Rabobank

Economic Update Italy

7 June 2011

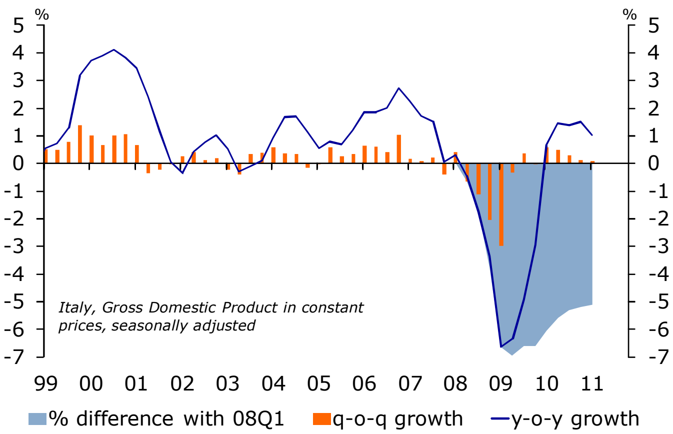
Terribly tardy recovery

Year-on-year change (%)	'10	'11	'12
Gross Domestic Product	1.2	1	1½
Private consumption	1.0	¾	1
Government consumption	-0.6	-1	0
Investment	2.3	2	3
Exports	8.9	6¼	4½
Imports	10.3	4	3
Inflation	1.6	2½	1½
Unemployment (%)	8.5	8¼	8
Government balance (% GDP)	-4.6	-4	-3¼
Government debt (% GDP)	119.0	120½	120

Source: Reuters EcoWin, Rabobank

The Italian economy has started 2011 as weak as it ended 2010. The economic recovery is clearly lagging that in the northern part of the eurozone. This is to a large extent due to the slow recovery of industrial production. Italian exports are hit relatively hard by the financial and economic problems in the other Southern European countries. On the other hand, the country is not well-placed to take advantage of the high economic growth in Asia. Private consumption has staged a relatively robust recovery, despite the drop in households real disposable incomes. But given further pressure on real incomes, consumption is likely to grow only slowly both this year and next.

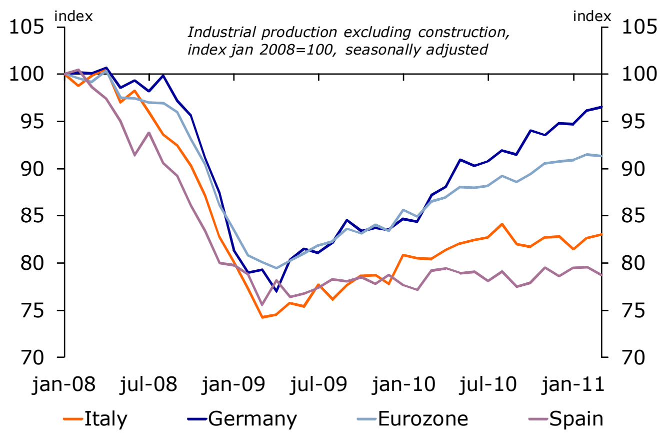
Economy starts 2011 as it ended 2010



Source: Reuters EcoWin

Like in the last quarter of 2010, the Italian economy grew by 0.1% q-o-q in the first quarter of 2011. The economic recovery is terribly tardy, both in light of the sizeable GDP-contraction during the recession and when compared to the much higher growth figures seen in the Northern European countries. German GDP has already returned to its pre-recession level while France is only 1% below its former peak. But Italian GDP is still more than 5% below the early 2008 level. The expenditure breakdown will not be published until later this week, but it appears spending weakness was broad based. Export growth was probably weak while households are pessimistic; partly due to falling real disposable incomes.

Industry lagging behind



Source: Reuters EcoWin

An important factor in the muted recovery seen so far has been the slow growth of industrial production (IP). In the past two quarters, IP even contracted outright. Over the same period, the sector kept performing very well in the eurozone as a whole, with Germany clearly leading the way. Italian IP is developing more like that in Spain, which is suffering from the steep drop in activity of the construction firms and their suppliers following the burst of the property bubble. Italy is not faced with a property downturn, but part of the disappointing industrial recovery there can be attributed to weak domestic demand growth. The more important (and worrying) factor though, seems to be the weak export recovery.

www.rabobank.com/kennisbank

Tim Legierse
Tel. +31 (0)30 – 2162677
T.Legierse@rn.rabobank.nl

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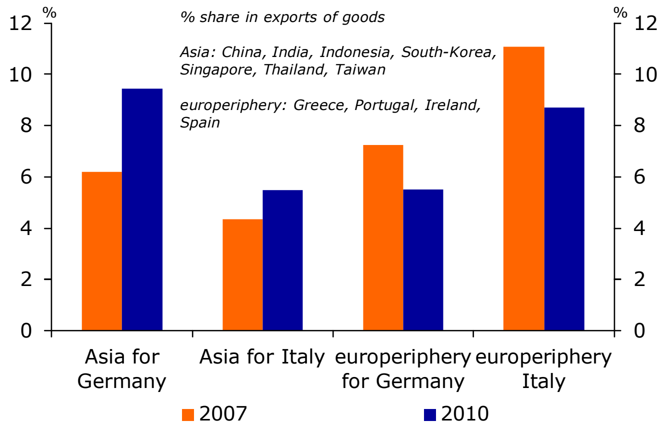
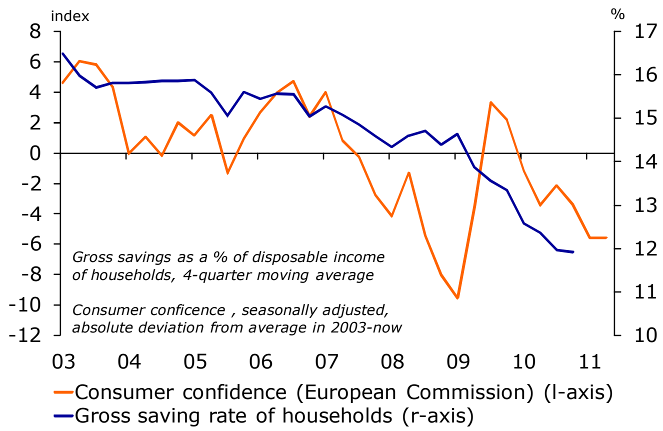
Composition by region and goods is hindering exports



Source: Reuters EcoWin, Rabobank

Even though the export volume is almost back to pre-crisis levels in Germany, and even higher than that in Spain, Italian exports are still 14% below their former peak. If we compare the composition of exports with that of Germany, it is clear that before the recession Italy was more dependent on demand from the European countries that are now in financial difficulties. German exporters, however, were more dependent on Asia. Moreover, the share of capital goods in German exports (44%) is much higher than that of Italy (32%). As a result, Italian exports are hit harder by the European debt crisis and have not been able to take advantage of the high (investment driven) economic growth in China.

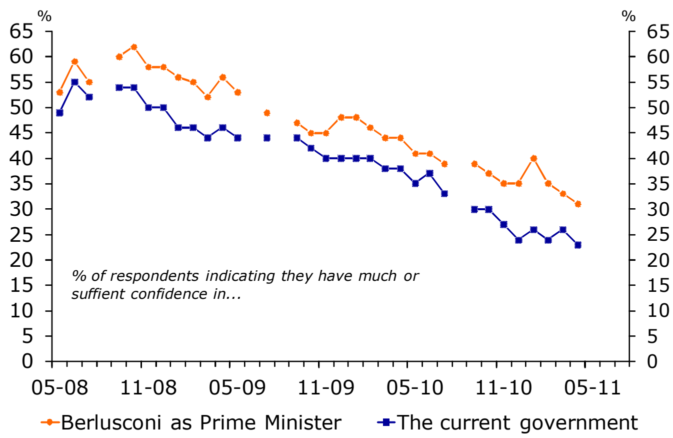
Limits to consumption growth



Source: Reuters EcoWin

Private consumption has staged a relatively strong recovery since the middle of 2009. But with falling employment and a lack of a fiscal stimulus, real disposable incomes of households have been in decline. The growth in consumer spending has only been made possible by a sharp drop in the household saving rate. Inflation has recently risen above wage growth, putting further downward pressure on consumers' purchasing power. Consumer confidence remains at very depressed levels, and might take another hit from the recent announcement of additional austerity. We doubt that households will further reduce their savings. Hence, we expect only very modest consumption growth this year and next.

Austerity is the only name in the game



Source: IPR Marketing

With government debt at 120% of GDP and a budget deficit of more that 4%, the Italian government cannot support the economy with higher spending and/or lower taxes. On the contrary, rating agency Standard & Poors recently put further pressure on the Italian authorities to implement structural reforms and reduce the budget deficit, by placing the outlook on the government debt rating on *negative*. The authorities responded by announcing further budget cuts, and targeting a balanced budget in 2014. That is an ambitious and great goal. But given the new low-point of confidence in the government, the current group of ministers are unlikely to be in office until 2014.

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T.Legierse@rn.rabobank.nl