Economic Update Italy

5 March 2013

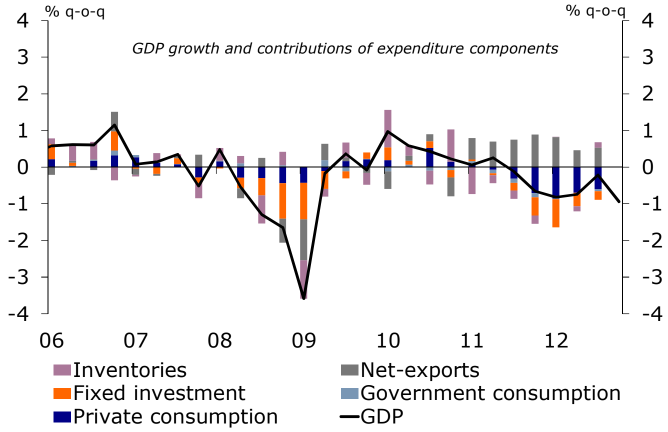
Uncertainty on the road to Rome

Year-on-year change (%)	'12	'13	'14
Gross Domestic Product	-2.2	-1¾	½
Private consumption	-4.2	-2¼	½
Government consumption	-0.9	-1	-½
Investment	-9.2	-5¼	3¼
Exports	1.6	1¾	4¼
Imports	-8.3	-1¼	6¼
Inflation	3.3	1½	1¼
Unemployment (%)	10.6	12¼	13
Government balance (% GDP)	-3.0	-2¾	-2¼
Government debt (% GDP)	126.3	130	129¼

Source: Reuters EcoWin, Rabobank

In 12Q4, GDP shrank for the sixth quarter in a row, making the current recession longer than that in 2008 and 2009. Monthly data suggest that mainly private consumption and investment are to be blamed for the 12Q4 GDP contraction. Italy has missed the deficit target for 2012 and for 2013 more fiscal consolidation might be requested. Policy uncertainty due to the recent election outcome has led to increased government bond yields. Furthermore, this may also weaken the fragile confidence of consumers and producers. In combination with rising unemployment, the above-mentioned factors are likely to lead to another contraction in domestic spending in 13Q1.

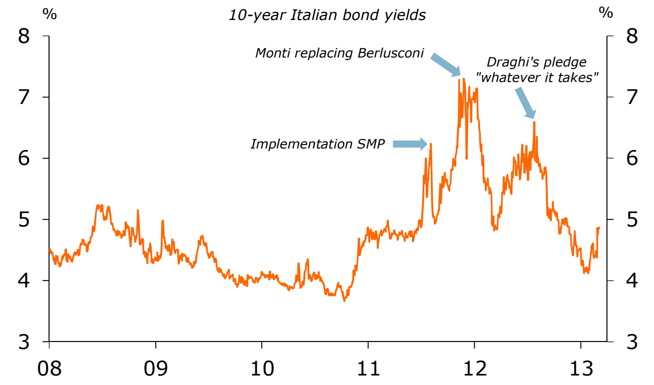
Large contraction in GDP in 12Q4



Source: Reuters EcoWin

In 12Q4, GDP contracted sharply (-0.9% q-o-q). The expenditure breakdown has not been published yet. Monthly data however suggest that mainly private consumption and investment acted as a drag on growth. As a result of a much stronger decline in imports compared to exports, net exports likely contributed positively. In 2012 the public deficit (3% of GDP) missed the target (2.4% of GDP), due to which Italy failed to meet its agreements with Brussels. That said, in combination with disappointing growth expectations for 2013, Italy might be requested to implement additional austerity measures this year. This, obviously, would act as another headwind to economic growth.

Financial market stress to return?



Source: Reuters EcoWin

The relative calm in the financial markets has been disrupted by the Italian elections. The 10-year Italian bond yields have increased slightly since the elections as financial markets are concerned about Italy's fiscal sustainability. No party has obtained a workable majority and a coalition seems, at the very least, extremely difficult to be formed. The chance of new elections being called this year, therefore, is non-negligible. In any case, the appetite for further fiscal austerity and reform will be lower than desired. Against this backdrop, European leaders will be less forthcoming if Italy seeks a bailout agreement under market pressure.

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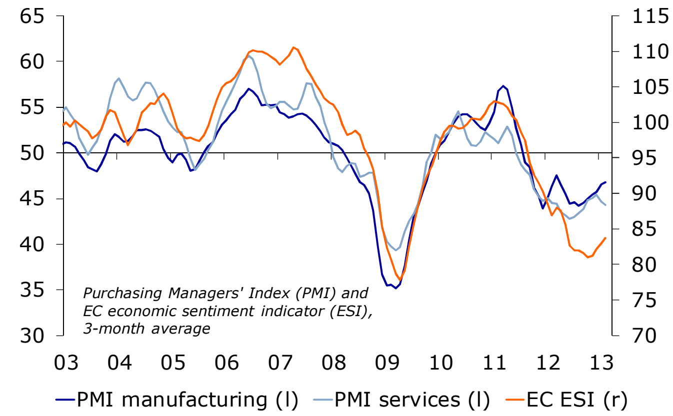
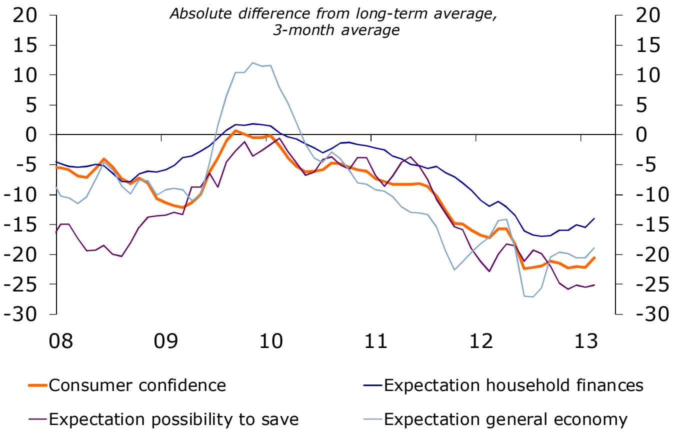
Producer sentiment remains weak ahead of election…



Source: Reuters EcoWin

A slight increase in industrial production (IP) in December (+0.4% m-o-m) was not sufficient to prevent a sharp contraction of IP in 12Q4 (-2.1% q-o-q). Although the Economic Sentiment Indicator (ESI) and the Purchasing Managers' Index (PMI) for the manufacturing sector increased recently on a 3m/3m basis, in February both the manufacturing and services PMI fell (from 47.8 to 45.8 and from 43.8 to 43.5, respectively). The business surveys were conducted before the Italian elections held on 24-25 February. The inconclusive outcome can lead to renewed uncertainties amongst entrepreneurs. This may further erode producer sentiment, which will have negative consequences for the already weak IP.

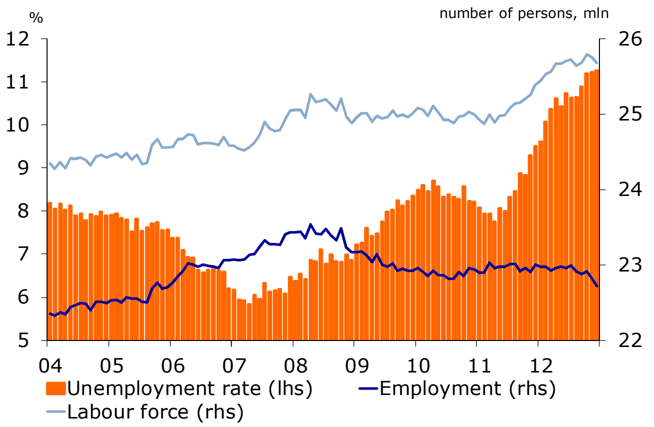
…and the same goes for consumer sentiment



Source: Reuters EcoWin

Consumer confidence rose slightly in February, but we cannot read too much into it since this survey was also carried out before the election. Rising unemployment, painful austerity measures and a high level of inflation weigh on consumer sentiment and thereby push down private consumption growth, which has been contracting for six consecutive quarters. Given the uncertain political outcome and severe economic headwinds, we expect a further decline in household consumption this year. The planned increase in the VAT rate on the 1st of July from 21% to 22% may lead to a front-loading of spending in Q2, but in the following quarter the positive impulse will dissipate.

Unemployment remains at record high



Source: Reuters EcoWin

In December 2012, the unemployment rate stayed at 11.2% for the third consecutive month. This was partly due to lower employment (-0.5% m-o-m) and contraction of the workforce (-0.4% m-o-m). Without the government-assisted *'cassa integrazione scheme'* employment losses would even be higher. This scheme allows businesses to send permanent employees home temporarily with a reduced pay instead of cutting the workforce. The prospects for the labour market are not rosy either. Amid the bleak economic outlook, we expect a further contraction in employment in the coming months.

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