

EY Italian Macroeconomic Bulletin

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Executive summary

- The global economy recorded a 3.5% GDP growth in 2025 and is expected to slow down to 3.0% in 2026 before strengthening to 3.4% in 2027. The global picture remains marked by strong heterogeneity across major economies, against a backdrop of high uncertainty.
- The conflict in the Middle East remains the main risk to the global economy, with significant negative effects for key maritime trade routes (notably the Strait of Hormuz), energy commodity prices and global supply chains. The geopolitical risk index, while gradually easing in recent months, remains at historically high levels.
- In the United States, growth is expected at 2.3% in 2026 and 2.2% in 2027, after 2.1% in 2025, while inflation remains above the 2% target. Against this backdrop, on 16 September the Federal Reserve decided to raise interest rates by 0.25 percentage points, its first hike in around three years.
- The Eurozone is expected to see subdued growth in 2026 (0.9%), improving slightly in 2027 (1.2%), after 1.4% in 2025. In the second quarter of 2026 GDP grew by 0.4% quarter-on-quarter (1.2% year-on-year), but the environment remains fragile and uneven across member countries, with the industrial sector still struggling. Further areas of concern are the level of public debt and pressures on external trade, with risks tilted mainly to the downside.
- The conflict in the Middle East has reversed the ongoing disinflation process: Eurozone headline inflation stood at 3.2% in August 2026, up slightly from 3.0% in July, with core inflation at 2.1%. The latest European Central Bank staff projections see inflation at 3.0% in 2026, 2.5% in 2027 and 2.1% in 2028. In response, on 10 September the ECB decided to raise its key policy interest rates – bringing the rates on the main refinancing operations, the marginal lending facility and the deposit facility to 2.65%, 2.90% and 2.50% respectively – while maintaining a *data-dependent* approach to developments in the macroeconomic environment.
- In Italy, industry shows a mildly negative trend: in July industrial production contracted by 0.1% year-on-year and remains around 6 percentage points below its 2021 average. Alongside dynamic sectors such as pharmaceuticals, strong signs of weakness persist in sectors such as textiles and wood. In services, turnover is growing modestly, driven mainly by the price component.
- The consumer price index rose by 3.3% in August 2026 (from 2.9% in July and 3.0% in June), a marked acceleration from the 2025 average (1.5%), driven mainly by the energy component. The labour market remains healthy, with the number of persons employed close to record highs (around 24.3 million) and an unemployment rate of around 5.8%, supporting household consumption.
- Public debt, already mentioned among the Eurozone's sources of fragility, has become more significant in an environment of rising interest rates. Despite high levels of debt in several OECD economies, rising indebtedness and higher interest expenditure to service the debt, these vulnerabilities have not so far translated into actual market stress.
- Against this backdrop, EY forecasts for Italy point to real GDP growth of 1.0% in 2026 and 0.7% in 2027, while inflation is expected at 3.0% in 2026 and 2.4% in 2027. The public deficit is projected at 3.1% of GDP in 2026 and 2.8% in 2027, with the debt-to-GDP ratio falling from 138.6% to 137.4%.

Figure 1: Real GDP, Italy - % change

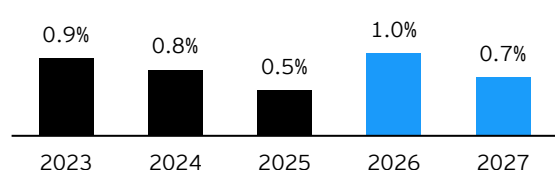
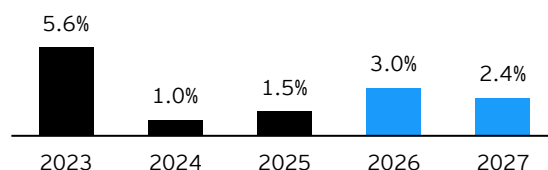


Figure 2: Consumer prices, Italy - % change



The global outlook

The world economy

According to the latest data from the International Monetary Fund, world economic growth came in at 3.5% in 2025 and is expected to be followed by a more moderate expansion in 2026 (3.0%) and a strengthening in 2027 (3.4%).¹

As always, this aggregate figure masks divergent economic trends across the major economies. US growth was 2.1% in 2025 and, according to the International Monetary Fund, will be followed by a slightly stronger expansion in 2026 (2.3%) and a similar one in 2027 (2.2%). Growth in the Eurozone appears more subdued: after 1.4% in 2025, it is expected to slow to 0.9% in 2026 before picking up to 1.2% in 2027.

These forecasts are broadly in line with those set out in the April 2026 World Economic Outlook,² relative to which growth for advanced economies has been revised down slightly for 2026 (-0.1 percentage points), followed by an upward revision of similar size for the following year.

Developing economies show a similar pattern, albeit of a different magnitude, particularly the Middle East and Central Asia, where growth is expected at 0.7% in 2026 (-1.2 percentage points compared with the April forecast), followed by a significant rebound (6.5% in 2027, an upward revision of 1.9 percentage points).

As regards prices, the conflict in the Middle East has temporarily reversed the global disinflation process.

Figure 3: Real GDP - % change

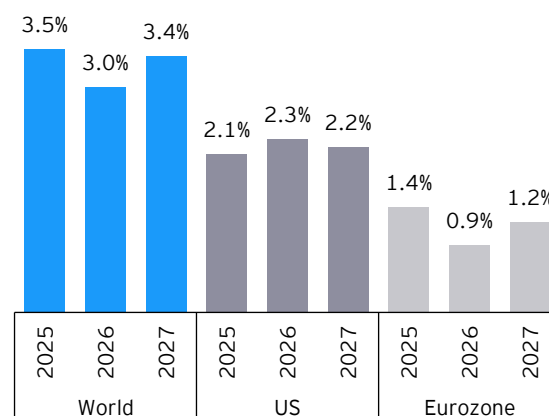
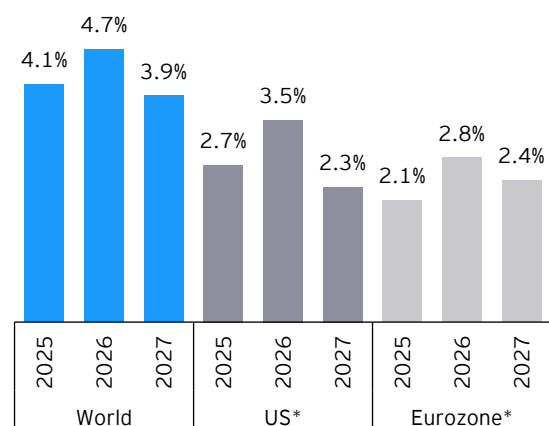


Figure 4: Consumer prices - % change



Source: EY-Parthenon elaborations based on IMF World Economic Outlook data, July 2026. * Source: OECD Economic Outlook, Volume 2026 Issue 1.

In its July estimates, the International Monetary Fund projects an increase in inflation in 2026 compared with the previous year (4.7% globally, after 4.1% in 2025, followed by a partial easing in prices). This increase is also confirmed by the June estimates of the Organisation for Economic Co-operation and Development, which

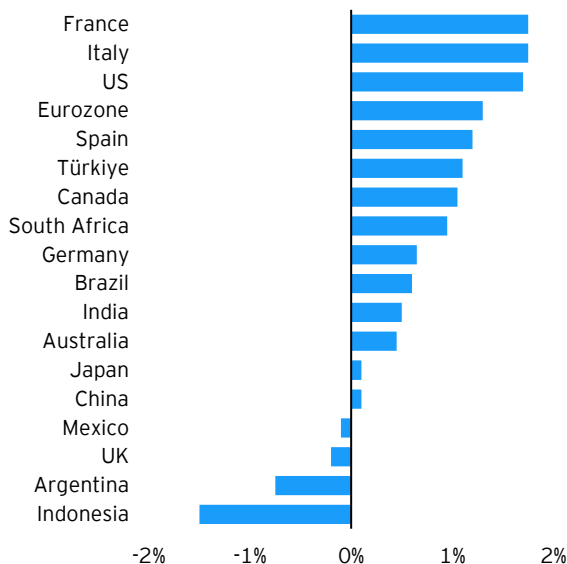
¹ IMF, Global Economy in Crosscurrents of War and Technology - World Economic Outlook Update, July 2026.

² IMF, Global Economy in the Shadow of War - World Economic Outlook, April 2026.

point to a rise in the inflation rate in OECD countries of around 0.4 percentage points in 2026 compared with 2025 (from 4.0% to 4.4%), before it eases in 2027 (3.0%).³

Global growth and price developments depend almost entirely on the geopolitical situation of recent months, which has translated into high levels of uncertainty. In this context, the war in the Middle East between the United States and Iran is the foremost issue to monitor closely in order to understand the direction of the global economy in the short to medium term. Particularly on the price front, the conflict in the Middle East is an important influence in the world's major economies, as highlighted by the International Monetary Fund.⁴

Figure 5: Change in inflation rate from February 2026 to June 2026 - percentage points



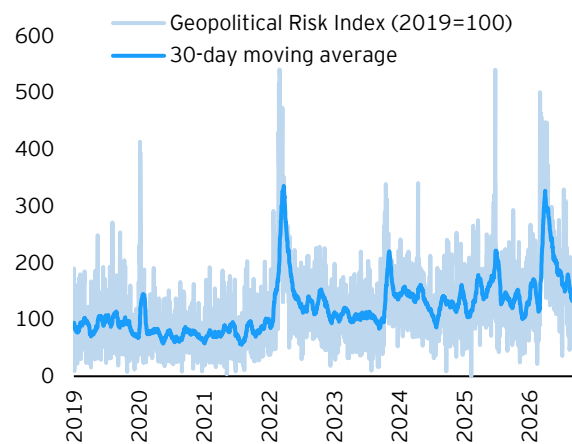
Source: International Monetary Fund.

It is important to note, however, that the effects of the conflict in the Middle East on inflation differ across countries. This divergence reflects a range of factors specific to each economy (such as the historical path of inflation, the size of the *pass-through*⁵ of higher energy costs to consumer prices, and the policy choices

made in response to these events), which shape the overall impact on prices in each country.⁶

The conflict in the Middle East therefore continues to weigh on the overall geopolitical picture, as shown by the Geopolitical Risk Index. Despite a significant and gradual easing in recent months, the index remains at very high levels - above pre-pandemic values and currently in line with those recorded in 2024 and 2025.

Figure 6: Geopolitical Risk Index, World - daily values and 30-day moving average



Source: EY-Parthenon elaborations based on data from Caldara et al. (2019).⁷ Last updated: 8 September 2026.

In addition to the *Geopolitical Risk Index*, global uncertainty is also captured by other indicators. One is the Economic Policy Uncertainty Index, a broader-based measure of uncertainty, which has declined in recent months although its overall level remains high. Another is the World Uncertainty Index, whose trend is broadly in line with the other two indicators.

³ OECD Economic Outlook, Volume 2026 Issue 1.

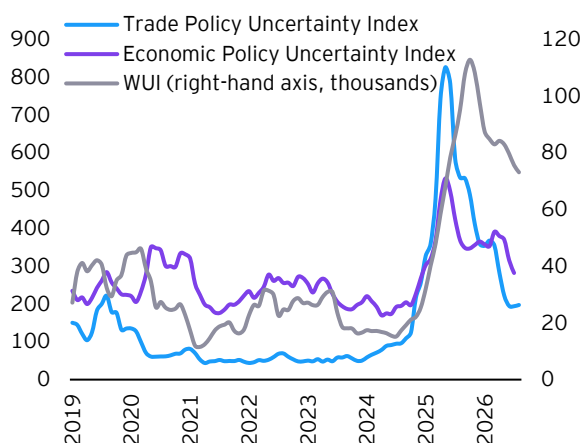
⁴ Georgieva, K. (2026) - Global Economy Endures War Shock-So Far, IMF Blog, 15 June 2026.

⁵ *Pass-through* (or "price transmission") refers to the extent to which a change in an "upstream" cost or price (e.g. transport costs) is passed on to "downstream" prices (consumer prices).

⁶ Imam, P. A. and Poghosyan, T. (2026) - One Global Shock, Many Inflation Paths: Explaining Post-COVID Inflation Divergence, IMF Working Paper 26/103.

⁷ Caldara, Dario, Matteo Iacoviello, Patrick Molloy, Andrea Prestipino, and Andrea Raffo, "The Economic Effects of Trade Policy Uncertainty", revised November 2019, Journal of Monetary Economics, forthcoming.

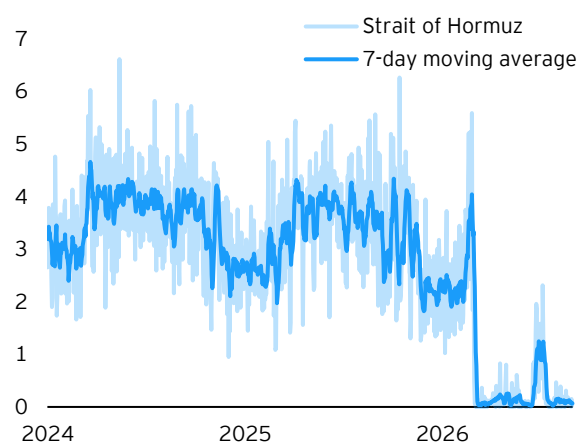
Figure 7: Uncertainty indices, World – 3-month moving averages



Source: EY-Parthenon elaborations based on data from Caldara et al. (2019),⁸ Economic Policy Uncertainty database. WUI: World Uncertainty Index. Last updated: 8 September 2026.

The rise in global uncertainty therefore largely reflects recent events in the Middle East, which have heightened tensions along one of the main maritime trade routes, the Strait of Hormuz. By way of example, before the conflict around 20 million barrels per day of crude oil and petroleum products passed through the strait, equivalent to 20% of global daily oil consumption, along with many other types of goods (such as fertilisers, helium and others). The most recent data on transit volumes through the strait show a broadly stable situation since the outbreak of the war in the Middle East, with the number of vessels in transit falling almost to zero, apart from the temporary reopening of the strait following the June 2026 memorandum.

Figure 8: Daily volumes of goods transiting the Strait of Hormuz, in millions of metric tonnes



Source: EY-Parthenon elaborations based on IMF PortWatch data. Last updated: 8 September 2026.

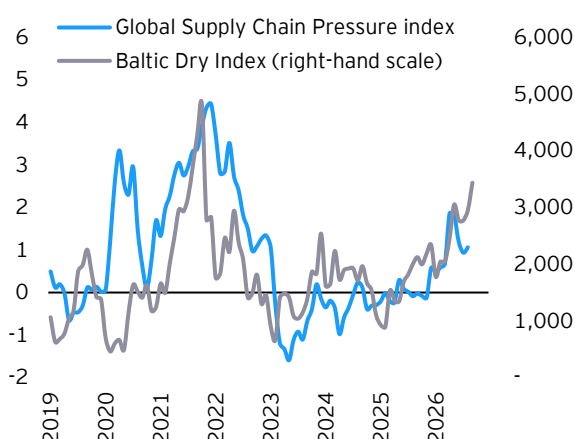
The difficulties in the Strait of Hormuz are feeding through to conditions in global supply chains. The Federal Reserve Bank of New York's Global Supply Chain Pressure Index and the Baltic Dry Index, two indicators of supply chain pressures, have both picked up from their 2023-2024 lows, signalling a deterioration in transport and supply conditions globally. Higher transport costs and longer delivery times add to price pressures, providing a further channel through which the conflict could push up inflation in the coming months and quarters.

This is particularly relevant in light of the latest empirical evidence on the link between supply chains and price dynamics. A recent European Central Bank study shows that the transmission of energy price shocks to inflation is not constant over time but is significantly amplified during periods of high supply chain uncertainty. When bottlenecks emerge at critical logistics hubs – such as the Strait of Hormuz – firms tend to read an increase in energy prices also as a signal of a broader and more persistent deterioration in supply conditions, raising their selling prices as a precaution and leading to a stronger and more lasting *pass-through* to inflation.⁹

⁸ Caldara, Dario, Matteo Iacoviello, Patrick Molligo, Andrea Prestipino, and Andrea Raffo, "The Economic Effects of Trade Policy Uncertainty," revised November 2019, *Journal of Monetary Economics*, forthcoming.

⁹ Merendino, A. and Monacelli, T. (2026) - Supply Chain Uncertainty, Energy Prices, and Inflation, ECB Working Paper 3230.

Figure 9: Global Supply Chain Pressure Index and Baltic Dry Index



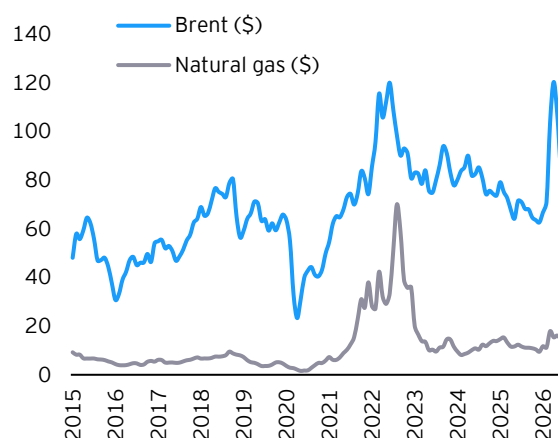
Source: EY-Parthenon elaborations based on Federal Reserve Bank of New York and Baltic Dry Index data. The *Global Supply Chain Pressure Index* (GSCPI) - the index developed by the New York Fed to monitor supply chain pressures - combines a number of commonly used metrics to provide a summary measure of potential supply chain disruptions (for further information, see <https://www.newyorkfed.org/research/policy/gscpi#/overview>). The Baltic Dry Index is an index of the average prices paid to ship raw materials on more than 20 routes (for further information, see <https://www.balticexchange.com/en/index.html>). Last updated: 8 September 2026.

Inflationary episodes such as those triggered by the geopolitical developments of recent years may also affect long-term inflation, as highlighted in a report by the *Bank for International Settlements*. The report notes that the inflation surge of 2021-2023 raised inflation expectations among economic agents, who were therefore inclined to bring forward price increases in response to energy price volatility and rising prices more generally.¹⁰ In the current context too, expectations of higher inflation would thus translate into actual price increases, as economic agents seek to limit the effects of future price rises (e.g. households bringing forward consumption, firms raising consumer prices, etc.).¹¹

As regards the effects on energy prices, it is also worth examining the latest official data. Brent crude averaged 67 \$/bbl¹² in January 2026 and 71 \$/bbl in February 2026. In March,

following the escalation of the conflict, the average price rose to 104 \$/bbl (+46% on the previous month), exceeding 100 dollars a barrel for the first time since the start of the year. After peaking at 120 \$/bbl in April, prices gradually eased, although upside risks remain: the latest available data show 85 \$/bbl in June, 83 \$/bbl in July and 91 \$/bbl in August.

Figure 10: Energy commodity prices (\$)



Source: EY-Parthenon elaborations based on World Bank data. Brent and natural gas prices are expressed in \$/bbl and \$/mmbtu respectively. The natural gas price refers to natural gas traded on the Title Transfer Facility (TTF). The futures figure is calculated as a 15-day average of the quarterly value in order to reduce daily volatility. Latest available data: August 2026.

Looking more closely at oil prices, it is worth stressing that the largest disruption to global oil supply in decades should have led to a much sharper price increase than the one observed: as noted above, after the initial spike crude prices stabilised between 80 and 90 \$/bbl, a lower level than might have been expected. The de facto closure of the Strait of Hormuz has halted the transit of around 20 million barrels per day of crude and refined products (one-fifth of global consumption), while the alternative routes activated by Saudi Arabia and the United Arab Emirates have only partly offset the lost volumes.¹³

¹⁰ BIS, Annual Economic Report 2026, June 2026.

¹¹ See, for example, Coibion O. and Gorodnichenko Y., Inflation, expectations and monetary policy: what have we learned and to what end? revised July 2025, NBER WP 32488.

¹² Dollars per barrel of oil. One barrel is equivalent to around 159 litres.

¹³ Natal, J.-M. and Sadikov, A. (2026) - The Oil Market Absorbed the War Shock, but Buffers Are Running Low, IMF Blog, 15 July 2026.

[illegible]

Several factors allowed the market to absorb the shock and explain why oil prices rose less than might have been expected. First, there was a supply surplus of around 2 million barrels per day even before the conflict. Second, global crude demand contracted (mainly in Asia, with a shift towards other forms of energy such as coal and renewables). In addition, production outside the Gulf countries rose by around 2 million barrels per day compared with 2025, led by the United States and supported by Venezuela, Guyana and Russia. Finally, the remaining shortfall was covered almost entirely by drawing down global stocks, including China's strategic reserves. However, some of these buffers are expected to become less effective over time, requiring strategic reserves to be rebuilt, sources and supply routes to be diversified, and consumer support to be kept targeted and temporary. The effect of these dampening factors may therefore prove only temporary, with possible upward pressure on oil prices should the conflict in the Middle East not be resolved in the short to medium term.

Component	Value
Surplus (Jan-Feb)	2.0
Gulf countries' production	-13.6
Other countries' production	1.7
Lower consumption	5.8
Inventories	4.1
Total	10.2

Natural gas traded on the European market (TTF) stood at 12 \$/mmbtu in January 2026 and 11 \$/mmbtu in February,¹⁴ edging down. In March prices reached 18 \$/mmbtu (+59% on the previous month), reflecting the direct impact of disruptions to energy supply. Prices remained high in the following months, fluctuating between 15 and 16 \$/mmbtu from April to June, before rising again to 18 \$/mmbtu in July. August saw a new peak, with the average gas price at 21 \$/mmbtu.

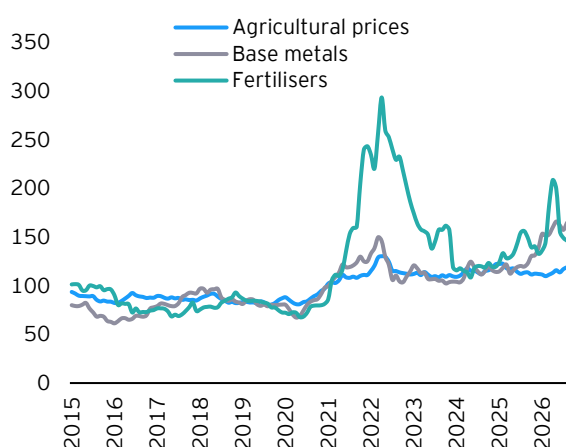
Here too, prices rose less than expected. According to the ECB, this reflects first and foremost more favourable market conditions than in 2022: Europe had already diversified its supplies away from Russian gas, expanded its LNG import capacity and benefited from better-supplied markets. Moreover, much of the price increase was driven by precautionary demand linked to the risk of future disruptions, rather than by actual supply losses for Europe, whose direct dependence on Middle Eastern LNG remains limited. Finally, Asian competition for LNG cargoes was weaker, thanks to greater flexibility in energy demand and a sharper fall in Asian LNG imports, helping to contain pressure on global gas prices.¹⁵ Nevertheless, natural gas prices in August were well above the levels seen in the last months of 2025 and the first months of 2026.

Agricultural commodity prices were broadly stable in the first quarter of 2026, down on the

¹⁵ Demuth et al. (2026) - Energy Shock - Why Oil and Gas Prices Have Risen Less Than Expected.

same period of the previous year. In April, May and June too, agricultural prices remained broadly in line with those of the previous months, falling by 3.6%, 1.5% and 0.5% respectively compared with the same months of 2025. The last two months (July and August), however, showed a different pattern, with year-on-year increases of 4.4% and 4.9% respectively. This may be linked to the rise in fertiliser prices, which have been on a broadly upward path, albeit easing in recent months.

Figure 13: Agricultural, base metals and fertiliser price indices (2010=100)

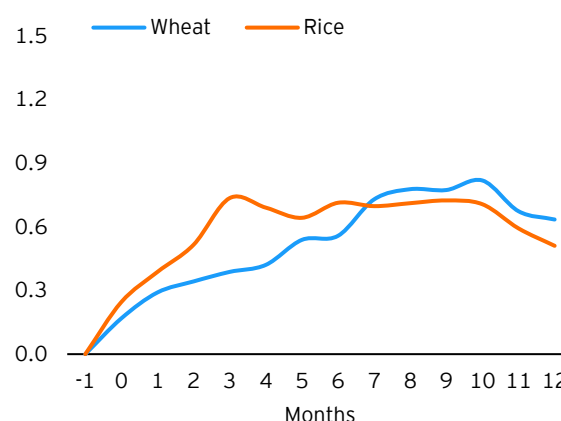
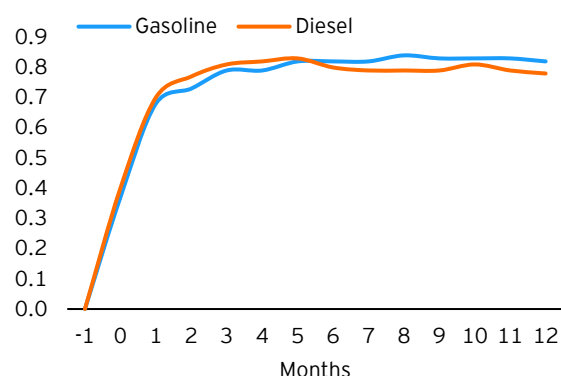


Source: EY-Parthenon elaborations based on World Bank data. Latest available data: August 2026.

When considering agricultural and energy prices, it is important to bear in mind that the effects of an increase in their prices on global consumer prices tend to materialise with a lag relative to the initial shock.

According to recent evidence from the International Monetary Fund, the pass-through of changes in international prices to retail prices is generally rapid and almost complete for fuels, while it is more gradual for food. Estimates indicate that most of the effect on fuel prices materialises within a few months, whereas for food items such as wheat and rice full transmission takes up to around ten months.¹⁶

Figure 14: Pass-through of an energy/agricultural price shock to consumer prices



Source: Nguyen, Thevenot (2026).

This implies that part of the inflationary pressure associated with the 2026 energy shock may continue to feed through to the real economy in the coming quarters, despite the normalisation of oil and gas prices from their spring peaks. In particular, the gradual *pass-through* in food sectors suggests that the effects on consumer prices may prove more persistent than those seen for energy goods, keeping central banks focused on developments in core inflation.

Finally, base metal prices remain on a significant upward path: in the second quarter of 2026 the index reached 162.8 (2010=100), up 40% on the same period of 2025, followed by a moderate correction in July (-2.9%) and a renewed rise in August (+4.6%). The World Bank expects the main base metals to exceed their record highs in 2026 (based on the published historical series), supported by structural demand linked to the energy transition, the upgrading of

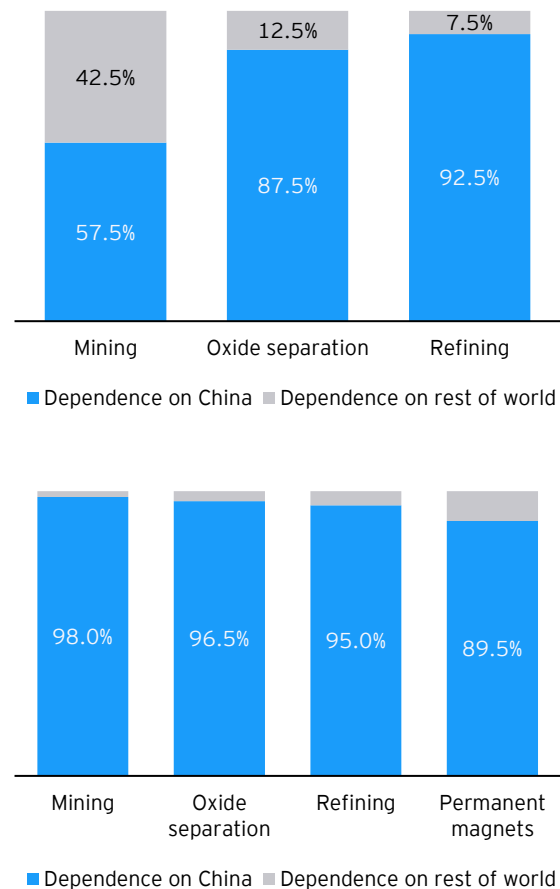
¹⁶ Nguyen, H. and Thevenot, C. (2026) - Pumps and Plates: Passthrough of International Fuel and Food Price Shocks to Domestic Markets, IMF Working Paper 26/148.

power grids and the expansion of data centres driven by the development of artificial intelligence. On the supply side, the ban imposed by the United States and the United Kingdom since April 2024 on trading new Russian aluminium, copper and nickel production on the main metal exchanges, together with precautionary stockpiling in some countries, has contributed to relative scarcity on international markets.

Beyond the pressures seen on energy and agricultural markets, the conflict has refocused attention on another structural vulnerability of the global economy: the high geographical concentration of supply chains for certain critical raw materials. Rare earths are a key issue in this respect, even though they are not directly linked to the situation in the Middle East.

According to the International Monetary Fund, China holds a dominant position along the entire rare earth supply chain. For light rare earth elements (LREE),¹⁷ the country accounts for 57.5% of global mining activity, a share that rises to 87.5% in oxide separation and 92.5% in refining. Concentration is even higher for heavy rare earth elements (HREE),¹⁸ where China controls 98% of mining, 96.5% of oxide separation and 95% of metal refining. This structure shows how any trade restrictions or production disruptions could have significant effects on global industrial supply chains, particularly in the energy transition and advanced technology sectors.¹⁹

Figure 15: Dependence on China along the value chain for light (LREE, first chart) and heavy (HREE, second chart) rare earths - %



Source: Bogmans et al. (2026).

The vulnerability of the supply chain became clear in April 2025, when China introduced export licensing requirements for seven rare earths and for permanent magnets: at the trough, magnet exports plunged by around 70% year-on-year, while dysprosium and terbium prices on European markets almost tripled by mid-2025. The episode triggered a new wave of *de-risking* industrial policies, culminating in the international agreements of October 2025, which mobilised around 6.4 billion dollars in public and private funds. Diversification, however, is neither simple nor quick: new mining projects outside China typically take 10-15 years to move from discovery to commercial production. Moreover, recent studies have shown that a fragmentation of the

¹⁷ LREE = Light Rare Earth Elements: the elements with the lowest atomic weight, relatively more abundant in the Earth's crust. They include, among others, neodymium and praseodymium.

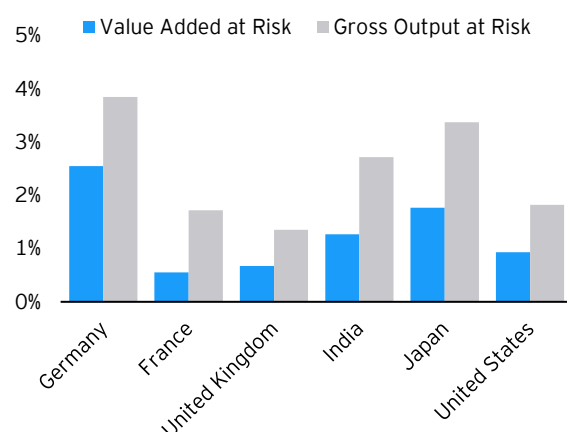
¹⁸ HREE = Heavy Rare Earth Elements: the elements with the highest atomic weight, much less abundant and more difficult to extract in significant quantities. They include dysprosium and terbium.

¹⁹ Bogmans, C., Cuadros-Bloch, F., Natal, J.-M. and Paloschi, A. (2026) - Industrial Policy and Supply Chain Bottlenecks in Commodity Markets: Evidence from Rare Earth Elements, IMF Working Paper 26/72.

market into two blocs would be highly disruptive, above all downstream: in the first year the price of refined rare earths would surge to around 80 times its baseline level (compared with around 7.4 times for the raw product), and demand for refined output would contract by around 48%. The cost of rebalancing is also significant: with a global rare earth market worth around 6 billion dollars, achieving a 25% *de-risking* target by 2035 would require, for the United States alone, investment subsidies equal to 134% of the annual value of the US market (around 1.13 billion dollars) if it acted unilaterally – a share that would fall to 90% (around 0.76 billion) if action were coordinated simultaneously among the main importing countries.

Beyond the effects on prices, it is also useful to quantify the overall macroeconomic impact of a disruption to rare earth supply. A first measure of exposure is *value added at risk* (VAAR), which aggregates the value added of sectors that use rare earths, weighted by their exposure. In the United States, 34 of the 405 sectors considered are particularly dependent on rare earths; these sectors accounted for value added of around 155 billion dollars in 2017 (0.8% of nominal GDP, of which around 70% is attributable to permanent magnets alone).²⁰ Exposure varies considerably across countries, however – from 0.4% of GDP in France to 2.5% in Germany – depending on the size of downstream sectors such as automotive, renewables and electronics. Incorporating these network effects into a general equilibrium model, the study estimates that an 80% reduction in rare earth supplies would, in the short term (horizons of less than a year, with limited substitutability of inputs), cause GDP losses of 1.8% for Japan, 1.5% for the United States and 1.2% for Germany, the most exposed economies. Over longer horizons, with greater elasticity of substitution, the aggregate effects tend to diminish significantly.²¹

Figure 16: Value Added and Gross Output at Risk



Source: Bogmans et al. (2026). Value added at risk (VAAR): value added attributable to activities dependent on rare earths, as a share of total GDP. A sector is considered “exposed” if it uses rare earths in any component of production, regardless of intensity. Gross output at risk: gross output dependent on rare earths, as a share of total gross output.

Overall, the geopolitical and economic situation remains complex and marked by high uncertainty, linked in particular to the conflict in the Middle East and its effects on inflation, international trade and supply chains. Alongside strictly cyclical factors, there are long-term trends, including the growing importance of critical raw materials and the spread of artificial intelligence. The overall effects of these developments on the global economy will depend on how geopolitical tensions evolve, on commodity price developments and on the ability of economies to mitigate supply chain vulnerabilities.

²⁰ The Input-Output tables used in the analysis refer to 2017.

²¹ Bogmans, C., Jerez-Osses, M., Miranda-Pinto, J. and Natal, J.-M. (2026) - Macroeconomic Effects of Rare Earths Supply Chain Disruptions, IMF Working Paper 26/73.

Growth in the major economies: the latest data

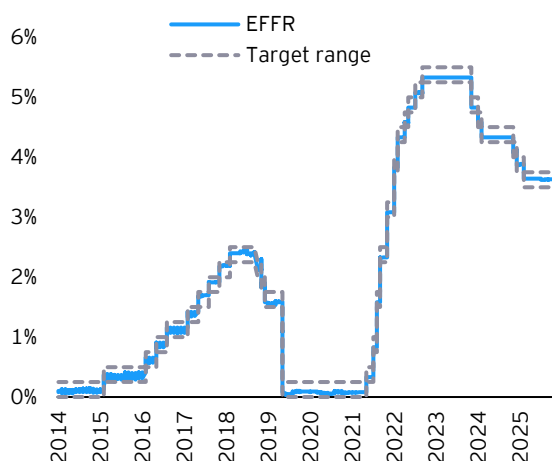
The international picture is characterised by heterogeneous performance across the major economies, including over the shorter term.

United States

US GDP grew at an annualised rate²² of 1.5% in the second quarter of 2026, after 2.1% in the first quarter. Growth was driven mainly by positive contributions from private consumption and investment (2.3 and 0.5 percentage points respectively), while net external demand made a negative contribution to overall growth (-1.1 percentage points).²³

As regards prices, US inflation remains above the Federal Reserve's price stability objective (2.0%), at 3.7% in July 2026, down from May (4.1%) but still well above the February figure (2.9%). A similar pattern is seen in the Personal Consumption Expenditure (PCE) Price Index, which is slightly up on February but down from its May peak.²⁴

Figure 17: Federal Reserve policy rates, United States

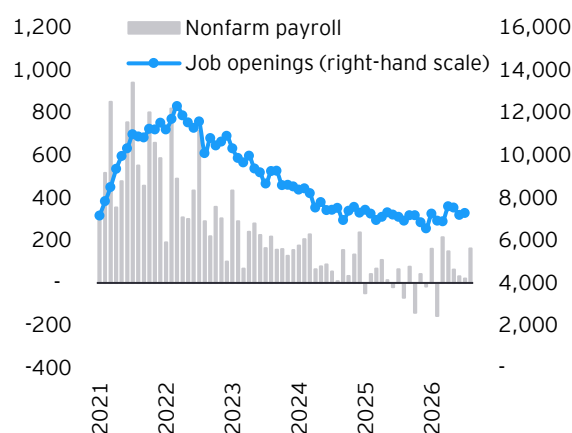


Source: EY-Parthenon elaborations based on Federal Reserve Bank of New York data. EFFR: Effective Federal Funds Rate; the EFFR is calculated as a volume-weighted median of reported overnight transactions. For further information, see <https://www.newyorkfed.org/markets/reference-rates/effr>.

With the economy growing solidly overall and inflation above the 2% price stability benchmark, at its latest meeting on 16 September the Federal Reserve decided to raise interest rates by 0.25 percentage points, bringing the target range to 3.75%-4.00%. The increase was decided unanimously by the *Federal Open Market Committee* after around three years of cuts or unchanged rates.²⁵ In this context, the Federal Reserve's latest projections point to headline PCE inflation of 3.7% in 2026 (with core inflation at 3.4%), followed by a decline the following year (2.3% and 2.5% for headline and core PCE respectively).²⁶

The labour market - a key issue for the US central bank, given its dual mandate of maximum employment and price stability - strengthened in August after three less dynamic months. In August, employment increased by 161,000, after an average gain of 38,000 in the previous three months. Job openings were also stable, broadly in line with previous months. The unemployment rate remains broadly stable at around 4%.²⁷

Figure 18: Change in nonfarm payrolls and job openings - United States



Source: EY-Parthenon elaborations based on Bureau of Labor Statistics (BLS) data. *Nonfarm payroll* refers to the number of US workers in the economy, excluding business owners, household employees, unpaid volunteers, farm employees and unincorporated self-employed workers. This measure accounts for around 80% of the workers who contribute to Gross Domestic Product (GDP). For further information, see <https://fred.stlouisfed.org/series/PAYEMS>.

²² For further information, see <https://www.bea.gov/help/faq/463>.

²³ GDP (Second Estimate) and Corporate Profits, 2nd Quarter 2026, <https://www.bea.gov/news/2026/gdp-second-estimate-and-corporate-profits-2nd-quarter-2026>.

²⁴ For further information, see <https://www.bea.gov/data/personal-consumption-expenditures-price-index>.

²⁵ Federal Reserve issues FOMC statement, September 16, 2026, <https://www.federalreserve.gov/newsevents/pressreleases/monetary20260916a.htm>.

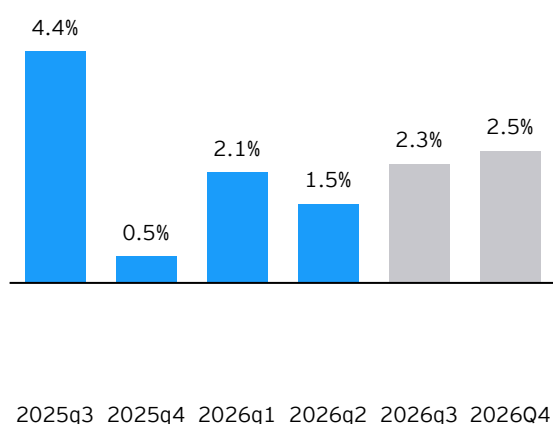
²⁶ September 16, 2026: FOMC Projections materials. For further information, see <https://www.federalreserve.gov/monetarypolicy/fomcprojtbl20260916.htm>.

²⁷ Bureau of Labor Statistics, Employment Situation News Release. For further information, see <https://www.bls.gov/news.release/empsit.toc.htm>.

Turning to the most recent data, consumer spending was flat in July 2026 compared with the previous month (0.0%), after positive growth in May and June (0.4%).²⁸ The stagnation in July reflects a decline in goods consumption (-0.6% month-on-month, contributing -0.2 percentage points to consumption growth) and weak growth in services consumption (0.3%, corresponding to a positive contribution of 0.2 percentage points).

Industrial and manufacturing activity is weak: industrial production grew by 0.2% month-on-month in July 2026 (after growth of 0.3% in June 2026 and 0.0% in May); manufacturing followed a similar pattern, growing by 0.2% in July after a slight increase in the previous month (0.3%). Year-on-year, industrial and manufacturing production are both on a positive trend, growing by 1.1% and 1.2% respectively.²⁹

Figure 19: GDP, United States - annualised QoQ % change



Source: EY-Parthenon elaborations based on Federal Reserve Bank of New York and U.S. Bureau of Economic Analysis (BEA) data. Grey bars show the available forecasts for the coming quarters (New York Fed Staff Nowcast). Growth rates are annualised. Last updated: 8 September 2026.

Looking at the coming quarters, the Federal Reserve Bank of New York's latest projections of September 2026 point to average GDP growth over the next four quarters in a range of 0.1% to 3.4%, with a median of 2.0%,³⁰ pointing to an economy that is broadly dynamic.

In addition, the Federal Reserve Bank of New York's short-term forecasts for the US economy point to annualised growth³¹ of 2.3% and 2.5% in the third and fourth quarters of 2026 respectively.³²

When discussing the US economy, it is important to consider recent trade policy developments, which are a further source of uncertainty for both the US and the global economy. Recently, the average effective tariff rate applied by the new US administration has fallen for many countries, which may partly improve and support global trade.

One useful way to interpret this is to compare the statutory tariff rate - the duty formally set by US administration measures - with the effective rate, i.e. the duty actually collected at the border as a share of the value of imports. The gap between the two measures widened during 2025. While the gap was virtually zero in January, by December the average statutory rate stood at around 15.5%, against an effective rate of around 9.5% - a gap of around 6 percentage points attributable to exemptions, implementation delays and avoidance by importers.³³ A comparison of the rates calculated with fixed weights (based on the 2024 import mix) and with current weights (updated month by month according to what is actually imported) also shows that both rates are lower with current weights. This signals that imports have shifted towards goods and countries less affected by tariffs. The gap between the statutory and effective rates is particularly wide for China, at around 10 percentage points.

This trade reallocation is also reflected in how tariffs pass through to import prices. At the level of individual country-product pairs (e.g. "steel imported from Brazil"), tariffs are passed almost entirely onto the tariff-inclusive prices paid by US importers, while the prices set by foreign exporters remain broadly unchanged; an 8 percentage point increase in the average effective rate between February and December 2025 is associated with a contraction in imports of around 3.6%. However, aggregate prices at product level - summing across all countries

²⁸ Personal Income and Outlays, July 2026. For further information, see <https://www.bea.gov/news/2026/personal-income-and-outlays-july-2026>.

²⁹ Industrial Production and Capacity Utilization, July 2026. For further information, see <https://www.federalreserve.gov/releases/g17/current/default.htm>.

³⁰ Federal Reserve Bank of New York, Outlook-at-Risk: Real GDP Growth, Unemployment, and Inflation, see <https://www.newyorkfed.org/research/policy/outlook-at-risk>.

³¹ For further information, see <https://www.bea.gov/help/faq/463>.

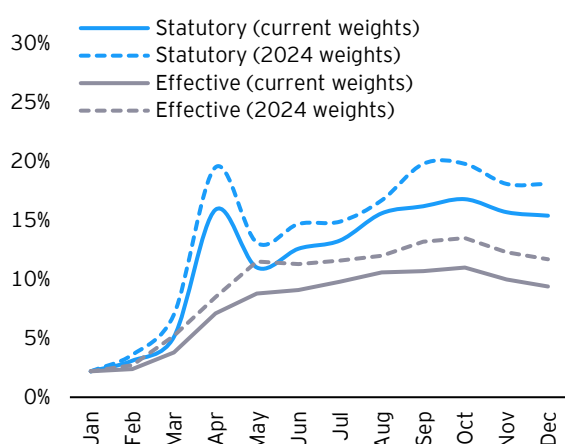
³² For further information, see <https://www.newyorkfed.org/research/policy/nowcast#/overview>.

³³ Ahn, J., Rotunno, L. and Ruta, M. (2026) - Tariff Pass-Through and Import Reallocation, IMF Working Paper 26/149.

supplying the same good - have fallen significantly in the sectors hit hardest by tariff increases. This is because US importers are replacing more expensive suppliers with cheaper ones, a shift driven mainly by the entry of new low-price suppliers and the exit of more expensive ones, rather than by discounts from incumbent suppliers. Part of these savings, however, reflects a shift towards products of lower perceived quality than those replaced, with possible adverse effects on the welfare of final consumers and on the productivity of firms that use these goods as production inputs.

A further factor limiting the effect of tariffs on prices has been the squeeze on the margins of US importing firms. According to the Bank for International Settlements report, firms in the sectors most affected by tariffs absorbed around two-thirds of the price increase during 2025, passing only one-third on to final consumers. This strategy could be interpreted as a temporary response to trade policy uncertainty, aimed at avoiding price increases that would be difficult to reverse in the future.³⁴

Figure 20: Statutory and effective tariff rates, United States



Source: Ahn et al. (2026).

United Kingdom

The United Kingdom grew by 0.4% in the second quarter of 2026, following growth of 0.6% in the previous quarter.

Performance in the second quarter of 2026 was driven mainly by growth in services and construction (0.5% and 0.3% respectively), while production stagnated.³⁵

Higher-frequency data show positive signals: after growth in May and June 2026 (0.1% and 0.4% month-on-month respectively), the services sector expanded by 0.4% month-on-month in July.³⁶

Construction was stable in July, growing by 0.1% after two months of contraction (0.1% in June and 0.8% in May).³⁷ Industry moved in a similar direction, posting modest growth in July (0.2%) after contractions of 0.2% in June and 0.7% in May.³⁸

Finally, as regards prices, inflation stood at 3.1% in August, up from previous months (2.9% in July, 2.6% in June). Core inflation also remains high and broadly stable compared with the previous month (2.6% in August, after 2.6% in July and 2.6% in June).³⁹

China

The Chinese economy is showing signs of slowing. This is not only a matter of GDP growth in recent years or the forecasts for 2027 (in its latest Economic Outlook the OECD projects growth of 4.5% in 2026 and 4.3% in 2027), but reflects a long-term trend under way since the aftermath of the financial crisis (2008).

³⁴ BIS, Annual Economic Report 2026, June 2026.

³⁵ GDP first quarterly estimate, UK: April to June 2026, <https://www.ons.gov.uk/economy/grossdomesticproductgdp/bulletins/gdpfirstquarterlyestimateuk/apriltojune2026>.

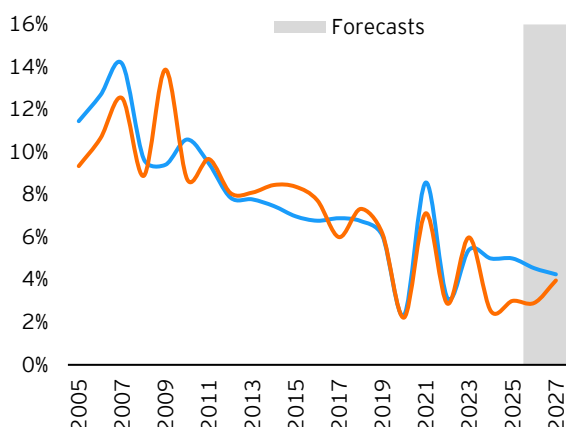
³⁶ Office for National Statistics, Index of Services, UK: July 2026, <https://www.ons.gov.uk/economy/economicoutputandproductivity/output/bulletins/indexofservices/july2026>.

³⁷ Office for National Statistics, Construction output in Great Britain: July 2026, <https://www.ons.gov.uk/businessindustryandtrade/constructionindustry/bulletins/constructionoutputingreatbritain/july2026>.

³⁸ Office for National Statistics, Index of Production, UK: July 2026, <https://www.ons.gov.uk/economy/economicoutputandproductivity/output/bulletins/indexofproduction/july2026>.

³⁹ Office for National Statistics, Consumer price inflation, UK: August 2026, <https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/august2026>.

Figure 21: GDP, China - % change

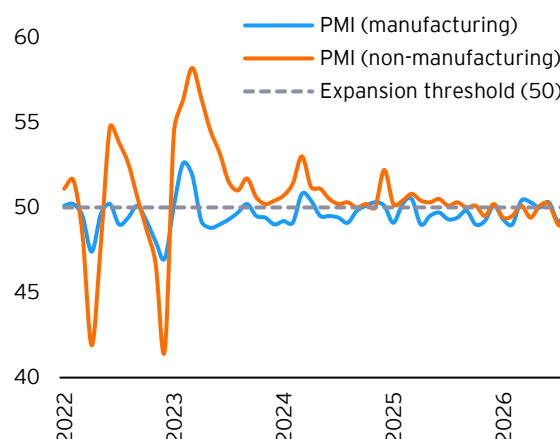


Source: EY-Parthenon elaborations based on OECD data and forecasts. Domestic consumption expenditure: expenditure on goods and services for final use.

The latest data show Chinese GDP growing by 4.3% year-on-year in the second quarter of 2026, after 5.0% in the first quarter of 2026 and 4.5% in the fourth quarter of the previous year. Quarter-on-quarter, GDP rose by 0.9% in the second quarter, after growth of 1.3% and 1.1% in the first quarter of 2026 and the fourth quarter of 2025 respectively.⁴⁰

Industry slowed slightly compared with June: in July industrial production rose by 4.5% year-on-year, after 5.3% in June and 4.5% in May. Despite the recovery from the April low (4.1%), industrial growth remains below the previous year's rates, when the lowest annual figure was the 4.8% recorded in November.⁴¹

Figure 22: Purchasing Managers' Index (PMI), manufacturing and non-manufacturing activity, China



Source: EY-Parthenon elaborations based on National Bureau of Statistics of China data. Latest available data: August 2026.

As regards the expectations of operators in manufacturing and non-manufacturing, the Purchasing Managers' Index (PMI) published by the National Bureau of Statistics of China shows a slight contraction in July, while remaining broadly in line with the expansion threshold (50).⁴²

The real estate sector remains in crisis, with investment down 19.2% in the first seven months of 2026 compared with the same months of the previous year, evidence of a sector in severe difficulty.⁴³

Looking at total investment more broadly, investment growth in the first seven months of 2026 was negative, with a contraction of 6.7%, a deterioration compared with the cumulative figures for January-February and January-March (growth of 1.8% and 1.7% on the same months of the previous year).⁴⁴

Retail sales grew moderately in July (0.6%) after stronger growth in the previous month (1.0%), which had followed a contraction in May (-0.6%); domestic market growth remains weak in the first seven months of the year.

⁴⁰ Preliminary Accounting Results of GDP for the Second Quarter and the First Half of 2026, https://www.stats.gov.cn/english/PressRelease/202607/t20260717_1964160.html.

⁴¹ Industrial Production Operation in July 2026, https://www.stats.gov.cn/english/PressRelease/202608/t20260818_1965071.html.

⁴² Purchasing Managers' Index for July 2026, https://www.stats.gov.cn/english/PressRelease/202608/t20260803_1964272.html.

⁴³ Investment in Real Estate Development from January to July 2026, https://www.stats.gov.cn/english/PressRelease/202608/t20260819_1965077.html.

⁴⁴ Investment in Fixed Assets from January to July 2026, https://www.stats.gov.cn/english/PressRelease/202608/t20260818_1965072.html.

On the external trade front, exports grew by 14.0% year-on-year in July 2026, while imports rose by 22.0%.⁴⁵

Staying with external trade, China's current account surplus increased by around 300 billion dollars compared with the previous year - the largest widening in absolute terms since at least 2000 - to around 0.6% of world GDP. The US deficit, although it narrowed by 69 billion dollars, remains by far the largest in the world, at around 0.9% of global GDP, exceeding the combined surpluses of China and the Eurozone.⁴⁶

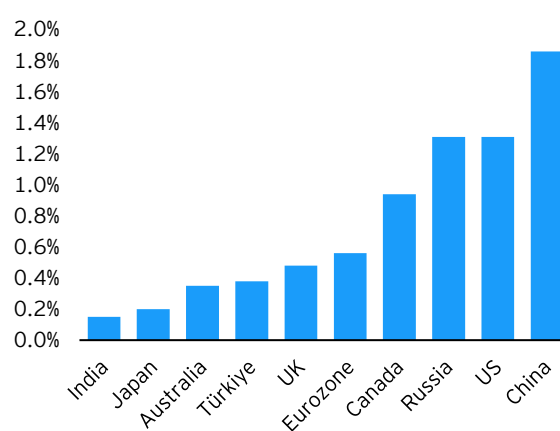
According to the IMF, the slowdown in investment - first in real estate and more recently in manufacturing and infrastructure - has been the main driver of the widening of China's surplus since 2023, together with a structurally high private saving rate, fuelled by precautionary motives linked to weak social safety nets. While these imbalances are not in themselves an immediate source of instability, they may signal an inefficient allocation of resources, fuel financial vulnerabilities and increase the risk of a disorderly adjustment, especially for economies with large net foreign liabilities.

The growing use of industrial policies and subsidies targeted at strategic sectors is a further source of tension in international trade.

A recent IMF study estimates that, over the period 2015-2023, China allocated on average 1.8% of sectoral value added to direct subsidies, compared with 1.3% in the United States and 0.6% in the Eurozone; this share more than doubled over the period, rising from 1% to 2.6%. In a scenario in which only China implements the estimated subsidies, the simulations point to an increase of around 12% in Chinese exports in strategic sectors, against an 8% fall in imports in the same sectors. Taking into account the combined effects of all the main subsidising economies, China's share of world exports of strategic products would rise from 27% to 29%, driven above all by electronics, where China's share of global exports would increase from 39% to 45%. The trade tensions between the United States and China have partly offset these effects: US tariffs on imports from China rose from 3% in

2015 to 16% after the 2018-19 episode and to 31% in March 2026, while Chinese tariffs on US imports rose from 6% to 27% over the same period. According to the study, the most recent tariff tightening would more than offset the boost from subsidies, leading to a 4% fall in Chinese exports in strategic sectors relative to the baseline scenario, while US imports in the same sectors would plunge by around 25%. At the aggregate level, the combination of subsidies and tariffs would result in a global real income loss of 0.3%, illustrating the efficiency costs of an uncoordinated subsidy-tariff spiral.⁴⁷

Figure 23: Value of subsidies - % of value added, 2015-2023 average



Source: Rotunno et al. (2026).

On the monetary policy front, policy interest rates remain low compared with previous years, a choice maintained even when the world's major central banks were pursuing restrictive monetary policy to counter rising prices. Specifically, the one-year and five-year Loan Prime Rates (LPR, the benchmark rate used by commercial banks to set the cost of loans to customers with the highest credit standing) stood at 3.00% and 3.50% respectively in May 2026. The MLF rate (Medium-term lending facility rate, the rate at which commercial banks and other banks - such as the China Development Bank - borrow from the central bank over the medium term) remains unchanged at 2.00%.⁴⁸

⁴⁵ For further information, see <http://english.customs.gov.cn/statics/report/preliminary.html>. The year-on-year change in exports stands at +18.5% when exports are expressed in dollars, while that of imports stands at +26.7%.

⁴⁶ Chen, J. and Platzer, J. (2026) - Rising Global Imbalances Underscore Need to Confront Domestic Distortions, IMF Blog, 30 July 2026.

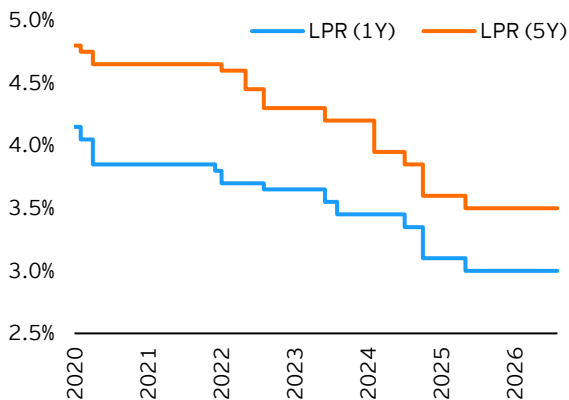
⁴⁷ Rotunno, L., Ruta, M. and Verma, P. (2026) - Industrial Policy and Trade Tensions in Strategic Sectors, IMF Working Paper 26/155.

⁴⁸ For further information, see <http://www.pbc.gov.cn/en/3688229/3688335/3883798/index.html>.

The slowdown in the Chinese economy is expected to continue, highlighting the need to reform its growth model. The main challenges include demographics (population ageing will shrink the labour force),⁴⁹ slowing productivity growth (given its transition towards advanced economy status),⁵⁰ and diminishing returns on investment, which, fuelled by savings (now at record highs), is being channelled into less productive sectors such as real estate.

Overall, the international environment is once again marked by complex geopolitical dynamics following the new conflict in the Middle East. These add to existing sources of uncertainty, such as protectionist US trade policy, possible escalation on other geopolitical fronts and possible new global inflationary pressures.

Figure 24: 1-year and 5-year Loan Prime Rate (LPR), China



Source: EY-Parthenon elaborations based on People's Bank of China data. Latest available data: August 2026.

⁴⁹ International Monetary Fund (IMF). 2017. "Asia: At Risk of Growing Old before Becoming Rich?" Chapter 2 in Asia and Pacific Regional Economic Outlook: Preparing for Choppy Seas. May 2017: Washington, DC.

⁵⁰ Madsen, Jakob B., Md. Rabiul Islam, and James B. Ang. 2010. "Catching Up to the Technology Frontier: The Dichotomy Between Innovation and Imitation." Canadian Journal of Economics 43(4): 389-1411.

The European outlook

The Eurozone economy and short-term indicators

GDP grew by 0.4% quarter-on-quarter in the second quarter of 2026, after broadly stagnating in the first quarter. Year-on-year, Eurozone GDP grew by 1.2%, up from the previous quarter (0.6%), albeit still slightly below the average growth recorded in 2025 (around 1.4%). Looking at contributions to growth by country, the four largest economies (Germany, France, Italy and Spain) all posted positive year-on-year growth in the latest quarter (ranging from 0.5% in France to 2.7% in Spain), confirming a heterogeneity that has persisted for several quarters.

Figure 25: GDP and contributions by country, Eurozone - YoY % change and percentage points

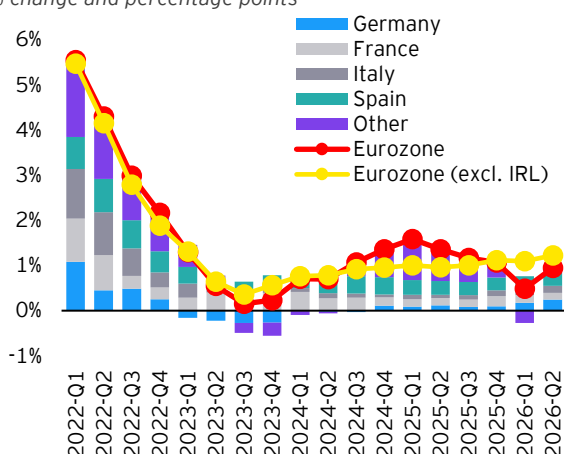
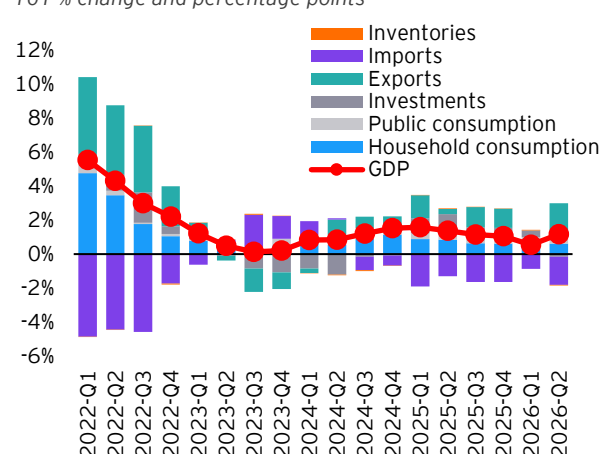


Figure 26: GDP and contributions by component, Eurozone - YoY % change and percentage points



Source: EY-Parthenon elaborations based on Eurostat data.

Looking at Eurozone economic performance by country, Germany's growth deserves particular attention, as it is the largest economy in the Eurozone by GDP. Its persistent weakness in recent quarters (average year-on-year growth of 0.5% since the first quarter of 2025) largely reflects structural rather than purely cyclical dynamics. According to a recent International Monetary Fund study, this is largely due (around 60%) to a decline in potential growth (the maximum sustainable growth rate an economy can achieve in the long run without generating inflationary pressures), while the remainder (around 40%) reflects cyclical factors linked to the 2022 energy shock and the subsequent monetary tightening.⁵¹

A complementary interpretation, developed in another International Monetary Fund study, frames cases such as Germany within a broader pattern of "convergence from above", in which economies that previously sustained relatively high income levels find it increasingly difficult to maintain their historical growth paths - not as a result of an isolated shock, but through gradual adjustment towards lower long-term potential.⁵² Germany's growth path has also been weighed down by some longer-term structural factors that have amplified the negative cyclical phase, such as low levels of public investment in infrastructure, a regulatory burden perceived by firms as increasing, population ageing and a gradual deterioration in external competitiveness, as shown by the loss of export market share, especially since 2017.

⁵¹ Kemp, H. (2026) - Drivers of Germany's Growth Downturn, IMF Working Paper 26/112.

⁵² Imam, P. A. (2026) - Convergence from Above: When Global Catch-Up Reflects Falling Back, IMF Working Paper 26/159.

Turning to the components of GDP, the pick-up in year-on-year growth was driven by domestic demand, supported by a recovery in private consumption and government spending (contributing 0.6 and 0.4 percentage points respectively to year-on-year growth). Export growth also played a positive role, with net external demand contributing +0.3 percentage points. Investment, on the other hand, contracted significantly quarter-on-quarter (-2.4%, corresponding to a contribution of -0.1 percentage points to GDP growth). In this respect, household consumption merits closer attention, as it is the largest component of GDP and is particularly exposed to external developments (e.g. rising uncertainty).

Uncertainty linked to the conflict in the Middle East has proved to be a key driver of Eurozone consumption, operating both through a confidence channel and through a real income channel linked to higher energy prices. Two recent ECB contributions make it possible to disentangle these two mechanisms and quantify their impact on household spending, offering useful insights into the weakness of private consumption within the broader context of Eurozone growth.

Figure 27: Consumption, Eurozone - YoY % change

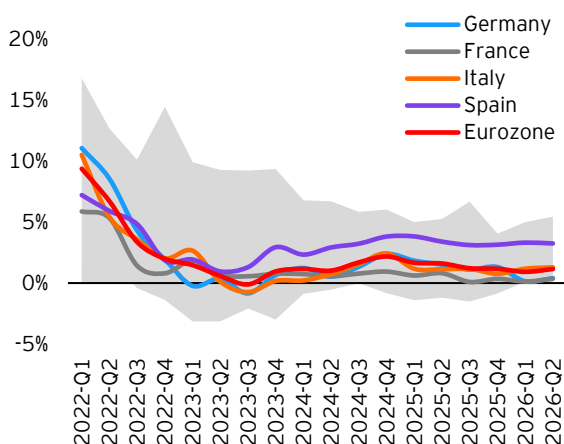
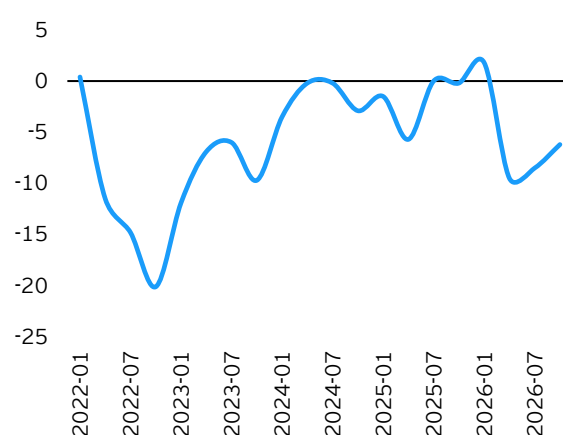


Figure 28: Consumer confidence, Eurozone - YoY % change and percentage points



Source: EY-Parthenon elaborations based on Eurostat and European Central Bank data.

On the confidence side, the consumer confidence index based on the ECB's Consumer Expectations Survey fell by around 12 points between February and April - a drop comparable in magnitude to the 15 points recorded in the two months following Russia's invasion of Ukraine - before partially recovering by 3.5 points between May and June. At the same time, nominal consumption growth weakened from the 3-4% pace seen since mid-2024 to around 2.5% year-on-year in April 2026, with the adjustment concentrated on discretionary spending rather than essentials, and more pronounced among higher-income households. Estimates based on CES (*Consumer Expectations Survey*) microdata indicate that a 10-point fall in individual confidence is associated with a reduction of around 0.4 percentage points in individual nominal consumption growth in April 2026 - an effect twice the size of the long-run historical relationship (around 0.2 percentage points) and comparable to that observed after the start of the war in Ukraine.⁵³ In addition, there is the energy price shock, whose effects work mainly through the labour income channel rather than through the direct effect on relative prices: around 80% of the fall in aggregate consumption reflects the loss of real income caused by lower wages and employment, against 20% attributable to the direct effect of higher energy prices. The impact is regressive, falling mainly on liquidity-constrained households that spend a larger average share of their disposable income on energy.⁵⁴

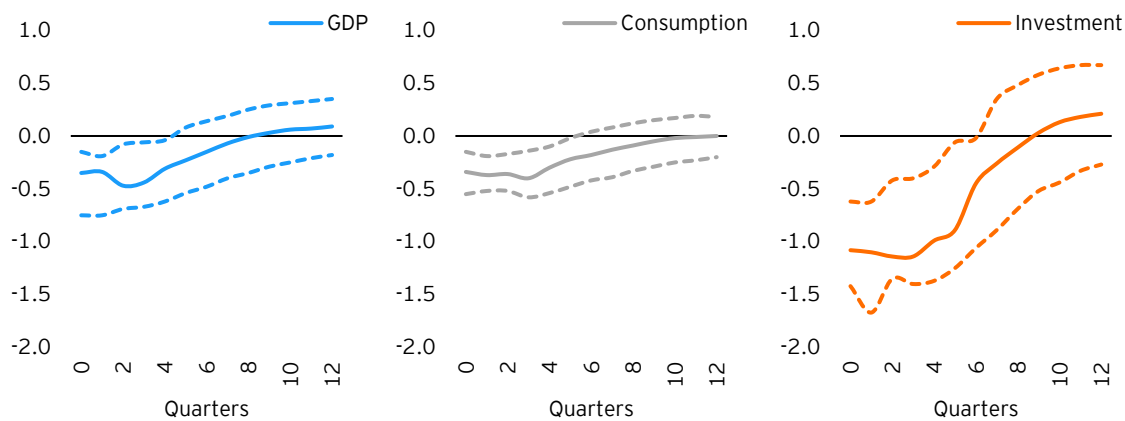
Beyond consumption, uncertainty also has a marked effect on investment. It is worth noting that during the main episodes of high uncertainty experienced by the Eurozone in recent years, private consumption remained relatively resilient, with a limited decline of around 0.4% at the trough and a recovery already visible in the following quarters. Business investment, by contrast, reacted more strongly, contracting by

⁵³ Dausà i Noguera, N., Dimou, M. and Kouvavas, O. (2026) - "Tracing the ripple effects of the Middle East war on euro area consumption", ECB Economic Bulletin, Box 2.

⁵⁴ Bobasu, A. and Dobrew, M. (2026) - "Feeling the heat unevenly: energy prices and household consumption", ECB Economic Bulletin, Box 3.

around 1.2% and remaining at lower levels for a longer period, mainly because, faced with a more uncertain future, firms tend to postpone spending decisions that are difficult to reverse (such as long-term investment), while households can partly cushion the shock by drawing on savings or reallocating spending over time. Analyses using alternative methodologies confirm the same ranking of impacts, albeit with slightly larger magnitudes (i.e. a fall in GDP of around 1%, with consumption declining by around 0.7% and investment by up to 2%). Looking at the more recent period, the same analysis suggests that uncertainty reduced Eurozone GDP growth by around 0.4 percentage points between early 2025 and early 2026, with the largest contribution once again coming from investment rather than consumption. Given the typical persistence of these effects and the continuing high geopolitical uncertainty linked to the conflict in the Middle East, this drag on real economic activity can reasonably be expected to persist throughout 2026.⁵⁵

Figure 29: Cumulative impact of an increase in uncertainty on GDP, consumption and investment - percentage points



Source: Andersson et al. (2026). Values show the response of the variables analysed to a one-standard-deviation economic policy uncertainty shock (measured by Economic Policy Uncertainty, EPU). Dashed lines show confidence intervals (68%).

In industry, the production index was broadly flat month-on-month in June, after growth of 0.4% in May and 0.3% in April. Overall, the Eurozone industrial production index remains around 1 percentage point below its 2021 average, having been on a weak trend since 2025. Year-on-year, the index rose by 0.2% compared with June 2025, after a contraction of 0.2% in May, which had followed growth of 0.5% in April.

⁵⁵ Andersson, M., Bobasu, A., Saiz, L., & Scrofani, S. (2026). The cost of not knowing: how uncertainty weighs on the euro area economy. *Economic Bulletin Articles*, 5.

Figure 30: Industrial production by main country, Eurozone - index, 2021=100

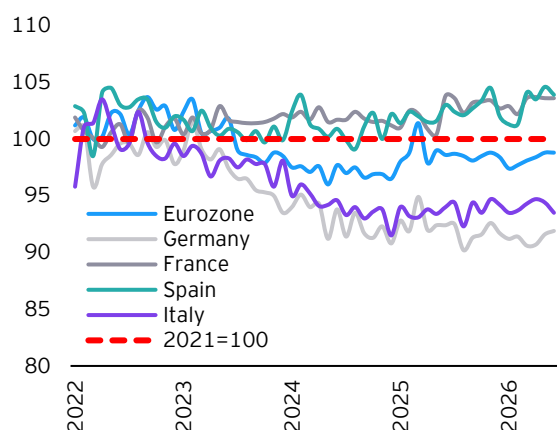
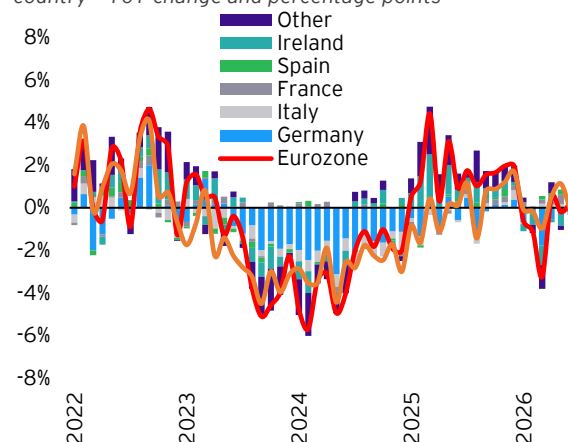


Figure 31: Industrial production and contributions by main country - YoY change and percentage points



Source: EY-Parthenon elaborations based on Eurostat data. Industrial production refers to NACE Rev. 2 codes B-D (Mining and quarrying; manufacturing; electricity, gas, steam and air conditioning supply). Latest available data: June 2026.

Continuing with year-on-year growth in the industrial production index and looking at the main categories of goods produced, growth in the Eurozone was driven mainly by capital goods (0.9%, after year-on-year growth of 2.4% and 3.0% in May and April respectively) and by growth of 0.5% in intermediate goods production (1.4% and 0.5% in the previous two months). Consumer goods production, by contrast, contracted (-0.8%, following contractions of 6.5% and 4.8% - the consumer goods industrial production index recorded its seventh consecutive year-on-year decline in June 2026).

Turning to short-term indicators, the PMI⁵⁶ indicators for manufacturing and services provide interesting and timely insights into developments in the main sectors of the economy. Starting with manufacturing, sentiment among operators is positive in the four largest Eurozone economies, improving above all in Germany. *Sentiment* among services operators is similar, with overall confidence improving in recent months, especially in Spain and Italy.

Figure 32: Purchasing Managers' Index (PMI), manufacturing

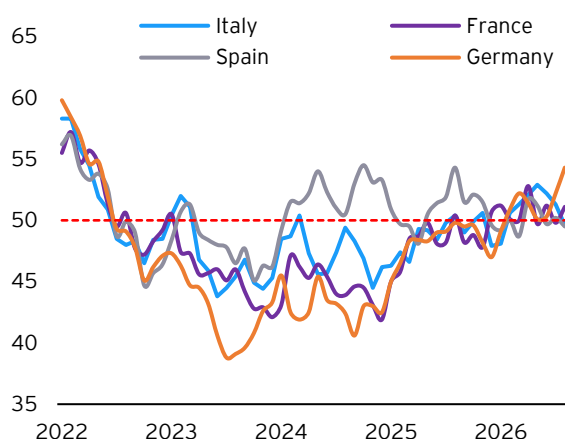
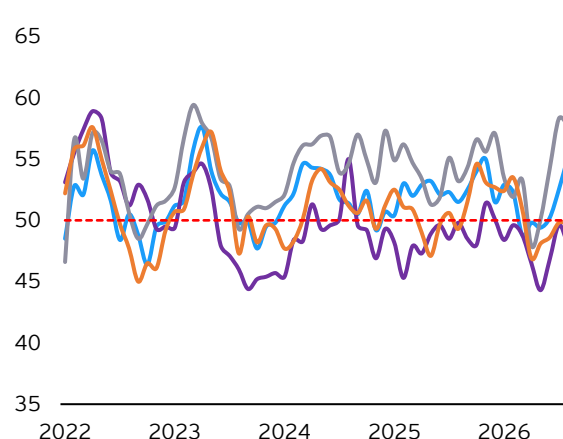


Figure 33: Purchasing Managers' Index (PMI), services



Source: EY-Parthenon elaborations based on S&P Global data. Latest available data: August 2026.

⁵⁶ The Purchasing Managers' Index (PMI) is one of the most widely followed short-term indicators. It measures the prevailing direction of economic trends in manufacturing, construction and services, based on timely surveys of the most representative companies in each sector. Values above 50 indicate expanding economic activity, values below 50 a contraction.

Despite the complex geopolitical environment and the deterioration in some short-term indicators, the probability of a recession in the Eurozone remains low. *Ad hoc* models,⁵⁷ which combine macroeconomic and financial conditions to estimate recession risk at a monthly frequency, do not currently signal any concrete risk of a contraction in Eurozone economic activity.

Figure 34: Recession probability in the United States

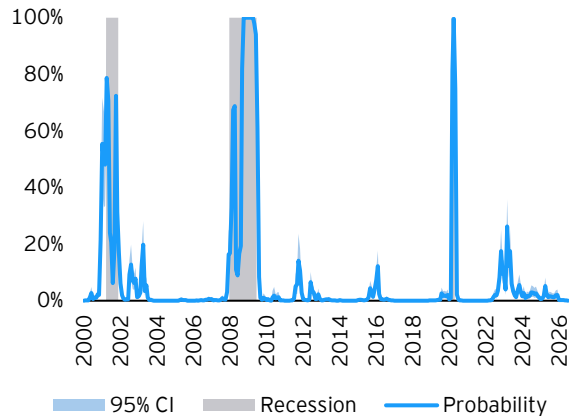
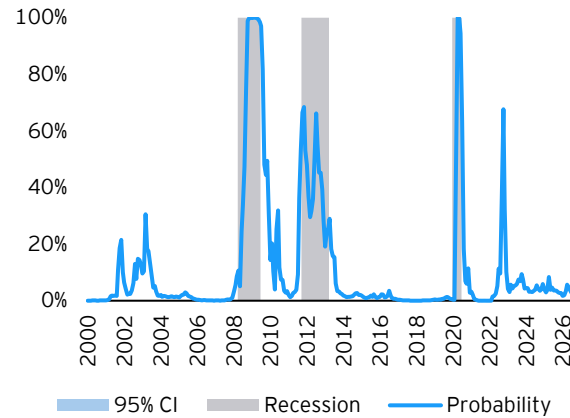


Figure 35: Recession probability in the Eurozone



Source: EY-Parthenon elaborations based on Furno and Giannone (2024).

⁵⁷ Furno, Francesco and Giannone, Domenico, Nowcasting Recession Risk (January 22, 2024). Handbook of Research Methods and Applications in Macroeconomic Forecasting, Available at SSRN: <https://ssrn.com/abstract=4706700> or <http://dx.doi.org/10.2139/ssrn.4706700>.

Monetary policy and prices in the Eurozone

The complexity and uncertainty of the current geopolitical environment are crucial factors for monetary policy, in the Eurozone and beyond. The evolution of the conflict in the Middle East and its repercussions on oil prices and transport costs along strategic routes are the first factors for *policymakers* to assess. Specifically, three dimensions need to be considered: (i) the duration of the shock; (ii) the size of the shock; (iii) and the *pass-through* of higher energy costs to final consumer prices. While it is still difficult to obtain clear and definitive information on these points, central banks are expected to maintain a *data-dependent* approach, monitoring developments in the external environment and reacting accordingly, including through the use of new tools and models.⁵⁸

Against this backdrop, on 10 September 2026 the European Central Bank decided to raise its key policy interest rates, taking into account the overall macroeconomic picture and the rise in prices caused by the war in the Middle East. The new staff projections see the Harmonised Index of Consumer Prices rising by 3.0% in 2026, 2.5% in 2027 and 2.1% in 2028.⁵⁹ The interest rates on the main refinancing operations, the marginal lending facility and the deposit facility⁶⁰ therefore stand at 2.65%, 2.90% and 2.50% respectively.

Figure 36: European Central Bank key policy interest rates

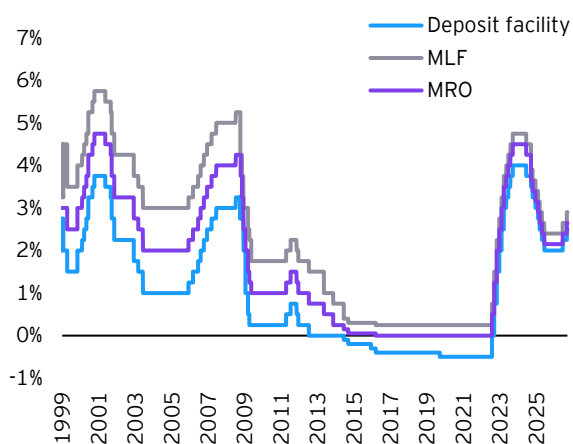
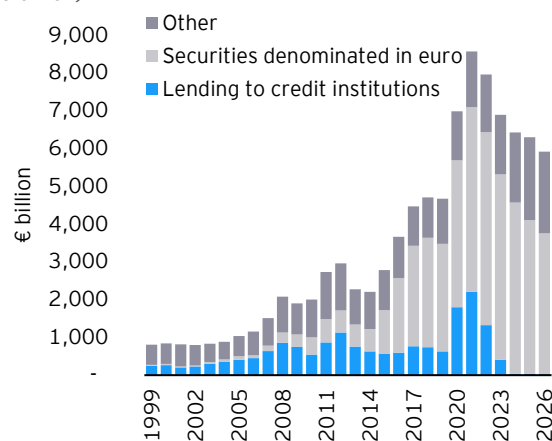


Figure 37: Main European Central Bank balance sheet items (€ billion)



Source: EY-Parthenon elaborations based on European Central Bank (ECB) data. MLF = Marginal Lending Facility; MRO = Main Refinancing Operations. The deposit rate refers to the deposit facility at the central bank. Balance sheet items - lending to credit institutions: lending to Eurozone credit institutions related to monetary policy operations denominated in euro (items include main refinancing operations and LTROs); securities denominated in euro: securities of Eurozone residents denominated in euro (items include assets acquired for monetary policy purposes); other: items include gold and claims denominated in foreign currency on Eurozone residents and non-residents. The latest available data for 2026 refer to the *weekly financial statement* of 8 September 2026.

The effects of the war in the Middle East are visible in the Eurozone Harmonised Index of Consumer Prices. Headline inflation stood at 3.2% in August 2026, up slightly from the previous month (3.0%) and in line with the rates recorded between April and May.

The core component (2.1% in August, after 2.2% in the previous month and 2.1% in June) edged down, mainly because of its services component, which continues to make a significant contribution to underlying inflation. It is worth noting that core inflation continues to show high persistence, averaging 2.6% between 2024 and today.

⁵⁸ Arce, O., Klieber, K., Lenza, M., & Paredes, J. (2026, 21 April). Navigating uncertain times with the help of artificial intelligence. The ECB Blog. European Central Bank.

⁵⁹ ECB, Monetary policy decisions, 10 September 2026. For further information, see <https://www.ecb.europa.eu/press/pr/date/2026/html/ecb.mp260910~314e508016.en.html>.

⁶⁰ The deposit facility rate is one of the three key interest rates that the ECB sets every six weeks as part of its monetary policy decisions. It defines the interest banks receive on their overnight deposits (for the duration of one business day) with the central bank. The other two key rates are the rate on the main refinancing operations (MRO) and the rate on the marginal lending facility (MLF). The MRO rate defines the cost at which banks can borrow from the central bank with a one-week maturity. If banks need overnight liquidity, they can use the marginal lending facility at a higher rate. For further information, see https://www.ecb.europa.eu/stats/policy_and_exchange_rates/key_ecb_interest_rates/html/index.en.html.

Figure 38: Headline inflation and components, Eurozone - YoY % change

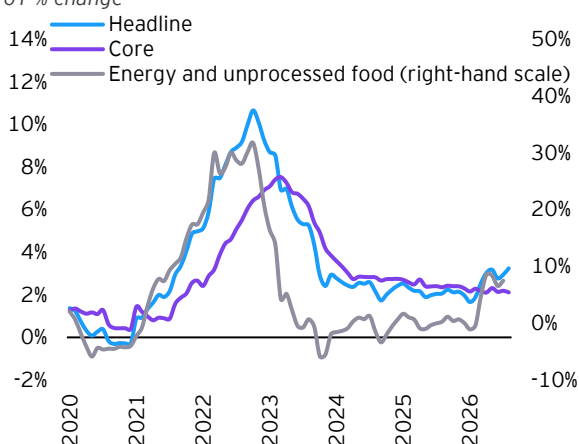
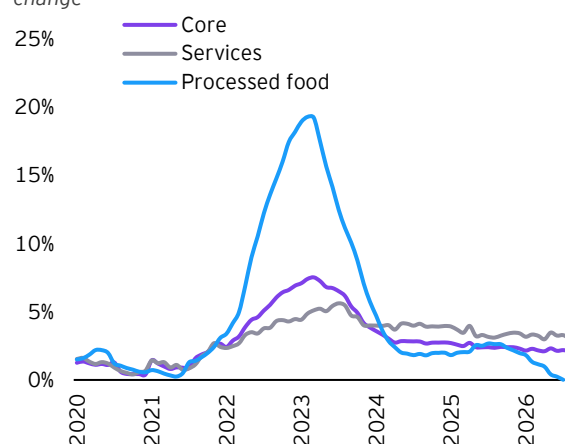


Figure 39: Core inflation and components, Eurozone - YoY % change



Source: EY-Parthenon elaborations based on Eurostat data. The *headline* measure covers all goods in the basket used to calculate price changes; the *core* measure covers the goods in the *headline* basket excluding energy and unprocessed food. Rates refer to harmonised rates. Latest available data: August 2026.

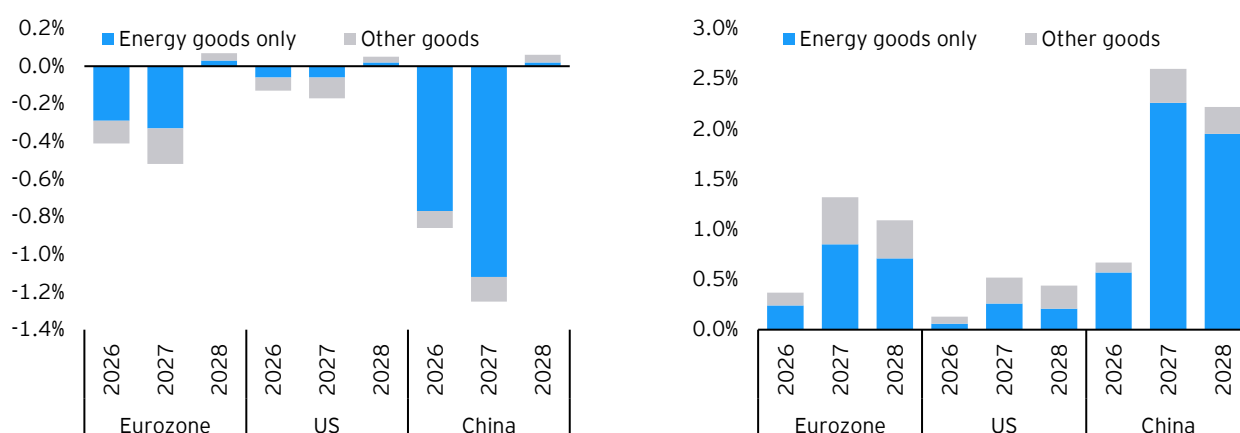
When discussing Eurozone inflation, it is also important to consider the nature of the shocks that have hit member countries in recent years, especially in view of the European Central Bank's monetary policy response. ECB analyses confirm that current price developments, unlike those observed in 2022, are driven mainly by a supply shock linked to higher energy prices along the production chain, rather than by a recovery in aggregate demand. This would suggest a less aggressive monetary policy response than a demand-driven shock would require, although there remains a risk that the supply shock could feed through to wages and inflation expectations, fuelling broader and more persistent pressures that might still require ECB action in the future.⁶¹

A prolonged disruption of trade flows through the Strait of Hormuz would have macroeconomic consequences that go beyond higher energy prices, given that other goods also transit the strait (such as fertilisers, aluminium, helium, etc.). In this regard, a scenario analysis by the European Central Bank shows the possible effects on the Eurozone in two specific cases: a first in which only exports of energy goods are disrupted, and a second, broader one in which exports of other goods are also disrupted. In the first scenario, *output-at-risk* is estimated at 3% in the Eurozone (assuming inputs are difficult to substitute), falling to 0.4% if firms can replace missing supplies more easily. Asian countries would be much more exposed, with output losses of up to 11% in South Korea, 8% in India and 7% in Japan, owing to their greater dependence on Gulf energy supplies. Dynamic simulations, which also take into account how costs propagate along production chains over time, show that the combined scenario (disruption of both energy and non-energy goods) would reduce Eurozone GDP growth by around 0.4 percentage points in 2026 and push up inflation by up to 1.3 percentage points at its peak in 2027, with the effects fading more slowly for prices than for economic activity. China would be hit far more severely, with GDP growth 0.9 percentage points lower and inflation 2.6 percentage points higher at the peak, owing to its greater dependence on energy inputs from the Middle East.⁶²

⁶¹ Battistini and Trebbi (2026) - Demand or Supply-Driven - How Firms View Inflation Right Now.

⁶² Aguilar et al. (2026, ECB Blog) - Beyond Energy Prices - The Ripple Effects of Gulf Supply Disruptions.

Figure 40: Impact on GDP (left-hand chart) and inflation (right-hand chart) of the disruption of trade in goods transiting the Strait of Hormuz - percentage points



Source: Aguilar et al. (2026).

It also remains important to highlight some differences compared with the energy price dynamics seen in 2022. When Russia invaded Ukraine, Eurozone headline inflation was already between 5% and 6% year-on-year and accelerating, while energy inflation had risen rapidly from around 15% in mid-2021 to over 30% in February 2022.

The current shock, by contrast, hit an economy in different conditions: at the end of February 2026, when the war in the Middle East broke out, *headline* inflation stood at around 2%, close to the ECB's medium-term target, with energy inflation and underlying inflation (*core* inflation) moderate. The initial level of inflation when the shock hits is an important factor in how it propagates to consumer prices: when price pressures are subdued, firms tend to absorb small cost increases rather than pass them on immediately, whereas when inflation is already high, the risk of margin erosion leads to more frequent *repricing*, with more persistent effects on inflation. Starting from inflation close to target therefore reduces the risk that higher energy prices trigger a disproportionate reaction from price and wage setters.⁶³

The persistence of underlying inflation also reflects, among other factors, the strength of the labour market in the services sector. Wage growth in services is playing a crucial role in services price developments, with possible persistent effects on the general price level.

While developments in the services component of the price index basket remain important for understanding the evolution of Eurozone inflation, it is worth noting that underlying wage pressures now appear much more contained than in recent years. The ECB wage tracker provides useful indications in this respect. This indicator draws on a large and detailed database of collective labour agreements, collecting and aggregating information on wage growth from agreements between trade unions and employers' associations.⁶⁴ One of its advantages is that it provides timely information even on recently concluded agreements.⁶⁵ Although the ECB wage tracker is not a forecasting tool, it is a high-frequency source of information that can help anticipate the wage data that will later emerge from the national accounts and other official statistics. The most recent data, updated with agreements signed up to the first week of July 2026 and with a horizon extending to March 2027, suggest a broad stabilisation of negotiated wage pressures. In particular, the headline ECB wage tracker stands at 2.3% on average in 2026 and converges to 2.7% in the first quarter of 2027, while both the series including unsmoothed *one-off*⁶⁶ payments and the

⁶³ Arce et al. (2026) - A Tale of Two Energy Crises - Initial Conditions Matter.

⁶⁴ The headline "ECB wage tracker" aims to track the annual growth of employees' salaries at any point in time and includes one-off payments smoothed over the twelve months that follow each payment. As one-off payments can make series very volatile, smoothing them renders the series easier to interpret and more aligned to their economic intent (that they cover a period of time even if they are disbursed in one payment). The ECB wage tracker also publishes an indicator with unsmoothed one-off payments.

⁶⁵ Lane, P. (2024), "Underlying inflation: an update", Speech at the Inflation: Drivers and Dynamics Conference 2024 organised by the Federal Reserve Bank of Cleveland and the ECB; Bing, M., S. Holton, G. Koester, and M. Roca I Llevadot (2024): "Tracking euro area wages in exceptional times", ECB Blog post, 23 May 2024; Gornicka, L. and G. Koester (eds) (2024): "A forward-looking tracker of negotiated wages in the euro area", Occasional Paper Series, No 338, ECB.

⁶⁶ This refers to payments provided for in collective agreements that are not permanent and are therefore not incorporated into base pay.

series excluding such components entirely show values of 2.6% in 2026 and 2.7% in early 2027.⁶⁷ Overall, this evidence indicates that the role of the one-off payments introduced in recent years is gradually diminishing and that growth in negotiated wages is normalising at rates more consistent with inflation settling close to the ECB's target.⁶⁸

Figure 41: Real wages in the services sector, Eurozone - index, 2019=100

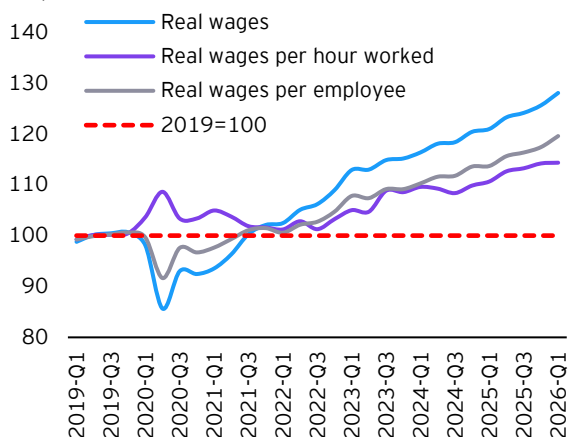
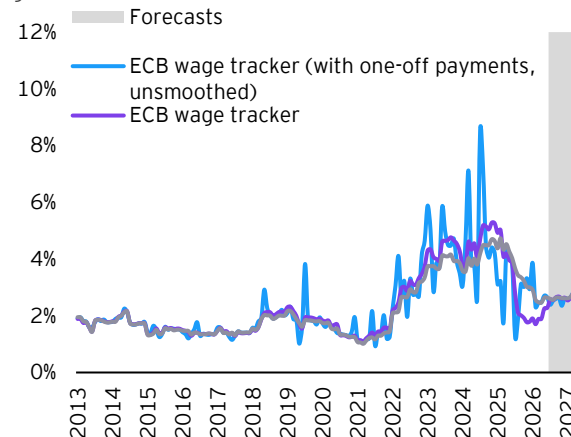


Figure 42: ECB wage tracker, Eurozone - negotiated wage growth



Source: EY-Parthenon elaborations based on Eurostat and European Central Bank data.

Energy prices and inflation more generally are also linked to public spending in the Eurozone. Of particular interest in this respect is the International Monetary Fund's Global Policy Tracker, which has recorded almost 900 policy measures introduced in around 170 countries since the outbreak of the conflict in the Middle East. European economies have relied mainly on fiscal measures and price-dampening measures to protect households and firms - a pattern similar in composition to that seen in 2022, but set against more limited fiscal space and rising debt service costs. As a result, the design of these policies is now more delicate, leaving governments less room for error than during the previous energy shock.⁶⁹

In the Eurozone, the fiscal support implemented since the outbreak of the conflict has been considerably smaller than in the 2022 episode, reflecting less favourable starting conditions. While expected nominal deficits were similar in the two episodes (3.2% and 3.3% of GDP respectively), the structural deficit projected for 2026 (3.3%) is significantly larger than the pre-shock deficit of 2022 (2.6%), as the room then provided by the unwinding of pandemic support and the strong cyclical recovery is no longer available. The interest rate-growth differential on debt, which was strongly negative in 2022, has also gradually eroded as interest rates have risen, making debt expectations less favourable despite a broadly comparable stock in the two episodes (close to 89% of GDP). Discretionary support introduced since the start of the war therefore amounts to around 0.1% of GDP at the aggregate level - an order of magnitude well below the peaks recorded in 2022-2023 - and consists of around 60% direct price measures, with two-thirds of the support targeted at households.⁷⁰

⁶⁷ For further information, see https://www.ecb.europa.eu/press/pr/date/2024/html/ecb.pr241218_1~1acca7fac8.en.html.

⁶⁸ ECB wage tracker at 2.7% in Q1 2027, indicating stable negotiated wage pressures, <https://www.ecb.europa.eu/press/pr/date/2026/html/ecb.pr260729~4ad7508d8a.en.html>.

⁶⁹ Dabla-Norris, E., Mumssen, C., Valdés, R. and Zakharova, D. (2026, 18 June). *The Energy Shock Is Testing Government Budgets*. IMF Blog. International Monetary Fund.

⁷⁰ Bouabdallah, O., Checherita-Westphal, C. and Muggenthaler-Gerathewohl, P. (2026). *Assessing the scope for compensatory fiscal measures in response to the recent energy shock*. Economic Bulletin, Issue 5/2026, Box 8. European Central Bank.

Figure 43: Number of compensatory measures by region - % of regional total

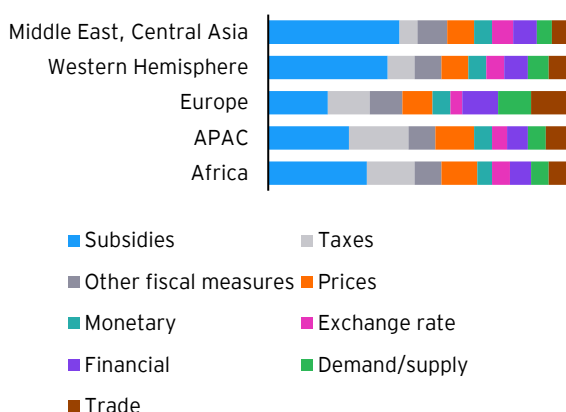
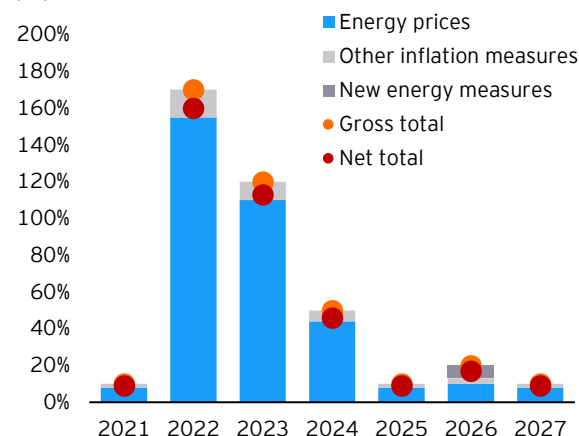


Figure 44: Size of fiscal measures implemented, Eurozone - % of GDP



Source: International Monetary Fund, European Central Bank. Subsidies: fuel and electricity subsidies or transfers to households and firms; Taxes: cuts in duties and excise taxes on fuel, electricity, transport or food; Other fiscal measures: provision of new or increased credit and bank guarantees; Prices: price controls on food, fuel, electricity, water or transport; Monetary: changes in interest rates or reserve requirements; Exchange rate interventions: currency purchase/sale operations and swap agreements; Financial: capital flow management tools, liquidity support and other regulatory actions; Demand/supply: supply-side measures (e.g. release of strategic reserves) and demand-side measures (rationing, energy saving, remote working, shorter working week); Trade: export bans or controls on fuel and other products.

Moreover, an analysis of the underlying causes of rising prices in the Eurozone during the pandemic crisis showed that inflation was driven not only by exogenous supply-side shocks - particularly energy-related ones - but also by policy responses (both fiscal and monetary). While the latter were not the dominant factor, their contribution was significant. In the current context, therefore, price developments will also depend on the fiscal policy response to the ongoing shock.⁷¹

Figure 45: Public investment in the main Eurozone countries - % of GDP

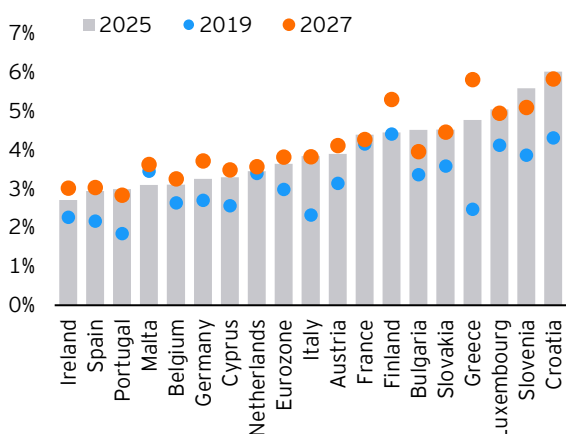
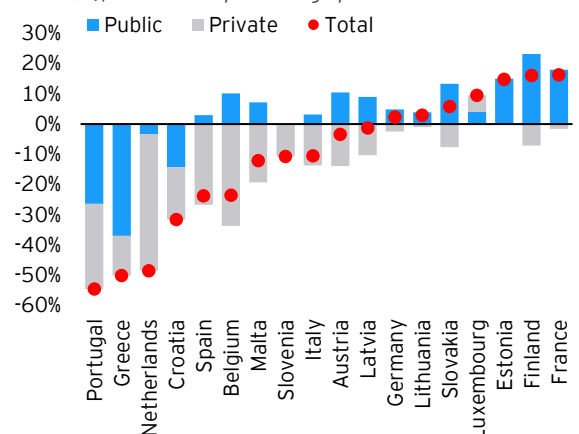


Figure 46: Change in public and private debt (2019Q1-2025Q4), Eurozone - percentage points



Source: EY-Parthenon elaborations based on European Commission and European Central Bank data.

Overall, the focus on fiscal constraints concerns not only the management of the energy shock but also the strategic investment needs of the European Union, which is required to increase spending significantly on digitalisation, infrastructure, climate and defence. The public financing needs for these priorities are estimated at around €510 billion a year, against an aggregate EU debt-to-GDP ratio of 80.7% in 2024 and almost half of Member States running deficits above the 3% threshold. The flexibility offered by the reformed

⁷¹ Barauskaitė Griškevičienė, K., Brand, C., & Nguyen, A. D. M. (2025). Pandemic-era inflation dynamics in the euro area: the role of policy and non-policy demand and energy and non-energy supply factors. ECB Working Paper Series, No. 3201. European Central Bank.

governance framework - an extended adjustment period and the national escape clause for defence - covers only around one-third of the estimated needs, leaving a public financing gap of more than €100 billion a year. In this context, raising the technical efficiency of investment spending is a concrete lever for freeing up fiscal space without further recourse to debt. An empirical application of this principle to transport infrastructure investment - which alone accounts for more than a quarter of public investment spending in the EU - shows significant scope for improvement. Estimates point to median efficiency of around 50% for the EU27 (i.e. the same outcome could potentially be achieved with half the investment actually made), while a further analysis of rail and motorway investment yields median values of 38% and 43% respectively, with marked heterogeneity between countries at high and low risk in terms of debt sustainability. Closing this efficiency gap could generate potential savings estimated at €46-50 billion a year, a figure of the same order of magnitude as the financing gap identified for strategic investment, although the results remain sensitive to methodology and to limits on cross-country comparability. The resulting picture is one in which the very scarcity of fiscal space that now calls for a contained and targeted approach to managing the energy shock also makes the efficiency of public spending an essential priority for meeting Europe's structural investment challenges in the coming years.⁷²

Returning to prices, their evolution is closely linked to developments in bank lending. The effects of the current level of interest rates on bank lending can be gauged from the latest Eurozone Bank Lending Survey,⁷³ which offers some interesting insights.⁷⁴

Figure 47: Credit standards for loans to enterprises, Eurozone - net percentage of respondents

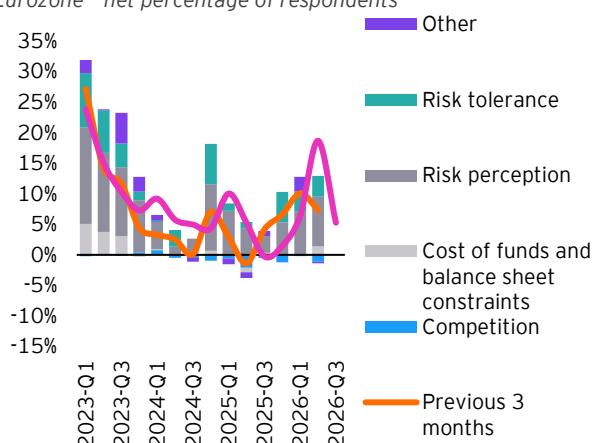
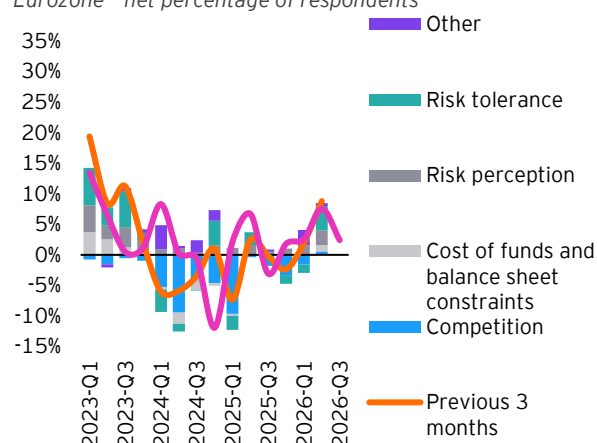


Figure 48: Credit standards for loans to households, Eurozone - net percentage of respondents



Source: EY-Parthenon elaborations based on European Central Bank data (Bank Lending Survey). For households, the figures refer to credit standards for loans for house purchase. Net percentages are defined as the difference between the sum of the percentages of banks responding "tightened considerably" and "tightened somewhat" and the sum of the percentages of banks responding "eased somewhat" and "eased considerably" with regard to changes in credit standards. Net percentages for responses to questions on contributing factors are defined as the difference between the percentage of banks reporting that a given factor contributed to tightening and the percentage reporting that it contributed to easing.

Eurozone banks reported a moderate net tightening of credit standards for loans to enterprises in the second quarter of 2026 (net percentage of 7%). This was lower than in the first quarter (10%) and considerably smaller than banks had expected in April (19%), slightly below the historical average since 2003 (8%), though still well above the average since 2014 (3%). Among the four largest Eurozone economies, banks in Germany, Spain and France reported tighter standards, while Italy saw an easing.

By firm size, the tightening was broadly similar for SMEs and large firms (net percentages of 5% and 6% respectively); by maturity, banks reported a stronger tightening for long-term than for short-term loans (7%

⁷² Haroutunian, S., Nerlich, C., Rodríguez-Vives, M. and Schauhoff, C. (2026). *Boosting efficiency in public investment in times of fiscal constraint*. Economic Bulletin, Issue 2/2026. European Central Bank.

⁷³ The Bank Lending Survey (BLS) has been conducted since January 2003 by the national central banks of the countries that have adopted the single currency, in cooperation with the European Central Bank. It is addressed to the heads of credit policy at the area's main banks (around 150). The survey makes it possible to identify separately, on the one hand, the factors affecting the supply of credit and the terms and conditions applied to customers and, on the other, developments in credit demand and its determinants.

⁷⁴ The euro area bank lending survey - Second quarter of 2026.

and 2% respectively), both smaller than in the previous quarter. The factors behind the tightening include a worsening in the perception of risks related to the economic outlook and lower risk tolerance among banks, consistent with high risk aversion and an increasingly cautious approach to lending. Specifically, the industry or firm-specific situation (12%) and the general macroeconomic outlook (11%) had the greatest impact. In the second quarter of 2026, cost of funds, balance sheet constraints and competitive pressure had a broadly neutral impact on credit standards. Banks also reported that geopolitical and energy developments exerted additional tightening pressure on credit standards, particularly in the automotive sector. Across countries, in Germany, Spain and France the tightening was driven mainly by higher perceived risks; in Germany and France lower risk tolerance also played a role, while in Italy no specific tightening factor emerged, consistent with the easing observed. Eurozone banks expect a further tightening of credit standards for loans to enterprises in the third quarter of 2026, albeit at a more moderate pace (net percentage of 5%). The expected tightening would be equal for large firms and for small and medium-sized enterprises (5% in both cases), as well as for short-term and long-term loans (5% in both cases). Among the four largest countries in the area, banks in Germany and France expect a further tightening of standards, while in Spain and Italy they expect broadly unchanged conditions.

Turning to lending to households, Eurozone banks reported a net tightening of credit standards for housing loans in the second quarter of 2026 (net percentage of 9%), broadly in line with the expectations reported in the previous quarter (8%). Among the four largest Eurozone countries, conditions tightened in Spain, Germany and France, while standards remained unchanged in Italy. As regards the main factors behind this development, higher risk perceptions and lower risk tolerance among banks had a tightening effect on credit standards, while competition had a broadly neutral impact in the quarter. Eurozone banks expect a further, albeit slight, tightening of credit standards for housing loans (net percentage of 2%) in the third quarter of 2026. Among the main countries, a tightening is expected in Spain and Italy, while an easing of credit standards is expected in Germany and France.

The response of bank lending volumes (and interest rates) to monetary policy decisions is a key channel of monetary policy transmission, influencing the investment, consumption and saving decisions of economic agents and, in turn, developments in the real economy and inflation.

Turning to external trade, the effects of US trade policy are visible in the Eurozone, where the last months of 2025 and the first months of 2026 were characterised overall by a contraction in exports to the United States. This led to weak or declining Eurozone goods exports, despite the positive contribution from demand for goods from other regions, such as the rest of Europe and Asia. The latest data also show significant export growth in June, supported by all the regions analysed. Among the main products behind this significant growth (~14%) compared with the same month of the previous year, a significant contribution came from exports of other transport equipment (such as ships, boats, aircraft, etc.), exports of computers and electronics and, to a lesser extent, exports of chemicals, pharmaceuticals and machinery.

Figure 49: Goods exports by destination, Eurozone - YoY % change and percentage points

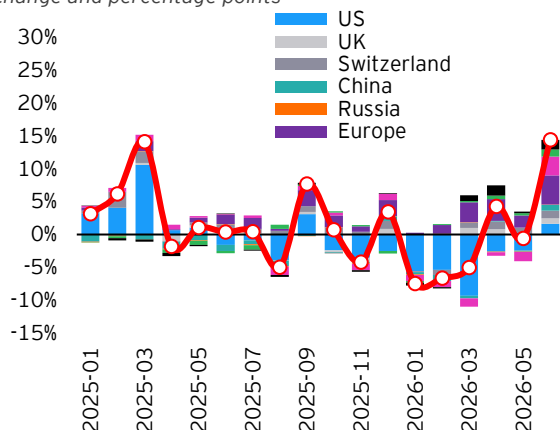
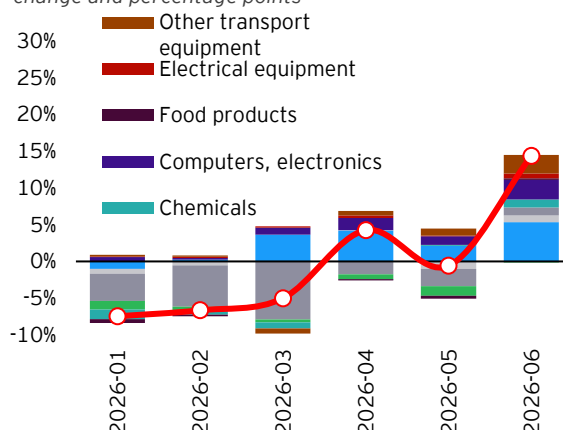


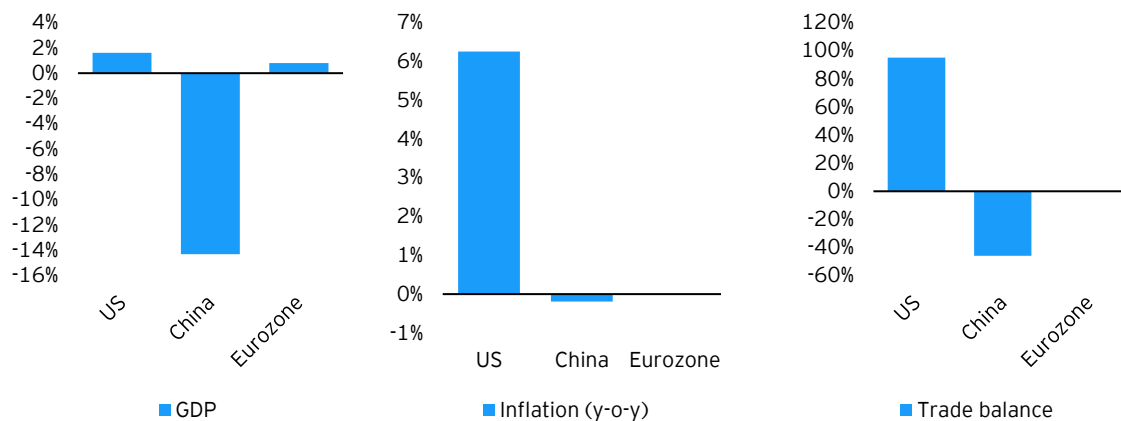
Figure 50: Goods exports by type of goods, Eurozone - YoY % change and percentage points



Source: EY-Parthenon elaborations based on Eurostat Comext data.

To assess the overall effects of trade policy choices in recent months and years, reference can be made to a recent ECB study,⁷⁵ which analyses the macroeconomic effects of a US-China trade war, calibrated on a symmetric 10 percentage point increase in tariffs. For the Eurozone, which is not directly involved in the tariff dispute, the model estimates an aggregate GDP response that is broadly zero over the twelve-quarter horizon considered. This result, however, should not be read as a sign of “immunity” from the effects of these trade policies, but rather as the net outcome of opposing forces of far from negligible size. On trade with the United States, trade diversion in favour of European producers is positive in all the manufacturing sectors examined, with the largest contributions concentrated in other manufacturing, electronics, textiles, pharmaceuticals, electrical equipment and chemicals. This gross gain vis-à-vis the United States is, however, eroded by a symmetric negative margin vis-à-vis China, whose demand contracts following the shock, as well as by smaller but non-negligible adjustments vis-à-vis the rest of the world.

Figure 51: Transmission of US-China tariff shocks



Source: European Central Bank. The chart compares the average effects over three years of a 10 pp increase in US tariffs on Chinese imports. The bars show the macroeconomic response in the benchmark model. Changes in GDP are expressed as percentage deviations from the baseline scenario; inflation is measured in percentage points and the trade balance in percentage points of GDP.

⁷⁵ Aguilar, P., Darracq Pariès, M., Dieppe, A., Domínguez-Díaz, R., Eugenio, A., Gallegos, J.-E. and Quintana, J. (2026) - Tariffs, Production Networks, and Spillovers: The Case of a US-China Trade War, ECB Working Paper 3254.



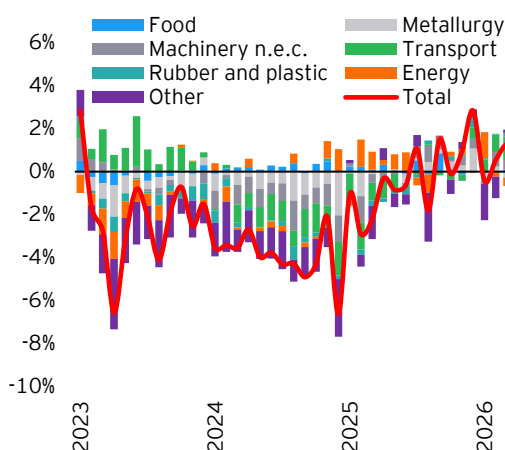
Overall, the Eurozone picture in the second half of 2026 is fragile, with risks tilted mainly to the downside. Economic growth remains weak and uneven across member countries, with the industrial sector still struggling and private consumption providing only partial support to aggregate demand. The conflict in the Middle East has interrupted the disinflation process under way over the previous two years, pushing headline inflation back above the ECB's target and making the calibration of monetary policy particularly complex. In addition, there are pressures from the international trade environment, with US protectionist policies and growing Chinese competition weighing on the area's manufacturing competitiveness. In this scenario, growth will depend crucially on the evolution of the geopolitical conflict, on governments' ability to balance fiscal support with debt sustainability, and on the policy response to an environment that combines exogenous inflationary pressures with still-sluggish domestic demand.

The Italian economy

Developments in the real economy

In July, Italy's industrial production index contracted by 0.1% year-on-year, after a sharper contraction in the previous month (0.5%). March, April and May, by contrast, had seen solid growth (1.1% on average between March and May). The contraction in the latest month was driven mainly by declines in metallurgy and machinery production, as well as in other smaller sectors. The industrial production index therefore remains around 6 percentage points below its 2021 average, evidence of a sector facing structural, and not only cyclical, challenges.

Figure 52: Industrial production index and components - YoY % change and percentage points, Italy



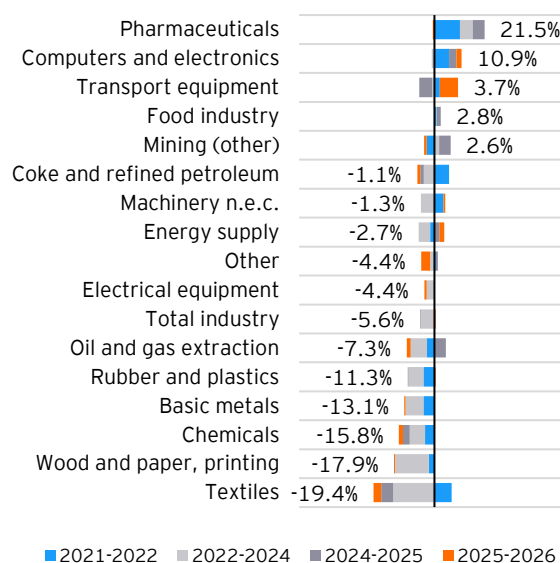
Source: EY-Parthenon elaborations based on Istat data. Latest available data: July 2026.

Looking more closely at individual industrial sectors, it is interesting to see which have grown most strongly and which remain below the levels of the year following the pandemic crisis.

Specifically, between 2021 and the latest 2026 data (July), the sectors with the strongest growth in the industrial production index were pharmaceuticals (21.5%), computers and electronic products (10.9%), and transport equipment and food products (3.7% and 2.8% respectively).

By contrast, the industrial sectors in greatest difficulty are textiles (-19.4%), followed by wood, paper and printing (-17.9%) and chemicals (-15.8%). This is partly explained by the fact that these sectors are among the most energy-intensive industrial segments.

Figure 53: Industrial production index by industrial sector, Italy - % change relative to 2021 and contributions by year



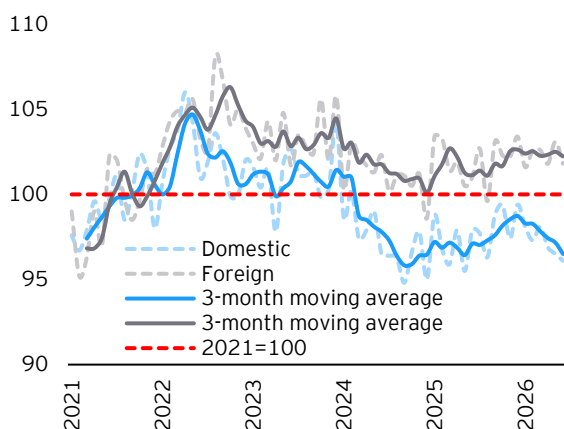
Source: EY-Parthenon elaborations based on Istat data. Machinery n.e.c.: manufacture of machinery and equipment not elsewhere classified.

Although sectoral dynamics are highly diverse, it is important to stress the role of interconnections across sectors and countries. A crisis in a single sector can indirectly slow down other sectors through reduced activity along supply chains. For example, a recent Bank of Italy study found that the fall in car sales in Europe has

an effect on the supply chain 1.5 times larger than on final producers.⁷⁶ A further indicator of Italian industrial performance is turnover volume, broken down into turnover generated on the domestic market and on foreign markets. The two components have diverged in recent years, unlike in 2021-2022 and, in part, 2023.

While the volume index of industrial turnover on foreign markets is on an upward trend, albeit not a particularly dynamic one, the domestic turnover index is declining and remains below its 2021 average. These data therefore point to an industrial sector that is struggling overall, supported in part only by foreign rather than domestic demand.

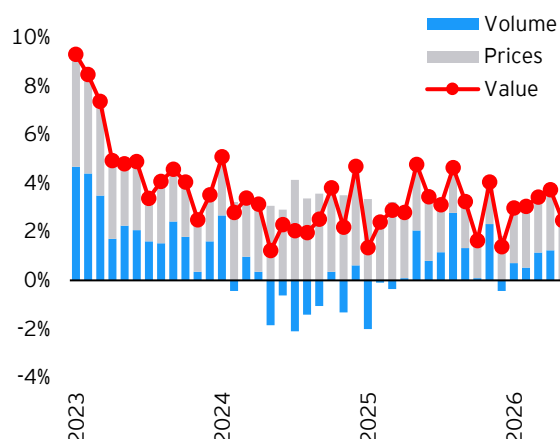
Figure 54: Industrial turnover volume (excl. construction), Italy - index, 2021=100



Source: EY-Parthenon elaborations based on Istat data.
Latest available data: June 2026.

Shifting the focus to services, turnover data again offer some interesting insights. Specifically, breaking down turnover growth in value terms into its volume and price components shows that in June 2026, and in the two previous months, the price component was the main driver of growth, while the volume component played a more marginal role.

Figure 55: Growth in services turnover in value terms and components, Italy - YoY % change and percentage points



Source: EY-Parthenon elaborations based on Istat data.
Latest available data: June 2026.

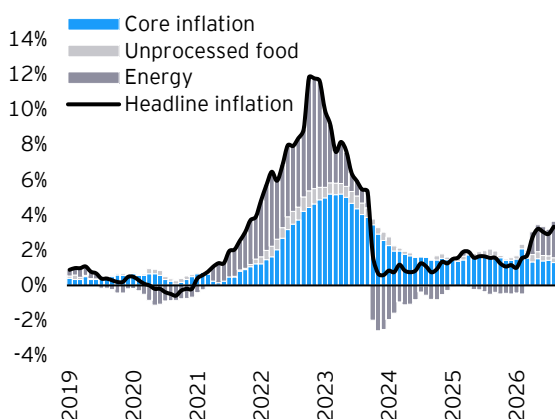
Prices and the labour market in Italy

Inflation stood at 3.3% in August, up from previous months (2.9% in July, 3.0% in June).

The acceleration in price growth relative to the 2025 average (1.5%) is mainly due to a larger contribution from the energy component, together with a persistent but declining contribution from the core component.

⁷⁶ Brugnara L., Cariola G., Recchia P. and Zuccolà S. (2026) - Mapping supply chains with micro data: the case of the Italian automotive industry, Bank of Italy Occasional papers N. 1041.

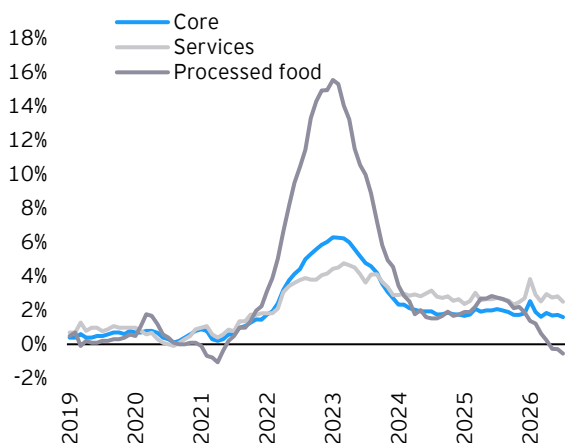
Figure 56: Inflation and components, Italy - YoY % change and percentage points



Source: EY-Parthenon elaborations based on Istat data.
Latest available data: August 2026.

Specifically, in August 2026 the energy price index rose by 19.7% year-on-year, after 14.1% in the previous month. This increase, driven by price pressures linked to the conflict in the Middle East, comes alongside a slight easing in the services price index (2.5% in August, 2.8% in July, 2.7% in June), which nonetheless keeps the positive contribution of core inflation to overall inflation high.

Figure 57: Core inflation and components, Italy - YoY % change and percentage points



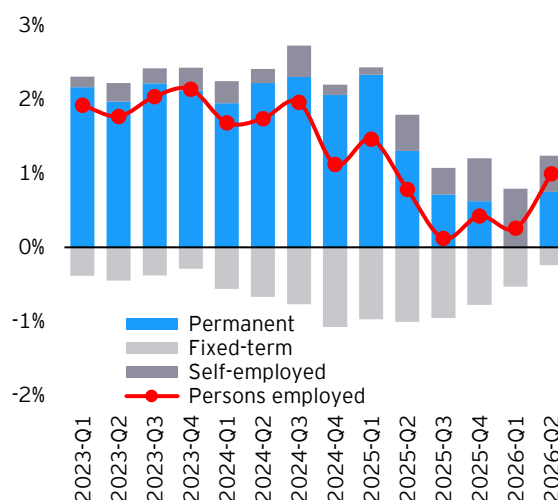
Source: EY-Parthenon elaborations based on Istat data. Latest available data: August 2026.

In recent months, price developments have therefore been driven *first and foremost* by higher energy costs and, secondly, by the core component. The latter is also linked to the labour market, which continues to show a degree of resilience. The number of persons employed is

close to record highs (around 24.3 million people), with an unemployment rate of around 5.8%.

Employment growth in recent quarters has been driven mainly by workers entering the labour market on permanent contracts, with the sole exception of the first quarter of 2026. This supports consumption in Italy, which benefits from the greater stability of permanent contracts compared with fixed-term ones.

Figure 58: Growth in persons employed by type of contract, Italy - YoY % change and percentage points

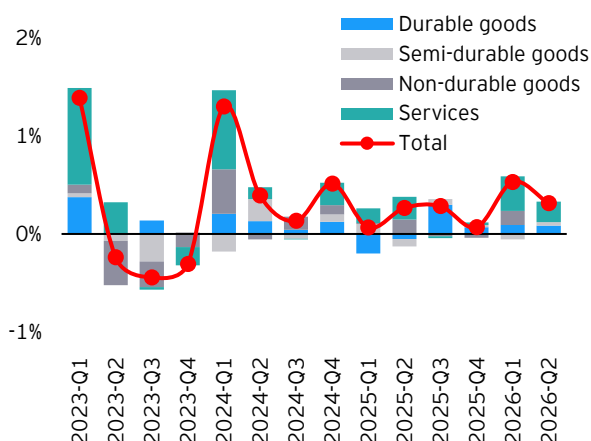


Source: EY-Parthenon elaborations based on Istat data.

The broadly positive trend in employment is reflected in growth in the wage bill (real growth of 1.7% year-on-year in the first quarter of 2026, followed by more modest growth of 0.2%), although real wages per hour worked remain below their 2021 level.

In recent quarters, the growth in the wage bill has supported household consumption. With the exception of the last quarter of 2025, when growth was broadly zero, consumption grew by 0.5% and 0.4% quarter-on-quarter in the first and second quarters of this year respectively, supported largely by consumption of services.

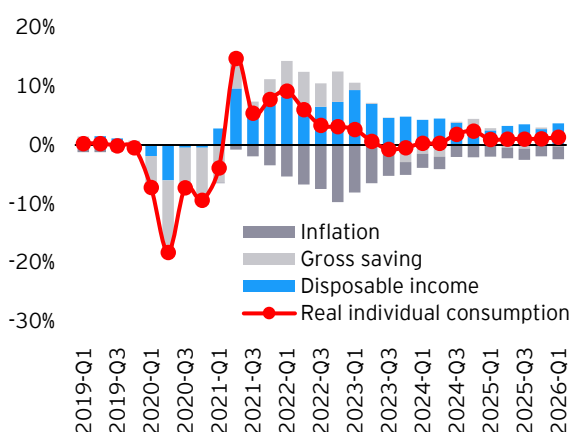
Figure 59: Household final consumption expenditure by spending category, Italy - QoQ % change and percentage points



Source: EY-Parthenon elaborations based on Istat data.

The role of household income in consumption dynamics is also clear when consumption growth is broken down into the contributions of price growth, gross saving and disposable income. Specifically, in recent quarters inflation has continued to be a significant drag on real consumption growth, which has been supported almost exclusively by household disposable income, without any reduction in the saving rate (the ratio of saving to total disposable income).

Figure 60: Growth in real individual consumption, Italy - YoY % change and percentage points

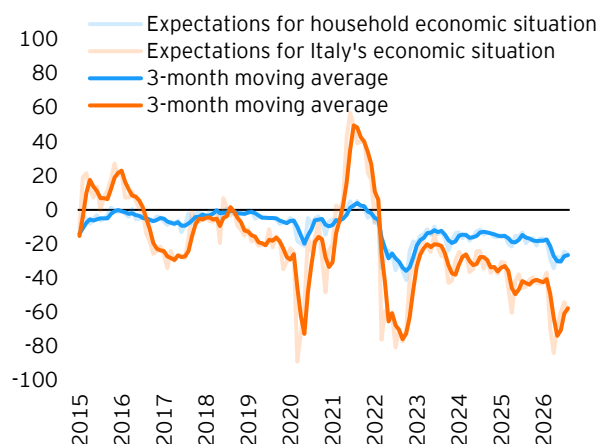


Source: EY-Parthenon elaborations based on Istat data.

Private consumption growth is therefore supported mainly by a positive labour market, which is driving growth in the wage bill, although real wages per hour worked are still below their 2021 average. This last factor has translated into

a deterioration in overall confidence among Italian households.

Figure 61: Consumer households' expectations for the household and national economic situation, Italy - balances

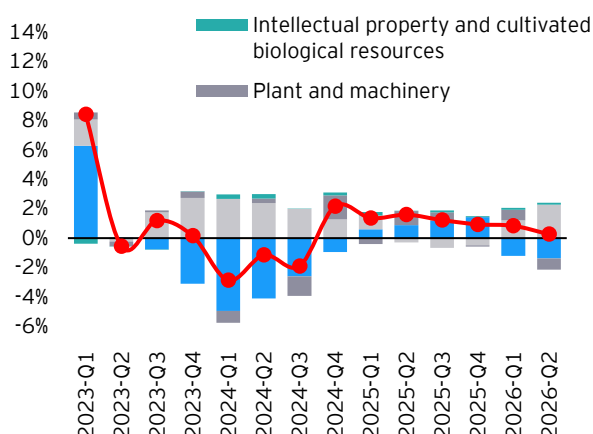


Source: EY-Parthenon elaborations based on Istat data. The balance is calculated as the difference between the share of responses indicating an improvement and the share indicating a deterioration; negative values indicate a prevalence of negative assessments.

As regards the other components of GDP, investment continues to grow, albeit more slowly, rising by 0.3% quarter-on-quarter, after growth of 0.8% and 0.9% in the first quarter of the year and the last quarter of 2025 respectively.

Growth in the second quarter of 2026 was driven mainly by an increase in investment in non-residential buildings (a positive contribution of 2.3 percentage points), probably attributable to residual investment linked to the NRRP (National Recovery and Resilience Plan), while investment in dwellings (a negative contribution of -1.4 percentage points) and in plant and machinery (-0.8 percentage points) contracted.

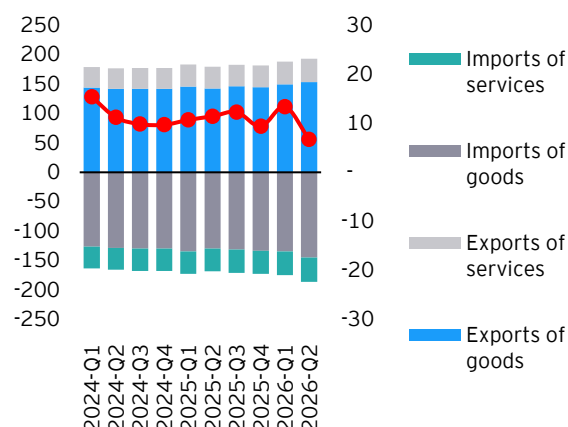
Figure 62: Investment and components, Italy - QoQ % change and percentage points



Source: EY-Parthenon elaborations based on Istat data.

Finally, as regards external trade, in the second quarter of 2026 Italy continued to post a trade surplus (€7 billion in nominal terms), although this was smaller than in the previous quarter (€13 billion).

Figure 63: Exports and imports, Italy - € billion, nominal values



Source: EY-Parthenon elaborations based on Istat data.

Overall, the Italian economy has recently shown a resilience that few expected, helped by a labour market that is supporting consumption. Investment continues to grow, albeit at a slower pace, and external trade continues to record a surplus. The complex geopolitical picture, reflected in rising consumer prices, risks undermining the country's fragile growth balance.

The Italian economy: GDP and EY forecasts

In the second quarter of 2026, Italian GDP rose by 0.2% quarter-on-quarter, a pace broadly in line with that seen in the first quarter of 2026. Growth was driven mainly by domestic demand, thanks to higher household consumption (+0.4%, contributing 0.2 percentage points to growth) and investment (growth of 0.3%). Net external demand, by contrast, made a negative contribution (-0.2 percentage points), as export growth (+0.8%) was weaker than import growth (+1.7%). Year-on-year - that is, compared with the same quarter of the previous year - foreign trade was the most dynamic component of GDP, with imports up 5.3% and exports up 4.4%, making a slightly negative contribution to growth (-0.1 percentage points). Investment grew by 3.3%, slowing from the previous quarter (+4.7%), while private consumption grew by 1.3%, in line with the previous quarter.

Figure 64: GDP components, Italy - QoQ % change and contributions to growth

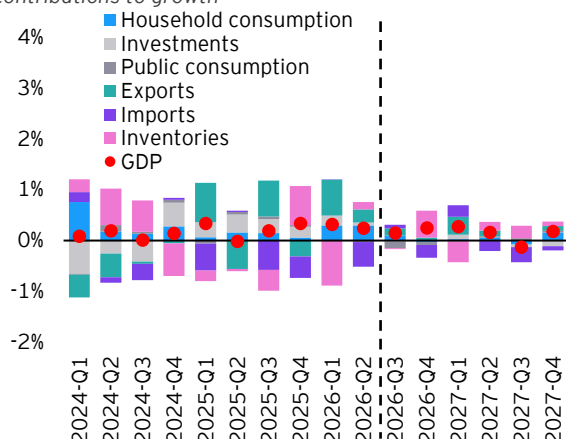
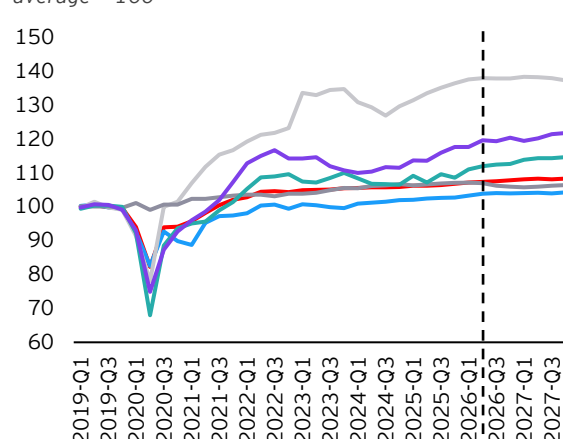


Figure 65: GDP components, Italy - index, 2019 quarterly average = 100



Source: EY-Parthenon elaborations based on Istat data and EY forecasts. The dashed line shows the forecast horizon. EY forecasts start from the third quarter of 2026. "Investment" refers to public and private investment and includes gross fixed capital formation, acquisitions less disposals of valuables, and depreciation.

In commenting on the Italian economy in the second quarter of the year, it is important to note that all GDP components performed more strongly than expected. Private consumption, for example, was particularly strong, probably reflecting both a solid labour market and a higher propensity to consume among households (i.e. households continue to devote a larger share of their disposable income to consumption than in the past). Investment remains on a growth path linked to the completion of the final NRRP projects, for which the deadline for eligible expenditure was set at 31 August. Finally, Italian exports continued to grow, albeit more slowly, despite persistent international tensions, evidence of a resilient economic fabric able to handle highly uncertain situations better than expected.

In light of the evidence presented in the previous sections and the latest available data, we can now set out EY's outlook for the Italian economy.

In the third quarter of 2026, GDP is expected to expand modestly compared with the previous quarter (+0.1%), after a stronger performance in the first two quarters (0.3% in the first quarter and 0.2% in the second). This stagnant GDP performance is expected to reflect moderate domestic demand (growth of 0.2% in consumption and a 0.1% contraction in investment), together with a decline in government consumption (-0.7%); the contribution of net external demand, by contrast, is expected to turn positive again, thanks to export growth (+0.5%) and a concurrent contraction in imports (-0.2%). The last quarter of the year will

instead see slight growth in private consumption and stagnant investment, with a renewed negative contribution from net external demand. 2026 is therefore expected to close with growth of 1.0%, stronger than in the previous year (0.5%) despite the geopolitical uncertainty and international tensions that continue to weigh on the global economy. Investment is expected to grow by around 2.7% overall, thanks to the final positive effects of tax incentives introduced in previous years and the “tail end” of the NRRP; the contribution of net external demand, by contrast, will be broadly zero.

The picture for 2027 looks different, with household consumption slowing after the positive performance of recent years. This will be mainly due to purchasing power coming under pressure from recent inflation developments, and will lead to a fall in the propensity to consume, bringing it closer to historical norms. Investment is expected to grow weakly (0.1%), mainly because of higher interest rates (and hence the cost of debt) and the continuing uncertainty in the international environment. Net external demand, by contrast, will make a positive contribution, mainly thanks to slower import growth (1.2%) alongside positive export growth (2.0%).

Table 1: Forecasts for the Italian economy

	2022	2023	2024	2025	2026	2027
GDP, % change	4.8%	0.9%	0.8%	0.5%	1.0%	0.7%
Household consumption, % change	5.3%	0.5%	1.2%	1.1%	1.3%	0.3%
Investment, % change	7.4%	10.1%	-3.1%	3.5%	2.7%	0.1%
Exports, % change	9.9%	-0.2%	-0.4%	1.2%	3.1%	2.0%
Imports, % change	12.9%	-1.9%	-1.0%	3.6%	3.5%	1.2%
Unemployment rate	8.1%	7.7%	6.6%	6.1%	5.5%	6.2%
Consumer price index, % change	8.2%	5.6%	1.0%	1.5%	3.0%	2.4%
Deficit, % of GDP	-8.1%	-7.2%	-3.4%	-3.2%	-3.1%	-2.8%
Public debt, % of GDP	138.4%	133.9%	134.9%	137.1%	138.6%	137.4%

Source: Forecasts from the EY Italy macroeconometric model, “HEY-MoM”. The grey area shows the forecast horizon. Changes in GDP and its components are calculated on real values. “Investment” refers to public and private investment and includes gross fixed capital formation, acquisitions less disposals of valuables, and depreciation.

Looking in more detail at investment, expected growth in 2026 will be driven mainly by non-residential buildings (6.4%), while investment in machinery and in intangibles will also continue to grow (2.3% and 2.9% respectively). Investment in dwellings, by contrast, is expected to contract, falling by around 2.6% over the year as a whole (a negative contribution of 0.5 percentage points to investment growth). In 2027, investment in dwellings is expected to recover (4.2%) and investment in non-residential buildings to contract, while the other components are projected to continue growing, albeit less strongly than in 2026.

Inflation is expected at 3.0% in 2026, driven mainly by higher energy prices, slowing in 2027 (to 2.4%). The public deficit is projected at 3.1% of GDP in 2026 and 2.8% in 2027, while the public debt-to-GDP ratio will resume a downward path in 2027 (from 138.6% in 2026 to 137.4% in 2027), helped in part by the effect of inflation. The forecasts nonetheless remain subject to high uncertainty and are therefore exposed to significant downside and upside risks, mainly linked to the global macroeconomic environment.

While the growth estimates above refer to the country as a whole, it is interesting to look in more detail at the performance of the different sectors of the Italian economy to capture their different dynamics. Against overall growth in output volume of 1.8% between 2025 and 2027, estimates from EY’s proprietary MAIOR model⁷⁷ point to positive performance for accommodation and food services (+4.2%), manufacture of computers, electronic and optical products (+4.2%) and manufacture of machinery and equipment n.e.c. (+3.7%). By contrast, output is negative or flat in public administration (-0.2%), other transport equipment

⁷⁷ Golinelli, Butiniello, Caruso, Montana, Rocco (2026), MAIOR: A Framework for Sectoral Output Forecasting from Aggregate Predictions Using Input-Output Linkages and Short-Run Indicators, Mimeo.

(-0.2%) and manufacture of coke and refined petroleum products (+0.0%). Construction is expanding moderately (+0.8%), thanks to positive momentum in 2026 linked to the final effects of tax incentives introduced in previous years, followed in 2027 by a return to values more in line with the sector's historical trend.

Figure 66: % change in output volume 2025-27 by sector, Italy (1/2) - contributions by year

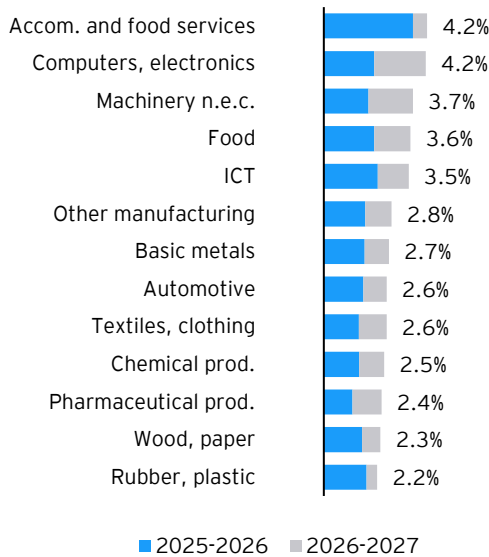
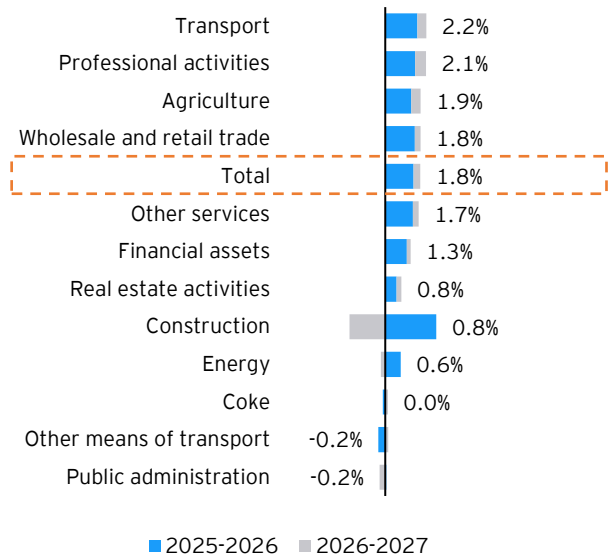


Figure 67: % change in output volume 2025-27 by sector, Italy (2/2) - contributions by year



Source: Forecasts from the EY Italy sectoral analysis model, "EY MAIOR".

These growth rates, however, do not capture the size of the sectors analysed, which is instead made clear by looking at contributions to growth by sector. From this perspective, wholesale and retail trade (a contribution of +0.2 pp) and professional activities (+0.2 pp) are the two sectors making the largest positive contribution to growth in the volume of output in Italy over the coming years. Sectors with weaker dynamics, such as public administration and other transport equipment, make a zero or negative contribution.

Figure 68: Sectoral contributions to aggregate output growth 2025-27 by sector, Italy (1/2) - contributions by year

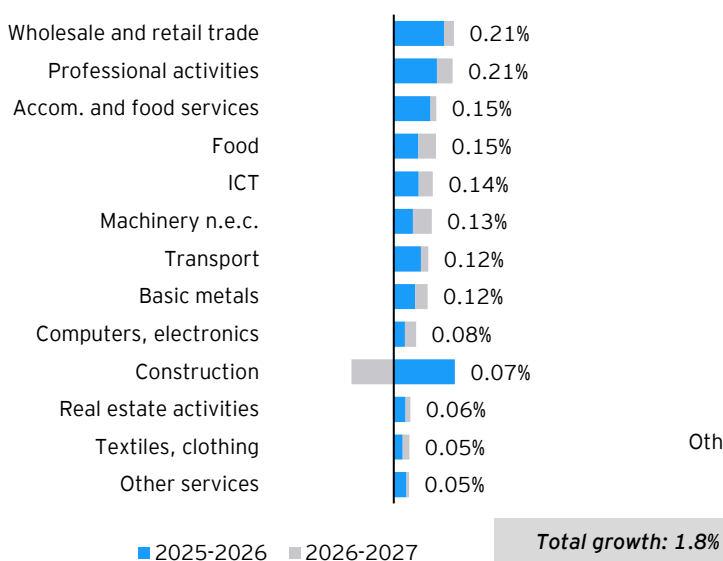
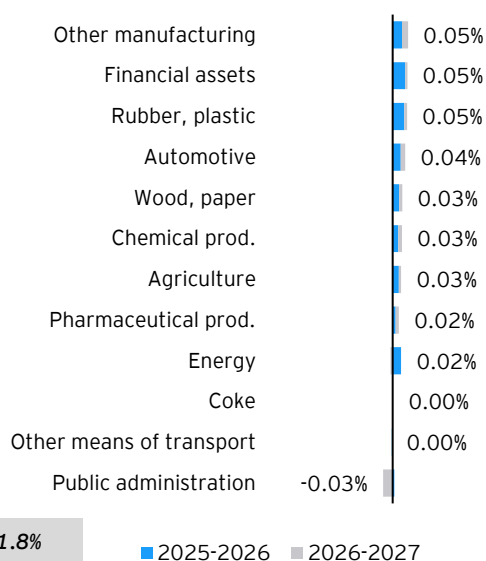


Figure 69: Sectoral contributions to aggregate output growth 2025-27 by sector, Italy (2/2) - contributions by year



Source: Forecasts from the EY Italy sectoral analysis model, "EY MAIOR".

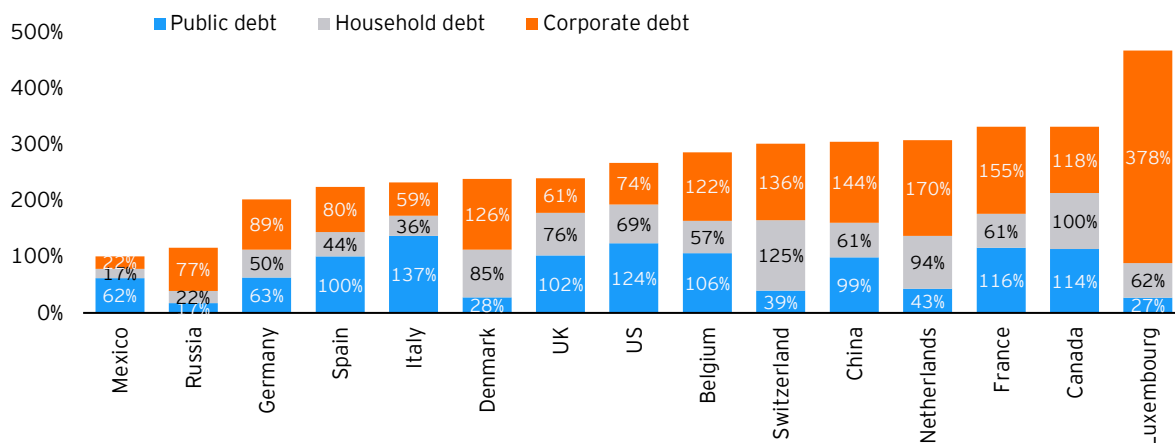
Financial stability in a high-debt environment

Key messages:

1. *In 2026, public and private sector borrowing on bond markets is expected to reach around \$29 trillion globally, equivalent to around 23% of world GDP, a level exceeded only during the pandemic crisis years. What sets this apart from past cycles is not the volumes but the fact that they are being issued in an environment of high yields, a combination unprecedented since 2007.*
2. *OECD central government bond debt reached a record \$61 trillion in 2025, up from \$55 trillion in 2024. Net interest expenditure stood at 2.3% of OECD GDP in 2025, and in 2026 the contribution of higher interest costs to the debt-to-GDP ratio is expected, for the first time, to outweigh the downward pressure from inflation.*
3. *The shrinking of central bank balance sheets is leaving the market to absorb a growing share of securities, while demand for long-dated securities remains concentrated among a small number of non-bank intermediaries (e.g. pension funds). In this environment, new issuance is increasingly short-dated: this strategy contains current spending but shortens the average maturity of debt, with around one-third of fixed-rate debt maturing between 2026 and 2028 at a time when market yields are around two percentage points higher than those on maturing securities.*
4. *On the financial stability front, the replacement of central bank reserves with government bonds on bank balance sheets strengthens the link between sovereign risk and bank risk, while the narrowing of corporate yield spreads between riskier and less risky assets and the high exposure of European portfolios to US AI-related assets create a risk of a simultaneous repricing of valuations. These vulnerabilities, however, have not so far translated into actual market stress: composite stress indicators in the United States and Italy remain at low levels and markets have continued to function smoothly.*

The environment of high interest rates and geopolitical uncertainty described in the previous pages is part of a longer-term trend involving the growth in the stock of public and private debt and the resilience of the markets that finance it. A first assessment requires both components to be considered together, since it is an economy's overall level of indebtedness, and not only the share attributable to the public sector, that determines the potential effects of changes in interest rates and financing conditions on the economy. International comparisons show high aggregate levels but markedly different compositions. In Italy, public debt stood at 137% of GDP in 2025, while household (36%) and corporate (59%) debt are among the lowest: the overall total, at around 230% of GDP, is lower than in most of the countries considered, including France, Canada, the Netherlands, Switzerland and China, where the private component is by far the largest. The opposite case is Denmark and the Netherlands, with public debt-to-GDP ratios below 45% but household and corporate debt above 210% and 260% of GDP respectively.

Figure 70: Public and private debt in the main countries - % of GDP



Source: EY-Parthenon elaborations based on International Monetary Fund data. Public debt data refer to 2025; household and corporate debt data refer to 2024.

These stock levels are matched by an equally high annual flow of issuance. Public and private sector borrowing on bond markets is expected to reach around \$29 trillion globally in 2026, a record compared with the past two decades. The largest contribution comes from government debt issuance by OECD countries and developing countries, which is also rising to meet numerous medium- to long-term challenges (sustainability, defence, technological revolution, demographics), while the remainder is attributable to the *corporate* sector. Overall, new issuance is expected to reach around 23% of global GDP in 2026, a level that, over the period considered (since 2007), has been exceeded only in the two years of the pandemic crisis.⁷⁸

Figure 71: New debt issuance - US\$ trillion and % of GDP

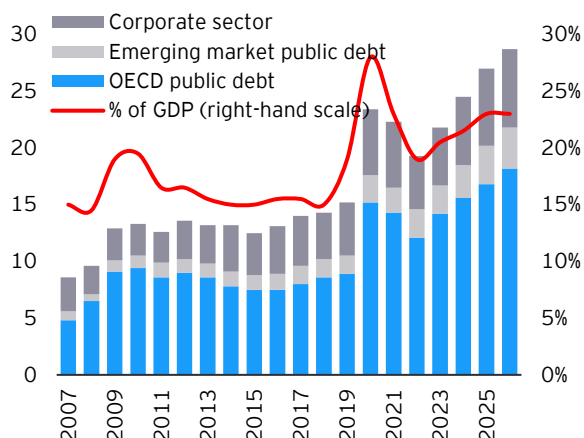
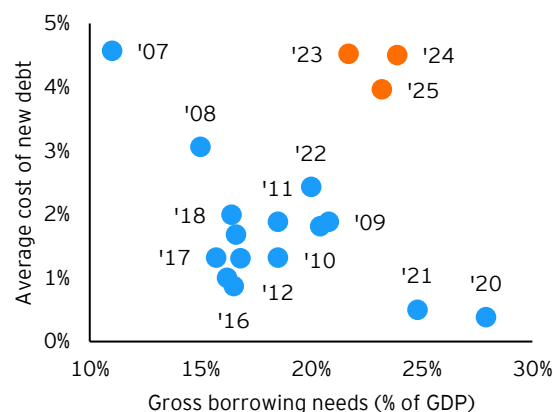


Figure 72: Gross borrowing needs and cost of debt in OECD countries



Source: OECD. "Emerging market debt" refers to countries classified as emerging and developing economies by the International Monetary Fund and the World Bank.

What sets this apart from past cycles, however, is not the volumes themselves but the conditions under which they are issued. Historically, periods of high financing needs have coincided with accommodative monetary conditions and low yields; since 2023, by contrast, issuance volumes and yields have both been high at the same time, a combination unprecedented in the period observed.

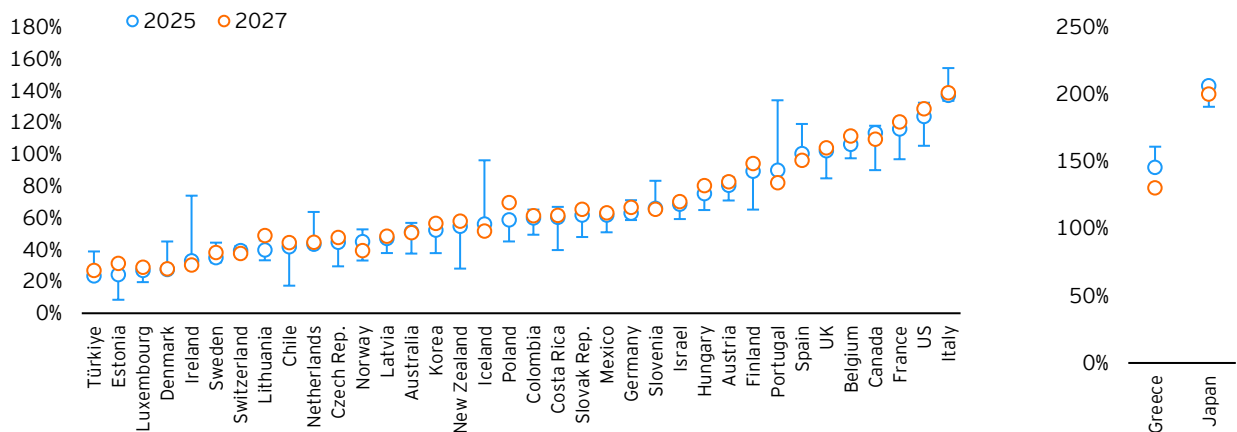
The stock of debt increasingly reflects this long-standing trend towards higher borrowing. OECD central government bond debt reached a record \$61 trillion in 2025, up from \$55 trillion in 2024, the largest annual increase since the pandemic (around one-third of this increase is attributable to the depreciation of

⁷⁸ OECD Global Debt Report 2026.

the dollar against the euro and sterling: for a given nominal value of debt denominated in another currency – e.g. euro or sterling – its nominal value in dollars rises). As a share of GDP, the aggregate remained stable at around 83% between 2024 and 2025, but is expected to rise to 85% in 2026, the highest level since 2021 and 39 percentage points above 2007. According to International Monetary Fund estimates, the global debt-to-GDP ratio is expected to approach 100% in 2029.⁷⁹

As usual, the aggregate picture conceals considerable heterogeneity across countries. In 2025 the debt-to-GDP ratio rose in several OECD countries, approaching or in some cases exceeding the levels reached during the pandemic. Italy has the third-highest ratio in the area (after Japan and Greece), with a further slight increase expected by 2027; similar trends can be seen in France and the United States, while countries such as Greece, Portugal and Ireland continue on a downward path.

Figure 73: Public debt in the main OECD countries – % of GDP

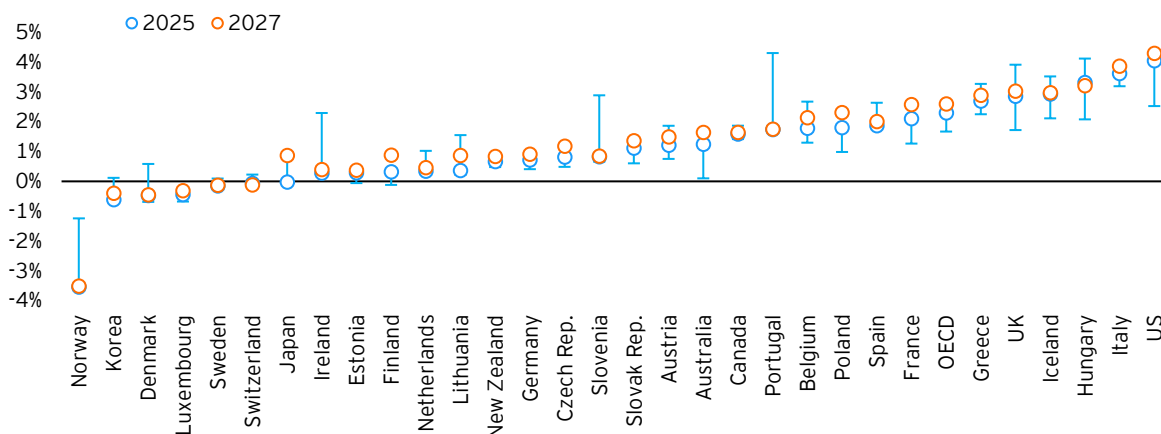


Source: EY-Parthenon elaborations based on International Monetary Fund data. Error bars show the maximum and minimum values over the period 2015 to 2025.

The combination of high debt and higher interest rates translates, first and foremost, into higher net interest expenditure. In OECD countries this stood at 2.3% of GDP in 2025 and is expected to rise to 2.6% by 2027. Italy is among the countries with the highest burden, with net interest expenditure of around 3.6% of GDP in 2025 (~€80 billion), estimated to rise further towards 3.9% in 2027 (~€90 billion), second only to the United States among the large advanced economies and well above the OECD average.

⁷⁹ IMF Fiscal Monitor, April 2026.

Figure 74: Net interest expenditure on public debt, main OECD countries - % of GDP



Source: EY-Parthenon elaborations based on OECD data. Error bars show the maximum and minimum values over the period 2015 to 2025.

Second, the underlying dynamics of the debt-to-GDP ratio are particularly significant. While in recent years inflation had helped to reduce the ratio by eroding the real value of debt, according to the OECD in 2026 the effect of higher interest payments (estimated at +2.5 percentage points on the aggregate ratio) is set to outweigh the downward pressure from inflation (-2.4 points), reversing the sign of the contribution.⁸⁰ The gradual decline in inflation, while desirable on the price front, therefore removes one of the factors that had been containing the real “weight” of debt, while real growth continues to make only a modest contribution. In this context, it is important to stress that growth plays a dual role. First, it affects the budget balance by supporting revenue and containing cyclical spending (e.g. unemployment benefits), and hence the financing needs that drive the accumulation of new debt. Second, it enters directly into the dynamics of the debt-to-GDP ratio through the differential between the average cost of debt and the nominal growth rate of the economy - when the cost of debt exceeds growth, the ratio tends to rise even with a balanced primary budget (i.e. before interest payments), and only a sufficiently large primary surplus can offset this effect.

Figure 75: Decomposition of the change in the debt-to-GDP ratio in OECD countries - percentage points

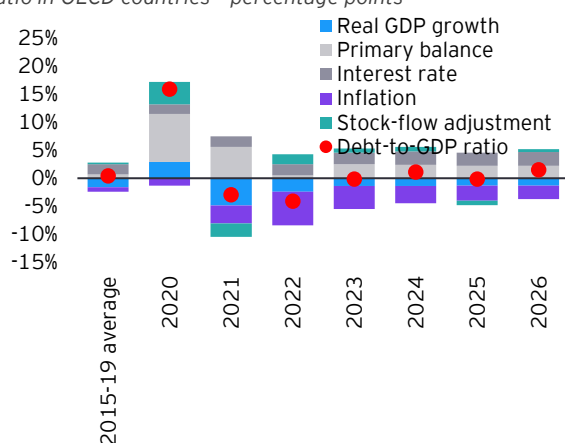
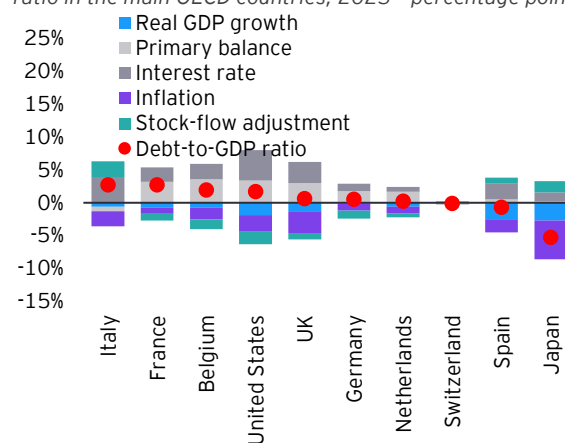


Figure 76: Decomposition of the change in the debt-to-GDP ratio in the main OECD countries, 2025 - percentage points



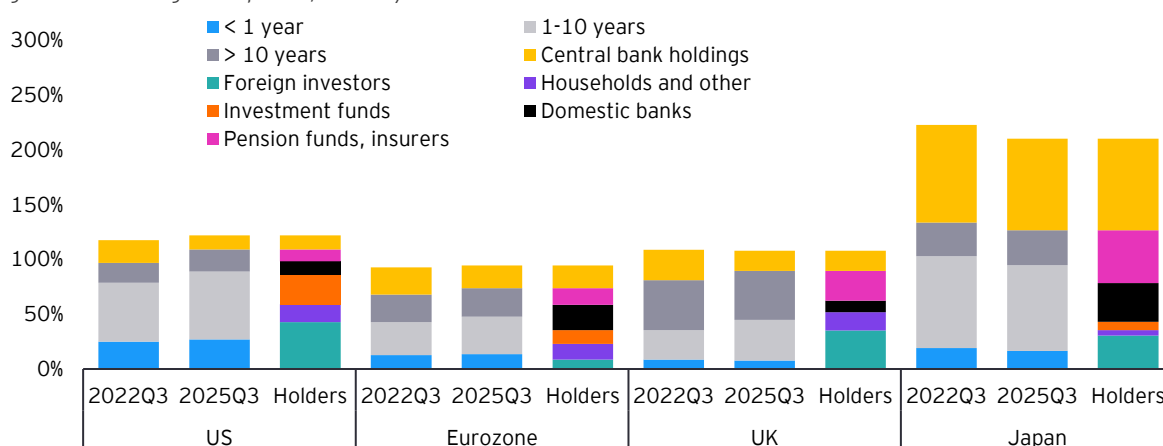
Source: OECD.

Alongside the level and dynamics of debt, its structure determines its actual exposure to market conditions. Two dimensions are relevant here: the maturity profile of outstanding securities and the

⁸⁰ OECD Global Debt Report 2026.

composition of holders. A comparison between the third quarter of 2022 and the third quarter of 2025 reveals two trends common to the main areas. The first is that debt growth has been concentrated in the intermediate segment, with maturities of between one and ten years, which increased by around 8 points of GDP in the United States, 10 in the United Kingdom and 4 in the Eurozone, while changes in maturities of over ten years were limited; the exception is Japan, where this component declined. The second is the fall in central bank holdings, down by around 8 points of GDP in the United States, 9 in the United Kingdom, 4 in the Eurozone and 5 in Japan as a result of balance sheet normalisation, leaving a growing share of securities to be absorbed by the market. The composition of the investor base remains heterogeneous, however: in the United States and the United Kingdom foreign investors predominate, joined in the latter case by a significant share of pension funds and insurance companies; in the Eurozone the largest share is held by domestic banks, while in Japan the central bank continues to hold more than any other category.

Figure 77: Sovereign debt profile, maturity structure and investor base - % of GDP



Source: International Monetary Fund. Data on holders refer to the third quarter of 2025.

The composition of demand is particularly relevant for the Eurozone, where the maturity structure has specific features. Non-bank financial intermediaries hold around 40% of the area's government bonds with a residual maturity of between ten and thirty years and 60% of those with a maturity of over thirty years - a concentration that makes the long end of the yield curve dependent on a small number of investor categories, mainly insurance companies and pension funds. Moreover, empirical evidence indicates that Eurozone investors react more strongly to yield changes at maturities other than those to which they are already exposed than to changes in their own segment, encouraging reallocation along the curve rather than a proportional increase in total holdings. These factors help explain the steepening observed in 2025 and make long-dated borrowing more expensive.⁸¹

It is in response to this higher cost of long maturities that recent refinancing management can be explained, while the scale of refinancing has meanwhile grown significantly. In the OECD area, maturing debt to be refinanced has more than tripled, from around \$4.4 trillion in 2007 to \$13.5 trillion in 2025, and is projected to rise further towards \$14 trillion in 2026, equal to around 19% of OECD GDP, close to post-pandemic highs; refinancing now accounts for almost 80% of gross borrowing needs. To contain its cost, issuers have progressively shifted issuance towards the short end: the ratio of issuance with maturities of thirty years or more to issuance at one to five years fell to 6% in 2025, the lowest level since at least 2008, while short-term government securities (maturing within one year) accounted for around 48% of gross borrowing and 15% of the stock. On top of this, budget deficits remain large: net borrowing in the OECD area remains at around 5% of GDP, around 2 points above the pre-pandemic average.

⁸¹ ECB Financial Stability Review, November 2025, May 2026.

Figure 78: Maturing public debt to be refinanced, OECD countries - US\$ trillion and % of GDP

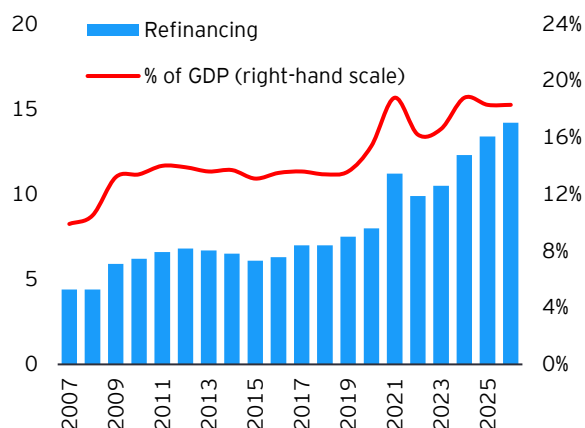
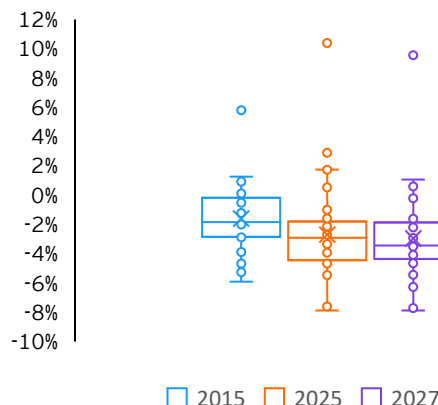


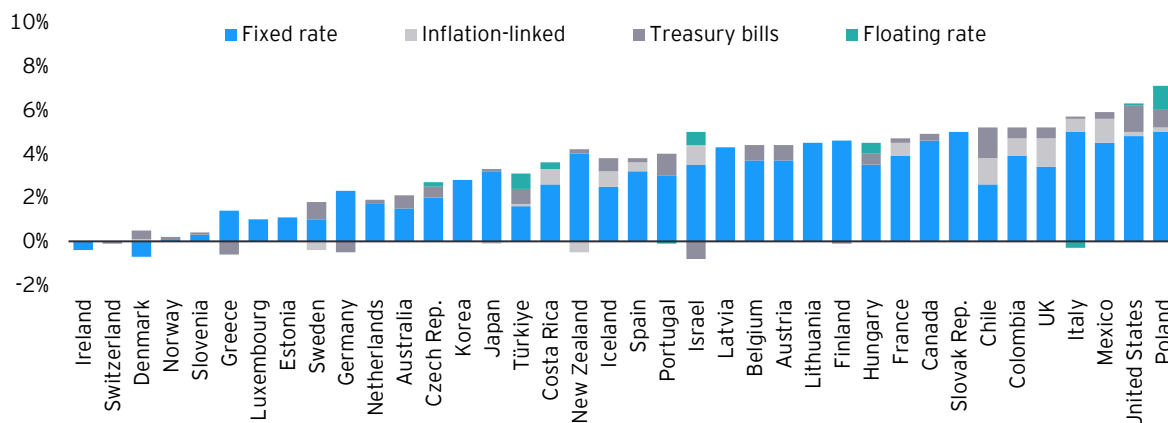
Figure 79: Net lending (+)/ net borrowing (-) in the main OECD countries - % of GDP



Source: OECD; EY-Parthenon elaborations based on International Monetary Fund data.

The nature of this repositioning can be seen in the composition of net issuance. Fixed-rate debt accounts for the bulk of OECD countries' net borrowing, at an average of 3% of GDP, while net issuance of floating-rate and inflation-linked debt remains marginal in almost all countries. Short-term securities, while accounting for around half of gross issuance, show negligible net issuance - no more than 1% of GDP in 36 of the 38 countries, the only exceptions being Chile and the United States - because high issuance volumes are matched by a similar volume of redemptions. The shift towards short maturities therefore results in faster rollover of outstanding debt rather than a structural change in its composition, consistent with a share of short-term securities that is stable at around 15% of the stock.

Figure 80: Public net lending (+)/ net borrowing (-) by instrument in the main OECD countries - % of GDP, 2025



Source: OECD. Fixed rate: the security pays coupons set at the time of issuance. Inflation-linked: the security provides a return indexed to the inflation rate. Treasury bill: pays no coupons; payment is made at maturity. Floating rate: the security provides a return indexed to a reference rate (e.g. the Euribor interest rate).

This strategy reduces current interest expenditure but leaves public finances more exposed to future market conditions, as debt has to be rolled over more frequently and at rates not known at the time of issuance. With around one-third of OECD countries' fixed-rate debt maturing between 2026 and 2028 and

market yields consistently around two percentage points higher than those on maturing securities, the interest burden is set to rise even in the absence of further stress, and any rise in yields would translate into a rapid increase in spending rather than being spread over a multi-year horizon. The exposure is asymmetric, however: countries with higher debt-to-GDP ratios and a shortening average maturity are more vulnerable to a renewed rise in interest rates. The current environment makes this scenario less remote, as Eurozone government bond yields have risen across the entire curve owing to higher term premia and renewed inflation concerns, while structural needs – defence spending, the green and digital transitions, population ageing – are hard to compress and come on top of possible support measures for households and firms in response to higher energy prices, at a time when available fiscal space in several countries is limited.⁸²

A second transmission channel runs through the banking sector. The shrinking of the Eurosystem's balance sheet has led to a fall of more than €2,000 billion in the reserves held by Eurozone banks at the central bank compared with the 2022 peak. As these reserves are the most liquid component of the assets held for prudential purposes, banks have progressively replaced them with government bonds. For given liquidity requirements, this rebalancing helps to absorb the additional supply of bonds, but at the same time increases the share of assets exposed to revaluation risk and strengthens the link between sovereign risk and bank risk. The mechanism recalls what the literature on the sovereign debt crisis of the early 2010s called the *diabolic loop*: a deterioration in sovereign creditworthiness reduces the value of bonds on banks' balance sheets, weakens their solvency and, through expectations of public intervention, feeds back into sovereign risk. The analogy should be qualified, however: at that time the loop was triggered by bank bailouts and fuelled by the high concentration of portfolios in bonds issued by banks' own countries; today the rebalancing is driven by the normalisation of the Eurosystem's balance sheet and, in most countries, is accompanied by a gradual reduction in precisely the domestic component, i.e. the element that made the loop more intense. In addition, there is the strengthened prudential framework and the mechanisms of the banking union, which were partly created in response to that experience.⁸³

It should be noted, however, that the conditions prevailing in the corporate debt market do not fully reflect the risk picture described above. Corporate credit spreads remain at historically compressed levels, but available analyses indicate that this compression is not mainly attributable to an improvement in credit quality, but rather to lower liquidity premia and greater risk appetite among investors. At the same time, the capital needs associated with the expansion of artificial intelligence – estimated at around \$4,100 billion of investment for the nine largest players between 2026 and 2030 – are set to be financed increasingly on debt markets, in competition with the supply of public debt. For the Eurozone, the main risk lies not in the size of direct exposures but in the possibility of a simultaneous and correlated repricing of valuations: the portfolios of the area's non-bank intermediaries have high exposure to, and marked concentration in, US assets, particularly AI-related companies, and could amplify any correction through procyclical selling, at a time when liquidity buffers are declining. These considerations should be viewed against the growing involvement of non-bank financial institutions in the sovereign debt market: the emergence of a new “fiscal-financial” nexus, owing to the presence of the same players in both sovereign and private securities markets, increases the risk of shocks spreading between the two markets.⁸⁴

Finally, it should be noted that the vulnerabilities described have not so far translated into actual market stress, and the available composite indicators consistently point to broadly contained stress conditions. The financial stress index compiled by the US Office of Financial Research, built on thirty-three market variables relating to credit, equity valuations, funding, safe assets and volatility, stood at clearly negative values (around -2.4) in early September 2026, consistent with a level of stress well below the historical average.⁸⁵ Italian indicators point in the same direction: although it rose sharply after the outbreak of the conflict in the Middle East and exceeded its level of a year earlier, the financial stress indicator for Italy remains below

⁸² OECD Global Debt Report 2026.

⁸³ Brunnermeier M. K., Garicano L., Lane P. R., Pagano M., Reis R., Santos T., Thesmar D., Van Nieuwerburgh S., Vayanos D. (2016), “The Sovereign-Bank Diabolic Loop and ESBies”, *American Economic Review: Papers & Proceedings*, 106(5), pp. 508-512. See also Acharya V., Drechsler I., Schnabl P. (2014), “A Pyrrhic Victory? Bank Bailouts and Sovereign Credit Risk”, *Journal of Finance*, 69(6); and Farhi E., Tirole J. (2018), “Deadly Embrace: Sovereign and Financial Balance Sheets Doom Loops”, *Review of Economic Studies*, 85(3), pp. 1781-1823.

⁸⁴ BIS Annual Economic Report 2026.

⁸⁵ For further information, see <https://www.financialresearch.gov/financial-stress-index/>.

its median of the past two decades, while the composite systemic risk indicator for the domestic financial cycle signals a profile consistent with a phase of limited build-up of vulnerabilities.

Market functioning points in the same direction: the spread between Italian and German government bonds, after peaking at around one hundred basis points, has returned to historically low levels, primary market placements have continued smoothly and the secondary market's ability to absorb large orders without significant price impact has remained solid.⁸⁶

⁸⁶ Bank of Italy, Financial Stability Report, April 2026.



Forecast assumptions

The forecasts and analyses are based on data available as at 11 September 2026.

The forecasts described above rest on a set of assumptions that define the baseline scenario. Specifically, the following assumptions have been made:

- **Foreign demand for Italian goods:** overall growth of around 1.8% is assumed for 2026, followed by stronger growth in 2027 (2.5%);
- **Natural gas:** the price of natural gas (Dutch Title Transfer Facility) is assumed to average around 18 \$/mmbtu in 2026; an average price of 17 \$/mmbtu is assumed for 2027;
- **Oil:** the oil price is assumed to average around 91 \$/bbl in 2026 and 80 \$/bbl in 2027;
- **Exchange rate:** the euro/dollar exchange rate is assumed to stand at 1.15;
- **Public spending:** the information contained in the April 2026 Public Finance Document (Documento di Finanza Pubblica)⁸⁷ and the latest Istat national accounts data on the public sector have been taken into account;
- **Monetary policy and interest rates:** key policy interest rates are assumed to remain at their current level until the end of 2027.

Finally, given the current highly uncertain environment, some downside and upside risks are listed below to provide a more complete view of what could happen over the forecast period.

Upside risks

- **Resolution of the war in the Middle East:** the early-June agreement between the United States and Iran may prove to be the definitive agreement ending the conflict in the Middle East, leading to a normalisation of oil and gas prices and lower inflationary risks;
- **Easing of trade tensions:** trade tensions could ease, leading to a recovery in trade and supporting the economies of Italy and its main trading partners;
- **Lower commodity prices:** a faster-than-expected fall in commodity prices would make inflation easier to manage and allow an easing of monetary policy, with positive effects on growth;
- **Labour market:** weaker wage pressure on prices could reduce the risk of persistent inflation;
- **Monetary policy:** the resolution of the conflict in the Middle East and an easing of geopolitical tensions could lead to possible rate cuts supporting growth in the Eurozone economies;
- **Stronger foreign demand:** higher economic growth in key trading partners such as China, Germany and the United States, helped also by the end of trade policy uncertainty, would translate into a larger contribution from foreign trade to Italian growth;
- **Technology:** the adoption of new technological solutions could support growth more than expected through several channels, for example through higher productivity growth.

⁸⁷ Public Finance Document (Documento di Finanza Pubblica), April 2026. For further information, see <https://www.senato.it/service/PDF/PDFServer/BGT/001505177.pdf>.

Downside risks

- Escalation of geopolitical tensions: open geopolitical fronts at international level (mainly the conflict in the Middle East) could worsen and remain unresolved in the short to medium term, adding uncertainty to an already precarious global environment. If other countries were to become involved, the humanitarian and economic repercussions would be even more significant, with potential negative consequences for the prices of energy goods and other *commodities*;
- Heightened trade tensions: trade tensions could increase, with negative consequences for world trade;
- Tighter monetary policy: the ECB and other central banks could move back towards a more restrictive monetary policy. This could result in a risk of prolonged low growth, owing to lower consumption and investment discouraged by high interest rates;
- Financial system stress: further interest rate increases could translate into greater stress for financial institutions, with a consequent impact on savers and a tightening of credit conditions, in both the United States and the Eurozone;
- High public debt: the increase in public debt following the pandemic, together with interest rates higher than in the pre-pandemic period and numerous challenges of different kinds (such as the energy transition and higher military spending), poses challenges for fiscal sustainability in Eurozone economies, especially the most indebted ones such as Italy. Ultimately, this could translate into greater risks of financial market stress;
- Weaker growth in China, Germany and the United States: weaker future growth in China, Germany and the United States could lead to lower growth in foreign demand for Italian goods;
- Technology: the adoption of new technological solutions may not support growth as expected, with smaller benefits for the economies that adopt them.

Technical appendix

HEY-MoM: Hybrid EY MModel for the Macroeconomy⁸⁸

Building a new macroeconometric model required optimising an inevitable trade-off between constructing a model that emphasises the information in the data (such as ARIMA and VAR models, which make no use of economic theory) and a model focused solely on the foundations of its relationships (in the extreme case, calibrated RBC-DSGE models that pay no attention to the data for their variables).⁸⁹ This trade-off has been highlighted repeatedly in the literature; see, for example, the discussions in Granger (1999) and Pagan (2003).

In building HEY-MoM, we sought not to neglect either of these two ingredients (economic theory and data), with the aim of producing a hybrid model that carefully balances the specification of relationships that are (a) based on micro-founded economic behaviour and, at the same time, (b) grounded in the application of rigorous techniques for evaluating statistical information. An example of a hybrid model is MARTIN, the model currently used by the Reserve Bank of Australia (cf. Cusbert and Kendall, 2018).

In short, the role of HEY-MoM is to unify EY's analytical macroeconomic framework. To this end, the model covers the main aggregates of the Italian economy; it is grounded in empirical data, non-monetary in nature, with explicit long-run relationships between the variables it studies, and is oriented mainly towards short-term forecasting (over a two-year horizon).

Economic foundations

Price and wage rigidities imply rigidity in the speed at which macroeconomic systems adjust to unexpected shocks. Thus, in the model, market demand drives short-term fluctuations, as described by Keynesian theories, while in the long run supply-side determinants drive the state of the economy.

Long-run output (the economy's potential) depends on the combined effect of trends in total factor productivity, in labour supply and hours worked and, finally, on the capital stock. These factors are combined through a "Cobb-Douglas" technology with constant returns to scale. The demand for factors of production is the one that minimises cost for a planned level of output, in an economy characterised by forms of oligopolistic competition, in which firms are free to set prices as a mark-up over labour costs and, at those prices, are willing collectively to meet any level of market demand. Wages are determined by a "Phillips curve" driven by inflation inertia, labour productivity and the gap between the actual and natural rates of unemployment (defined by the long-run state of the labour market). Actual output consists of the following domestic and foreign demand components: private (household) and government consumption; private and public investment by type of asset (residential and non-residential buildings, machinery and equipment, and research and development expenditure); imports and exports.

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

⁸⁸ The model was developed in collaboration with the Department of Economics of the University of Bologna.

⁸⁹ "ARIMA" stands for "Autoregressive integrated moving average", "VAR" for "Vector autoregression" and "RBC-DSGE" for "Real Business Cycle - Dynamic Stochastic General Equilibrium".

Data evaluation techniques

The speed at which the economic dynamics described above evolve over time is estimated using econometric methods based on the actual time series of the model's variables of interest.

To this end, the model uses a combination of the London School of Economics approach and Fair's (2004) reworking of the Yale Cowles Commission approach. The synthesis achieved in HEY-MoM uses cointegration methods (Engle and Granger, 1987, and Johansen, 1995) to estimate long-run relationships between non-stationary variables (Dickey and Fuller, 1979), which can be interpreted in the light of economic theory and are identified by steady-state relationships whose parameters are estimated using error-correction models (Hendry et al., 1984, and Pesaran et al., 2001). Where some explanatory variables in the model are not exogenous, the relationships are first examined using an instrumental variables estimation approach and then estimated definitively using three-stage least squares (Hsiao, 1997).

The overall result is a model consisting of 74 equations, of which 29 are stochastic and 45 are accounting identities. The forecasts and analyses are conditional on scenarios for 65 exogenous variables, which can be classified as: fiscal and monetary policy instruments, the external block, and short-term indicators.

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EY MAIOR (Model for the Analysis of Input-Output Relations)

Modern quarterly macroeconomic models are a practical and well-established tool for generating consistent and timely projections of the main aggregate demand components. Their main limitation, however, is the limited scope for attributing aggregate dynamics to specific sectors. At the same time, Input-Output tables and the associated analytical tradition, dating back to Leontief (1936, 1986), offer a natural framework for quantifying inter-sectoral production linkages and for tracing the transmission of demand shocks across sectors. However, Input-Output tables are not forecasting tools in themselves, as they need to be combined with an external macroeconomic scenario. A fully integrated macro-sectoral approach, on the other hand, would entail high costs associated with estimating large disaggregated models.

This is the context for MAIOR, which, in the spirit of Eckstein et al. (1971), can be described as a data-driven framework built to translate aggregate macroeconomic projections into annual sectoral forecasts within a top-down structure. MAIOR combines the aggregate consistency of macroeconomic models with the sectoral linkages typical of the input-output system, while also allowing monthly sectoral indicators to be incorporated as soon as they become available.

The framework

MAIOR complements the aggregate macroeconomic projection through two distinct “blocks”, in the spirit of Adams (1986). The first block is a system of bridge equations that disaggregates the main demand components across sectors. The second block uses input-output linkages to transform disaggregated final demand into consistent forecasts of output, imports and intermediate demand, using the coefficients derived from the tables.

In the first block, the bridge equations break down the aggregates provided by the macroeconomic model into highly detailed demand components. The bridge equations are therefore specified as reduced-form relationships in which the disaggregated variables are calculated taking into account their respective aggregates. In addition to the macro projections, the bridge equations are augmented with a further 12 indicators (e.g. consumer confidence, vehicle registrations, VIX, etc.). Finally, MIDAS models make it possible to include monthly data. The MIDAS forecast is combined with the bridge model forecast, following the method set out in Diebold (2024b).

The disaggregated forecasts from the bridge block are not, however, homogeneous in terms of classification: household consumption is expressed by consumption category and investment by non-financial asset, while exports and government consumption already have sectoral detail. Within the input-output block, therefore, the final demand components are converted into a common format, namely demand vectors by sector, measured at constant basic prices. The conversion procedure also takes into account the need to allocate trade margins and transport margins and to strip out net taxes on products. In this way, the final demand components are expressed consistently with the accounting principles of the Input-Output tables.

Finally, the disaggregated demand components are “netted” of imports, so that only the domestic component of demand activates production. MAIOR is demand-driven: the inter-sectoral linkages, activated by domestic final demand, yield estimates of output and intermediate demand.

Forecast performance evaluation

MAIOR's forecast accuracy is assessed by comparing forecasts of output value by industry for years $t+1$ and $t+2$, produced with the information available in March of year $t+1$, with the corresponding national accounts outturns. The exercise aims to distinguish between the different sources of the final forecast error.

The first source ("Layer 1") relates to the input-output "block". Since input-output tables are available with a lag, the technical coefficients, conversion coefficients and import shares used refer, for Italy, to year $t-3$. The error therefore reflects the discrepancy between these lagged coefficients and the actual relationships in the forecast years. This block also covers the treatment of inventories, which in MAIOR are not forecast separately but are implicitly captured by the input-output mechanism. The second source ("Layer 2") stems from the "bridge" allocation systems, which distribute the aggregate macroeconomic scenario across detailed final demand components. The associated errors therefore measure the model's ability to correctly allocate aggregate developments before sectoral propagation.

The "Layer 1" error identifies errors arising from the first source (the input-output block). The "Layer 2" error, by contrast, cumulates errors from the first and second sources and captures the performance of EY MAIOR starting from an "exact" macro scenario, i.e. one without forecast errors. "Layer 2" therefore identifies the "pure" performance of the model, since the macroeconomic scenario is treated as an exogenous variable. EY MAIOR was subjected to the Diebold and Mariano (1995) test on three groups: all sectors, manufacturing sectors only and services sectors only. The null hypothesis is rejected at 1% for all three groups and for both error Layers, except in the case of Layer 2 for services, 2 steps ahead, for which the null hypothesis is rejected at 10%.

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