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Team Italy: An economic performance worthy of a gold medal?

Ludovic Subran
Chief Investment Officer and Chief Economist
ludovic.subran@allianz.com

Maddalena Martini
Senior Economist Southern Europe and Benelux
maddalena.martini@allianz.com

Pierpaolo Fiore
Research Assistant
pierpaolo.fiore@allianz.com

In Summary

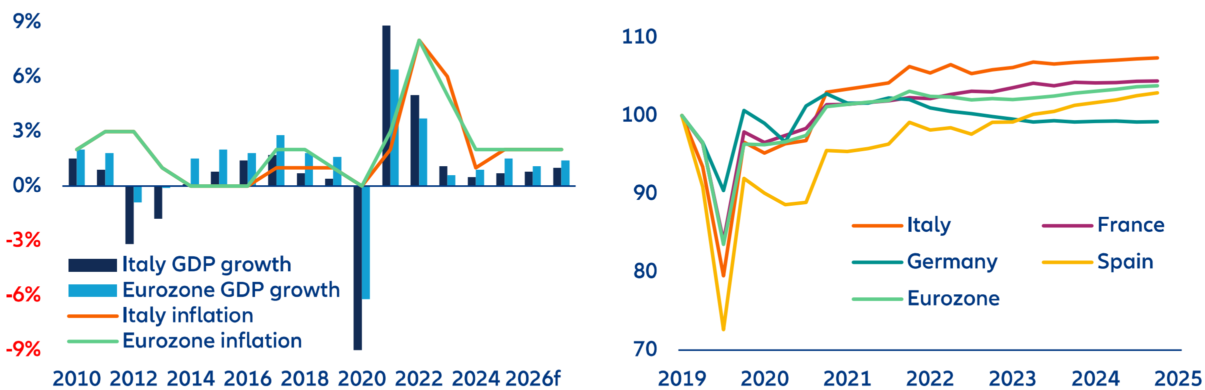
- **Italy approaches the Olympic Winter Games Milano Cortina 2026 with a notably stronger macroeconomic backdrop, underpinned by post-pandemic resilience in output, employment and trade, and an improved fiscal stance.** Italy had the strongest average per capita growth among large European economies since Covid-19, outpacing even Spain. Trade has also shown a degree of resilience despite heightened uncertainty, providing a partial buffer to external risks; the extra-EU trade surplus declined only by EUR1.5bn in 2025 compared to the previous year, supported by high-value sectors such as metals, pharmaceutical products and machinery and equipment. Upgraded sovereign ratings and BTP-Bund spreads at their lowest levels since 2008 signal greater external confidence in Italy's policy credibility and medium-term debt sustainability, creating favorable financial conditions.
- **Political stability has been a major driver of the narrowing in government spreads, with EU initiatives also contributing.** The current government is on track to become the longest-lasting in modern history, with potentially strong support heading into the 2027 election. A stable political backdrop supports timely policy implementation and helps prevent political-risk premium from offsetting the positive effects of NGEU. Since 2021, we estimate that NGEU has added 0.25pp of additional GDP growth on average per year and strengthened fiscal positions, which translated into an additional 50bps of spread tightening. However, fiscal tailwinds are fading as the grants that are currently cushioning the deficit by accounting as fiscal revenues will expire in 2026, while pressures persist as interest payments remain elevated at around 3.7% of GDP.
- **Structural challenges persist as much of the recent improvement reflects temporary or front-loaded factors.** Today's stronger macro-financial footing offers a more favourable backdrop to tackle longstanding constraints. Productivity and the activity rate have barely grown since the 2000s and lag peer economies; demographic pressures will see the working-age population fall by -16% by 2050 (compared to -9% in the Eurozone) and limited digitalization together with a fragmented business sector further weigh on efficiency. These weaknesses limit Italy's potential growth rate, demanding a renewed push on structural reforms, targeted investment in workforce reskilling and digital transformation and commitment to a long-term strategy that delivers sustained productivity gains and enhanced labor market participation.
- **The acceleration of NGEU-funded projects has already helped close Italy's public-investment gap with the Eurozone.** These projects are acting as catalysts for long-delayed upgrades in mobility, digital infrastructure and energy systems. With Italy still importing around 74% of its energy needs, the expansion of renewable capacity, grid reinforcement and diversified supply partnerships strengthens the case for these investments as key drivers of more resilient and sustainable long-term growth, increasingly supported by public-private partnerships.

Stabilizing growth amid mild progress on structural challenges

With GDP already standing 7.0% above pre-pandemic levels, Italy is regaining some economic momentum, supported by domestic demand. Consumption should remain resilient, supported by recovering household purchasing power, and investment will gradually pick up as uncertainty fades and NGEU-funded projects continue to be rolled out. GDP growth is projected at +0.8% in 2026 and +1.0% in 2027, after an estimated +0.7% expansion in 2025.

A sustained decline in prices, mainly driven by energy base effects, has brought Italian inflation below the ECB's 2% target, averaging 1.5% in 2025. A temporary rebound is expected due to energy volatility, but inflation should progressively converge back to target in 2027, offering some relief to households and businesses.

Figure 1: Annual GDP growth and inflation (%), and GDP per capita (2019=100)

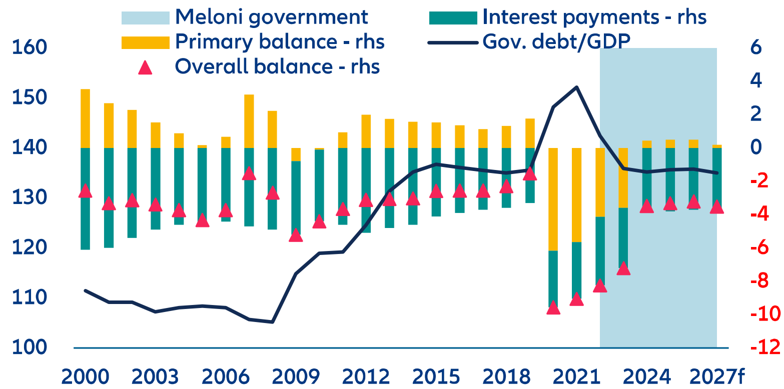


Sources: Eurostat, LSEG Datastream, Allianz Research

Employment levels reached a record high in 2025, though job creation has started to moderate. Unemployment should stay broadly stable around 6.0% through 2026–2027, while wage growth is set to ease below 3%, aligning with more subdued inflation. Structural challenges, such as low female labor force participation (the activity gender gap rate at 17.6% is more than double the Eurozone average), declining productivity and demographic pressures, continue to weigh on Italy's long-term potential.

Recent fiscal performance has improved, with stronger revenues narrowing the deficit toward the 3% target. Italy has absorbed almost 80% of NGEU resources, though actual spending remains just above 50%, leaving substantial funds – about 5.0% of GDP – still to be deployed. These resources will continue to support growth beyond 2026, but fiscal risks persist, especially as grant-related revenues fade and election-related spending pressures increase. The government projects the deficit to have already fallen to -3% of GDP in 2025, and to continue improving to -2.8% in 2026 and -2.6% in 2027, potentially enabling Italy to exit the Excessive Deficit Procedure by spring 2026. However, moderating tax revenues, expiring one-off measures and rising spending needs (including defense) will be a strain on public finances. We expect the deficit to drop below the 3% threshold only in 2028, with public debt stabilizing near 135% of GDP and interest costs remaining elevated at around 3.7%.

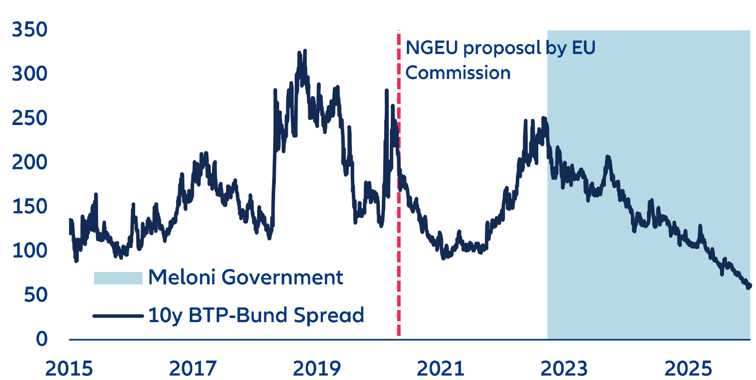
Figure 2: Government balance and debt, % of GDP



Sources: LSEG Datastream, Allianz Research. Light blue band refers to Meloni's government.

As a result, Italy's risk premium has fallen markedly from its 2022 highs. The government led by Giorgia Meloni – in office since October 2022 and on track to become one of the longest-lasting administrations of recent history – has contributed to a period of political stability. Combined with prudent fiscal policy and substantial NGEU inflows[1], this has supported a sustained narrowing of sovereign spreads to multi-year lows. 10-year BTPs are now widely viewed by global investors as significantly safer, with the BTP-Bund spread trading around 60-70bps, near its lowest levels since the post-2008 crisis, reflecting stronger market confidence and an improved appetite for Italian sovereign debt.

Figure 3: BTP-Bund 10-year spread, bps



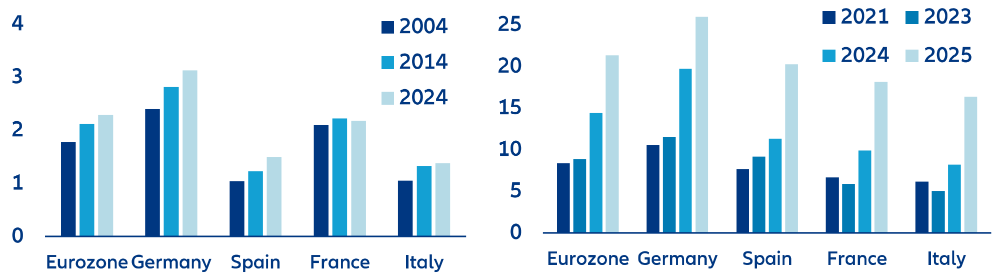
Sources: LSEG Datastream, Allianz Research.

Despite the improvement, Italy's competitiveness continues to lag behind key Eurozone peers due to structurally lower productivity, demographic pressures and a persistent investment gap, while its manufacturing base faces rising competition in high-value, technology-intensive sectors. Although wage dynamics remain moderate, supporting cost competitiveness, the country's performance is still constrained by high labor taxes (tax burden at 42.3%), regulatory complexity and slower innovation diffusion compared to Northern European peers. These structural weaknesses are reinforced by Italy's relatively low adoption of AI technologies, and by its comparatively modest R&D intensity, which remains below Eurozone leaders despite gradual improvement. Export performance has held up reasonably well, but without a stronger acceleration in digital transformation, AI uptake and R&D investment, Italy risks further erosion of its competitive position as peers advance more rapidly in innovation-driven growth.

[1] What to watch I November 14, 2025 | Allianz

Italy's competitiveness outlook is nonetheless supported by the renewed expansion of public investment, which has returned to pre-2010 levels (as a share of GDP). The rebound to Eurozone average levels has been enabled in part by the NGEU framework, which has provided Italy with additional investment capacity even as domestic fiscal space remains structurally tight. Stronger public investment should help address long-standing bottlenecks in infrastructure, digitalization and productivity.

Figure 4: R&D intensity (R&D expenditure as % of GDP) and % of enterprises using at least one AI technology

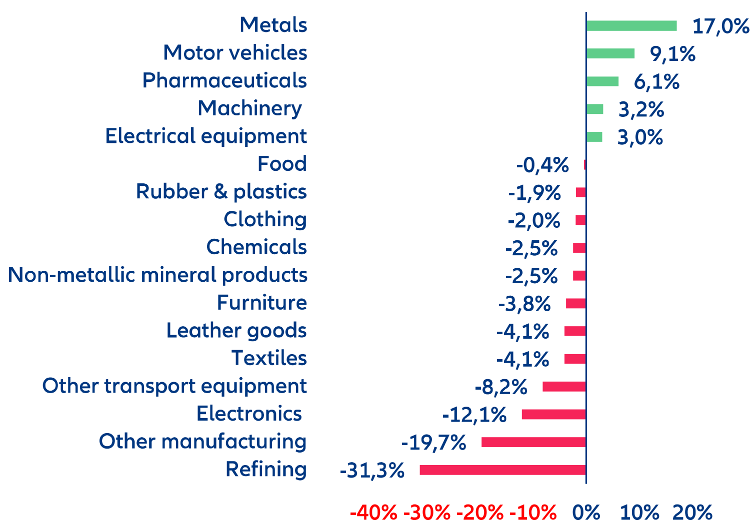


Sources: Eurostat, Allianz Research.

At the same time, Italy is regaining attractiveness for foreign investment. In 2024, foreign direct investment (FDI) trends confirmed a high degree of integration with core European economies – including Germany, France and the Netherlands – as well as the US. The broad-based rise in inward FDI stock relative to 2023 signals stronger investor confidence and reinforces Italy's appeal as a destination for capital deployment.

Trade has also proved resilient amid tariff-related uncertainty. Extra-EU data show that Italian exports and imports grew by +2.3% and +3.4%, respectively, in 2025 (from +1.3% and –3.1% in 2024), closing the year with a EUR56.1bn surplus – only EUR1.5bn below 2024. Notably, the surplus with the US narrowed only slightly to EUR34.2bn (from EUR38.9bn) as Italian exports to the US increased by +7.2% while imports surged +35.6%, largely driven by front-loaded purchases ahead of tariff changes. Although total exports were broadly flat year-on-year in November 2025 (-0.1%), key high-value sectors continued to support export resilience such as metals (+17.0% y/y), pharmaceutical products (+6.1%), and machinery and equipment (+3.2%).

Figure 5: Sectoral contributions to Italy's exports growth, 2025 (y/y, %)



Sources: Istat, Allianz Research.

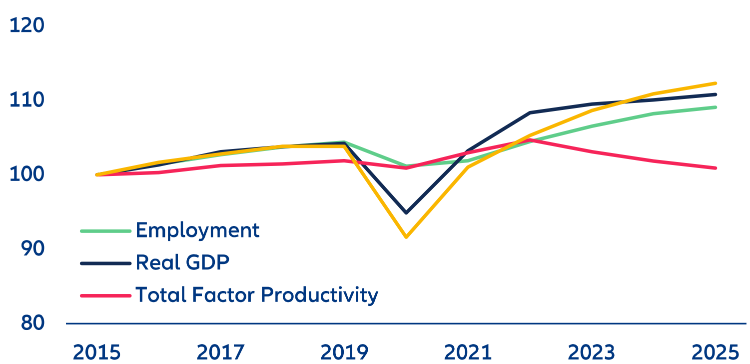
The new insolvency framework aims to tackle the longstanding issue of late crisis recognition by pushing firms toward earlier diagnosis and structured restructuring procedures, reducing incentives to delay filings. As a result, insolvencies are now being registered earlier and more transparently, contributing to the +35% estimated rise in cases in 2025 and helping limit late liquidations and supply-chain spillovers over time. Looking ahead, insolvencies are expected to stabilize around current levels, but the new framework will ensure a timelier detection of financial stress, making distress visible sooner rather than reducing it outright.

Short-term drivers lift growth, while reform delivery and industrial strategy lag

Italy's average annual GDP growth for 2022-2027 is set to outpace the 2010–2019 decade (+1.5% compared to +0.2%). Controlling for structurally low population growth, Italy has even outpaced Spain in cumulative growth terms, with GDP per capita having risen the most among the large European economies (Figure 1). However, a large part of the improvement stems from the inherited *Superbonus* tax credit scheme (approved during Covid-19), which boosted construction before being first scaled back and then abolished by the current government. Growth has also been strongly supported by NGEU funds (10.6% of 2021 GDP); we estimate the funds added roughly 0.25pp of additional GDP growth on average per year over 2021-2024.

Employment has reached record highs but gains largely reflect a cyclical recovery rather than new structural policies. The overall tax burden remains high, limiting incentives for households and firms. According to the Italian Fiscal Council, approximately 50% of the renewed tax-wedge reduction is projected to benefit taxpayers with incomes over EUR48k, who account for 8% of the total. The Meloni government abolished the citizenship income program (*Reddito di cittadinanza*) trying to shift from passive income support to activation-based labor-market participation, aligning incentives with training and employability.

Figure 6: Italy's growth paradox: more workers, stagnant productivity. Employment, real GDP, TFP and total hours worked (2015 = 100)



Sources: LSEG Datastream, Allianz Research.

The government's major reforms (public administration modernization, justice system efficiency, procurement simplification, digitalization and improved tax compliance) are centrally driven by the NGEU. The NRRP (National Recovery and Resilience Plan) embeds these reforms as mandatory milestones tied to successive disbursements, making EU funding a central lever for advancing structural reforms which will generate long-term impact.

Despite the central role of manufacturing, still accounting for 17.4% of gross value added, the country has not advanced any substantial industrial-policy overhaul. This gap is notable given the vulnerabilities exposed by the 2022 energy crisis, which highlighted the need for a coherent, long-term competitiveness strategy, particularly in high-value sectors where technological upgrading, digitalization and scale are essential.

On the fiscal side, one-off measures also contributed to the improved short-term outlook. The government has launched a privatization program worth EUR20bn by 2026, increasing non-recurrent revenues and helping to reduce near-term pressure on public finances. Additional resources are being mobilized through efforts to address tax evasion (including recent tax amnesties), which have generated solid revenue inflows but risk turning into a structural and recurring tool.

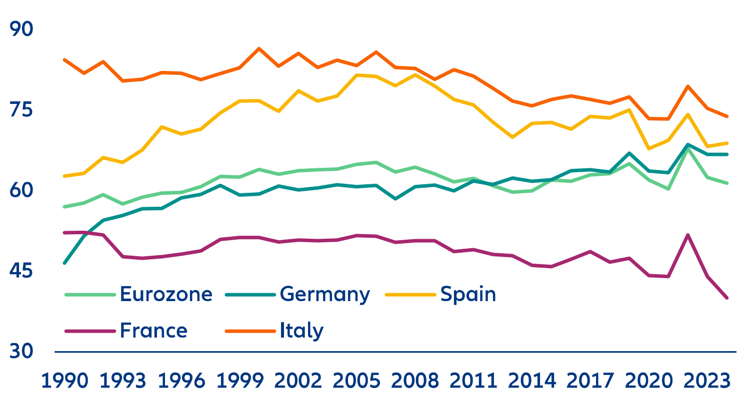
Finally, Meloni has strengthened Italy's geopolitical profile: more central within EU decision-making, more aligned with major partners on strategic priorities and more proactive in shaping Mediterranean and African policy through the Piano Mattei, which promotes joint projects in renewables, natural gas, water infrastructure and broader energy-transition initiatives across key African partner countries, supported by a EUR5.5bn initial budget. Within the EU, this geopolitical repositioning has been reinforced by efforts to upgrade ties with key partners. Notably, Italy and Germany have moved to elevate their bilateral relationship across European policy, industrial competitiveness, security, energy transition, development partnerships and cultural cooperation, reflecting shared commitments to NATO, EU integration and sustained support to Ukraine. Although the public communication stresses political alignment, this deepening cooperation also reflects pragmatic economic interdependence: Germany is Italy's single most important trade partner, consistently accounting for a significant share of Italian exports and imports. In 2024 data, Germany represented 10% of Italian exports and 15% of Italy's imports, underscoring the structural importance of this relationship for Italy's manufacturing-driven economy.

NGEU: the long-term payoffs

NGEU already had a positive short-term effect on the economy from the demand side, but there is also a longer-term supply-side payoff derived from infrastructure upgrades. Italy's NGEU-funded investment plan allocates EUR23.7bn to sustainable mobility – including rail corridors, regional links and high-capacity transport – alongside EUR41.3bn for digitalization and competitiveness and EUR16.9bn for cohesion, targeting long-standing bottlenecks in logistics, accessibility and territorial disparities. These investments offer a rare opportunity to address constraints that have long weighed on productivity, and to deliver durable improvements in travel times, connectivity and growth potential.

A similar dynamic applies to energy. With EUR55.5bn dedicated to the green transition and a further EUR11.2bn under the REPowerEU chapter, Italy is accelerating renewable deployment, grid reinforcement and efficiency upgrades – critical steps for lowering structurally high energy costs and reducing exposure to external shocks. The need is significant: Italy has one of the highest energy-dependency ratios in the Eurozone, importing roughly 74% of its total energy needs, primarily in the form of natural gas and oil. While dependence has eased slightly compared with 2019, the country remains heavily exposed to foreign supply risks, with key imports sourced from Algeria, Azerbaijan, Libya and the US. National initiatives such as the Piano Mattei complement these efforts by diversifying supply partnerships. Taken together, these measures form a key pillar, alongside infrastructure modernization, for strengthening Italy's long-term resilience and growth potential.

Figure 7: Energy imports dependency, %



Sources: Eurostat, Allianz Research. Note: Energy imports dependency shows the share of total energy needs of a country met by imports from other countries

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