# Economic Update Italy

## 8 August 2012

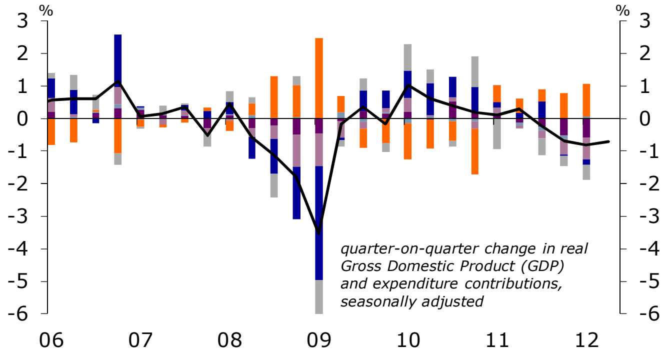
### That sinking feeling

| Year-on-year change (%) | '11 | '12 | '13 |
|---|---|---|---|
| Gross Domestic Product | 0.5 | -2 | 0 |
| Private consumption | 0.4 | -3¼ | -¾ |
| Government consumption | -0.9 | -1 | -1 |
| Investment | -1.2 | -9½ | -2 |
| Exports | 6.3 | 1 | 3¾ |
| Imports | 1.0 | -8½ | 3 |
| Inflation | 2.9 | 3½ | 2¼ |
| Unemployment (%) | 8.5 | 10¾ | 11 |
| Government balance (% GDP) | -3.9 | -3 | -2 |
| Government debt (% GDP) | 120.1 | 124 | 125 |

Source: Reuters EcoWin, Rabobank

With a 0.7% quarterly contraction of GDP in 12Q2, the current Italian recession is now a year old. As in the preceding quarters, the economic decline is mainly the result of falling domestic demand. Exports may even have grown again in the second quarter. The unemployment rate has continued its upward path over the past months. In contrast to what we had expected given the large falls in output, this rise in unemployment is not the result of falling employment. Hikes in VAT and excise duties have resulted in stubbornly high inflation since the start of the year. Rising indirect tax rates will likely put further downward pressure on purchasing power next year.

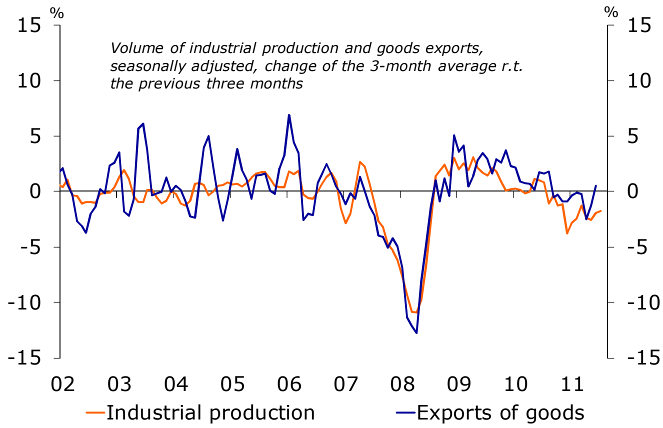
### Fourth quarter of recession




Source: Reuters EcoWin

Italian real GDP fell for the fourth consecutive quarter in 12Q2. The 0.7% q-o-q contraction was slightly smaller than the output fall of the previous quarter. In general, the current recession is much more benign than the sharp decline seen in 2008/09. But with GDP having only recovered very modestly since then, economic activity is by now almost back at the low point reached in 09Q2. An important difference with the previous recession is that falling domestic demand is dominant right now whereas a decline in exports was more important back then. Although the expenditure breakdown is not available yet, this pattern has probably persisted into 12Q2 as well.

### Exports holding up relatively well




Source: Reuters EcoWin

The dominant role of domestic demand in 12Q2 is confirmed by the development of industrial production (IP) and exports of goods. IP contracted for the fourth quarter in a row in 12Q2. The manufacturing PMI for July points to a weak start to the third quarter. Export growth has performed much better until May. Even a sharp fall in June cannot prevent exports from growing in the second quarter as a whole. Italian exports have thus been able to benefit from continued world trade growth in the second quarter. Even so, the disappointing recovery of exports since the 2008/09 recession, with goods exports in May still 13% below the 08Q1 level, is very worrying.

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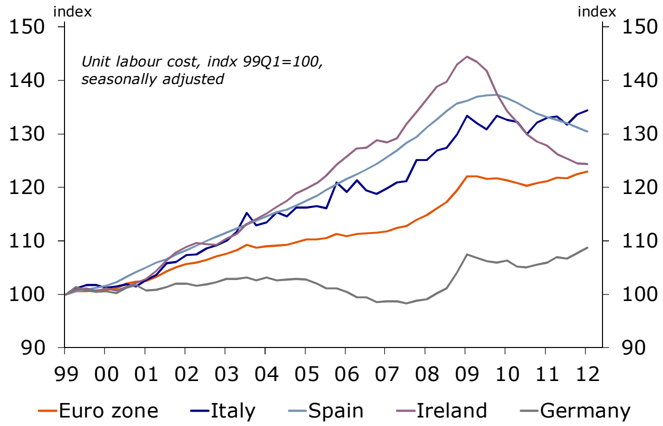
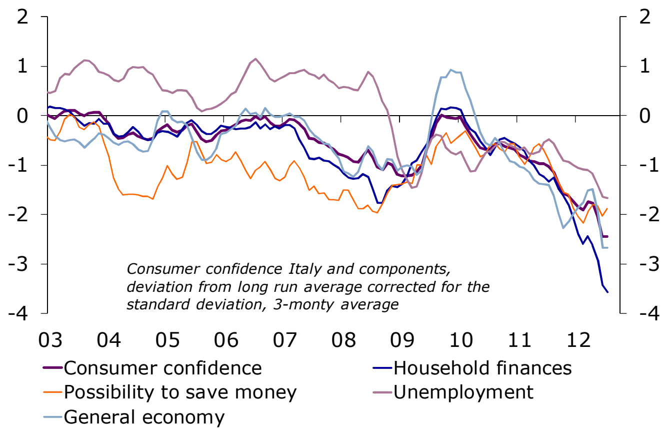
### Unit labour costs keep on rising




Source: Reuters EcoWin

For structurally higher export growth, Italy needs to win back price competitiveness. But in contrast to Ireland and Spain, this is regrettably not happening yet in Italy. The unemployment rate rose further in 12Q2, to 10.8% in June from 10.4% in March. In our previous economic update on Italy we illustrated that the rise in unemployment was due to an increase in the labour force and not due to falling employment. This was still the case in the second quarter. Wage growth has moderated because of rising unemployment, but is still positive. Combined with lower production but constant employment this has resulted in rising unit labour costs.

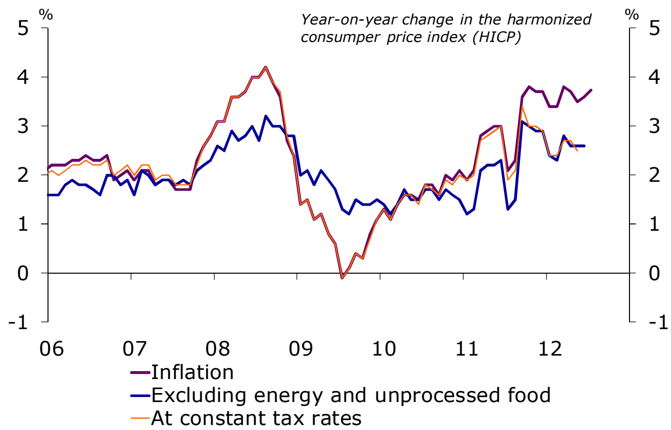
### Consumer confidence falls to record low




Source: Reuters EcoWin

Recession, rising unemployment, fiscal austerity and the renewed escalation of the European debt crisis has pushed down consumer confidence further in the second quarter. The confidence index, which is available from 1980 on, fell to record lows in May and June. The government will probably be able to postpone a VAT-hike that was scheduled for October. This is made possible by speeding up expenditure cuts this year. That will prevent a sharp fall in purchasing power in the second half of the year. But given continued austerity, we do not anticipate a sharp rise in confidence and we expect a further contraction of private consumption.

### Rising indirect tax rates keep inflation high




Source: Reuters EcoWin, Rabobank

Although inflation in the euro area as a whole has steadily fallen since the start of the year, the rise in the consumer price index for Italy has remained stubbornly high. The high inflation rate is the result of a VAT-hike in September 2011 and a rise in the petrol tax in December. Such increases in indirect taxes only boost inflation for one year. As such, if the VAT-hike is really postponed, inflation can fall back sharply in the second half of the year. Then again, given that the VAT-hike will probably still be forthcoming next year and other indirect tax hikes might be necessary to keep the reduction of the budget deficit on track, government measures may well lead to new upward inflationary pressure next year.

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