Economic Update Italy

4 December 2012

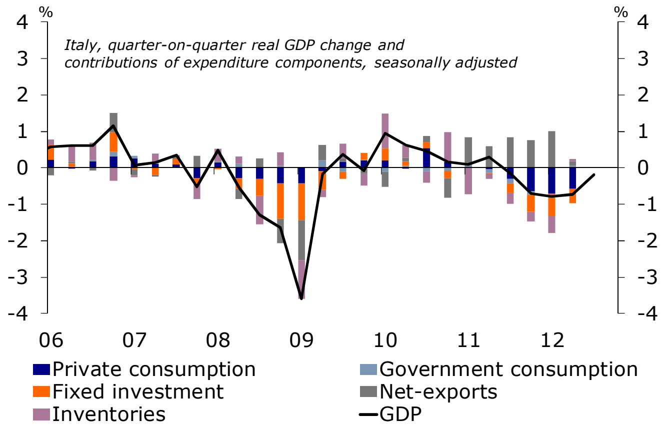
Recession eased in 12Q3

Year-on-year change (%)	'11	'12	'13
Gross Domestic Product	0.5	-2	-½
Private consumption	0.4	-3½	-1
Government consumption	-0.9	-¾	-1½
Investment	-1.2	-8½	-2½
Exports	6.3	1	3½
Imports	1.0	-7¼	3¼
Inflation	2.9	3¼	1¾
Unemployment (%)	8.4	10¾	11¾
Government balance (% GDP)	-3.9	-3	-2
Government debt (% GDP)	120.0	124	125

Source: Reuters EcoWin, Rabobank

In the third quarter, the Italian recession was more moderate than in the first half of the year. The GDP contraction amounted to 0.2% q-o-q in 12Q3, from -0.7% in 12Q2. With lower export growth than in the previous quarter, it seems that a smaller contraction of domestic demand has been instrumental in the easing of the recession. While consumer spending did not recover, government spending did rise in the third quarter. Next to that, a markedly improved financial market sentiment might have made Italian firms more confident, sparking a restocking process. Although business sentiment improved in the past months, the recession is set to continue.

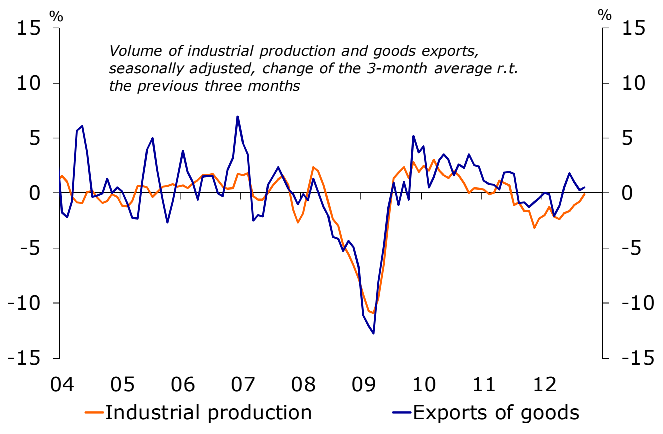
Markedly lower contraction in the third quarter …



Source: Reuters EcoWin, Rabobank

The Italian GDP volume fell by 0.2% q-o-q in 12Q3. That is a significant improvement when compared to the much sharper contractions seen in the previous three quarters. The expenditure breakdown will be published on December 10. The available monthly figures do not give a clear-cut view on the most important factors leading to the easing of the recession. Car- and retail sales have continued to fall. Disappointing budget figures show rising government expenditure in spite of austerity. Developments in industrial production (IP) and goods exports point to positive contributions from net trade and stock building.

… in part helped by the stabilisation of manufacturing



Source: Reuters EcoWin, Rabobank

Although industrial production fell back in September, the previous rise in August has been sufficient to reduce the contraction in the quarter as a whole to 0.1% q-o-q, from a 1.6% fall in 12Q2. But export growth was weaker than in the previous quarter and we already mentioned the continued decline in consumer spending. Perhaps the improved sentiment in the financial markets (see below) has prompted firms to become less cautious, leading to a (re-) building of inventories. What's more, perhaps a slower pace of business investment contraction supported the economy in 12Q3. In any case, the sharp falls in both IP and exports in September do not bode well for 12Q4.

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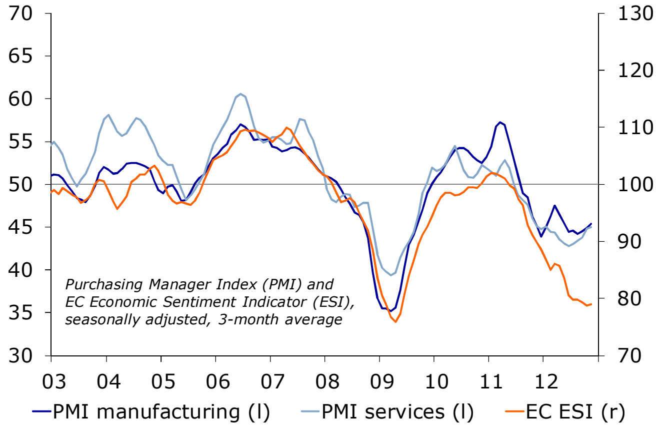
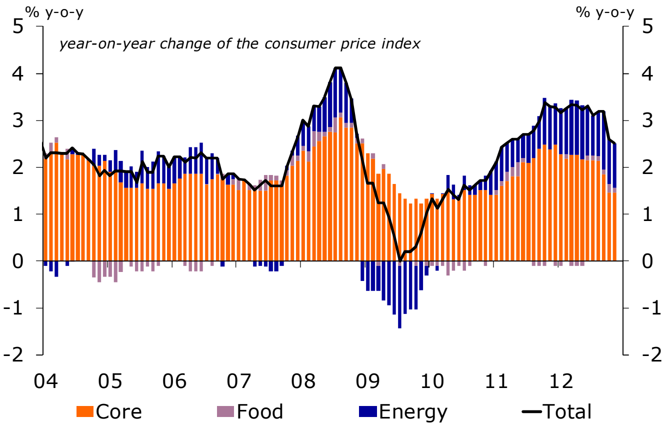
Animal spirits being revived?



Source: Reuters EcoWin

Even though we had anticipated a slowdown in the pace of contraction, the outturn for 12Q3 was better than expected. To the extent that this was driven by higher government spending, this will prove to be a temporary relief. A sharp rise in inventories cannot be sustained as a source of growth either. As such, a re-intensification of the recession cannot be excluded. The weak starting point of exports and industrial production and the low levels of sentiment indicators support this notion. Even so, the improvement in producer sentiment indicators in the three months to November makes a return to the pace of contraction seen in 12H1 unlikely.

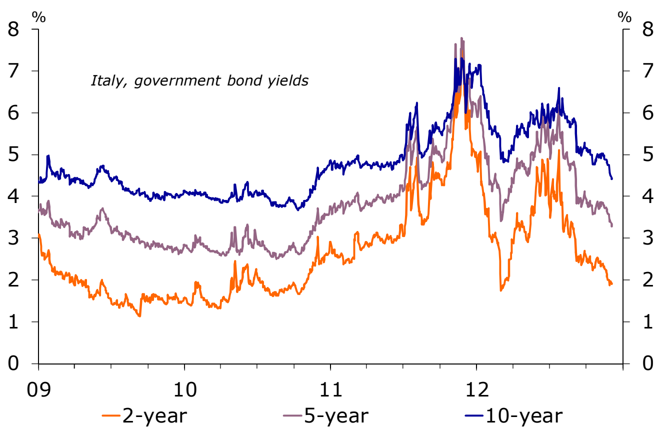
Further fall of inflation ahead



Source: Reuters EcoWin, Rabobank

After hovering above 3% for twelve months, the inflation rate suddenly fell to 2.6% in October from 3.2% in September. The fall in October is the result of the mid-September 2011 VAT hike, which has pushed inflation to a higher level for a year. Core inflation has fallen sharply because the statistical effect of the VAT dissipated. The December 2011 petrol tax hike is still present in the numbers though, resulting in a still elevated energy price contribution. But this effect will recede over the next month, leading to a further fall in inflation to below 2%. With wage growth remaining significantly below inflation, this will provide a welcome reprieve for household purchasing power.

Remarkable fall in government bond yields



Source: Reuters EcoWin

In August, the ECB announced the possibility of Outright Monetary Transactions, in which it is willing to buy government bonds of countries that abide by all the agreements regarding budgetary and economic policies in a European financial assistance programme. This strengthening of the eurozone financial backstop has resulted in a sharp fall in Italian government bond yields, significantly reducing the interest cost for newly issued debt. But new problems in other eurozone countries, Italy missing its budgetary targets and the potential uncertainty about the consequences of the April 2013 elections will all have the potential to quickly push Italian bond yields back up.

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