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COMMISSION STAFF WORKING DOCUMENT

In-depth review for Italy

Prepared under Regulation 1176/2011 on the prevention and correction of macroeconomic imbalances

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European Commission

Italy

In-Depth Review 2025

This in-depth review presents the main findings of the Commission's staff assessment of macroeconomic vulnerabilities for Italy for the purposes of Regulation (EU) No 1176/2011 on the prevention and correction of macroeconomic imbalances. It provides technical input to the Commission for the Communication "European Semester – 2025 Spring Package" that will set out the Commission's assessment as to the existence of imbalances or excessive imbalances in Italy. That Communication will be published in June

CONTENTS

1. INTRODUCTION

This in-depth review (IDR) analyses the evolution of Italy's vulnerabilities related to high government debt and weak productivity growth in a context of labour market fragilities and some residual weaknesses in the financial sector, and possible newly emerging risks. This year's IDR, which follows the 2025 Alert Mechanism Report (AMR) published in December 2024, assesses the persistence or unwinding of the vulnerabilities identified last year, potential emerging risks, relevant policy progress and policy options that could be considered for the future[1]. Given the size of the Italian economy and its interlinkages with the other Member States, these vulnerabilities have a cross-border relevance.

The vulnerabilities in Italy are analysed against the background of slow economic growth and increasing global uncertainties. Real GDP grew by 0.7% in 2024, the same as in 2023 and much slower than in the two previous years. Overall, foreign demand made a nil contribution to GDP growth in Italy between 2019 and 2024. Conversely, Italian domestic demand contributed 0.7 percentage points (pps) to EU growth over the same period. Thanks to Recover and Resilience Facility (RRF)-backed investment, which is expected to offset the fall in residential construction due to the end of tax incentives to housing renovation, growth is forecast to pick up to 1.0% and 1.2% in 2025 and 2026, respectively, although the outturn data for the fourth quarter of 2024 came out lower than expected, and recent indicators point to somewhat slower 2025 growth[2]. Headline inflation declined to 1.1% in 2024, but its core measure, excluding energy and food, remained somewhat higher at 2.2%; both metrics are below the euro area average. Headline inflation is forecast to rebound to 1.9% in 2025, following the swing in energy prices, and then ease to 1.7% in 2026; core inflation is forecast at 2% and 1.8%, respectively, on account of moderate wage increases[3]. Downside risks to economic growth stemming from the geopolitical environment, mainly through Italy's large direct and indirect exports to the US, have heightened since the publication of the Commission autumn 2024 forecast.

[1] European Commission (2024), Alert Mechanism Report 2025, Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee, COM(2024) 702 final; and European Commission (2024), Alert Mechanism Report 2025, Staff Working Document, SWD(2024) 700 final.

[2] All forecast data used in the IDR come from the Commission Autumn 2024 Forecast (European Economy, Institutional Paper 296), unless stated otherwise, in order to ensure the coherence of the various figures and calculations. The cut-off date for the data for the preparation of this IDR was 24 March 2025. Actual outturn data that have become available after the Autumn Forecast, and before the cut-off date for the IDR, are mentioned.

[3] Over the period 2020-2024, cumulated inflation amounted to 18.6%, of which about 1.1 pps. is estimated to have been due to imported value-added inflation. See European Commission Institutional Paper 2025 (forthcoming) – "Economic spillovers and financial linkages in the EU".

2. ASSESSMENT OF MACROECONOMIC IMBALANCES

Italy has been marked by high government debt coupled with sizeable fiscal deficits and weak productivity growth in a context of labour market fragilities and some residual weaknesses in the financial sector. Italy's public debt-to-GDP ratio declined by almost 20 pps since its peak during the pandemic crisis. However, the downward trend reversed in 2024 and the public debt ratio remained high (at 135.3% of GDP according to latest data by Istat)[(4)]. Weak labour productivity has been a drag on Italy's economic growth for almost two decades, reflecting persistent structural shortcomings, and it has declined during the past two years. Labour market conditions have improved with falling unemployment and rising participation rates, although the latter are still comparatively low, notably among women. The financial sector has strengthened over the past years with improvements in bank asset quality and profitability, while Italian banks' balance sheets were still considerably exposed to the sovereign and to state-guaranteed loans.

2.1. GOVERNMENT SECTOR

Assessment of gravity, evolution and prospects of vulnerabilities

After falling almost back to its pre-pandemic level in 2023, Italy's public debt-to-GDP ratio edged up again in 2024 and is projected to further increase in 2025 and 2026. After the 2020 peak at 154.3% of GDP, Italy's public debt fell markedly to 134.8% of GDP at end-2023[(5)], close to its already high pre-pandemic level. This post-pandemic decline was driven by a strong economic recovery and high inflation despite large government deficits at above 8% of GDP per year on average. However, in 2024 the downward path reversed and, according to the Commission Autumn 2024 Forecast, assuming no policy changes, the debt-to-GDP ratio is expected to increase to 139.3% by 2026. This is despite a progressive reduction of the government deficit from 3.8% in 2024[(6)] to 2.9% of GDP by 2026. The projected debt increase is due to the lagged impact on cash borrowing of the tax credits for housing renovations that affected previous years' deficits, while nominal GDP growth becomes less favourable (see Graph 2.1.a).

Public debt servicing costs remain sizeable, limiting the space for growth-enhancing fiscal policies. In 2024, yields on Italian government bonds with 10-year maturity decreased

(4) On 03.03.2025, the Italian National Institute of Statistics (Istat) released general government data for 2024, including revised data for preceding years. On that basis, Eurostat will publish validated government finance statistics on 22.04.2025.

(5) According to data released by Istat on 03.03.2025, the general government debt was 134.6% of GDP at end-2023.

(6) According to data released by Istat on 03.03.2025, the general government deficit was 3.4% of GDP in 2024.

moderately from around 3.8% at the beginning to around 3.4% at the end of the year. Spreads to the 10-year German Bund decreased slightly more, from around 1.6 pps in January to 1.1 pps in December. Lower bond yields mitigate Italy's debt servicing costs for new bond issuances. Nonetheless, 10-year bond yields have risen to 3.9% at the cut-off date of this report and the Commission projected in autumn debt servicing costs to remain sizeable, at around 4% of GDP this year and next, thus limiting the government's ability to finance growth-enhancing policies. The average residual maturity of Italy's outstanding securitised debt stock remained broadly stable at around 7 years at end-2024 compared to previous year, which is less than the euro area's 8.2 years average [(7)]. Government gross financing needs are expected to remain large, at around 26% of GDP over 2025-2026. At the same time, medium-term risks to fiscal sustainability are high overall (see Box 2.1). On the positive side, risk-mitigating factors include relatively stable government financing sources, with an increasing share of fixed-rate securities. In addition, government guarantees granted during the pandemic further decreased to 13.3% of GDP in June 2024 from 14.1% in December 2023 and 15.7% of GDP at their peak in 2021.

Assessment of MIP relevant policies

In its medium-term fiscal-structural plan (MTFSP), Italy commits to a net expenditure growth[(8)] that does not exceed 6.2% in cumulative terms by 2029. In particular, Italy commits to a net expenditure growth that does not exceed 1.3% in 2025, 1.6% in 2026, 1.9% in 2027, 1.7% in 2028 and 1.5% in 2029[(9)], corresponding to average net expenditure growth of 1.6% over that period. According to the plan, general government debt would increase to 137.8% of GDP at the end of 2026 (from 135.8% of GDP in 2024) and then decrease to 132.5% of GDP at the end of the adjustment period in 2031. The plan's indicative fiscal strategy aims to deliver the commitments on net expenditure through both expenditure restraint and discretionary revenue increases. The set of 24 reforms and investments underpinning an extension of the adjustment period from 4 to 7 years is composed of several commitments building on the Recovery and Resilience Plan (RRP), as well as some new reforms and investments.

Structural trends, in particular rising ageing costs, are expected to weigh on public finances. In recent years, several measures kept the government deficit well above the 3% reference value. While in 2024 the deficit significantly declined, driven by the phase-out of measures to mitigate the impact of high energy prices and of tax credits for housing renovations, several structural trends are expected to continue exerting pressure on expenditure in the coming years. In particular, public spending is skewed towards social protection (in 2024, 20.3% of GDP and 43.6% of primary expenditure) which poses fiscal

(7) Securitised debt accounts for more than 80% of total public debt in Italy. If non-securitised debt is taken into account as well, as published by the Bank of Italy, the average residual maturity of Italy's outstanding debt stood at 7.9 years in both December 2024 and December 2023.

(8) Net expenditure as defined in Article 2 of Regulation (EU) 2024/1263, namely government expenditure net of (i) interest expenditure, (ii) discretionary revenue measures, (iii) expenditure on Union programmes fully matched by revenue from Union funds, (iv) national expenditure on co-financing of programmes funded by the Union, (v) cyclical elements of unemployment benefit expenditure and (vi) one-off and other temporary measures.

(9) These are also the growth rates that the Council recommended. The cumulative growth rates are calculated by reference to the base year of 2023. Council Recommendation of 21 January 2025 endorsing the national medium-term fiscal-structural plan of Italy, Official Journal of the European Union C/2025/651, 10 February 2025.

challenges in the face of demographic pressures[10]. In addition, the taxation system is still characterised by several inefficiencies, including high tax evasion.

Some recent policy measures support fiscal sustainability. The government has implemented several policies both on the expenditure and the revenue side with expected positive results for fiscal sustainability. Progress has been made in recent years to enhance the national framework for the annual spending review, including by incorporating annual savings targets in the budget cycle starting from 2023. In addition to the annual savings targets, the 2025 budget includes an additional revision of expenditures of ministries and local authorities. Besides this, the authorities took steps on the reform aimed at reducing environmentally harmful subsidies by 2030. Some tax expenditures, mainly related to income taxes, have also been revised. In addition, previous policies against tax evasion, also implemented under the RRP, aimed at making control systems more efficient and at incentivising taxpayers to reveal undeclared income, are yielding positive results, with a progressive reduction of the propensity to evade, especially for VAT. The 2025 budget, following the MTFSP commitments, includes further measures aimed at strengthening the fight against tax evasion resulting from omitted declarations. Further improvements on tax collection and compliance are expected in the medium term following the implementation of measures under the RRP, supported also by the improved operational capacity of the tax administration. At the same time, the recently introduced simplified tax settlement system, whereby self-employed workers can agree ex ante their tax liability with the tax administration, could raise compliance risks. To make the tax system more growth-friendly, the 2025 budget includes measures aimed at permanently reducing the tax wedge through a new system of tax deductions and the extension of the lower personal income tax brackets, which were already implemented in 2024. While these measures improve the quality of public finances, their budgetary impact needs to be factored into the fiscal targets (see Table A).

The full implementation of the fiscal path as well as the reforms and investments included in the RRP and MTFSP is key to improve fiscal sustainability. The set of reforms and investments included in the MTFSP envisages, among others, to maintain the level of nationally financed public investment beyond the RRP horizon. It also includes commitments to further strengthen the capacity for programming, monitoring and evaluating public spending as well as to streamline and improve the efficiency of state-owned enterprises. These measures are expected to reduce both the growth rate and the level of public expenditure, as a result of improved efficiency, and to contribute to a more growth-friendly composition of the budget with a positive impact on fiscal sustainability. More action is needed to fully implement the 2023 general tax reform which provides more incentives for growth with a reduction of the tax wedge on labour and to ensure that the tax system is fair, efficient and progressive. In this respect, the MTFSP includes further commitments, including simplifying the tax system through the review and streamlining of tax expenditures, including environmentally harmful subsidies, structurally reducing the tax burden on low- and middle-income taxpayers and supporting employment, and updating the cadastral register for

[10] Comparatively low birth rates as well as an old and increasingly ageing population combined with recent early retirement schemes are expected to increase the government's pension spending in the medium-term before the full implementation of the 2011 pension reform will help reduce it over the long-term. For more details see European Commission (2024), 2024 Country Report – Italy, Staff Working Document, SWD(2024) 612 final, page 13.

properties renovated by using public funds since 2019. Finally, the MTFSP includes additional commitments aimed at further increasing tax revenues from prevention and enforcement activities for tax compliance and from more targeted and risk-based anti-evasion actions, with an overall reduction of revenue losses from tax evasion.

2.2. COMPETITIVENESS AND PRODUCTIVITY GROWTH

Assessment of gravity, evolution and prospects of vulnerabilities

The steady employment recovery outpaced GDP growth, dampening labour productivity. With employment growth (1.6%) still much stronger than output growth (0.7%), labour productivity per worker is estimated to have fallen by 0.9% in 2024, after it declined by 1.2% in 2023 (see Graph 2.1.b). GDP growth is forecast to pick up in 2025-26 with employment growth slowing down so that productivity dynamics are expected to turn positive.

In Italy, unlike in its euro-area peers, hours worked per employee increased in recent years. Compared with the average of the euro area and its largest Member States, Italy's performance since the Covid-19 pandemic appears different depending on whether productivity is computed per employee or per hour worked. Per-capita productivity grew more rapidly than in euro-area peers until mid-2022, then declined faster than in Germany, while it rose slightly in France and Spain. On a per-hour basis, however, Italy's labour productivity was even weaker due to the simultaneous increase in hours worked per employee. Labour productivity in 2023 was around 2% below the 2019 level in both agriculture and manufacturing; it was well above in construction, and somewhat above in non-financial services. Hours worked per person employed are anticipated to keep rising slightly through 2025, possibly exerting continued downward pressure on hourly productivity growth until 2026.

Productivity growth in Italy has long been hindered by low investment, particularly in R&D, innovation and human capital. The sectoral composition of output explains only a minor share of Italy's sluggish productivity growth: if Italy had France's or Germany's business structure, its productivity level would be somewhat higher, but the dynamics between 2014 and 2019 would have been similar [11]. In contrast with both countries' growing capital deepening, however, the real stock of capital per hour worked in Italy fell throughout the 2014-23 period, by nearly 6% in the total economy and by 10% in the non-farm business sector (excluding financial and real estate services). In the post-pandemic period, Italy's manufacturing and ICT sectors went through capital deepening, while in most other industries the labour input increased more than the capital stock. Overall, investment by non-financial corporations is expected to rebound in 2025-26, also thanks to government support, after two years of contraction due to high financing costs.

(11) R. Greco (2023), *A structural analysis of productivity in Italy: a cross-industry, cross-country perspective*, Bank of Italy Occasional Paper N. 825. Counterfactual simulation applying France's or Germany's labour input shares by NACE 2 industry in 2014 to Italy, and then aggregating total labour productivity growth until 2019.

The composition of investment and the structure of the corporate sector dampen productivity dynamics. Italy's overall gap with the EU on R&D spending increased from 0.7 pps of GDP in 2019 to 0.9 pps in 2023, due to sharply declining private investment, the share of which ended up 8 pps below the euro-area average. In recent years public R&D funding was stable at around 0.5% of GDP and is planned to rise gradually over the medium term (see below). Another important driver of Italy's slow productivity growth is the misallocation of labour and capital across firms of different sizes (with smaller firms investing less in machinery and intangible assets), regions, corporate structure, ownership, etc [12]. Recent literature[13] highlights the relative dearth of high-growth young firms and the scarcity of risk capital for their scaling up (see Section 2.4). Inadequate human capital development is also associated with productivity dynamics: in Italy, on top of low tertiary attainment, the number of students attaining the highest education level (doctorate or equivalent) is smaller than in peer countries, although the share of doctorates in scientific and technical areas is comparable. Finally, the number of patent applications per capita is still significantly smaller than in other developed EU economies, though slightly increasing.

Assessment of MIP relevant policies

Over the last year, Italy has made some progress in implementing growth-enhancing reforms. Following the adoption of the relevant enabling law, the government is advancing with the primary legislation for the rationalisation of incentives to firms. The reform process creates an opportunity to concentrate public resources on the most effective instruments, in particular to support private R&D and innovation, as well as closer collaboration among smaller firms or their merger to create larger companies. The ongoing implementation of structural reforms in the areas of justice, public procurement, public administration, and public employment, as well as secondary and tertiary education, could also help raise the growth potential of the country (see Table A).

Accelerating the implementation of the RRP measures on competitiveness and productivity would be an important step to enhance potential growth. Productivity growth is expected to benefit from the extensive structural reforms under the RRP and included in the MTFSP, as well as by the acceleration of the investments foreseen over the final two years of the RRP. According to the MTFSP, as from 2025 public R&D spending would increase steadily by nearly 7% per year, to attain 0.6% of GDP in 2029. Higher private investment in R&D and innovation is also needed, along with a stronger partnership between research institutions and businesses focused on applied and industrial research. Entrepreneurship could benefit by expanding internships and easing the development of prototypes and business ideas within advanced training programmes. Increasing government support to the scale up of firms with high growth potential would help to increase average firm size. It could also help to reduce the productivity gap of Italian SMEs compared to other peer countries.

[12] S. Calligaris et al. (2016), *Italy's productivity conundrum. A study on resource misallocation in Italy*, European Economy Discussion Paper 030, May 2016.

[13] A. Cintolesi et al. (2024), *High-growth young firms in Italy*, Bank of Italy Occasional Paper N. 889.

2.3. LABOUR MARKET

Assessment of gravity, evolution and prospects of vulnerabilities

Unemployment has declined steadily, but low participation of women has kept labour potential underused. After expanding for three consecutive years across both genders and most age groups, labour market participation (Y15-64) has stagnated in 2024 (66.6%, -0.1 pp), further diverging from the euro-area average of 75.4%. The gap is much larger for women (13.2 pps) than men (4.3 pps), and since 2019 increased for both genders. By contrast, at 67.1% the employment rate (Y20-64) hit a new record, further reducing to 8.2 pps the gap with the euro-area average. Reflecting both strong employment growth and inadequate participation, the unemployment rate fell further in 2024 for both men (5.9%) and women (7.3%), while for young people (Y15-24) it dropped from 22.7% to 20.3%, still well above the euro-area average (14.6%). The share of tertiary graduates among people aged 25-34 increased to 30.6% in 2023 but remained far below the EU average (43.1%). The 2023 OECD-PIAAC survey highlighted the low level of Italian adults' basic skills, particularly in problem solving. This also reflects the insufficient public and private training offer to potential and actual workers.

Net job creation continued to be dominated by open-ended rather than fixed-term contracts, while wage increases outpaced inflation. Total employment grew by 1.6% in 2024, while hours worked increased by 2.1%. The number of employees on fixed-term contracts continued to decline sharply (-6.4%), whereas open-ended contracts rose by 3.3% and the self-employed increased by 1.2% (see Graph 2.1.c). Job vacancies decreased slightly in 2024, to 2.1%, which remains high by historical standards, as corroborated by the large share of employers flagging labour shortages. Contractual wages increased by 3.1% last year, marginally faster than in 2023, while actual wages grew by 3.4% (see Graph 2.1.d). Both indicators rose more than inflation (1.1%), eventually allowing wages to grow in real terms after two consecutive years of losses. However, such wage growth combined with negative productivity dynamics implied that unit labour costs accelerated marginally to 4.3% in 2024, from 4.2% in 2023, after showing subdued growth and supporting cost competitiveness gains for a decade. At the end of 2024, just 49% of employees were covered by collective contracts in force, although the share was 62% in the business sector and 78% in private services, as public-sector collective contracts expired at end-2024, just after being renewed for the three previous years. Most manufacturing and construction workers await renewal of their national collective contracts in 2025.

Assessment of MIP relevant policies

Ongoing reforms aim to increase participation and employability. The RRP introduced several reforms and investments in active labour market policies, vocational training and adult learning. The government has also adapted the social safety net, prioritising labour market re-entry at the expense of coverage. Two recent programmes aim to raise labour activation and facilitate job transitions by reducing skill mismatches. Italy reports that by the end of 2024 the National Programme for the Guaranteed Employability of Workers (GOL) reached more than 3.1 million people, who received personalised assistance mostly geared towards up-skilling and job placement, while a majority of job centres have started to strengthen their IT systems and to train staff. Reforms to enhance the vocational training system and the technical and professional institutes, adopted in 2022 and 2024, are expected to support students' transition to the labour market and to bridge supply and demand of young workers. This will raise the number of tertiary graduates, as well as help to meet the increasing demand for workers in medium-level occupations requiring specific qualifications [14]. To further reduce skill mismatch, it would be important that the implementation of these reforms ensure a regional balance and effectively integrate the most vulnerable groups. To boost youth and women employment, exemptions from social security contributions apply for hiring workers under 35 and vulnerable women on permanent contracts. Several other measures, including under the RRP and the MTFSP, aim to combat undeclared work, expand the supply of affordable childcare, and better target the social safety net towards labour activation (see Table A).

2.4. FINANCIAL SECTOR

Assessment of gravity, evolution and prospects of vulnerabilities

Overall, the Italian banking sector appears solid, thanks to the continued improvement in asset quality, capitalisation and profitability. Over the last decade, non-performing loans (NPL) have been a key concern which has now largely been unwound, as far as the banking sector is concerned. The gross NPL ratio slightly increased from 2.7% in Q4 2023 to 2.8% in Q3 2024 (see Graph 2.1.e). Nonetheless, NPLs in banks' balance sheets remain at a historically low level and well below the peak of 17.2% registered in Q3 2015. While the bulk of NPLs have exited banks' balance sheets, freeing up capital for new, healthy lending, the stock of NPLs outside the banking sector still to be reabsorbed by the economy remains substantial [15]. Banks' capitalisation remains robust, with the total capital ratio and the Common Equity Tier 1 (CET1) ratio at 19.9% and 15.7%, respectively, in Q2 2024, slightly higher than in 2023 but still below the EU average[16]. Risks related to banks' liquidity position remain limited and the banking system successfully managed the full repayment of targeted longer-term refinancing operations (TLTRO III). Bank lending in Italy has slowed down in 2024, primarily due to reduced demand and weak economic growth. This trend has been more pronounced in the corporate sector compared to households. Banks' Return on Equity proved resilient, rising from a historic high of 12.7% in Q4 2023 to an annualised 14.1% in Q3 2024, despite a decline of interest rate margins, which is so far offset mainly by an increase in fee income. The government's plan to boost incomes by postponing banks' tax deductions should not affect the sector's profitability and dividend distribution policies.

While the reabsorption of guaranteed loans continues, the corporate-sovereign-bank nexus is still significant. The stock of public guarantees decreased from 15.8% of GDP in 2022 to 13.3% in June 2024, following the progressive repayment of COVID-19 guaranteed

(14) Cedefop, Future employment needs | CEDEFOP.

(15) According to Banca Ifis, the outstanding stock of NPLs in the economy still amounted to EUR 298 billion in 2024.

(16) This refers to an average across all EU countries unweighted by the economy size akin to the approach used in the Alert Mechanism Report (see AMR 2025, SWD(2024) 700 final, Graph 3.26).

loans. Bank exposure to domestic sovereign debt also decreased to (9.4%) of total assets in December 2024, lower than its peak of September 2020 (10.9%)[17], but it is still high by historical standards and compared to other euro-area peers. The share of government securities measured at amortised cost[18] has slightly decreased to 74.7% of the portfolio, reflecting the change observed at significant banking groups. Between March and September 2024, the decrease in interest rates has halved the level of unrealised losses accumulated on securities, which would impact CET1 capital by 42 basis points if ever realised (Bank of Italy). Sovereign holdings are unevenly distributed across banks, mostly concentrated in cooperative and local banks which, however, generally maintain comfortable liquidity positions.

Access to non-bank financing remains limited for Italy's non-financial corporations, hindering their investment opportunities. The relative cost of non-bank financing has risen due to the monetary tightening over the last two years. Corporate bond issuance has rebounded in 2023 as a share of GDP to 1.4% from 0.8% in 2022 but listed shares and issued bonds represented only 13.3% of all funding sources for firms in 2023, down from 15.3% in 2015 and less than the EU average of 23.8%[19]. Venture capital (VC) and private equity (PE), also negatively affected by the monetary conditions, decreased from 0.04% and 0.6% of GDP in 2022 to 0.03% and 0.3% respectively in 2023. From a long-term perspective, however, the average VC investment has grown nearly 5-fold between 2011-2013 and 2021-2023. Despite this positive development, Italy's market remains far from best performers like France or the Netherlands[20].

Assessment of MIP relevant policies

The MTFSP includes commitments to ensure the effective monitoring and enforcement of the reformed insolvency framework. In recent years, Italy has made progress to reform its insolvency framework and to develop its NPLs market[21]. As part of the MTFSP, Italy has further committed to strengthen its data system to monitor the outcome of the reform and to take further corrective action where needed. Regarding the sovereign-bank nexus, lifting or relaxing territorial restrictions on lending could assist small and cooperative banks in diversifying their assets, where sovereign holdings are currently more significant.

In late 2024, the government adopted a reform to foster the development of venture capital in Italy. As part of the RRP, Italy has adopted a reform to attract institutional investors into the VC market. Tax incentives for pension funds are now conditional on the share of VC investment in their portfolio which should be at least 5% in 2025 and 10% in 2026 (see Table A "Financial sector").

(17) ECB BSI DATA, including Cassa Depositi e Prestiti.

(18) Classifying securities at amortized cost limits their vulnerability to short-term market movements unless they are subject to forced sale

(19) Based on Eurostat data on NFC funding in % of GDP and own calculations

(20) In 2023 private equity and venture capital investment as percentage of GDP was 0,7% and 0,06% in France and 0,7% and 0,11% in the Netherlands.

(21) In-Depth Review 2023 - Italy - European Commission and In-Depth Review 2024 Italy - European Commission

Table A: **Main policies increasing or reducing risks of imbalances considered in this IDR**

Vulnerability	Policies	Implementation status
Public debt	Completion of the 2024 annual spending review cycle and setting of additional targets for 2025-2027.	Ongoing under the RRP
	Permanent reduction of the tax wedge.	Adopted in 2024 for implementation in 2025
	Revision of some tax expenditures.	Adopted in 2024 for implementation in 2025
	Adoption of a government report to define the roadmap to reduce environmentally harmful subsidies by 2030.	Implemented in 2024
	Hire of new staff units by the Revenue Agency.	Implemented by 2024
	Measures to fight tax evasion from omitted declarations: (i) integration of national short term rental codes in the databases for tax risk analyses; (ii) introduction of com-pulsory connections between automatic cash registers and electronic payments for all businesses; (iii) require-ment of traceable payments for the tax deductibility of expenses for transport, food and accommodation.	Adopted in 2024 for implementation in 2025 and 2026
Productivity and competitiveness	Investments to improve educational outcomes, digitise public administration and increase the efficiency of the judicial system.	Ongoing under the RRP
	Rationalisation of firm incentives: adoption of primary legislation required by the enabling law passed in 2023.	Initiated in 2024, to be completed.
	Increase public R&D investment by 7% per year.	MTFSP Target: 0.6% of GDP by 2029
Labour market participation and unemployment	Guaranteed Employability of Workers (GOL) plan implementation	Ongoing under the RRP
	Deductions on social security contributions between 20% and 130%, for hiring with permanent contracts people under 35, women, and underprivileged, unemployed or vulnerable people in the south.	Implemented as of 2024
	New National Plan for New Skills – Transition	Adopted in 2024
	Reform of the secondary technical and professional schools to enhance the vocational training system and improve the school-to-work transition	Adopted in 2024
	The 2022-25 plan to combat undeclared work included stronger sanctions for non-compliance, strengthened inspections, and awareness-raising on the phenomenon.	First actions implemented in 2022-24. By Q4 2025, increase inspections by at least 30% compared to 2019-21 baseline. By Q1 2026, develop indicators measuring how much a firm or professional is at risk of undeclared work, allowing to send letters urging compliance, and to promote membership of a network of agricultural firms complying with labour standards.

Table A: **Main policies increasing or reducing risks of imbalances considered in this IDR**

Vulnerability	Policies	Implementation status
	Childcare: commitment under the RRP and MTFSP to reach 33% coverage of relevant population by 2027 Higher support to lower income families to pay nursery school fees for newborn children.	Ongoing under the RRP (by end-2024, only around 3% of planned childcare facilities completed and around 94% of funds allocated to local authorities). "Bonus Asilo Nido" already increased to up to EUR 3 600.
Financial sector	Comprehensive financial legislation reform, including: i) option by EU legislation (4) AIFMD to allow for a registration (instead of authorisation) regime for Alternative Investment Funds below a threshold, and ii) admitting retail investment in Registered Alternative Funds over a certain threshold of client's portfolio.	Adoption to be expected in Q1/Q2 2025.
	The Annual Competition Law reviewed the definition of start-up to concentrate public incentives on start-ups with greater growth potential. It also extended public guarantees for SMEs to venture capital (VC) operations and made tax incentives for pension funds conditional on reaching a share of at least 5% in 2025 and 10% in 2026 of VC investment in their qualified portfolio.	Adopted on 17 December 2024.

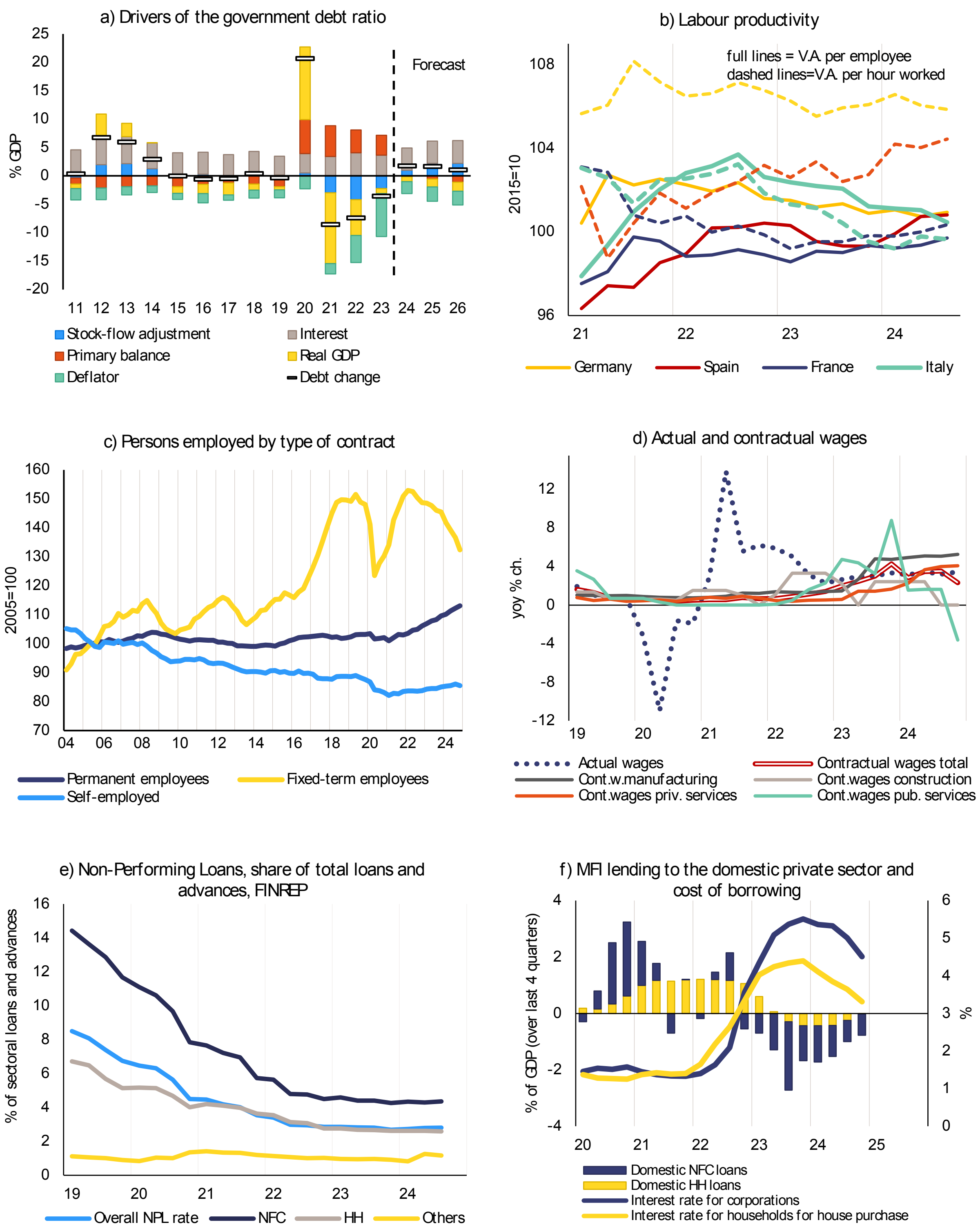
Note: This table lists the main measures that may increase or reduce the risks of macroeconomic imbalances. The measures are described more at length and reviewed in the text of this IDR.

Conclusions

Italy continues to face vulnerabilities relating to high government debt and weak productivity growth. Italy's public debt-to-GDP ratio fell almost back to its pre-pandemic level by end-2023 (134.8%), but the downward path reversed in 2024, as nominal GDP growth slowed down markedly, while stock-flow adjustments are projected to increase the debt ratio until 2026. Debt servicing costs are likely to remain sizeable at around 4% of GDP this year and next, which narrows the government's possibilities for growth-enhancing policies. Rising pension spending in the medium term due to demographic trends further reduces the government's scope to support growth. Overall, fiscal sustainability risks remain high over the medium term. In order to raise productivity growth and competitiveness, Italy needs to step up investment in R&D and innovation and boost the supply of tertiary graduates. Venture capital for the scale up of innovative start-ups is growing, but from a very small base. All this hampers adoption of new technologies, particularly by smaller firms, ultimately dampening productivity growth. Labour market indicators have continued to improve, with robust growth in employment and moderate wage rises, but further efforts in activation of youth and women are warranted to exploit Italy's full labour potential. Italian banks have made significant progress in strengthening asset quality and profitability. Their exposure to sovereign risk and the stock of state-guaranteed loans have receded somewhat but remain a vulnerability.

Some previous policies already addressed the identified vulnerabilities, yet a continued and effective implementation of reforms and investments together with a prudent fiscal stance remain crucial. An ageing population and past policy measures weigh on Italy's public finances. In contrast, the government has implemented several policies to foster fiscal sustainability, like enhancing the annual spending review, making public finances more growth-friendly by permanently reducing the tax wedge, and revising tax expenditures. Italy's MTFSP, which extends several reforms and investments started under the RRP and comprises new policy measures, sketches out the required future fiscal consolidation path, in line with the commitment to limit net expenditure growth over the MTFSP's adjustment period. To support productivity gains, ultimately boosting economic growth and resilience, the ongoing rationalisation of incentives to firms, fostering private investment in R&D and the aggregation of firms, as well as the full and timely implementation of RRP reforms aimed at improving competition and the business environment would be conducive. To strengthen the labour market, RRP-supported reforms and investments have focused on labour activation, skills enhancement, and increased provision of childcare. To improve access to non-bank finance, ongoing reforms make Italy's venture capital market more attractive to institutional investors. Reforms also led to significant progress in the insolvency framework and NPL market. Implementation of the MTFSP commitment will further strengthen the insolvency framework.

Graph 2.1: **Selected graphs, Italy**



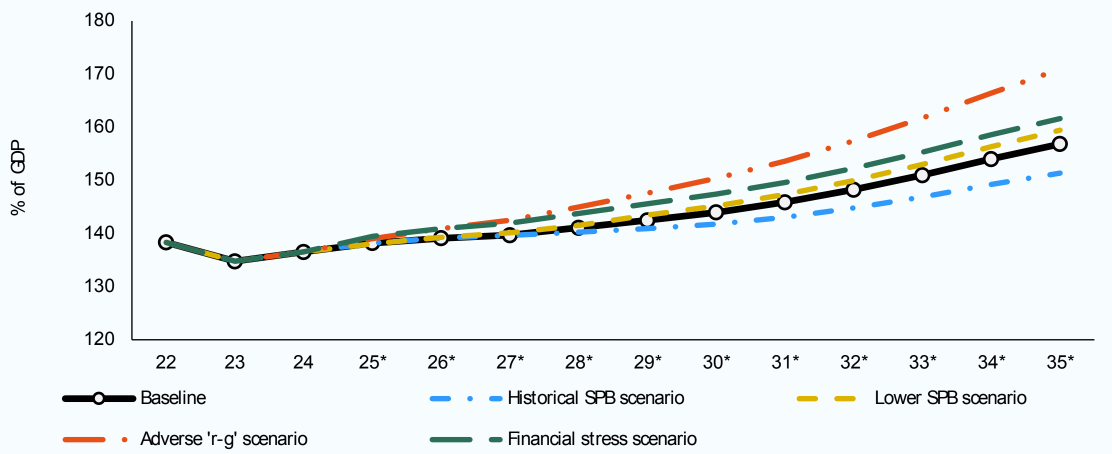
Source: ECB, Eurostat, ISTAT and European Commission calculations.

Box 2.1: **Medium-term government debt projections**

This box summarises government debt to GDP projections for Italy over the next decade, based on the latest government debt sustainability analysis conducted by the Commission.

Medium-term risks to fiscal sustainability for Italy are overall high, whereas they are overall low in the short term and overall medium in the long term. The debt sustainability analysis carried out by the Commission indicates that, under the baseline scenario, the government debt-to-GDP ratio is projected to increase to around 143% in 2029 and to around 154% in 2034 (Graph 1) [1]. This Commission's assessment of fiscal sustainability risks does not take into account Member States' commitments as outlined in the medium-term fiscal-structural plans. In line with standard practice, it only incorporates fiscal measures that have been legislated or agreed for 2025 and assumes unchanged policy afterwards.

Graph 1: **Government debt projections, based on scenario analysis for Italy**



The baseline projection for government debt is stress-tested against four alternative deterministic scenarios to assess the impact of changes in key assumptions: 'historical structural primary balance (SPB)' scenario, in which the SPB returns to its historical 15-year average of 0.7% of GDP; 'lower SPB' scenario: the improvement in the SPB forecast for 2025 is halved compared with the baseline; 'adverse interest-growth rate differential' scenario: the interest-growth rate differential is 1 pp. higher compared with the baseline; 'financial stress' scenario: interest rates temporarily increase by 3.8 pps. compared with the baseline.
Source: Eurostat, Debt Sustainability Monitor 2024, and European Commission forecasts and calculations.

[1] European Commission (2025), Debt Sustainability Monitor 2024, European Economy Institutional Paper 306.

Table 2.1: **Key economic and financial indicators, Italy**

	average 2017-2019	average 2020-2022	2023	2024 +	forecast 2025	2026
Output and Prices						
Real GDP (1 year % change)	0.9	1.3	0.7	0.7	1.0	1.2
Real GDP per capita (1 year % change)	1.2	1.7	0.8	0.8	1.2	1.5
GDP deflator (1 year % change)	0.9	2.1	5.9	2.1	1.9	1.8
Harmonised index of consumer prices (1 year % change)	1.0	3.4	5.9	1.1	1.9	1.7
Core inflation (HICP excluding energy, food, alcohol and tobacco) (1 year % change)	0.6	1.5	4.5	2.2	2.0	1.8
External position						
Current account balance, balance of payments (% GDP, 3y average)	**2.4**	**2.5**	**0.1**	**-0.2**	**0.8**	**1.3**
Current account balance, balance of payments (% of GDP)	2.7	1.4	0.0	1.1	1.2	1.4
of which: trade balance (% GDP)	2.8	1.2	1.3			
of which: income balance (% GDP)	-0.1	0.1	-1.3			
Current account norm (% of GDP) (1)	1.4	1.8	1.8	1.8	1.8	1.8
Current account req. to reach fund. NIIP (% of GDP) (2)	1.0	1.1	1.2	1.2		
Net international investment position (% of GDP)	**-6.1**	**3.4**	**7.4**	**12.1**	**12.9**	**13.8**
NENDI - NIIP excluding non-defaultable instruments (% of GDP)	-5.9	1.0	5.1			
Net lending-borrowing (% of GDP)	2.7	1.6	0.7			
Competitiveness						
Nominal unit labour cost index per hour worked (3y % change)	**1.6**	**3.8**	**4.7**	**8.9**	**11.1**	**9.0**
Nominal unit labour cost index per hour worked (1 year % change)	1.0	0.9	3.8	4.2	2.8	1.8
Real effective exchange rate - 42 trad. part., HICP defl. (3y % ch.)	**0.3**	**-1.0**	**0.7**	**0.0**	**-2.4**	**-2.7**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)	0.1	-0.6	3.4	-1.2	-0.7	-0.3
Export performance against advanced economies (3y % change)	**-1.0**	**-4.2**	**3.1**	**-3.3**	**-1.2**	**-1.9**
Export performance against advanced economies (1 year % change)	-0.6	-1.3	4.3	-2.1	0.0	0.1
Core inflation differential vis-à-vis the euro area (pps.)	-0.4	-0.5	-0.4	-0.6	-0.4	-0.2
Corporations						
Non-financial corporate (NFCs) debt, consolidated (% of GDP) (3)	**65.6**	**67.2**	**58.2**	**55.6**		
NFCs debt fundamental benchmark (% of GDP) (4)	25.2	28.4	30.3	31.3		
NFC (excl. FDI) credit flow, cons. (% debt stock t-1, excl. FDI)	-0.1	3.1	-1.5	-3.1		
Households and housing market						
Household debt, consolidated (% of GDP) (3)	**40.9**	**42.3**	**37.1***	**36.1**		
Household debt fundamental benchmark (% of GDP) (4)	19.2	25.1	28.4	29.9		
Household debt, consolidated (% of Households' GDI)	52.6	53.5	49.4	47.7		
Household credit flow, consolidated (% debt stock t-1)	**2.5**	**2.7**	**-0.5**	**0.4**		
Household gross saving rate (&)	10.6	15.1	10.7			
House price index, nominal (1 year % change)	**-0.6**	**2.8**	**1.3**	**3.2**		
House prices over/undervaluation gap (5)	-8.4	-7.7	-8.9	-8.4		
Standardized price-to-income ratio	91.4	90.3	85.1			
Building permits (m2 per 1000 inh)	79.9	83.3	80.2			
Government						
General government gross debt (% of GDP)	**133.7**	**146.1**	**134.8**	**136.6**	**138.2**	**139.3**
General government balance (% of GDP)	-2.1	-8.8	-7.2	-3.8	-3.4	-2.9
Banking sector						
Return on equity of banks (%)	5.9	5.3	12.7			
Tier-1 capital ratio banking sector (% risk-weighted assets)	14.4	16.7	16.9			
Gross non-performing loans, domestic and foreign entities (% gross loans)	8.8	3.6	2.7	2.8		
Cost of borrowing for households for house purchase (%)	1.9	1.7	4.2	3.8		
Cost of borrowing for NFCs (%)	1.8	1.6	4.9	5.2		
Labour market						
Unemployment rate (% labour force Y15-74)	**10.6**	**9.0**	**7.7**	**6.5**	**6.0**	**5.9**
Labour force participation rate - % pop. aged 15-64 (3y change in pp)	**1.5**	**-1.0**	**3.2**	**2.1**	**1.5**	**0.6**

+ If actual data were unavailable at the cut-off date, forecast or nowcast data are presented instead; * Denotes values above prudential thresholds;
(1) Current accounts in line with fundamentals (current account norms): derived from reduced form regressions capturing the main determinant of the saving-investment balance, including fundamental determinants, policy factors and global financial conditions. See Coutinho, Turrini and Zeugner (2018), "Methodologies for the Assessment of Current Account Benchmarks", European Economy, Discussion Paper 86, DG ECFIN, European Commission.
(2) Current account required to reach the prudential level of the NIIP over 10 years: calculations make use of Commission's T+10 projections. See Coutinho, Turrini and Zeugner (2018), "Methodologies for the Assessment of Current Account Benchmarks", European Economy, Discussion Paper 86, DG ECFIN, European Commission.
(3) Prudential threshold for non-financial corporate and household debt-to-GDP ratio: corresponds to the level above which banking crises become more likely. It is derived from regressions minimising the probability of missed crises and that of false alerts. See Bricongne et al. (2020), "Is Private Debt Excessive?", Open Economies Review, 31:471-512.
(4) Fundamentals-based benchmarks for non-financial corporate and household debt-to-GDP ratios: assesses private debt from regressions capturing the main determinants of credit growth and taking into account a given initial stock of debt. See Bricongne et al. (2020), "Is Private Debt Excessive?", Open Economies Review, 31:471-512.
(5) House prices over/undervaluation gap: is the simple average of the price-to-income, price-to-rent and model valuation gaps. The model valuation gap is estimated in a cointegration framework using a system of five fundamental variables: total population, real housing stock, real disposable income per capita, real long-term interest rate and price deflator of final consumption expenditure. Based on Philiponnet, N., Turrini, A. (2017), "Assessing House Price Developments in the EU", European Economy - Discussion Papers 2015 - 048, DG ECFIN, European Commission.

Source: Eurostat and ECB; European Commission for forecast figures (Autumn Forecast 2024).