Rabobank

Economic Update Italy

6 December 2011

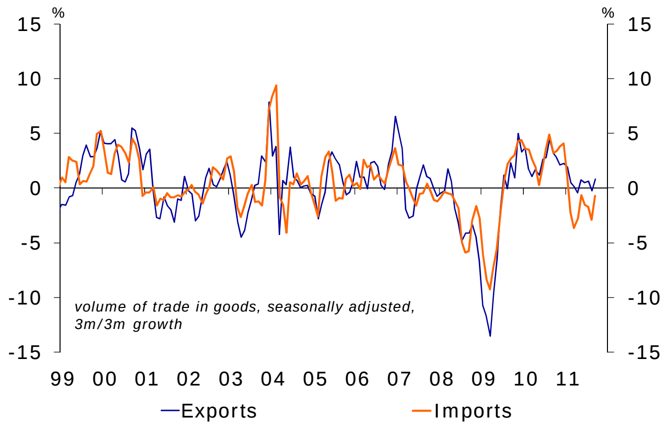
Monti tries to save Italy

Year-on-year change (%)	'10	'11	'12
Gross Domestic Product	1.2	½	-½
Private consumption	1.0	¾	-½
Government consumption	-0.6	-1	-1½
Investment	2.3	1	0
Exports	8.9	5¼	3½
Imports	10.3	3	1
Inflation	1.6	2¾	1¾
Unemployment (%)	8.5	8¼	9
Government balance (% GDP)	-4.6	-4	-2¼
Government debt (% GDP)	118.4	120½	120½

Source: Reuters EcoWin, Rabobank

Halfway November, Mario Monti took over as Prime Minister. In his technocratic cabinet, he will also serve as finance Minister. He has the difficult task of lowering the budget deficit and enacting structural reforms. He needs to do all this while the economy is falling back into recession. Under the motto “Save Italy”, the first set of measures to lower the deficit have been passed and put forward to parliament. But much needs still to be done, most notably on labour market reform. There is not much time and reforms will become ever harder to approve because political parties will increasingly want to position themselves for the general elections, which have to be held in April 2013 at the latest.

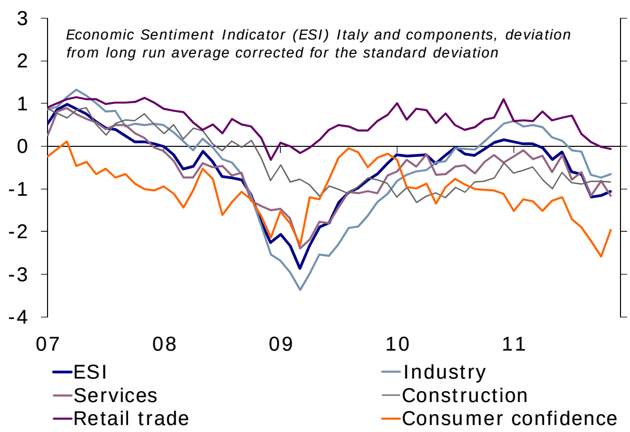
IP and net-trade better than expected in 11Q3...



Source: Reuters EcoWin, Rabobank

In the absence of the publication of the GDP flash estimate, we will have to wait for the 11Q3 growth figure until December 21st. We stick to our forecast of contraction in both 11Q3 and 11Q4 even though data on industrial production (IP) and international trade have been more positive in 11Q3 than we expected. IP closed the quarter with a fall of 4.8% m-o-m in September. But since this followed on an impressive 3.9% growth in August, the fall in production for 11Q3 as a whole was limited only 0.1% q-o-q. The modest continuation of export growth in combination with a further fall in imports points to a positive contribution of net trade to economic growth.

...but we still expect a new recession



Source: Reuters EcoWin, Rabobank

Our expectation of economic contraction in the second half of the year is partly based on the sharp falls seen in both the Purchasing Manager Indices (PMI) and the Economic Sentiment Indicator (ESI) since June. The good news is that the latter posted a modest recovery in both October and November. In November, the PMI for both manufacturing and services also rose slightly. If sentiment does not deteriorate much further in the coming months, the recession is set to be mild compared to that seen in 2008/09. Of note was the sharp rise in consumer confidence in November, the month that Berlusconi resigned and the technocratic government took office. This led to a much more positive judgement on the general economic outlook.

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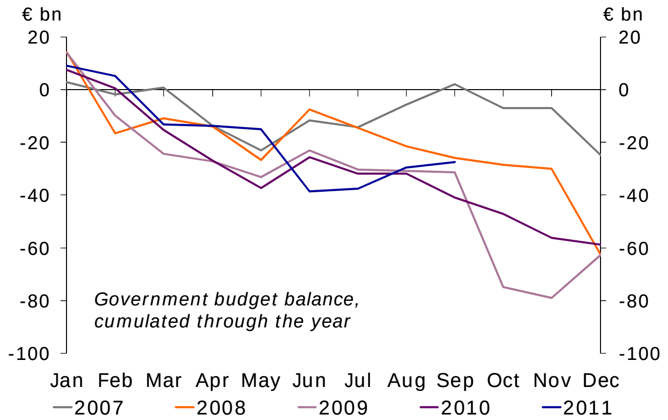
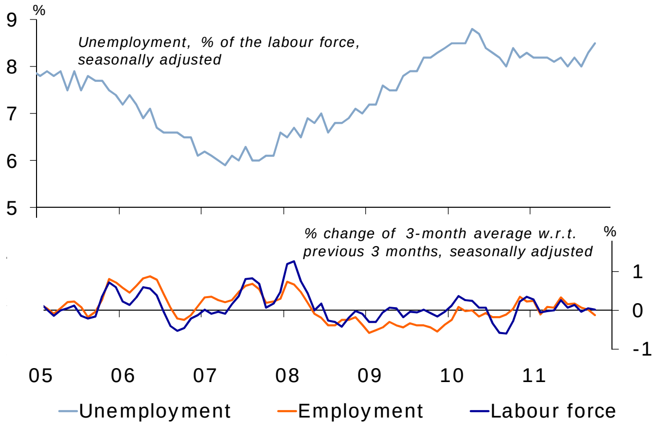
It is up to Monti now



Source: Reuters EcoWin, Rabobank

The change of power can certainly contribute to an eventual resolution to the current debt crisis. But Monti will have to take harsh measures, so the rise in consumer confidence will likely be short-lived. Monthly data show that the budget deficit was once again on a downward path in the third quarter, after being somewhat off course in 11Q2. To remain on the right track, the new government recently announced new austerity measures, which should make sure that the target of a balanced budget in 2013 is attainable in spite of the recession. That is good news for the sustainability of government finances and restoration of market confidence, but will certainly be economically painful.

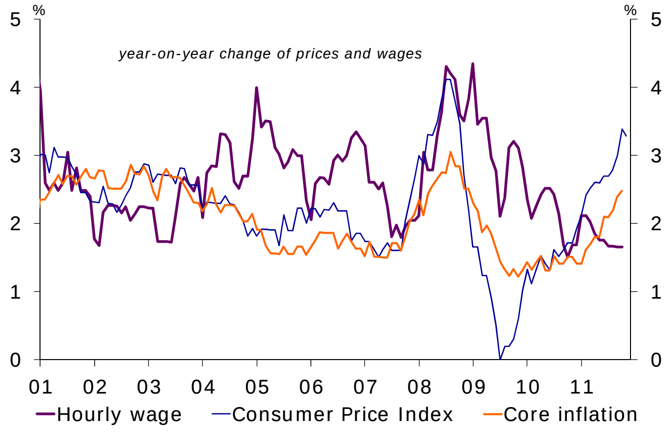
Unemployment on the rise...



Source: Reuters EcoWin

Lower economic growth is taking its toll on the labour market. After rising almost continually for almost a year, employment fell in the three months to October when compared with the three months before. The labour force remained constant. As a result, after having fallen in 2010 and having remained flat for most of 2011, the unemployment rate rose quickly in September and October, to 8.5%. Similar to general economic sentiment, employment intentions in manufacturing sector recovered slightly in November. But given our expectation of renewed recession and the weak economic outlook for 2012, unemployment is set to rise further in the year ahead.

... and purchasing power under downward pressure



Source: Reuters EcoWin

The high and rising unemployment has prevented wages from rising in line with inflation over the past months, eroding purchasing power of workers. Next to that, the recent government plans mean that apart from the lowest levels of income, public pensions will not be fully compensated for the increase in the price level anymore. The planned increase in taxes will lead to a further fall in real household disposable income. Over the next months, inflation will likely fall due to a lower contribution of energy prices. The increase in unemployment will perhaps help to reduce core-inflation over time as well. This would be very helpful for regaining the price-competitiveness that was lost in the past decade.

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