Economic Update Italy

7 February 2012

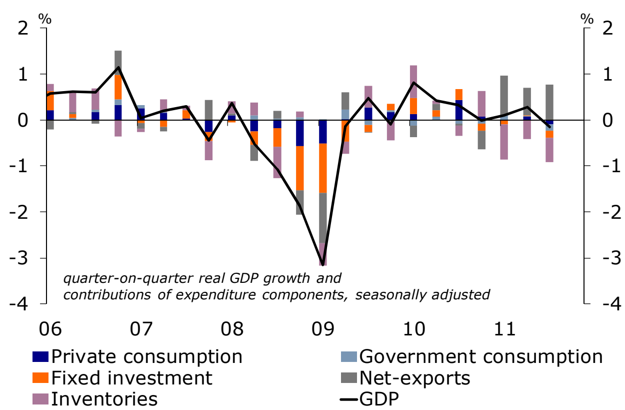
Recession deepens

Year-on-year change (%)	'10	'11	'12
Gross Domestic Product	1.2	¼	-1
Private consumption	1.0	¼	-1
Government consumption	-0.6	-1	-1½
Investment	2.3	1	-1
Exports	8.9	5¼	3½
Imports	10.3	3	0
Inflation	1.6	2¾	1¾
Unemployment (%)	8.5	8¼	9
Government balance (% GDP)	-4.6	-4	-2¼
Government debt (% GDP)	118.4	120½	121

Source: Reuters EcoWin, Rabobank

The Italian economy fell back into recession in the third quarter of 2011. GDP contracted by 0.2% q-o-q. The pace of decline probably accelerated in the fourth quarter and we expect a further contraction in the first quarter of 2012. The announced austerity measures will hold back growth in 2012 as a whole. Still, assuming that the European debt crisis does not spin out of control again, we expect to see a modest recovery in the second half of the year. Despite the return of recession and the steep increase in government bond yields, the budget deficit target for 2011 seems to have been attained. Meanwhile, the pressure from financial markets has eased significantly over the past weeks.

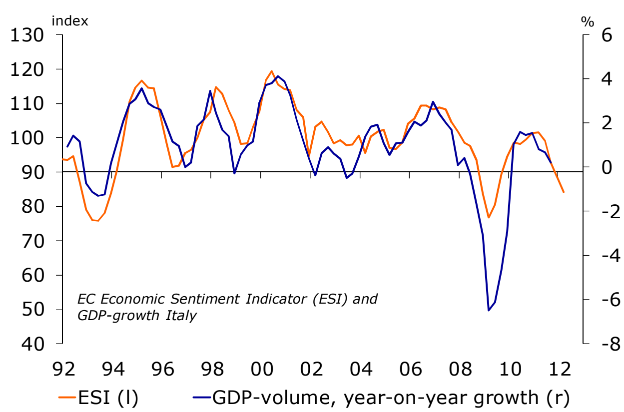
Recession in second half of 2011…



Source: Reuters EcoWin, Rabobank

As we expected, the Italian economy fell back into recession in the third quarter of 2011. GDP fell by 0.2% q-o-q. For the third quarter in a row, inventory formation subtracted sizeably from GDP growth. But the other domestic demand components also fell in 11Q3. In contrast, export growth accelerated. Similar to the previous two quarters, this was coupled with a contraction of imports, leading to a big positive contribution of net-trade to the headline growth figure. In the fourth quarter, world trade growth fell back. As a result, export growth is unlikely to post a similar positive contribution to economic growth in 11Q4.

… sets the stage for a very weak 2012



Source: Reuters EcoWin

Due to lower export growth and a further contraction of domestic demand, the contraction in GDP probably accelerated in the last quarter of 2011. Sentiment indicators also point to a further fall in economic activity in the first quarter of the current year. The announced spending cuts and tax hikes will constrain economic growth throughout 2012. Yet we do expect an end to recession in the course of the second half of the year. A continued negative development in inventory formation is unlikely. Next to that, with an expected renewed pickup in world trade growth, exports should be able to support economic growth again later this year.

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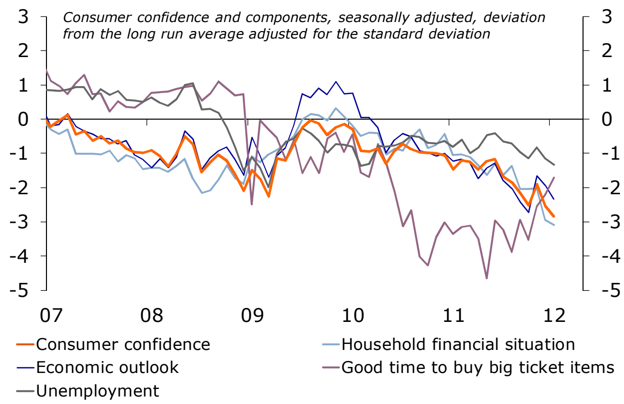
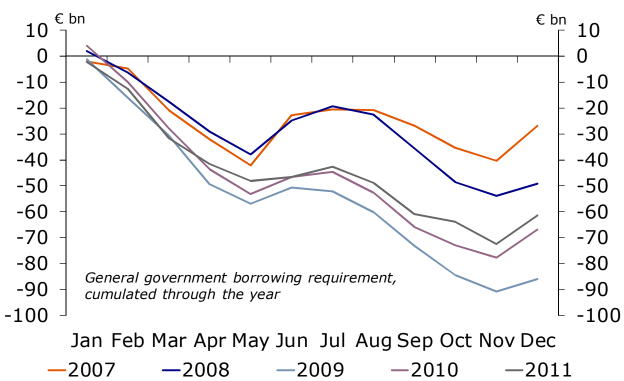
The mixed blessing of Mario Monti



Source: Reuters EcoWin, Rabobank

The rise in consumer confidence on the back of the takeover of Mario Monti as Prime Minister in November was bound to be short-lived. Monti has the specific task of pushing through hard measures, and has wasted no time in doing so. Indeed, consumer's judgement on their own financial situation approached an historic low in January. Of note though is the contrasting sharp decline in pessimism about buying big ticket items. Perhaps this testifies to increased confidence in future economic developments now that Monti is taking long overdue and sensible measures. Together with the high saving buffers of households, this may well dampen the decline in private consumption.

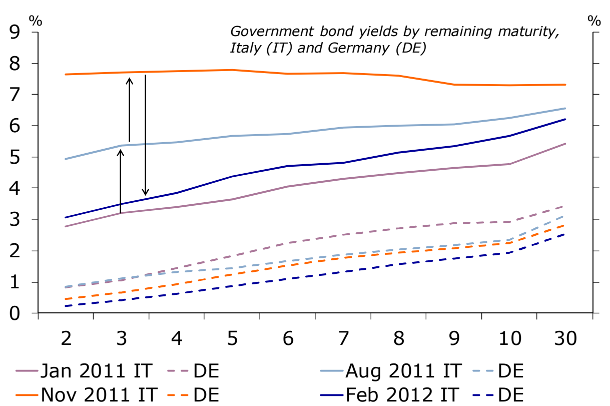
Budget deficit successfully reduced further



Source: Reuters EcoWin, Rabobank

Despite the return of recession and the steep increase in government bond yields, the budget deficit did not run out of control last year. The general government borrowing requirement was slightly lower compared to 2010 in the year to November. Preliminary data for December indicate that this improvement was maintained until the end of the year. Against this backdrop, the 2011 budget deficit will probably come close to the 3.9% of GDP target. This results in a rather favourable starting point to balance the budget in 2013 and stabilise the debt ratio, despite the economic headwinds. This may help to capitalise on the recent drop in government bond yields.

Financial market pressure eases significantly



Source: Reuters EcoWin

In 2010, the budget deficit was ½%-point lower than expected. The policy settings from the Berlusconi era now seem to have resulted in yet another year of successful fiscal consolidation. In spite of all this, the general negative sentiment in the markets resulted in a steep rise in Italian government bond yields in 2011. The provision of 3-year liquidity to banks by the ECB in December last year and February this year has led to a noticeable decrease in market stress. Hence, the Italian government bond yields have fallen significantly over the past few weeks, especially on the short end of the yield curve. The ECB actions make it very hard to gauge the underlying investor sentiment towards Italy though.

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