistics and Standard & Poor's Global Ratings data for the United States; on Office for National Statistics data for the United Kingdom; and on Statistics Bureau of Japan data for Japan; LSEG.
(1) Impulse response functions of consumer prices following a 10 per cent shock to natural gas prices (panel a) and to oil prices (panel b). The horizontal axis shows months. For the propagation of a natural gas price shock, estimates are based on data for the period January 1997-January 2026 (for the United States and the United Kingdom) and May 2015-February 2026 (for Japan). For the propagation of an oil price shock, estimates are based on January 1975-December 2025 data (for all three countries).

Markets have revised their interest rate expectations upwards for the major central banks. In June, for the fourth consecutive meeting, the Federal Reserve maintained a target range for its rate of 3.50 to 3.75 per cent, removing reference to a possible monetary easing from its press release and signalling that there would be a greater focus on upside risks to inflation. The Fed's projections point to a 25-basis-point increase by the end of the year, in line with market expectations. The Bank of England also kept its rates unchanged in June, at 3.75 per cent, while the Bank of Japan raised them by 25 basis points, to 1.0 per cent; markets expect both to hike their rates by the end of this year. The People's Bank of China continues to maintain an accommodative stance.

Sovereign yields and equity markets rise and the dollar appreciates. Long-term government bond rates rose in the major advanced economies (Figure 4.a), reflecting developments in tensions in the Middle East and expectations of a tighter monetary policy stance. In the case of Japan, predictions of a more expansionary fiscal policy also weigh on the situation.

Figure 4

Government securities market indicators and equity prices
(average weekly data)



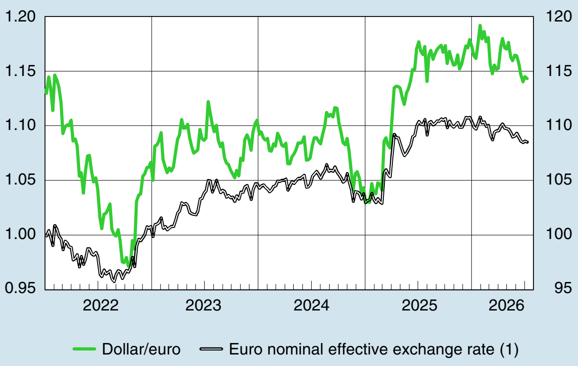
Source: LSEG. The latest figure refers to 10 July 2026.
(1) Datastream equity price index for the euro area and for Italy, Nikkei 225 for Japan, FTSE All-Share for the United Kingdom and S&P 500 for the United States.

Equity prices in the United States and Japan have risen significantly higher than where they stood before the hostilities began, while they have remained lower in the United Kingdom (Figure 4.b). Differences across countries are largely attributable to differing exposure to the technology sector, which was supported by the strong performance of AI-related industries, in particular the manufacture of data centre components and infrastructure. However, the concentration of price increases in a limited number of sectors and historically high valuations suggest caution, as some investors may have only partially assessed risks related to higher interest rates, geopolitical uncertainty and the sustainability of profitability projections.[2]

Following its depreciation in April after the announcement of the ceasefire between the United States and Iran, the dollar strengthened against the euro (Figure 5), reflecting expectations of a more restrictive stance by the Federal Reserve, lower US exposure to the energy shock and the role of the dollar as a reserve currency. The euro weakened in nominal effective terms.

Figure 5

Exchange rates
(weekly data; dollars per euro and index)



Sources: ECB and LSEG. The latest figure refers to 10 July 2026.
(1) Index: 1st week of January 2022=100. An increase in the index corresponds to an appreciation of the euro. Right-hand scale.

2 'The economic and financial system amidst uncertainty and innovation', speech by F. Panetta, Governor of Banca d'Italia, at the Meeting of the Associazione Bancaria Italiana, 15 July 2026.

1.2 THE EURO AREA

Euro-area GDP declined in the first three months of the year; net of the exceptional contraction in economic activity in Ireland, however, it grew by 0.3 per cent. According to our estimates, GDP expanded modestly in the spring, against a backdrop of uncertainty linked to the conflict in the Middle East. The rise in inflation since the onset of the hostilities has been driven by the energy components. At its June meeting, the Governing Council of the European Central Bank raised its key interest rates by 25 basis points, in response to the inflationary pressures generated by the conflict.

In the first three months of 2026 euro-area GDP, net of the marked decline in Ireland, grows at a similar pace to the previous quarters. Excluding the Irish data, GDP rose by 0.3 per cent (Table 2),[3] buoyed by the expansion of exports (which instead declined sharply if Ireland is excluded); imports stagnated, despite the good performance of the services component. Household consumption slowed, mainly owing to the fall in spending on non-durable goods. Investment decreased, partly as a result of severe weather conditions during the winter, which held back activity in the construction sector, especially in the civil engineering segment in Germany and France. Investment in capital goods instead increased.

In the same period, excluding Ireland, value added grew in industry (instead it fell sharply if Ireland is included; Figure 6), particularly in sectors more related to defence and to refined oil products, boosted by the supply problems caused by the crisis in the Middle East. Activity weakened in construction, while it increased in services, especially in professional and scientific consultancy, information and communication and tourism-related services.

Table 2

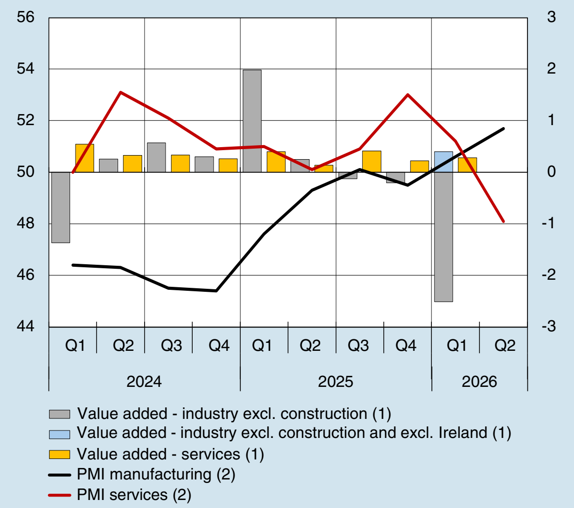
Euro-area GDP growth and inflation
(percentage changes)

	GDP growth			Inflation
	2025	2025 Q4 (1)	2026 Q1 (1)	2026 June (2)
France	0.8	0.2	-0.1	2.0
Germany	0.2	0.2	0.3	2.4
Italy	0.5	0.3	0.3	3.0
Spain	2.8	0.8	0.6	3.6
Euro area excl. Ireland	1.0	0.4	0.3	
Euro area	1.4	0.2	-0.2	(2.8)

Sources: Based on national statistics and Eurostat data.
(1) Quarterly data adjusted for seasonal and calendar effects; percentage changes on previous period. – (2) Monthly data; year-on-year percentage changes in the harmonized index of consumer prices (HICP).

Figure 6

PMIs and value added in the euro area
(monthly and quarterly data; percentage changes)



Sources: Eurostat and Standard & Poor's Global Ratings.
(1) Quarterly data adjusted for seasonal and calendar effects; percentage changes on previous period. Right-hand scale. – (2) Quarterly averages of the monthly diffusion indices for economic activity in the sector. Each index is obtained by adding half of the percentage of responses of 'stable' to the percentage of responses of 'increasing'. Values greater than 50 are compatible with expansion in the sector.

Among the main euro-area economies, GDP continued to rise markedly in Spain, driven by domestic demand. This expansion continued in Germany as well, supported by public sector consumption, and in Italy (see Section 2.1). GDP fell slightly in France, owing to the slowdown in net foreign demand (Table 2).

[3] In Ireland, there are sharp fluctuations in the measure of economic activity, partly due to the tax optimization accounting practices adopted by the multinational companies based there. The main contribution to the fall in GDP (-12.1 per cent) in the first quarter came from the sharp decline in the goods exports attributable to these firms, especially in the pharmaceutical sector.

The hostilities in the Persian Gulf have had a significant impact on euro-area GDP. According to our estimates and excluding the volatility of Irish data, euro-area economic activity increased modestly in the second quarter. The contribution of services to growth appears to have faded considerably, as indicated by the sharp worsening in the expectations of firms in the sector (Figure 6). Services to households, whose spending decisions tend to be more cautious, had a major impact on the slowdown in the service sector, while business services continued to expand, particularly in the areas of information and communication and of technical and professional consultancy. Manufacturing activity continued to make a positive contribution, in line with the indications of the PMI for current production. Activity appears to have been partly boosted by the frontloading of production in anticipation of further increases in commodity costs and of slowdowns in global supply chains. These developments seem to have mainly affected sectors with significant demand, such as those linked to the digital and energy transition and to the growth in military spending, as well as those that are more integrated into global value chains, such as pharmaceuticals.

Household consumption slows further. Its growth was affected by the significant deterioration in assessments of the general state of the economy, by concerns about labour market developments, by higher energy prices and by their negative impact on real disposable income.

Capital formation makes a slightly positive contribution to GDP's performance. Investment in machinery and equipment increased in the second quarter, in line with the improvement in the confidence of firms producing capital goods observed at the beginning of the year, prior to the conflict in the Middle East. Investment in construction also appears to have expanded, benefiting from the recovery in construction activity, the German government's fiscal stimulus for the renewal of infrastructure and the progress of the projects financed by the Recovery and Resilience Facility in several countries.

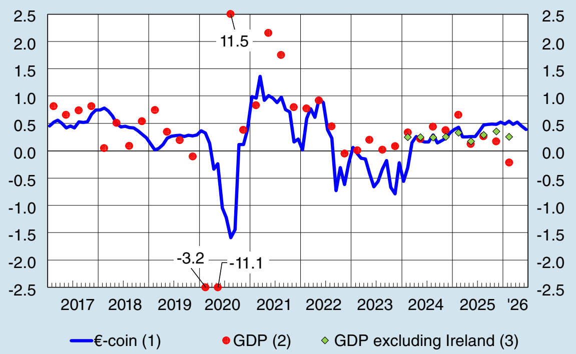
The performance of exports remains weak. The European Commission's surveys and the PMIs point to weak external demand overall in the second quarter; however, there is still a positive trend in the electronics, electrical equipment and defence-related sectors.

The underlying growth of the euro area has waned, as shown by the slight decline in the €-coin indicator in recent months (Figure 7).[4] The overall positive boost from industry has been offset by the rapid deterioration in the confidence of households and service firms.

Euro-area growth forecasts are revised slightly downwards. The Eurosystem staff macroeconomic projections released in June[5] point to GDP growth of 0.8 per cent in 2026, 1.2 per cent in 2027 and 1.5 per cent in 2028. Compared with March, the estimates have been revised downwards by 0.1 percentage points for

Figure 7

€-coin cyclical indicator and euro-area GDP
(monthly and quarterly data; percentage changes)



Sources: Banca d'Italia and Eurostat.
(1) For €-coin, monthly estimates of changes in GDP on the previous quarter, net of the most erratic components. The methodology used to construct the indicator and the updated data for the indicator are available on Banca d'Italia's website: 'Cyclical coincident indicator of the euro-area economy (€-coin)'. – (2) For GDP, quarterly data; percentage changes on the previous quarter. The €-coin indicator incorporates the information available up to 29 May 2026 and therefore does not include the marked downward revision of the change in GDP in the first quarter of 2026, from 0.1 to -0.2 per cent, which reflects the exceptional contraction in economic activity in Ireland. – (3) The figure also shows the change in euro-area GDP excluding Ireland, owing to the extreme volatility of the latter's data, which is largely unrelated to the European economic cycle.

4 The performance of the €-coin indicator in recent months is consistent with that of euro-area GDP, net of the strong fluctuations in the Irish economy.

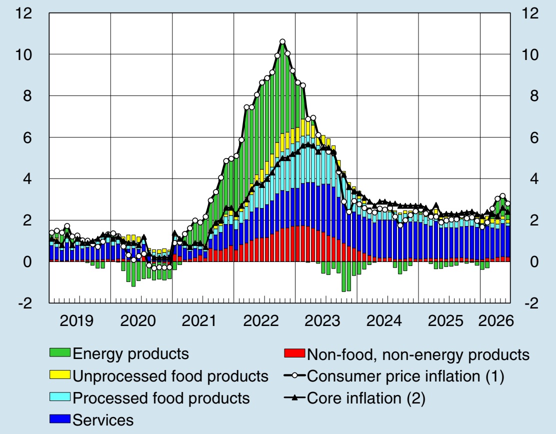
5 For more information, see the ECB's website: 'Eurosystem staff macroeconomic projections for the euro area', June 2026.

both 2026 and 2027, reflecting the greater impact of the crisis in the Middle East on commodity prices, real incomes and consumer confidence.

Inflation rises. The twelve-month change in the consumer price index reached 3.0 per cent in the spring months, driven above all by the energy component. The growth in the prices of the core component, which excludes food and energy products, increased marginally, spurred by the rise in non-energy industrial goods inflation. Among the most volatile components, energy inflation rose, mainly driven by higher fuel prices, while food inflation declined. In June, the fall in oil prices brought both energy and headline inflation down from the peaks reached in the previous month (Figure 8).

Figure 8

Consumer price inflation, contributions of its components, and core inflation in the euro area
(monthly data; percentage changes and points)



Sources: Based on ECB and Eurostat data.
(1) 12-month percentage change in the HICP. – (2) 12-month percentage change in the HICP, excluding energy and food.

Import prices recorded further growth in May, which spread to all the main components. The producer price inflation of industrial goods sold on the domestic market, excluding energy, rose to 2.8 per cent on an annual basis. The PMI recorded a deceleration in input prices in June, in both the manufacturing and above all in the service sectors, where it stood below the levels observed in April.

Contractual wages in the euro area slow. In the first quarter, wage growth faded more markedly in Germany and to a lesser extent in Spain and France, while it remained stable at moderate levels in Italy. According to the indications of the European Central Bank's wage tracker,[6] the increase in wages is expected to stabilize at around 2.6 per cent over the year. This weak wage growth is also being affected by the cooling in labour demand, as measured by the number of vacancies; the latter declined, while the unemployment rate remained stable at low levels (see the box 'The euro-area labour market: insights from vacancy and worker flow data). Headcount employment in the euro area rose slightly in the first three months of 2026 and the latest indicators suggest that it continued to expand at a modest pace in April and May as well.

THE EURO-AREA LABOUR MARKET: INSIGHTS FROM VACANCY AND WORKER FLOW DATA

In the first four months of 2026, the euro-area unemployment rate remained at historically low levels, at around 6 per cent. However, this trend was accompanied by a decline in labour demand, as measured by the job vacancy rate,[1] which fell to very low levels compared with the last five years (see panel (a) of Figure A). As a result, labour market tightness – measured as the ratio of job vacancies to the number of job seekers – declined, continuing the downward trend under way since the second half of 2022 (see panel (b) of Figure A). According to the latest Indeed Hiring Lab data on online job vacancies published, labour demand appears to have slackened further in the second quarter of

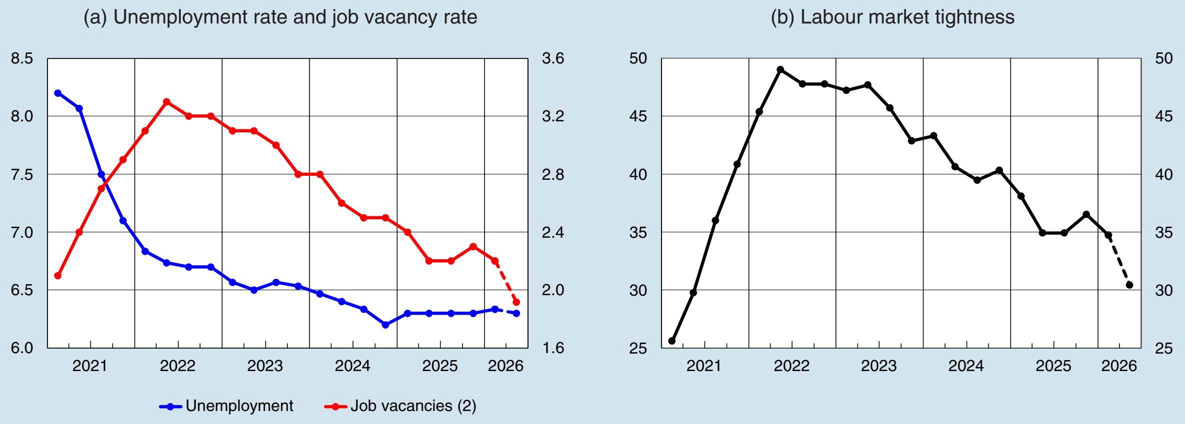
1 The job vacancy rate is defined as the ratio of vacant positions to the sum of occupied and vacant positions, expressed as a percentage.

6 The wage tracker is an indicator that measures wage growth based only on active collective bargaining agreements; for further details, see the box 'The impact of recent contractual wage increases on wage growth', *Economic Bulletin*, 1, 2026).

this year. The different dynamics of the job vacancy rate point to a weakening in labour demand that cannot be captured by the unemployment rate alone. The latter reflects fluctuations in labour supply and does not distinguish whether employment growth stems from greater job creation or lower job destruction.

Figure A

Unemployment, job vacancies and labour market tightness (1)
(quarterly data; per cent)



Source: Based on Eurostat data.
(1) For the second quarter of 2026, the unemployment rate and the job vacancy rate correspond to the average for the April-May values. The job vacancy rate is calculated using Indeed Hiring Lab data. Labour market tightness in the second quarter of 2026 is calculated using provisional values for the unemployment and job vacancy rates. – (2) Right-hand scale.

Our analysis of worker flows between employment, unemployment and inactivity (marked as E, U and I, respectively) makes it possible to break down changes in the unemployment rate. Using Eurostat data on transition probabilities between the three labour market states,[2] quarterly flows are grouped into three categories: (a) rates of entry into employment (from U to E and from I to E), which usually account for the largest share of changes in the unemployment rate; (b) rates of exit from employment (from E to U and from E to I); and (c) flows into inactivity due to discouragement (from U to I) and flows into active job searching (from I to U).

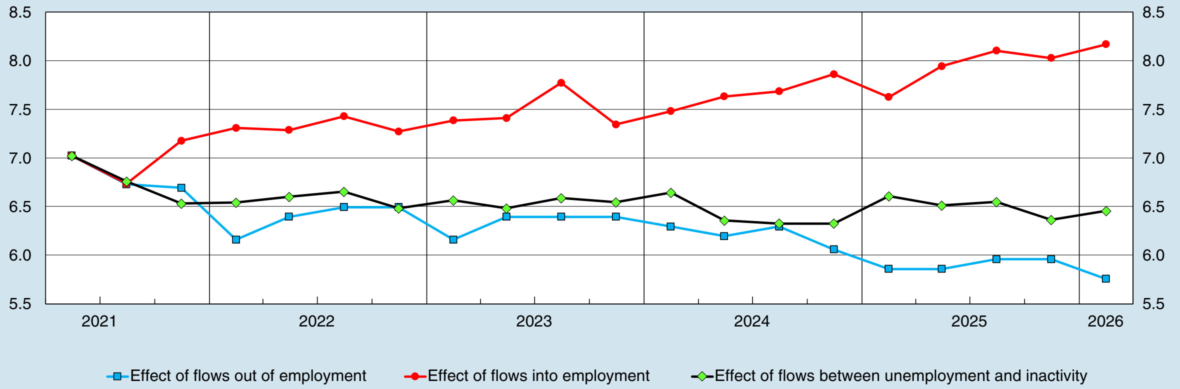
Figure B isolates the contribution of each category to unemployment rate developments in the period between the peak reached in the second quarter of 2021 and the latest available data (the first quarter of 2026). Each line shows the counterfactual path of the unemployment rate due to the flows in each category, with all other flows held constant at their first observed value (for example, the red line shows the path of the unemployment rate if only the rates of entry into employment had changed over time). The factors that helped to reduce unemployment were lower rates of exit from employment, and thus greater job stability (largely attributable to population ageing and later retirement), as well as increased discouragement among job seekers. Conversely, changes in flows into employment exerted upward pressure on the unemployment rate. Overall, the prolonged decline in the unemployment rate observed over the last four years reflects the contribution of structural factors and of weak labour supply, amid a slowdown in employment growth.

[2] The transition probabilities between the three labour market states are calculated using information from the longitudinal dataset of Eurostat's Labour Force Survey.

Figure B

Counterfactual unemployment rate developments based on worker flows (1)

(quarterly data; per cent)



Source: Based on Eurostat data.

(1) The blue line shows the counterfactual path of the unemployment rate in a scenario in which only the flows from employment to inactivity (E to I) and from employment to unemployment (E to U) vary over time. The red line shows the counterfactual path of the unemployment rate in a scenario in which only the flows from unemployment to employment (U to E) and from inactivity to employment (I to E) vary over time. The green line shows the counterfactual path of the unemployment rate in a scenario in which only the flows from unemployment to inactivity (U to I) and from inactivity to unemployment (I to U) vary over time. In each scenario, all other transition rates are held constant at the value observed in the second quarter of 2021 (the first observation in the time series). This exercise breaks down the dynamics of the equilibrium unemployment rate, i.e. the level towards which the unemployment rate would converge at each point in time if there were no changes in transition rates.

Inflation forecasts are revised upwards. According to the June Eurosystem staff projections, inflation will stand at 3.0 per cent in 2026 and at 2.3 per cent in 2027, returning to 2.0 per cent in 2028.[7] Compared with the March projections, the estimates have been revised upwards by 0.7 percentage points overall for the years 2026-27, mainly as a result of the increase in energy commodity prices and to the more marked indirect effects on non-energy inflation.

Households and firms expect higher inflation in the short term. The surveys conducted by the European Commission and the PMIs point to an increase on average in the second quarter in both the growth in selling prices expected by firms, especially in the sectors most exposed to higher energy costs, and in the inflation expected by consumers; however, this trend, which is being affected by the conflict in the Middle east, slackened over the quarter. According to the ECB's Consumer Expectations Survey, the median for consumer price inflation expectations over a twelve-month horizon for euro-area households fell to 3.5 per cent in May (from 4.0 per cent the previous month); expectations for longer-term horizons are lower.

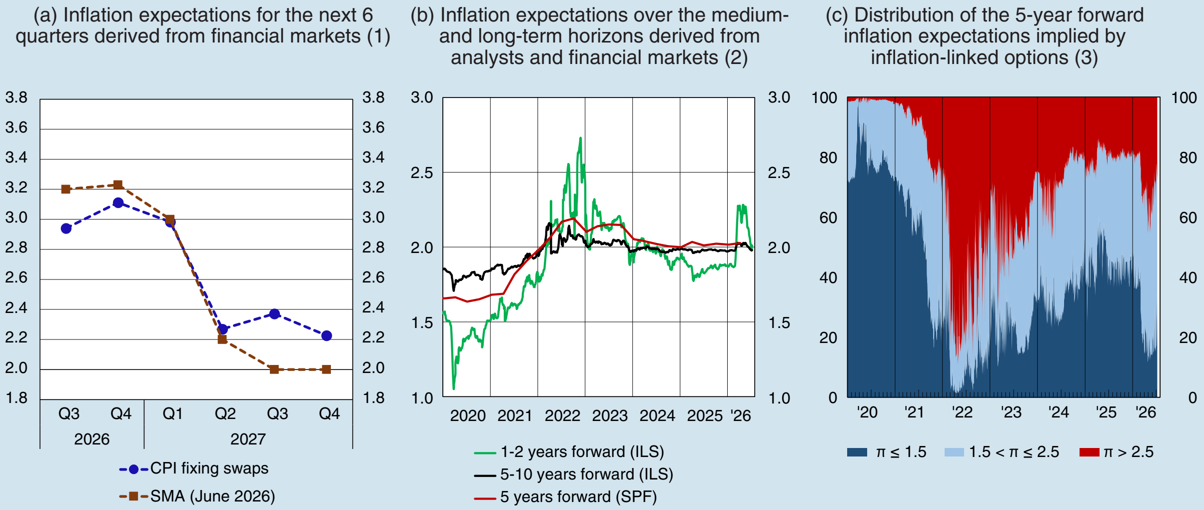
Short-term inflation expectations increase, while medium- and long-term inflation expectations remain anchored to the target. Since the second half of June, CPI fixing swaps[8] have included an expected inflation of 3.1 per cent at the end of 2026 and of between 2.2 and 2.4 per cent from the second quarter of 2027. According to the experts interviewed by the ECB at the end of May for the Survey of Monetary Analysts (SMA), inflation is expected to be above 3 per cent in the

[7] In addition to the baseline scenario, the ECB published three alternative scenarios – a more favourable one, an adverse one and a severe one – which, for illustrative purposes, project alternative paths for energy commodity prices and their pass-through to euro-area inflation and economic activity.

[8] CPI fixing swaps are swap contracts linked to the publication of monthly data on annual euro-area inflation, as measured by the HICP index excluding tobacco. The interest rates implied by these contracts indicate the annual inflation expected by financial markets over the next 24 months. Inflation expectations based on CPI fixing swaps are updated more frequently than those of analysts, and may be affected by sudden reactions to news about macroeconomic developments in the euro area and in the other major economies. For more details, see M. Bernardini, L. D'Arrigo, A. Lin and A. Tiseno, 'Real interest rates and the ECB's monetary policy stance', Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers), 857, 2024.

Figure 9

Inflation expectations in the euro area
(daily data; per cent)



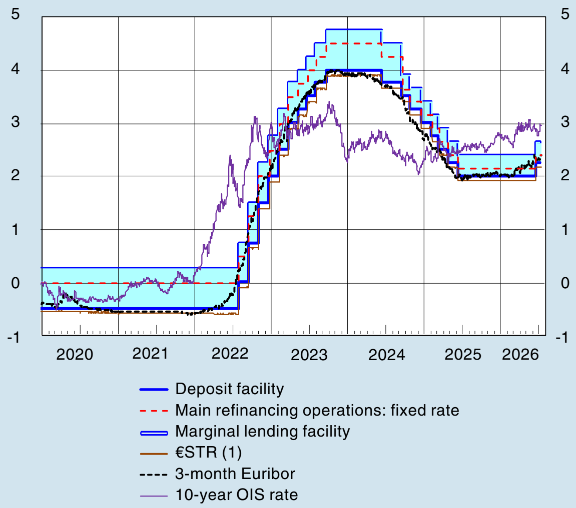
Sources: ECB and based on Bloomberg data. The latest figure refers to 2 July 2026, unless otherwise specified.
(1) Expected annual inflation rates for the next six quarters, implied by CPI fixing swaps (the underlying inflation rate is calculated on the euro-area HICP excluding tobacco) and the median of the expectations of respondents to the ECB for the SMA conducted between 25 and 27 May 2026. – (2) Expected inflation rates implied by ILS contracts with a duration of between 1 and 2 years ahead and between 5 and 10 years ahead, excluding risk components (see F. Lilla and G. Zinna, 'Survey-based daily estimates of inflation expectations and risk premia in the euro area', Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers), 991, 2025) and 5-year forward inflation expectations derived from the quarterly Survey of Professional Forecasters (SPF); the latest figure refers to the second quarter of 2026. – (3) The distribution of expected inflation (π) is estimated based on the prices of zero-coupon inflation options in the euro area over a 5-year horizon. The underlying inflation rate is calculated based on the euro-area HICP excluding tobacco.

third quarter of 2026, before gradually going down and returning to the 2 per cent target in the same period of 2027 (Figure 9.a). Inflation expectations as implied by inflation-linked swaps (ILS) over the one-year, one-year forward horizon have fluctuated between 2.0 and 2.2 per cent since the beginning of May (Figure 9.b). The distribution of inflation expectations based on options prices indicates a higher than 15 per cent probability of inflation being below 1.5 per cent on average over the next five years, while the probability of inflation exceeding 2.5 per cent is around 30 per cent (Figure 9.c).

The ECB raises its key interest rates. At its June meeting, the ECB Governing Council raised its key interest rates by 25 basis points (Figure 10), highlighting that the tensions in the Middle East are generating widespread inflationary pressures and that the decision is justified by taking account of various scenarios regarding the evolution of both the conflict and of the medium-term outlook for the euro area. The markets expect a further 25-basis point increase between September and December.

Figure 10

Key interest rates and money market rates in the euro area
(daily data; per cent)

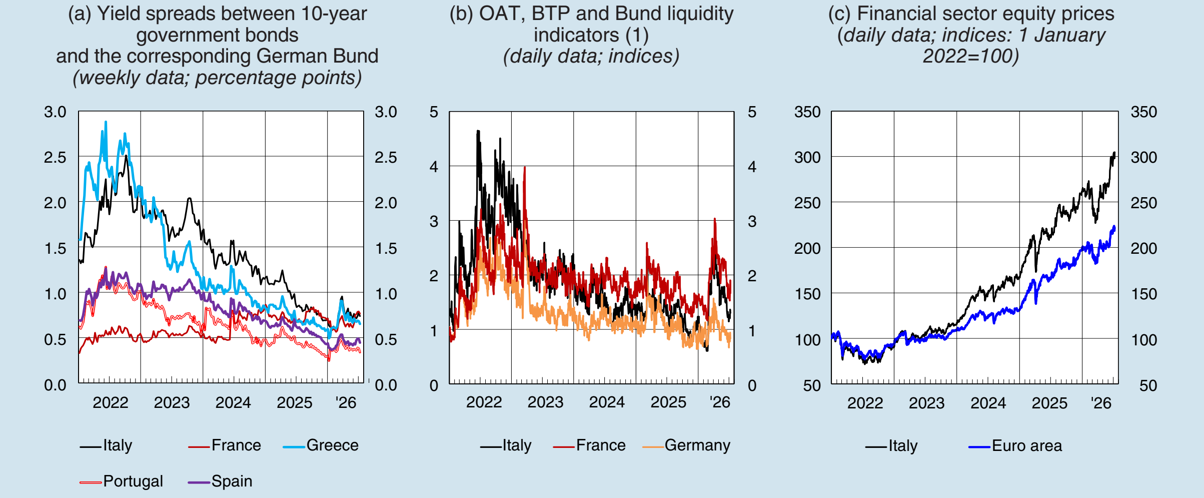


Sources: ECB and LSEG. The latest figure refers to 10 July 2026.
(1) As of 1 October 2019, the euro short-term rate (€STR) is the overnight benchmark rate for the euro-area money market.

Government bond yields remain virtually unchanged. The yields on the ten-year government bonds of the main euro-area countries are similar to those in April, except in France, where they increased (Figure 4.a). The yield spreads between the sovereign bonds of the main countries and the German Bund remained practically unchanged, with the exception of France, where the spread widened (Figure 11.a). Liquidity conditions in the government bond markets improved overall (Figure 11.b).

Figure 11

Government securities market indicators and equity prices



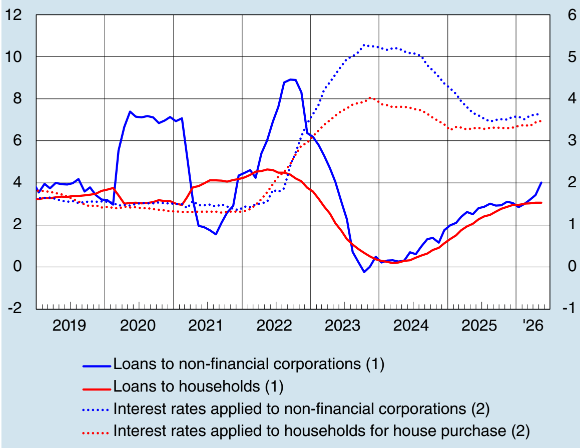
Sources: LSEG, based on Bloomberg and Tradeweb data. The latest figure refers to 10 July 2026, when not otherwise specified.
(1) OATs: *obligations assimilables du Trésor*. The methodology for calculating the indicator is described in R. Poli and M. Taboga, 'A composite indicator of sovereign bond market liquidity in the euro area', Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers), 663, 2021.

Stock prices rise. The euro-area equity index has risen since the beginning of April, returning to pre-conflict levels (Figure 4.b). This increase reflected better than expected results in the financial and energy sectors in the first quarter of the year, as well as an upward revision of expected earnings. In the euro area, as in the United States, the stock prices of technology firms also rose sharply, although they carry less weight in the European index than in that of the United States. The Italian stock market performed better than that of the euro area, buoyed by the good performance of financial sector securities (Figure 11.c).

The average cost of lending to households and firms has risen slightly. The interest rate on both new loans to non-financial corporations and new mortgage loans to households rose by about 10 basis points between February and May (Figure 12), despite the greater increase in short- and long-term market interest rates observed over the period.

Figure 12

Lending and interest rates in the euro area
(monthly data)



Source: ECB.
(1) 12-month percentage changes are calculated net of reclassifications, exchange rate variations, value adjustments, and other variations not due to transactions. Loans include bad debts, repos and loans not reported in banks' balance sheets because they have been securitized. – (2) Per cent. Average of interest rates on new short-, medium- and long-term loans, weighted using the 24-month moving average for new loan disbursements; for non-financial corporations, includes overdrafts. Right-hand scale.

Growth in lending to firms has strengthened. Growth in lending to non-financial corporations in the euro area went up in May (to 4.0 per cent on an annual basis), mainly driven by short- and medium-term loans. Lending accelerated in France, Spain and Italy (see Section 2.7), while its growth remained weak in Germany.

Credit standards for firms worsen again. In the euro area bank lending survey (BLS) for the first quarter of the year,[9] banks reported a further tightening of the credit standards applied to new bank loans to firms. This was due to the higher perceived risks to the economic outlook and to a lower risk tolerance.

Firms' demand for credit remained weak in the first three months of the year and decreased slightly compared with the previous quarter, mainly because there was less need to finance fixed investment. However, some banks indicated that recent developments in energy markets fostered an increase in demand for loans for liquidity needs in the second quarter of the year.

Lending to households continues to grow at a moderate pace. The growth in lending to households in May remained at similar levels to those recorded in February in all the main euro-area countries. The dynamics of loans to households for house purchase continue to reflect a still robust demand overall: according to the banks participating in the BLS, mortgage demand remained unchanged in the first quarter of the year for the first time after seven consecutive quarters of increases. Banks tightened their credit standards slightly for mortgage loans, mainly as a result of higher perceived risk, which was only partly offset by greater competition among banks.

9 For more details, see ECB, 'April 2026 euro area bank lending survey', press release, 28 April 2026.

2 THE ITALIAN ECONOMY

2.1 CYCLICAL DEVELOPMENTS

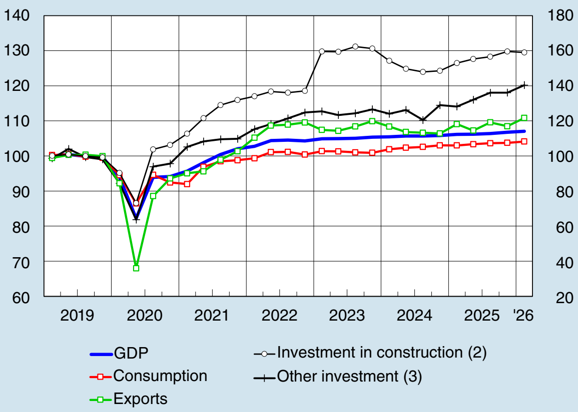
Italy's GDP continued to expand in the first quarter of 2026, supported by both domestic and foreign demand. Our estimates indicate that economic activity slowed in the second quarter, reflecting the lessening momentum in consumption and investment, which were held back by uncertainty over the international outlook and by the rise in energy prices.

Italian GDP grows in the early months of the year. Economic activity increased by 0.3 per cent in the first quarter, as it had done in the previous period, largely thanks to the marked increase in exports of goods and services (Figure 13 and Table 3), driven by temporary factors such as the Winter Olympics and the sale of goods relating to the shipbuilding sector, whereas imports declined. Investment continued to expand, driven by both non-residential construction and by transport equipment, with the latter benefiting from incentives for the purchase of low-emission commercial vehicles. Household consumption accelerated, especially as regards durable goods, which also benefited from the incentives for the renewal of vehicle fleets. Consumption growth reflected positive developments in disposable income, leading to a broadly stable saving ratio.

Figure 13

GDP and its main demand components (1)

(quarterly data; indices: 2019=100)



Source: Based on Istat data.
(1) Chain-linked volumes; data adjusted for seasonal and calendar effects. – (2) Right-hand scale. – (3) Includes, as well as investment in plant, machinery and arms (which also include transport equipment), cultivated biological resources and intellectual property products.

Value added grows in services. Value added grew significantly in services, albeit at varying rates across different areas: the expansion was pronounced in the sectors providing logistical support to firms and in those connected with tourism, whereas there was a decline in the financial and insurance sectors (see Section 2.2). Activity slowed in manufacturing, in spite of the persistently robust performance of the sectors exposed to technological upgrading, the energy transition and the increase in defence spending. At the same time, activity declined in construction.

Economic activity seemingly decelerates in the spring. Capital formation appears to have waned in the second quarter. The positive impulse from the digital and energy transition and from projects funded by the National Recovery and Resilience Plan (NRRP) was partly offset by the rising uncertainty and by the surge in the prices for energy products and production inputs connected to tensions in the Middle East (see Section 2.6). Household consumption slowed, reflecting poorer confidence and expectations for the international economic situation and the rise in energy prices (see Section 2.3). The contribution of net foreign demand to growth is expected to be almost nil, in line with qualitative information on foreign orders (see Section 2.4).

Table 3

GDP and its main components (1)
(percentage changes on previous period and percentage points)

	2025	2025			2026
		Q2	Q3	Q4	Q1
GDP	0.5	0.0	0.2	0.3	0.3
Imports of goods and services	3.6	0.2	2.0	1.3	-0.7
Domestic demand (2)	1.3	0.6	0.1	1.1	-0.7
Domestic consumption	0.9	0.3	0.3	0.1	0.4
Household spending (3)	1.1	0.3	0.3	0.1	0.5
General government spending	0.6	0.4	0.1	0.2	0.0
Gross fixed investment	3.5	1.6	1.3	1.0	0.7
Construction	3.3	1.5	0.8	1.9	-0.4
Capital goods (4)	3.6	1.7	1.7	0.0	1.8
Change in inventories (5)	-0.2	0.0	-0.4	0.7	-1.1
Exports of goods and services	1.2	-1.7	2.2	-1.0	2.2
Net exports (6)	-0.7	-0.6	0.1	-0.7	0.9

Source: Istat.
(1) Chain-linked volumes; the quarterly data are seasonally and calendar adjusted. – (2) Includes the item ‘changes in inventories, including valuables’. – (3) Includes non-profit institutions serving households. – (4) Include investment in plant, machinery and arms (which also include transport equipment), cultivated biological resources and intellectual property products. – (5) Includes valuables; contributions to GDP growth on previous period; percentage points. – (6) Difference between exports and imports; contributions to GDP growth on previous period; percentage points.

According to our macroeconomic projections published in early June, GDP growth will remain muted in the baseline scenario: GDP is estimated to rise by 0.5 per cent this year, by 0.4 per cent next year and by 0.9 per cent in 2028 (see the box ‘The macroeconomic projections for the Italian economy published in June’).

THE MACROECONOMIC PROJECTIONS FOR THE ITALIAN ECONOMY PUBLISHED IN JUNE

On 12 June 2026, Banca d’Italia published its projections for the Italian economy for 2026-28, prepared by its staff members as part of the Eurosystem coordinated exercise.[1] In view of the high uncertainty surrounding the forecasting scenario, the baseline projections were accompanied by alternative scenarios that explore the impact on the Italian economy of different assumptions on commodity price developments.

In the baseline macroeconomic projection, energy prices rise markedly in 2026, before gradually declining over the course of 2027, in line with futures prices. Global trade, held back this year by heightened uncertainty and rising commodity prices, is assumed to gradually pick up over the next two years. Borrowing costs for firms and households are assumed to increase over the entire projection horizon.

Based on these assumptions, Italy’s GDP is estimated to increase by 0.5 per cent in 2026, by 0.4 per cent in 2027 and by 0.9 per cent in 2028 (see the table). These estimates do not incorporate the revision of the quarterly accounts published by Istat on 29 May. Taking this revision into account, and all other things being equal, projected GDP growth this year is 0.6 per cent. Domestic demand will likely be affected by the surge in energy prices, the deterioration in business and consumer confidence, and the rise in financing costs; it is only expected to regain momentum in 2028, as inflationary pressures ease. Export growth looks set to be moderate in 2026, owing to the slowdown in global demand and the appreciation of the euro, and to

[1] Banca d’Italia, ‘Macroeconomic projections for the Italian economy (Eurosystem staff macroeconomic projections)’, 12 June 2026. The projections are based on information available as at 21 May (for the technical assumptions) and as at 27 May (for other data).

strengthen over the next two years. Employment is estimated to continue to expand at a moderate pace. The unemployment rate is expected to remain broadly stable over the projection horizon, close to historical lows. Consumer price inflation is projected to rise to 3.1 per cent this year, mainly reflecting the sharp rise in energy prices, and to return to 2 per cent over the next two years. Excluding food and energy, consumer price growth is projected to be close to 2 per cent over the entire projection horizon.

Table

GDP growth and inflation: forecasts by Banca d'Italia and other organizations
(percentage changes on previous period)

	GDP (1)			Inflation (2)		
	2026	2027	2028	2026	2027	2028
Banca d'Italia (June)	0.5	0.4	0.9	3.1	2.0	1.9
OECD (June)	0.5	0.6	–	3.0	2.2	–
European Commission (May)	0.5	0.6	–	3.2	1.8	–
IMF (July/April)	0.5	0.5	–	2.6	2.4	–
PBO (April)	0.5	0.6	0.6	3.0	2.3	1.9
MEF – current legislation scenario (April)	0.6	0.6	0.8	2.9	2.0	1.5
Memorandum item: Banca d'Italia (April)	0.5	0.5	0.8	2.6	1.8	1.9

Sources: Banca d'Italia, 'Macroeconomic projections for the Italian economy (Eurosystem staff macroeconomic projections)', 12 June 2026, and 'Macroeconomic projections for the Italian economy', 3 April 2026; OECD, *OECD Economic Outlook. Under Pressure*, June 2026; European Commission, *European Economic Forecast. Spring 2026*, May 2026; IMF, *World Economic Outlook Update. Global Economy in Crosscurrents of War and Technology*, July 2026, for growth, and *World Economic Outlook. Global Economy in the Shadow of War*, April 2026, for inflation; Parliamentary Budget Office (PBO), 'Hearing of the Chair of the Parliamentary Budget Office as part of the hearings taking place before the examination of the Public Finance Document 2026', April 2026; Ministry of Economy and Finance (MEF), Public Finance Document 2026, April 2026.
(1) The growth rates indicated in the projections made by Banca d'Italia and the OECD are adjusted for calendar effects; without this adjustment, the projected GDP growth rate is 0.6 per cent in 2026, 0.4 per cent in 2027 and 0.7 per cent in 2028. Our growth estimates do not include the impact of the revision of the quarterly national accounts published by Istat on 29 May. – (2) HICP. The PBO's forecasts refer to the consumption deflator.

Compared with the projections published last April, growth estimates have been revised marginally downwards for 2027 and upwards for 2028. Inflation projections have been revised upwards by 0.5 percentage points for 2026 and by 0.2 percentage points for 2027, mainly owing to higher commodity prices. The growth projections presented here are largely in line with those made by the main forecasters for 2026 and generally lower for 2027. The inflation projections are higher than those of most analysts for 2026.

The uncertainty surrounding these estimates is high. More favourable developments could stem from a faster decline in commodity prices than in the baseline projections as a result of the recent memorandum of understanding between the United States and Iran, from the positive impact of higher defence spending at European level, and from the possibility of an acceleration in investment as a result of the digital and energy transition process. Conversely, the ongoing tensions between the United States and Iran and delays in restoring trade flows (especially for energy goods) through the Strait of Hormuz could raise inflationary pressures, further weakening international trade and confidence, with a sharply negative impact on growth, especially if accompanied by financial market tensions. The possible consequences of alternative developments in the Middle East crisis and its effects on commodity price developments are assessed in the various scenarios published in June (see the box 'The consequences of the conflict in the Middle East: alternative scenarios', in Banca d'Italia, 'Macroeconomic projections for the Italian economy (Eurosystem staff macroeconomic projections)', 12 June 2026).

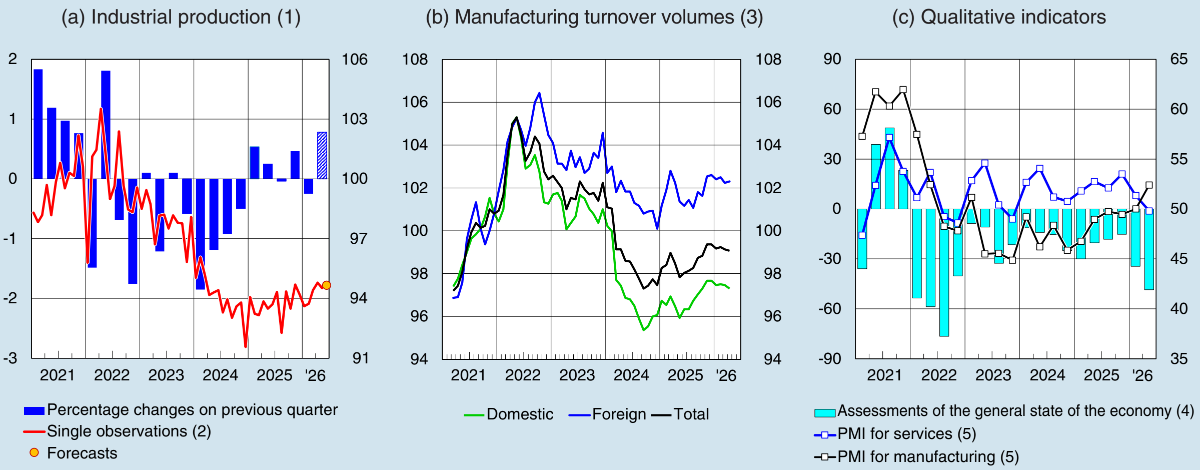
2.2 FIRMS

In the second quarter, economic activity returned to growth in manufacturing and in construction, especially in the non-residential sector. Value added instead slowed in services, reflecting greater caution on the part of consumers. Investment appears to have made a modest contribution to growth, held back by the uncertainty surrounding the effects of the tensions in the Middle East.

Value added and industrial production slow in the first quarter. The decline affected the production of consumer goods, especially durable goods, and to a lesser extent some sectors that had shown particularly strong growth in the second half of 2025, including pharmaceuticals. The ongoing weakness in demand continues to weigh on the textile and clothing industry. Production instead continued to expand in the sectors more closely linked to the digital transition and to defence, as well as in the machinery and equipment sector, albeit at a slower pace than in the second half of the previous year (Figure 14.a). Turnover volumes reduced slightly, mainly owing to the domestic component (Figure 14.b).

Figure 14

Industrial production, manufacturing turnover and qualitative indicators for industry and services
(quarterly data, unless otherwise specified)



Sources: Based on data from Banca d'Italia, Istat, Standard & Poor's Global Ratings and Terna.
(1) Data adjusted for seasonal and calendar effects. The yellow dot indicates the forecast for June 2026, the last bar represents the forecast for the second quarter of 2026. – (2) Monthly data. Index: 2021=100. Right-hand scale. – (3) Monthly data, volumes, 3-month moving average ending in the reference month. – (4) Balance, in percentage points, between the responses 'better' and 'worse' to the question on the general state of the economy (see 'Survey on Inflation and Growth Expectations', Banca d'Italia, Statistics Series, 14 July 2026). – (5) Average quarterly data. Diffusion indices for economic activity in the sector. Right-hand scale.

Economic activity in services returns to growth. Value added in the service sector rose in the first quarter, but with uneven trends across sectors. Economic activity contracted again in financial and insurance services, while it continued to expand in information and communication services, supported by the ongoing technological transformation. Logistical support services to firms and tourism-related activities rose for the fifth consecutive quarter, which, in the case of the latter, was partly as an effect of the Winter Olympics.

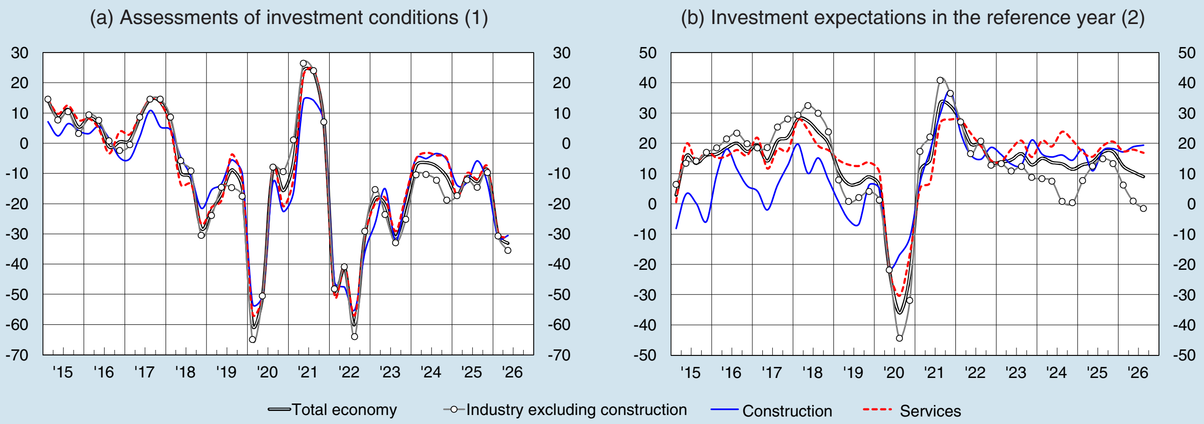
Activity in construction drops, instead. Value added dropped in the construction sector, largely on account of the residential component. Investment in housing declined, that is, after rising markedly in the latter part of 2025 ahead of the expiry of incentives for restructuring, which were subsequently extended until the end of 2026. At the same time, capital formation returned to growth in the non-residential sector.

Investment increases. Total investment continued to increase in the winter months, driven by the recovery in the transport equipment component, which was supported by incentives for the purchase of low-emission commercial vehicles. Investment in intangibles continued to record positive growth, as it has for more than two years now, whereas investment in construction declined.

In the spring months, manufacturing activity expands again. Industrial production returned to growth in April and May. The PMI for the manufacturing sector rose in the second quarter, partly on account of favourable developments for new orders (Figure 14.c), which is consistent with the confidence indicators included in Istat's surveys. However, the strengthening of demand in the manufacturing sector can be partly attributed to precautionary stockpiling along supply chains. The prolonged tensions in the Middle East have heightened supply difficulties and cost pressures, prompting firms to frontload the purchase of intermediate goods. Strains on global supply chains pose additional risks to the outlook for the sector. Banca d'Italia's Survey on Inflation and Growth Expectations, conducted in June, shows less pessimistic assessments on current demand than in the previous survey (Figure 15). Sales expectations remain favourable, despite a weakening among the firms most exposed to foreign markets.

Figure 15

Firms' assessments of investment conditions and expectations for investment expenditure
(quarterly data; percentage points)



Source: 'Survey on Inflation and Growth Expectations', Banca d'Italia, Statistics Series, 14 July 2026.
(1) Balance between positive and negative assessments compared with the previous quarter. – (2) Balance between expectations of an increase and of a decrease compared with the previous year. Expectations for the reference year are surveyed starting from the fourth quarter of the preceding year.

Activity in services appears to have slowed. There are signs of services decelerating, particularly in the sectors more closely connected to household consumption. The confidence of service firms is diminishing, as shown both by the PMI indicators, which have fallen below the threshold compatible with expansion, and by Istat's qualitative surveys. The deterioration in assessments is more marked among firms providing services to households, such as tourism, whereas less unfavourable assessments prevail for business services – especially in the information and communication sector and the technical and professional consulting sector. The service firms interviewed for Banca d'Italia's surveys reported a slight pickup in demand on the previous quarter, though expectations regarding an expansion in sales remain cautious.

The construction sector returns to growth. Economic activity in construction expanded in the second quarter, driven above all by the civil engineering segment, which continued to benefit from NRRP-funded projects. The firms interviewed in the Survey on Inflation and Growth Expectations reported an improvement in demand for their products compared with the previous survey and gave a less negative assessment of their expectations regarding their own business conditions.

Capital formation appears to have increased slightly. Investment benefited from the still positive contribution from structural factors linked to the digital and energy transition, although this was partly offset by rising energy costs and weak household demand stemming from tensions in the Middle East. Banca d'Italia's business surveys point to an expansion in fixed investment expenditure in 2026 as a whole, despite the fact that investment conditions are not yet deemed favourable.

2.3 HOUSEHOLDS

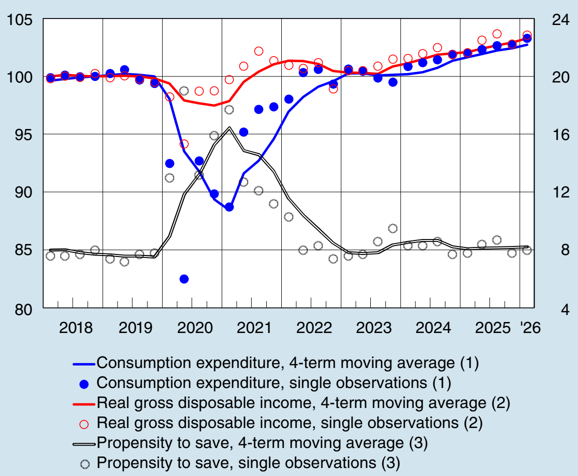
Household consumption grew and the propensity to save remained stable in the first quarter of the year. In the spring months, consumption appears to have slowed sharply, reflecting households' worsening assessments of developments in the international economic situation and their greater caution in spending in the face of the marked increase in energy prices.

Household consumption grows in the first quarter. The rise in consumption over the winter months was largely driven by durable goods, partly owing to the incentives for the purchase of electric cars. In parallel, consumption of non-durable goods and services also rose. Disposable income returned to growth, driven by the positive contribution of labour income, leading to a broadly stable saving ratio (Figure 16).

In the spring, consumption slows markedly. Our estimates indicate that, despite some favourable signs from retail and from data on payment flows, spending decisions tended towards caution in the second quarter, reflecting higher energy prices and their impact on households' disposable income. Similar conclusions can be drawn from Istat's short-term surveys. The confidence indicator fell further in the second quarter (Figure 17), to below its historical average, especially

Figure 16

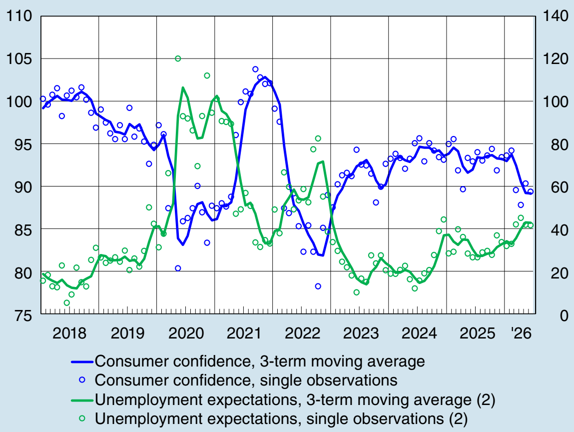
Consumption, income and propensity to save
(seasonally adjusted quarterly data; index numbers and percentage points)



Source: Based on Istat data.
(1) Chain-linked volumes; index: 2018=100. – (2) Net of the variation in the final consumption expenditure deflator for resident households; index: 2018=100. – (3) Consumer households' savings as a percentage of gross disposable income. Right-hand scale.

Figure 17

Consumer confidence (1)
(monthly data; indices: 2018=100 and percentage points)



Source: Based on Istat data.
(1) Seasonally adjusted data. In the absence of the figure for April 2020, which was not recorded owing to the pandemic, the moving average for the three months ending respectively in April, May and June 2020 is constructed on the basis of the two observations available. – (2) Weighted balance between the indications of a 'strong' or a 'slight' increase and those of a 'strong' or a 'slight' decrease. A rise in the balance signals a deterioration in the expectations regarding the unemployment rate. Right-hand scale.

for the components relating to expectations about consumers' personal financial conditions and the general macroeconomic outlook. The index measuring intentions to purchase durable goods also declined, in line with the slowdown in new car registrations.

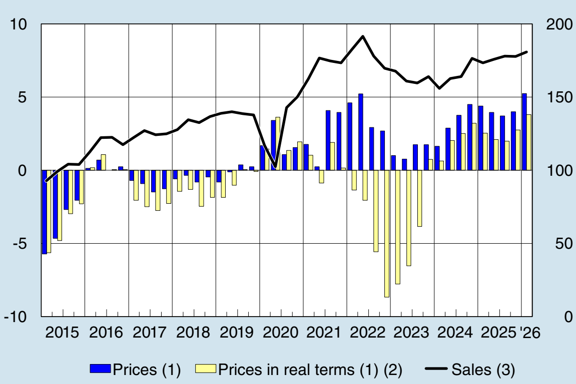
Real disposable income growth appears to have slowed in the spring months. Its slowdown reflected the lower rise in labour income than in prices, and may have contributed to dampening household consumption.

Housing market developments remain positive, but there are signs of moderation. House prices accelerated in the first quarter, driven by the growth in prices for new buildings. Sales volumes increased over the same period and continue to stand at high levels (Figure 18). According to the Italian Housing Market Survey conducted by Banca d'Italia in April and May, reports of an increase in house selling prices intensified across the country in the winter months; demand for housing is weaker than in the final quarter of 2025, while still benefiting from relaxed credit access conditions. Indications of a dampening of demand, which nonetheless continues to remain buoyant, also emerge from the online platform Immobiliare.it. The estate agents interviewed for the survey reported that rents were continuing to rise, albeit at a much slower pace than in previous quarters.

Figure 18

House prices and sales

(quarterly data; percentage changes and index numbers)



Sources: Based on data from Banca d'Italia, Istat and the Italian Revenue Agency's Osservatorio del mercato immobiliare (OMI).
(1) Year-on-year percentage changes. – (2) House prices deflated by the consumer price index. – (3) Adjusted for seasonal and calendar effects. Index: 2015=100. Right-hand scale.

2.4 FOREIGN TRADE AND THE BALANCE OF PAYMENTS

Exports returned to growth in the first three months of 2026 and the current account surplus widened. Italy's positive net international investment position was close to end-2025 levels. Goods export volumes held broadly stable in April and May compared with the average for the previous quarter, despite falling sales in the Middle East. The surge in energy prices will cause Italy's energy deficit to widen.

In the first quarter of 2026, exports return to growth, while imports fall. After declining in the final months of last year, export volumes increased in the first quarter of 2026 (Table 4), to a similar extent for both goods and services. There was growth in goods sales to markets outside the euro area, especially to the United States, largely driven by the volatile shipbuilding component, while sales to euro-area countries remained unchanged. By sector, the main contributions came from the shipbuilding industry, precious

Table 4

Export and import volumes (1)

(percentage changes on previous period)

	2025	2025			2026
		Q2	Q3	Q4	Q1
Exports	**1.2**	**-1.7**	**2.2**	**-1.0**	**2.2**
Goods	**0.7**	**-2.1**	**3.0**	**-1.5**	**2.2**
To euro-area countries	1.6	0.3	2.7	-2.3	0.1
To non-euro area countries (2)	..	-3.8	3.3	-0.8	3.8
Services	**3.6**	**-0.2**	**-1.0**	**0.9**	**2.2**
Imports	**3.6**	**0.2**	**2.0**	**1.3**	**-0.7**
Goods	**3.2**	**-0.4**	**1.6**	**1.8**	**..**
From euro-area countries	6.2	0.2	3.2	1.9	-1.2
From non-euro area countries (2)	-0.1	-1.0	-0.1	1.7	1.5
Services	**5.2**	**2.0**	**3.3**	**-0.4**	**-3.4**

Sources: Based on Istat's national accounts and foreign trade data.
(1) Chain-linked volumes; raw annual data; quarterly data adjusted for seasonal and calendar effects. – (2) Includes unspecified countries and, for exports, stores and provisions.

metals and pharmaceuticals. Total imports fell as a result of significantly lower purchases of services, while goods imports held stable.

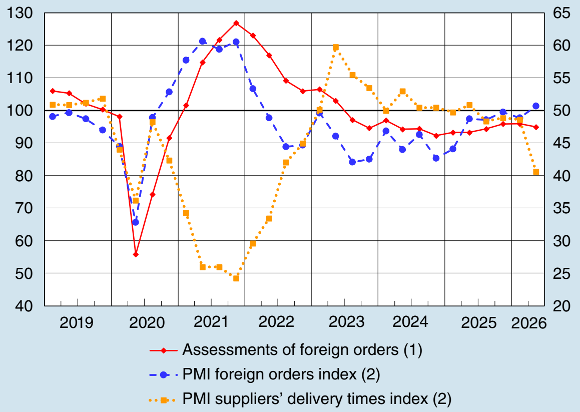
Goods exports appear to have remained unchanged in the spring months. According to our estimates based on foreign trade data, seasonally adjusted goods sales volumes held broadly stable in April and May compared with the prior quarter's average. The manufacturing firms' assessments of foreign orders and the corresponding PMI remained essentially unchanged on average in the second quarter of 2026 (Figure 19). Over the same period, the PMI suppliers' delivery times index fell to its lowest level since the end of 2022, reflecting the supply chain tensions stemming from the conflict in the Middle East. The hostilities have taken a toll on Italy's trade with this area, which accounted for around 4 per cent of Italian goods exports in 2025.[1] While sales fell sharply in March (Figure 20.a), the decline was much less pronounced in April and May, thanks in part to the gradual reopening of the region's airspace.

International tourism in Italy is only temporarily affected by the conflict. Based on mobile phone data, the number of visitors from the Middle East – accounting for 2.5 per cent of foreign tourist spending in Italy – fell sharply in March and April

Figure 19

Manufacturing firms' assessments of foreign orders and delivery times

(seasonally adjusted quarterly data; percentage points)

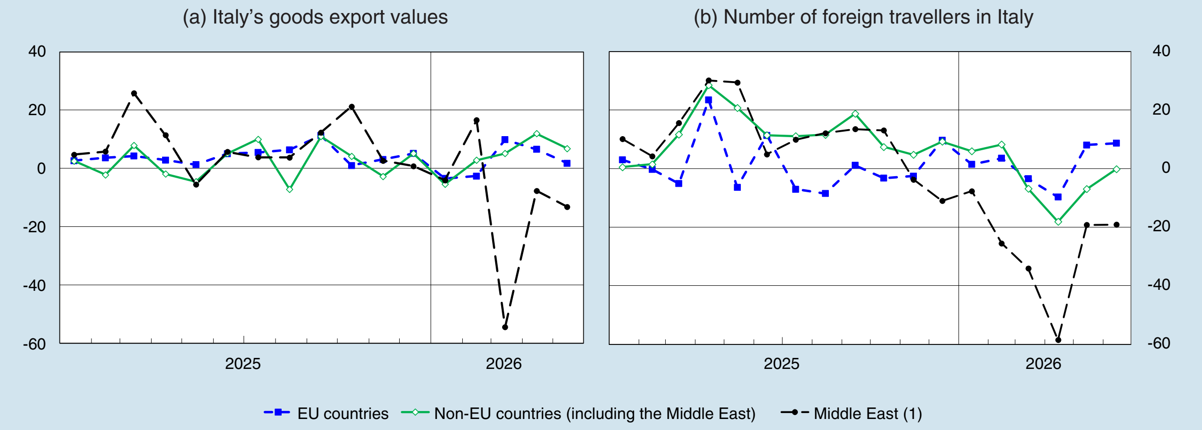


Sources: Istat and Standard & Poor's Global Ratings.
(1) Quarterly average based on Istat's monthly survey of firms; percentage balance of replies of 'increasing' or 'decreasing' foreign orders, minus the average since the start of the time series (January 2000) plus 100. The result thus obtained is therefore a balance between the replies of 'increasing' and 'decreasing' in line with the historical average. Q2 2020 is a 2-month average: the figure for April was not recorded owing to the pandemic emergency. – (2) Diffusion index obtained by adding half of the percentage of responses of 'stable' to the percentage of responses of 'improving'. For the PMI foreign orders index, values above (below) 50 indicate an increase (a decrease) in new foreign orders; for the PMI suppliers' delivery times index, values above (below) 50 indicate faster (slower) delivery times. Quarterly average. Right-hand scale.

Figure 20

Exports of goods and tourist footfall by geographical area

(monthly data; year-on-year percentage changes)



Sources: Based on Istat's foreign trade data, for panel (a); based on mobile phone data, for panel (b).
(1) The Middle East area includes: Saudi Arabia, Bahrain, the United Arab Emirates, Jordan, Iran, Iraq, Israel, Kuwait, Lebanon, Oman, Qatar, Syria, the Palestinian Territories (West Bank and Gaza Strip) and Yemen.

[1] For more details, see the box 'The Middle East's role in Italy's energy supply and trade', in *Economic Bulletin*, 2, 2026.

2026 compared with the same period a year earlier (Figure 20.b). The conflict also resulted in a temporary decline in the number of travellers from other non-EU countries, although arrivals rebounded strongly as early as May and June, returning close to year-earlier levels. Conversely, the number of travellers from the EU has not changed significantly following the outbreak of the conflict.

The current account surplus has widened. In the first three months of the year, the current account surplus as a share of GDP rose (Table 5 and Figure 21), reflecting the growth in exports of goods and services and the improvement in the primary income balance. Service exports benefited from the Winter Olympics, which generated total receipts of around €0.8 billion, arising equally from international tourism[2] and broadcast rights sold abroad.

The conflict in the Middle East is set to widen the energy deficit. According to our estimates, holding consumption constant, and assuming that oil and natural gas prices follow the path incorporated in the baseline scenario of the Eurosystem staff macroeconomic projections published in June,[3] the energy deficit will rise by about half a percentage point of GDP in 2026, before gradually declining in the following years.

The financial account balance is negative. In the first quarter of 2026, the financial account balance was negative by €14.8 billion (Table 5), mainly as a result of the 'other investment' balance, which reflected the increase in resident banks' foreign funding. The balance on portfolio investment was virtually nil: Italian residents' greater purchases of foreign assets, especially long-term government bonds and investment fund shares, were almost entirely offset by international investors' purchases of Italian securities. Foreign purchases of Italian financial assets, especially public-sector securities, remained robust in the first quarter as a whole – despite sales in March amid high volatility on international financial markets – and continued in April as well.

The TARGET balance remains stable in the first quarter. Banca d'Italia's debtor position was €356.7 billion at the end of March, and fell to €335.6 billion in the second quarter.

Table 5

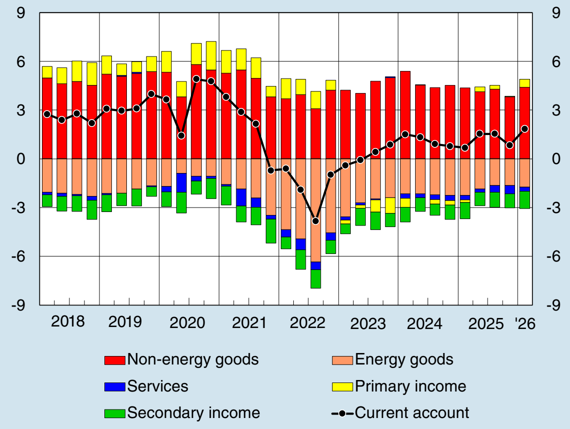
Balance of payments
(billions of euros)

	2025	2025 Q2	2025 Q3	2025 Q4	2026 Q1
Current account	**25.0**	**9.6**	**13.7**	**4.8**	**2.9**
Adjusted for seasonal and calendar effects	25.7	8.5	8.7	4.7	10.5
Memorandum item: % of GDP (1)	1.1	1.5	1.5	0.8	1.8
Capital account	**3.9**	**0.4**	**-1.2**	**4.6**	**0.3**
Financial account	**27.9**	**8.4**	**12.4**	**19.1**	**-14.8**
Foreign direct investment	18.5	7.9	6.7	10.2	4.5
Portfolio investment	-33.3	-42.7	25.5	-14.9	0.6
Derivatives	-3.0	0.1	-3.1	..	1.6
Other investment (2)	43.9	41.0	-17.1	24.2	-22.8
Changes in official reserves	1.7	2.2	0.4	-0.3	1.3
Errors and omissions	**-1.1**	**-1.6**	**..**	**9.6**	**-18.0**

(1) The annual figure for 2025 refers to the non-seasonally adjusted current account balance. – (2) Includes change in the TARGET balance.

Figure 21

Current account balance and its main components
(seasonally adjusted quarterly values; per cent of GDP)



Sources: Istat, for GDP; based on Istat's foreign trade data, for the breakdown of energy and non-energy goods.

[2] For more details, see 'Survey on International Tourism', Banca d'Italia, Statistics Series, 26 June 2026.

[3] The baseline scenario assumes an average oil price per barrel of $97, $82 and $77 in 2026, 2027 and 2028 respectively, and an average natural gas price per megawatt hour of €46, €38 and €28 respectively.

Italy's net international investment position remains virtually unchanged. At the end of March, it was positive by €351 billion (equal to 15.5 per cent of GDP) and broadly stable compared with the end of 2025.

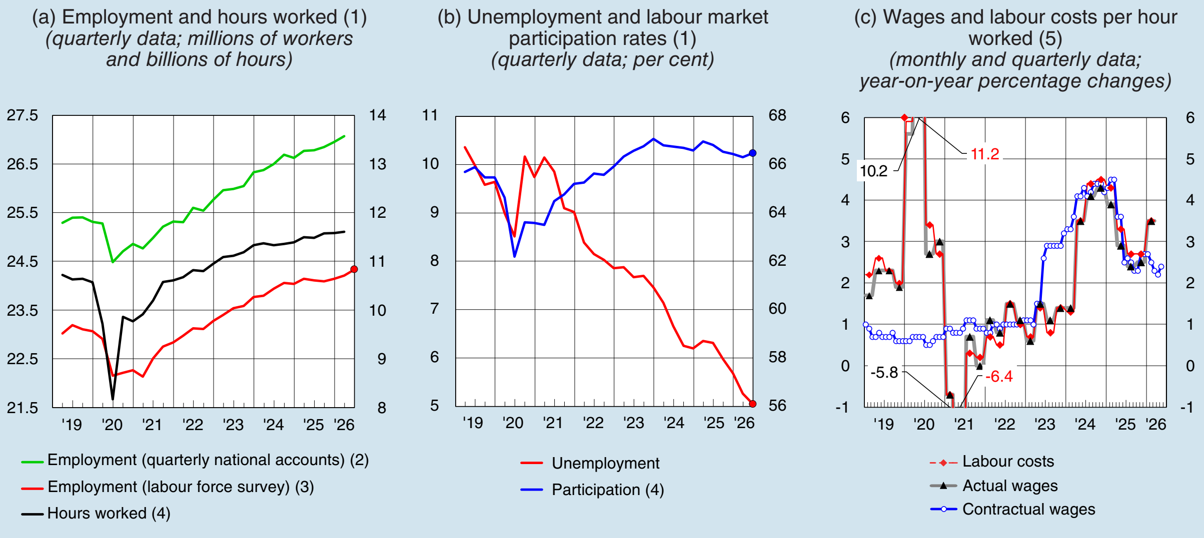
2.5 THE LABOUR MARKET

Employment continued to rise in the first quarter of 2026, boosted by construction and private services; according to preliminary data, the expansion continued into the spring months. The unemployment rate fell further, to an all-time low, while the participation rate was practically unchanged. Contractual wage growth continued to be moderate and is likely to remain so overall in the coming months, partly due to the small share of collective bargaining agreements awaiting renewal.

Employment continues to grow in the first quarter of 2026. According to Istat's quarterly national accounts, headcount employment rose further (Figure 22.a), to a larger extent in private services and in construction, and more weakly in industry excluding construction. The total number of hours worked went up, despite a slight reduction in the number of hours worked per worker; however, the latter remains high owing to the increase observed since 2021. The use of wage guarantee schemes declined compared with the corresponding quarter of 2025, although it remains above pre-pandemic levels. Self-employment continued to recover, exceeding pre-pandemic levels considerably. By contrast, the contribution of payroll jobs diminished and, according to data from Istat's labour force survey, the number of permanent contracts edged down.

Figure 22

Employment, unemployment, labour market participation and costs



Sources: Istat's quarterly national accounts (for employment, hours worked, actual wages and labour costs); Istat's labour force survey (for employment and for the labour market participation and unemployment rates); Istat's contractual wages by type of contract (for contractual wages).
(1) Seasonally adjusted data. The points corresponding to Q2 2026 indicate the average value for April and May. – (2) Includes all persons engaged in production activity in Italy's economic territory. – (3) Includes all resident persons that are employed, excluding workers living permanently in an institution and military personnel. – (4) Right-hand scale. – (5) Non-farm private sector. Raw monthly data for contractual wages. Seasonally adjusted quarterly data for actual wages and labour costs.

Labour market participation remains essentially stable. The participation rate continued to rise in the 50-64 age group, while it fell further, albeit slightly, among younger people. The labour supply from the latter is being affected by their gradually growing participation in education. The share of 15-29 year olds who are not in employment, education or training shrank further, falling to a historically low level, although it remains high by European standards (12.9 per cent, of which about one third reportedly seeking work). The unemployment rate dropped to 5.3 per cent (Figure 22.b).

Employment continues to expand in the spring months. According to provisional data from Istat's labour force survey, the unemployment rate fell further, to 5.0 per cent in May, the lowest figure since the start of the time series in 1977. The participation rate remained broadly unchanged. Business surveys point to further, albeit weaker, employment growth into the summer months.[4]

Growth in contractual wages is expected to remain moderate in the coming months as well. In April and May, contractual wages in the non-farm private sector rose by more than 2 per cent on an annual basis (Figure 22.c). Actual hourly wages grew at a faster pace, especially in private services, contributing to their gradual recovery in real terms, following a sharp contraction in 2021-23. This acceleration was only partly passed through to unit labour costs, also due to improved productivity (see Section 2.6). Wage growth is expected to continue to be moderate in the coming months, owing to cooling labour demand and to the small share of collective bargaining agreements awaiting renewal (see 'Labour demand', Chapter 7, *Annual Report for 2025*, 2026), which cover around 12 per cent of private sector workers (see the box 'The impact of recent contractual wage increases on wage growth', *Economic Bulletin*, 1, 2026). Moreover, under the current system, collective bargaining agreements do not generally provide for wage indexation to inflation. Where such clauses exist, indexation is usually based on the HICP net of imported energy.[5]

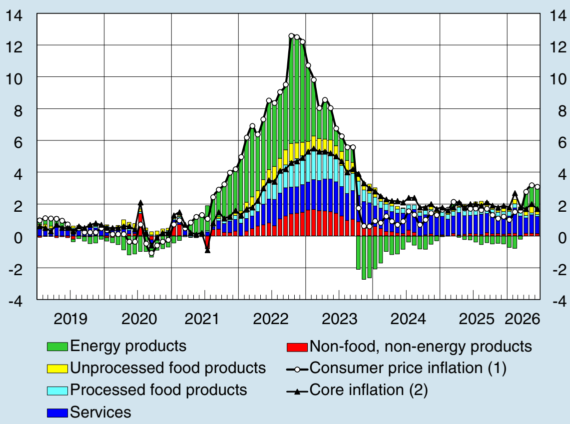
2.6 PRICE DEVELOPMENTS

Inflation reached 3 per cent in the second quarter of the year. The conflict in the Middle East caused a sharp rise in fuel prices, which partially retreated in June; the impact on electricity and gas bills was limited. The short-term inflation expectations of households and firms increased, though they remain below the levels observed in March 2022 following Russia's invasion of Ukraine.

Harmonized consumer price inflation has gone up. The twelve-month change in the harmonized index of consumer prices reached 3 per cent in the second quarter (Figure 23 and Table 6). Core inflation, which excludes food and energy, slowed owing to service price developments, while the prices of non-energy industrial goods accelerated. Among the most volatile components, energy inflation rose, mainly driven by surging fuel prices, while food inflation remained stable.

Figure 23

Consumer price inflation, contributions of its components and core inflation
(monthly data; percentage changes and points)



Source: Based on Eurostat data.
(1) 12-month percentage change in the HICP. – (2) 12-month percentage change in the HICP, excluding food and energy.

[4] For more details, see the European Commission's Business and Consumer Surveys and Istat's business and consumer confidence surveys.

[5] Collective bargaining agreements for the metalworking, electricity production, chemical-pharmaceutical and insurance sectors provide for indexation to the HICP net of imported energy; the agreement for the wood and furniture sector provides for indexation to the general HICP. According to the forecasts released by Istat in June, the HICP net of imported energy will rise by 2.4 per cent in 2026 and by 2.6 per cent in 2027 (about half a point more in both years compared with the previous forecasts published in June 2025), before hovering around 2 per cent in the following two years.

Table 6

Indicators of inflation in Italy
(year-on-year percentage changes, unless otherwise specified)

	HICP (1)				CPI (2)	PPI (3)
	General index	Food	Energy	Excl. food and energy	General index	General index
2022	8.7	8.0	51.4	3.3	8.2	42.8
2023	5.9	9.2	1.1	4.6	5.7	-8.3
2024	1.1	2.4	-10.1	2.2	1.0	-5.7
2025	1.6	2.9	-2.3	1.9	1.5	2.7
2026 – Jan.	1.0	2.2	-6.2	1.8	1.0	-2.1
Feb.	1.5	2.5	-6.6	2.7	1.5	-3.7
Mar.	1.6	2.7	-2.1	1.8	1.7	5.4
Apr.	2.8	2.9	9.3	1.7	2.7	8.8
May	3.2	2.5	12.0	2.0	3.2	9.1
Jun.	3.0	1.8	12.9	1.7	3.0	….

Sources: Based on Istat and Eurostat data. The figures in brackets are preliminary estimates.
(1) Harmonized index of consumer prices (HICP). – (2) National consumer price index for the entire resident population. This differs from the HICP principally on account of the different method for recording the prices of pharmaceutical products and promotional sales. – (3) Index of producer prices of industrial products sold on the domestic market.

In the second quarter, oil prices affect consumer energy price inflation. The increase in energy commodity prices was passed through to fuel prices up to May; in June, as oil prices declined, price pressures eased considerably. Based on the average weekly figures published by the Italian Ministry of the Environment and Energy Security, final prices have risen by 21 euro cents per litre for petrol and 26 euro cents per litre for diesel fuel, on average, since the start of the hostilities.[6] Between April and June, the Italian Government repeatedly extended the temporary excise duty discounts. The Ministerial Decree of 5 June cut excise duties on diesel fuel by 5 euro cents per litre and confirmed an equivalent reduction for unleaded petrol; both measures remained in force until 3 July. The impact of tensions in the Middle East on gas and electricity bills was limited overall, though it was more pronounced in Italy than in the other euro-area countries, especially for gas. The size of the increases remains well below the levels observed in 2022, when the rise in wholesale gas prices had been much sharper.

Pipeline pressures are increasing due to energy prices. In May, the producer prices of industrial goods sold on the domestic market rose by 9.1 per cent year on year, and by 2.4 per cent excluding energy. The PMIs for input prices went up significantly in manufacturing in the second quarter, returning to their highest levels since the first half of 2022, partly because of the difficulties in sourcing raw materials caused by the conflict in the Middle East. The increase was more modest in services. Both PMIs were affected by the energy commodity price hikes. Conversely, the PMI for selling prices only rose in manufacturing, though less than the input cost indicator, in line with what was observed in 2022; it remained broadly stable in services.

The unit labour cost (ULC) accelerates slightly in the first quarter. In the non-farm private sector, unit labour costs rose by 3.4 per cent year on year in the first three months of 2026 (Figure 24). This expansion mainly reflects the increase in hourly labour costs (3.5 per cent), which was not offset by the slight recovery in productivity (0.1 per cent, from -0.3 per cent in the fourth quarter of 2025).

[6] Latest data as of 13 July 2026.

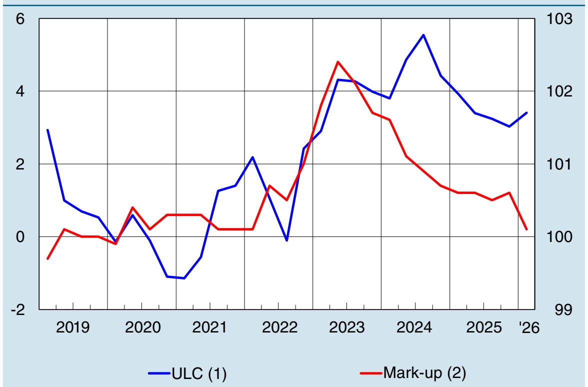
Profit margins shrank in both manufacturing and private services, nearing pre-pandemic levels.

The conflict in the Middle East has affected inflation expectations among households and firms. According to Istat's surveys, households' expectations for price developments over the next twelve months reacted quickly to the conflict, with a sharp rise in April, though they did not reach 2022 levels. Expectations of price increases continued to prevail in June as well, although far fewer respondents were expecting strong growth. The firms interviewed as part of Banca d'Italia's Survey on Inflation and Growth Expectations after the outbreak of the conflict in the Middle East expected to increase their selling prices over the next twelve months, by 2.4 per cent overall, up slightly from the previous surveys (Figure 25).

Figure 24

Unit labour costs and mark-ups

(quarterly data; percentage changes and index number)

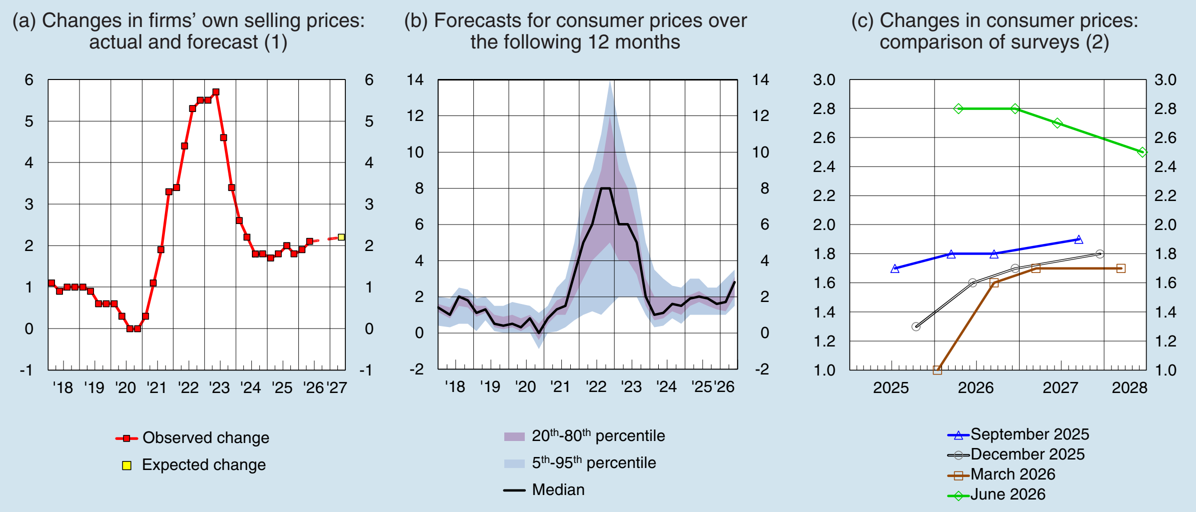


Source: Based on Istat data.
(1) Year-on-year percentage changes; non-farm private sector. – (2) The mark-up is the ratio of the output deflator to total variable costs. Index: Q4 2019=100. Total economy; right-hand scale.

Figure 25

Inflation expectations of firms in industry (excluding construction) and services

(quarterly data; year-on-year percentage changes)



Source: Based on the findings of the 'Survey on Inflation and Growth Expectations', Banca d'Italia, Statistics Series, 14 July 2026.
(1) Average (excluding outliers) of firms' responses to questions on the percentage change in their own prices over the previous 12 months and the change expected over the following 12 months. – (2) The key below the graph indicates the month in which the survey was carried out. The first point on each curve is the latest definitive figure for inflation available at the time of the survey (usually referring to 2 months earlier); the figure is provided in the questionnaire as the basis on which firms can formulate their expectations; the second point is the average of the respondents' forecasts for inflation 6 months after the survey date; the third point is the average 12 months forward; and the fourth point is the average 24 months forward.

2.7 CREDIT AND FINANCING CONDITIONS

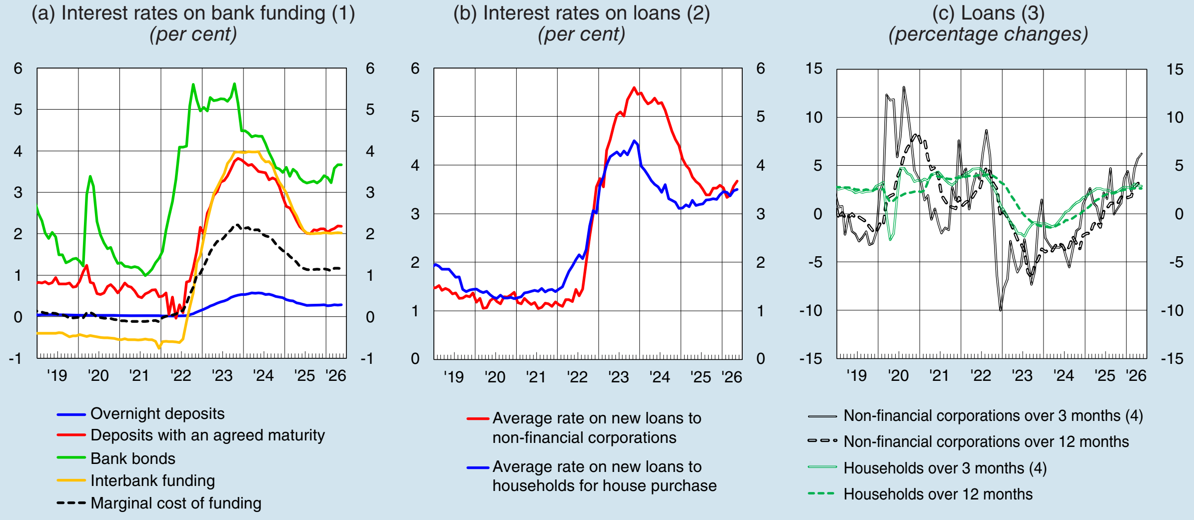
Interest rates on new loans to firms and, to a lesser extent, on new mortgage loans rose. Lending to firms accelerated, while the positive trend in lending to households remained stable. Credit standards for loans were unchanged in the first quarter of the year. Net bond issuance by non-financial corporations increased; the average yields remain high and above pre-Middle East conflict levels.

Bank funding strengthens and its cost edges up. The twelve-month growth rate in bank funding rose between February and May (from 3.8 to 4.5 per cent), driven by similar developments in liabilities to non-residents, only partly offset by the slowdown in deposits by residents. The marginal cost of funding went up slightly (Figure 26.a), reflecting the marked rise in bond yields, which nevertheless account for a rather small share of total funding.[7]

The average cost of loans to firms increases more than that of mortgage loans. Between February and May, the average interest rate on new loans to non-financial corporations rose more than short-term market yields (Figure 26.b). The average cost of new mortgage loans to households, predominantly fixed-rate loans, increased by about 10 basis points, while the ten-year interest rate swap (IRS) rose by around 0.3 percentage points.

Figure 26

Bank funding costs, lending rates and credit developments in Italy
(monthly data)



Sources: Based on data from Banca d'Italia, Bloomberg and ICE Bank of America Merrill Lynch.
(1) The marginal cost of funding is calculated as the weighted average of the costs of banks' various funding sources, using their respective outstanding amounts as weights. This is the cost that a given bank would incur to increase its balance sheet by one unit, drawing on funding sources in proportion to the composition of its liabilities at that time. – (2) Average values. Rates on loans refer to euro-denominated transactions and are collected and processed in accordance with the Eurosystem's harmonized methodology. – (3) Includes bad debts, repos and loans not reported in banks' balance sheets because they have been securitized. The percentage changes are net of reclassifications, exchange rate variations, value adjustments, and other variations not due to transactions. 3-month percentage changes are annualized. – (4) Data are seasonally adjusted following a methodology that is in accordance with the guidelines of the European Statistical System.

Lending to firms expands, while lending to households remains stable. Between February and May, the twelve-month growth rate of loans to non-financial corporations strengthened (Figure 26.c). In particular, loans with an original maturity of less than one year accelerated, partly in response to the greater liquidity needs induced by higher energy prices. Conversely, because of the developments in the demand for credit for investment purposes, growth in loans with maturities beyond five years remained negative, thereby halting the modest recovery that had begun last year.

The contraction in lending to small firms moderated (-5.5 per cent), while the expansion in lending to large firms intensified (4.1 per cent). Credit growth increased for manufacturing and, above all, service firms, while it declined for construction firms.

[7] Average bond yields remained virtually unchanged between the end of May and the beginning of July.

Household lending growth was broadly unchanged, as loans for house purchase remained stable and consumer credit accelerated slightly.

Credit standards for loans to firms and mortgages remain unchanged in the first quarter. According to the latest euro-area bank lending survey (BLS),[8] the Italian banks that took part in the survey reported leaving the credit standards for new loans to firms unchanged. Non-financial corporations' demand for credit declined, mainly owing to lower borrowing needs for fixed investment. Based on the latest information drawn from the surveys conducted by Istat and Banca d'Italia between mid-May and mid-June, conditions for access to bank credit deteriorated slightly in the second quarter of 2026.

Credit standards on loans to households remained unchanged in the first three months of the year for mortgages, while they tightened slightly for consumer credit. Households' demand for loans for house purchase was stable, while that for consumer loans inched up, driven mainly by greater spending on durable goods.

Growth in corporate bonds strengthens and bond yields edge down. The growth rate of net corporate bond issuance increased in May, reflecting higher external financing needs. The yields on bonds issued by Italian non-financial corporations fell slightly (4.0 per cent in early July), though they remain higher than before the outbreak of the conflict in the Middle East.

2.8 THE PUBLIC FINANCES

Based on the updated estimates contained in last April's Public Finance Document 2026, net borrowing will decline in the four years 2026-29; net expenditure will grow at rates in line with what has been agreed at European level, with the exception of 2027. The debt-to-GDP ratio will grow in 2026, to then decrease in the following years. In its European Semester Spring Package published in early June, the European Commission gave an overall positive assessment of the progress status of Italy's corrective path under the excessive deficit procedure.

The Government expects net borrowing to decrease gradually over the four years 2026-29. According to the Public Finance Document 2026 (PFD 2026) published in April, net borrowing is expected to decline on average by 0.2 percentage points per year in the three years 2026-28, reaching 2.5 per cent of GDP in 2028; it is expected to decrease even more in 2029, reaching 2.1 per cent of GDP. This would appear to be driven by the fall in the share of primary expenditure, which is largely attributable to the capital expenditure component, although public investment is expected to remain high compared with its historical average (peaking at 3.9 per cent of GDP in 2027). In the four years 2026-29, the annual growth rate of net expenditure[9] is expected to be in line with the maximum growth rates agreed with the European Commission and the EU Council, with the exception of 2027, when it is estimated to exceed the 1.9 per cent threshold by 0.3 percentage points (Table 7).[10]

[8] For further information on the survey and its results for Italy, see Banca d'Italia's website, 'Bank Lending Survey (BLS)'.

[9] Net expenditure consists of general government expenditure net of the following items: a) interest expenditure; b) discretionary revenue measures; (c) expenditure on EU programmes fully matched by revenue from EU funds; d) national expenditure on co-financing of programmes funded by the EU; e) cyclical elements of unemployment benefit expenditure (which include disbursements connected with short-time work schemes); (f) one-off measures; and (g) other temporary measures.

[10] The deviation reflects the stronger price dynamics in 2026, which have a direct impact on the revaluation of social benefits in cash that are spread out over time. For more details, see Chapter 10, *Annual Report for 2025*, 2026 (only in Italian) and 'Testimony at the preliminary review of the Public Finance Document (DFP) 2026', testimony by A. Brandolini, Director General for Economics, Statistics and Research at Banca d'Italia, before the 5th Committee of the Chamber of Deputies (Budget, Treasury and Planning) and the 5th Committee of the Senate of the Republic (Economic Planning and Budget), sitting jointly, Chamber of Deputies, Rome 28 April 2026 (only in Italian).

The public finance framework presented in the PFD 2026 is based on the current legislation scenario and does not include the higher defence spending mentioned by the Government last autumn (entailing a rise of up to 0.5 percentage points of GDP in 2028).[11]

Table 7

PFD 2026: current legislation scenario (April 2026) (1)
(per cent of GDP, unless otherwise specified)

	2025	2026	2027	2028	2029
Net borrowing	3.1	2.9	2.8	2.5	2.1
Primary surplus	0.8	1.2	1.5	1.8	2.4
Interest expense	3.9	4.1	4.2	4.4	4.5
Debt (2)	137.1	138.6	138.5	137.9	136.3
Growth in net expenditure (3)	1.9	1.6	2.2	1.7	1.5
Net expenditure growth according to the MTP 2025-29 (3)	1.3	1.6	1.9	1.7	1.5

Sources: Public Finance Document (PFD) 2026, medium-term fiscal structural plan 2025-29 (MTP 2025-29).
(1) Outturns for 2025 and current legislation scenario for the four-year period 2026-29. The PFD 2026 does not include official targets. Any mismatches are due to the rounding of decimals. – (2) Gross of financial support to other euro-area countries. – (3) Percentage change compared with the previous year.

The debt-to-GDP ratio will increase in 2026 and then decline in the following years. According to the Government's projections set out in the PFD 2026, the debt-to-GDP ratio will reach 138.6 per cent in 2026, broadly in line with the latest European Commission estimates. For 2027, the Government expects that the debt-to-GDP ratio will fall marginally, to 138.5 per cent, and then stand at 136.3 per cent in 2029. The estimate incorporates the expected reduction in the Treasury's liquidity holdings, as well as privatization proceeds for a total amount of 0.8 percentage points of GDP in the three years 2026-28. The European Commission forecasts a value of 139.2 per cent for 2027.

The Commission gives an overall positive assessment of Italy's corrective path for its excessive deficit. In its spring package published on 3 June, the Commission determined that, for the two years 2024-25, cumulative growth in net expenditure was broadly in line with the limits set, despite exceeding the agreed threshold in 2025. Moreover, in line with the deadline set by the EU Council, net borrowing is expected to return to below 3 per cent of GDP in 2026. The specific recommendations for Italy include: (a) compliance with the net expenditure path and the implementation of reforms and investments agreed with the European institutions; (b) scaling up defence spending; and (c) ensuring the compatibility of the measures to mitigate the impact of the hike in energy prices with fiscal sustainability and with retaining price signals for energy savings.

In the early months of 2026, the borrowing requirement and the debt both rise. In the first five months of 2026, the general government borrowing requirement amounted to €81.7 billion, up from the same period of 2025 (€74.9 billion). In the first six months of the year, tax revenue as recorded in the state budget rose by 1.4 per cent (€3.6 billion) year on year. At the end of May,

[11] At present, the Government has not invoked the national escape clause for defence expenditure of up to 1.5 per cent of GDP. On 3 June, the European Commission announced that, under this clause, dedicated fiscal space would be envisaged for measures designed to accelerate the clean energy transition. This fiscal space, available for the period 2026-28, will have an annual cap of 0.3 percentage points of GDP and an overall cap of 0.6 points.

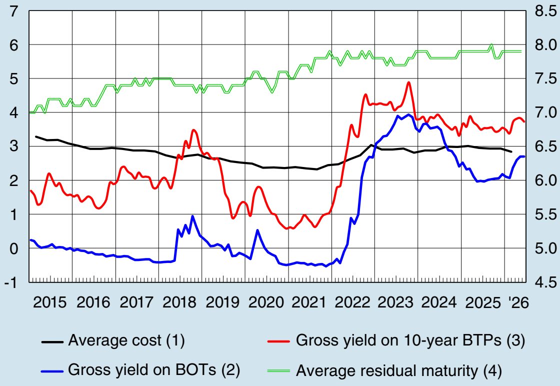
general government debt stood at €3,181.1 billion, some €85.2 billion more than at the end of last year. The residual maturity of the debt remained unchanged compared with end-2025 (7.9 years). The share of the debt held by Banca d'Italia amounted to 17.2 per cent, down from end-2025. In the first quarter of 2026, the average cost of the debt was 2.8 per cent, marking a slight decrease compared with 2025 (Figure 27).

By the end of 2025, Italy had spent around €110 billion on the NRRP. In early June, Italy received the ninth and second-to-last NRRP tranche, equal to €12.8 billion. The total amount received is €166 billion, equal to more than one third of the overall amount disbursed to all EU countries combined.[12] Italy's expenditure as at the end of 2025 amounted to around €110 billion, of which 84 per cent in the form of capital expenditure (more than 40 per cent in public investment, a significantly higher share than in the other main euro-area economies).

Figure 27

Average cost, gross yields on BOTs and 10-year BTPs, and average residual maturity of debt

(monthly and quarterly data; per cent and years)



Sources: For interest expense, Istat; for debt, gross interest rates and average residual maturity, Banca d'Italia.
(1) Ratio of interest expense in the four quarters ending in the reference quarter to the stock of debt at the end of the corresponding year-earlier quarter. – (2) The yield at issue is the average, weighted by the issue amounts allotted, of the compound allotment rates at the auctions settled during the month. – (3) Average monthly yield to maturity of the benchmark traded on the online government securities market. – (4) Right-hand scale.

[12] For more details on the funds disbursed to EU countries, updated to 20 May 2025, see Chapter 2 of the *Annual Report for 2025*, 2026 (only in Italian).