Interview by Alessandro Terzulli, Chief Economist at SACE

Beyond the fluctuations in the Italian economy, the analysis

Alessandro was Head of Analysis and Economic Research SACE SRV, a SACE group company where he worked on analysis on the developed countries, particularly Italy, and on industrial sectors. He previously worked as an economist at Confindustria Study Centre and collaborated in the drafting of several studies, notes and reports on economic issues of different nature.

Graduated in Economics from the Luiss Guido Carli University in Rome (2001), where he worked as Assistant for the Political Economy course - Faculty of Political Sciences (2004), has also collaborated with several Italian universities (Tor Vergata, Politecnico Milan, SDA Bocconi) teaching Elements of risk assessment country, International Economics, Risk insurance policies of export credit, Economic and structural aspects of the Italian economy.

Political outlook in August 2019

Italy has an "artistic flair" also in political life and we have seen a key change in the composition of the majority coalition. In a few words, after the dramatic collapse of the first Conte government, at the head of a coalition between the Five Star Movement (Movimento 5 Stelle, M5S) and League parties (Lega), the President of the Italian Republic Sergio Mattarella decided to give Prime Minister Giuseppe Conte a second mandate. M5S and the Democratic Party (Partito Democratico, PD) will support the new government.

Strengths and weaknesses of the Italian economy

One of the most important strengths is the Italian exports of goods. They have been increasing quite significantly over the last years: Made in Italy is strongly demanded in the world! In 2018 the Italian exports of goods grew by 3.1% (total value of €463 billion), after a record-high +7.6% in 2017. Since 2010 external demand has been the only positive-contribution component of GDP.

The main weakness at this juncture is probably the sluggish domestic demand that is severely limiting Italian growth. Internal demand has been a drag over the last 8 years. In particular, investments subtracted 2 p.p. of growth with respect to 2010. On a more structural note, Italian competitiveness suffers, among others, a low infrastructure expenditure (both in quantitative and qualitative terms), a slow civil justice system, a high tax wedge (e.g. Italy's tax wedge 2nd-worse in OECD for single-income households), high debt to GDP ratio (now it is over 132% of GDP).

The threats

Italy is heavily involved in global trade and, as I said, external demand for our goods has had a fundamental positive effect on Italian growth. Moreover, the main Italian trade partner, Germany, is strongly dependent on external demand too and it is being dramatically affected by the current stagnation in global import . Therefore, any risk for international trade has a potential negative impact on Italian GDP, via multiple channels.

Trump administration's protectionist policy spreads uncertainty. First of all, United States is the third most important market for Made in Italy goods (destination of €42.4 billion worth exports) and the threat pending on European automotive exports to US involves also Italian products. Second, tariffs are damaging investors' confidence around the world and Italy is one of the most important instrumental goods exporter. In our 2019 Export Report we made three alternative scenarios for Italian exports of goods; one of them is about the "Trade War": a 25% duty on all Chinese products and on car imports from the world (excluding Mexico and Canada), would reduce Italian exports in 2020 both total (-0.6 p.p. vs the baseline) and to US (-1.4 p.p.).

Italy just exited a technical recession, is the Italian economy on a path of sustainable growth?

According to Bank of Italy's July forecasts, Italian GDP will expand 0.1% in 2019 and 0.8% in 2020. Economic activity will be primarily driven by exports and household consumption. From January through March 2019, Italian real output rose by 0.1% on the back of a rebounding industrial sector and rising construction activity, the latter also boosted by mild weather conditions. Unfortunately, the existing margin of spare production capacity is unlikely to be reabsorbed over the short-term. Clearly we can say neither Italy is a "fast-growing country", nor that it is on a path of sustainable growth. In order to move to a path of sustainable growth Italy should tackle the mentioned structural issues, primarily public debt; Italy still should take serious actions to set up credible plans to stop and reverse the increasing debt ratio.

A new crisis? The way forward...

I think this is really a negligible risk. The new government will be more Europhile than the previous one. Therefore Italy has the opportunity to honor its past fiscal pledges to the European Commission, starting with an "on track" 2020 fiscal policy. The second Conte administration will have to make some difficult fiscal choices in order to reassure the European Commission and sovereign debt markets. Moreover, in the past Italy has been marked as a "dangerous" country several other times and in the end it has always come up doing what was necessary for the stability of the Eurozone. Furthermore, we are at the moment noticing a lower spread thanks to the positive market reaction to the new government: the spread between Italian 10y bond and German bund is at its lowest level since May 2018, with more potential room for further improvement

Several reforms are needed. Public finance reform should be probably the first one: public debt must be tackled through spending review and fight against tax fraud and evasion. Moreover, the Italian banking sector needs to keep up with the declining trend in NPL ratios (now at 8.4%), especially in light of the worsening economic global outlook. A consolidation of smaller banks in order to unlock credit flows to the private sector and, in particular, to SMEs would help. Furthermore, civil justice system needs a crucial reform to make it faster and smoother, in order to improve the business climate and the attractiveness of our economy.

Government measures

The new government will present the updated Economic and Financial Document (NADEF) on September 27th, the Draft Budgetary Plan to EU by mid-October and the new Budget Law proposal to the Italian Parliament by October 20th. By the end of December the Parliament must approve this Law.

PD and M5S agreed on a 29-point government program. According to this program, on the fiscal side, the priority is to avoid the planned VAT rate hikes in 2020 worth an estimated €23 billion in revenues. These are safeguard clauses introduced in 2011, a trigger to safeguard budgetary targets agreed with the European Commission. However, every government since 2011 has either postponed the VAT hike or proposed other fiscal tightening measures.

Moreover, the new European Commission led by Ms von der Leyen will probably be less hawkish on fiscal deficits, less rigid on the accounting of investment expenditures and more focused on growth. A greater flexibility that will be desirable not only for Italy but for Europe in general.

ANCE (Italian building contractors association)'s forecasts for 2019 point to an increase in investments in construction of 2% in real terms. Investments in the extraordinary maintenance segment should grow by 0.7%, while expenditure in new residential construction is expected to increase by

Alessandro Terzulli

3.5%.On a broader perspective, all the segments will recover in 2019, also the ones backed by public sector.
Total investments in construction are much lower than in 2000 and in 2010, except for extraordinary maintenance activity, but the construction sector will continue to slowly consolidate this and next year. Such a mild recovery will have, in my opinion, a slightly positive impact also on the demand for surety bonds.

Global trade and risks

We have estimated a slowdown in global trade this year and therefore we have lowered the forecasts for the Italian exports of goods in our flagship report. Unfortunately, CPB data shows a flat dynamic in the first six months, year-on-year and in volume terms. That is even worse than our estimates

We are still expecting a pick up next year, but it is heavily dependent, among other factors, on the US administration's trade policy. The US increase in tariffs is probably the main risk to global trade, but not the only one. A Hard Brexit, the Japan-South Korea trade dispute and several Middle-East tensions are also critical issues.

The other two alternative scenarios in our Export Report are the following: (i) "Trade War" plus a slowdown in the Chinese economy and (ii) "Trade war" plus a disorderly Brexit. In both scenarios the negative impact on Italian exports of goods ranges between 0.8 and 1.7p.p in 2020.

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