

Italy

Noticeable improvements in the business sector!

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Stress Free Country Monitoring #ChangingEurope



Forecasts

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017F	2018F	2019F	
Real GDP	-1.0	-5.5	1.6	0.7	-2.9	-1.7	0.2	0.9	1.1	1.6	1.9	2.2	
Nominal GDP, trn	1.6	1.6	1.6	1.6	1.6	1.6	1.6	1.6	1.6	1.7	1.7	1.8	1.9
HICP, avg	2.4	1.1	2.1	3.7	2.6	0.6	0.0	0.1	0.5	1.5	1.8	2.3	
Unemployment rate eop	7.0	8.5	8.6	9.5	11.6	12.6	13.3	11.9	12.2	10.8	9.5	8.5	
Budget deficit % of GDP	-2.7	-5.3	-4.2	-3.7	-2.9	-2.9	-3.0	-2.7	-2.4	-2.5	-2.4	-1.9	
Debt % of GDP	102.4	112.5	115.4	116.5	123.4	129.0	131.8	132.1	132.6	131.3	129.2	126.2	

Sources: Eurostat data, ADA Economics

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Italy: a recap of the past month

Economy: most indicators have continued to surprise to the upside, or have maintained an upward trend. The main exception is a slightly soft industrial production reading in September. However, we do not read much into this as surveys suggest that expected orders are high, inventories are fairly low – so they will need to be replenished – and the competitiveness of the manufacturing sector is improving.

The real estate sector is maintaining a gradual healing phase, with rising demand and hiring, although our models suggest that actual price gains, on average, will be limited in the coming two years.

Inflation has surprised again on the downside relative to the consensus. Our models suggest that inflation will rise gradually in the next two years, ending modestly above 2% in 2019E – the pick-up will be the response of the recovering commodities prices and increasing capacity constraints.

The flash estimate of 3Q real GDP showed that the economy grew by 1.6% yoy on a seasonal and calendar adjustment basis – in line with our expectations. We have lifted our outlook for 2018E and 2019E on the back of the improvements in the industrial sector's balance sheet and the favourable global backdrop. We note that the 2019E outlook is heavily dependent on the unfolding Brexit negotiations, so our projections are subject to downside risks.

What has caught our eye in politics

The autonomy referenda that took place in Lombardy and Veneto delivered a strong victory to the YES camp, as expected. There is no immediate implication from this result, but both regions will try to gain more fiscal and administrative leeway from the central state in the coming years.

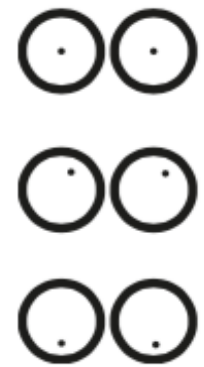
The regional elections in Sicily delivered a victory to the centre-right coalition and a very strong performance from M5. This was in line with our expectations and the survey results, but it triggered further turmoil within the centre-left parties.

We may see a change of leadership for the left camp – with both current Prime Minister Gentiloni and Senate speaker Grasso frequently mentioned in the press as hypothetical candidates. We believe that such a change could help to stop the decline in the Democratic party's approval rating, but is not enough, by itself, to make either a grand coalition (PD-FI) or a centre-left coalition (PD-MDP-SI) likely winners in the next elections.

M5 has been reported by the press to be working on a potential cabinet line-up, which will be strongly influenced by technocratic/expert members that do not belong to the movement.

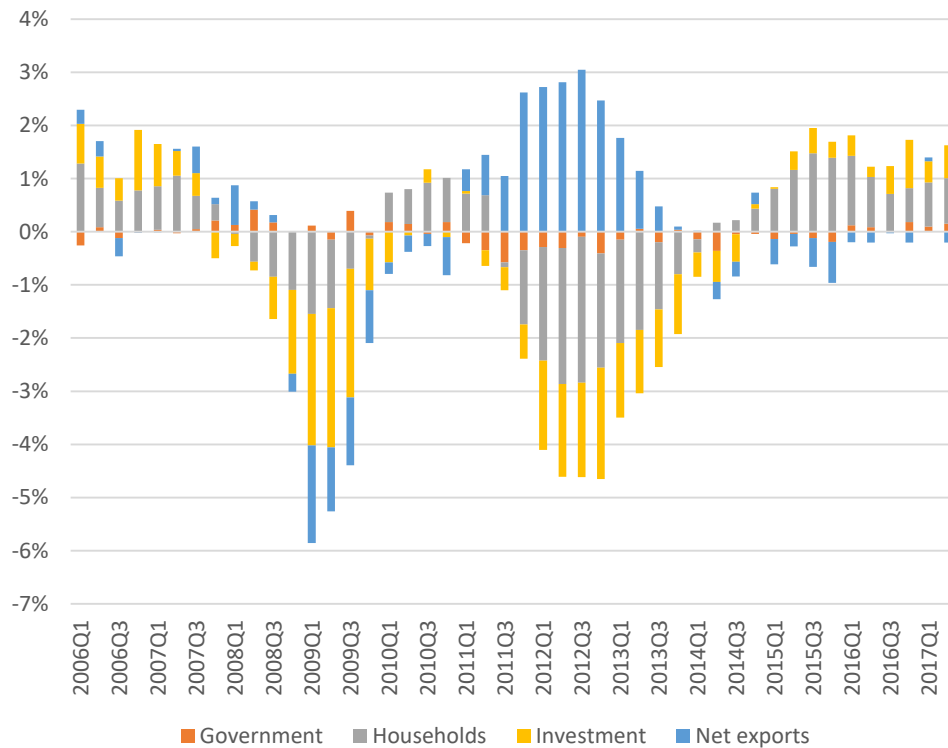
One of M5's senior figures– MP Di Battista – did not run in its internal premier race, and announced that he will not seek re-election in parliament. In our view, M5 has not yet started campaigning, but the party is evolving internally and getting ready to take power if it wins the elections.

Macroeconomic backdrop

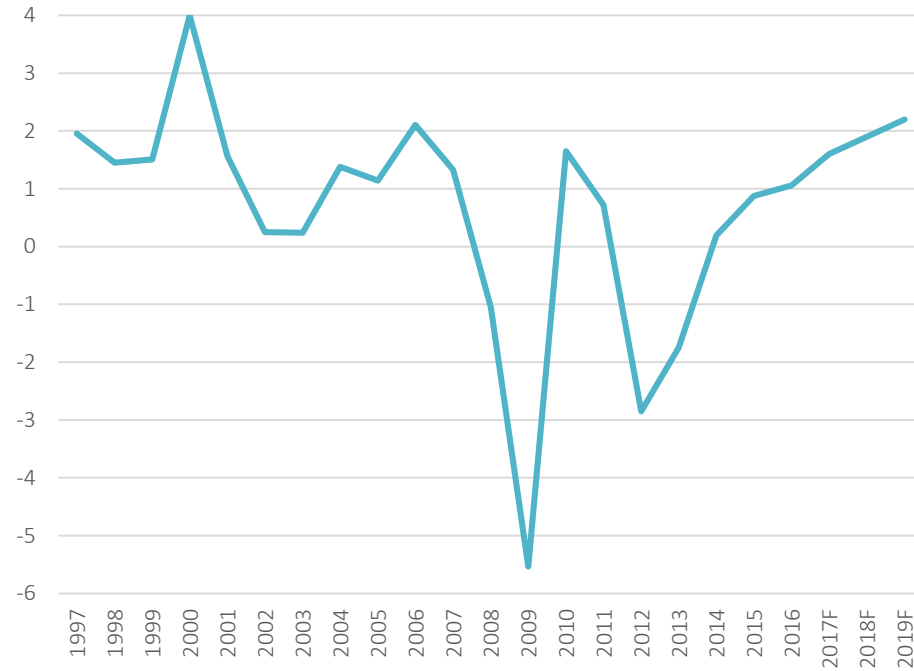


GDP growth and projections

Contributions by key component to YoY growth



Outlook for the next two years



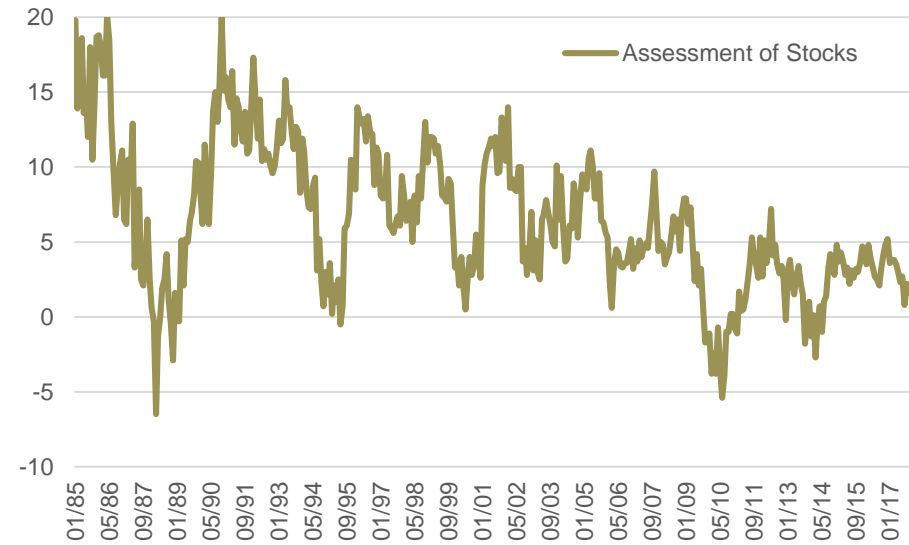
Sources: Macrobond, ADA Economics

Industrial sector

Industrial sentiment (RHS) and pricing power recovering



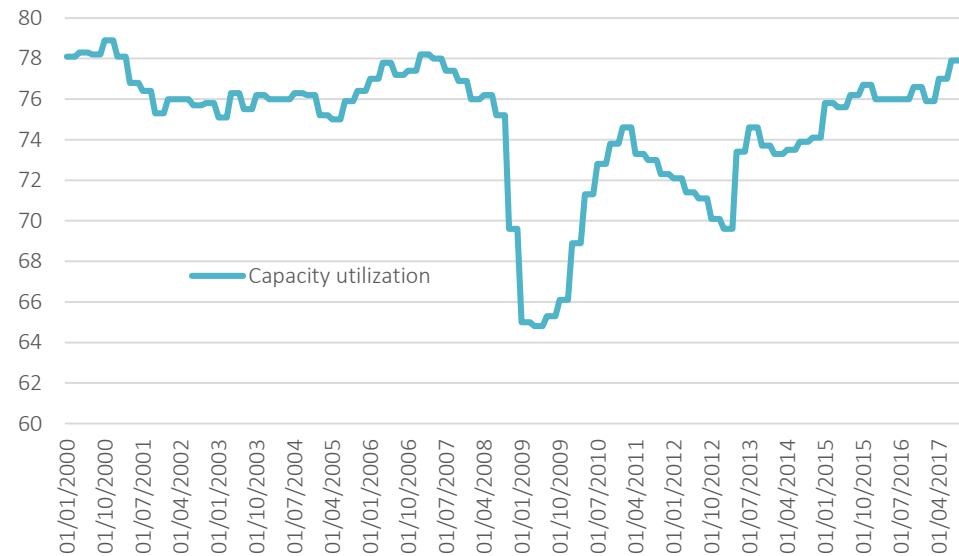
Inventories are relatively low



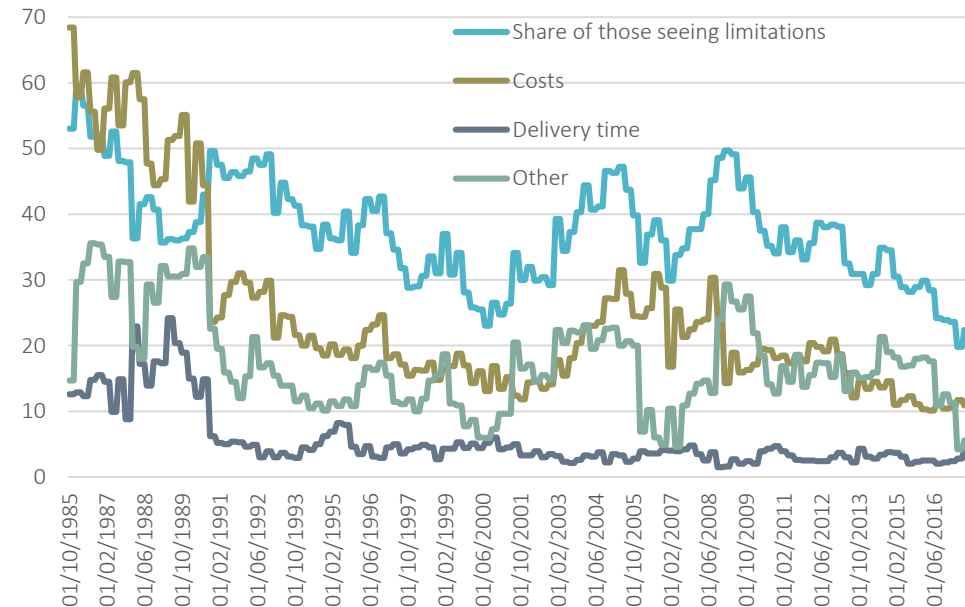
- Industrial production in coming months should be supported by improving demand, relatively low inventories and recovering pricing power (though still low in historical perspective)

Industrial sector

Manufacturing sector capacity utilization



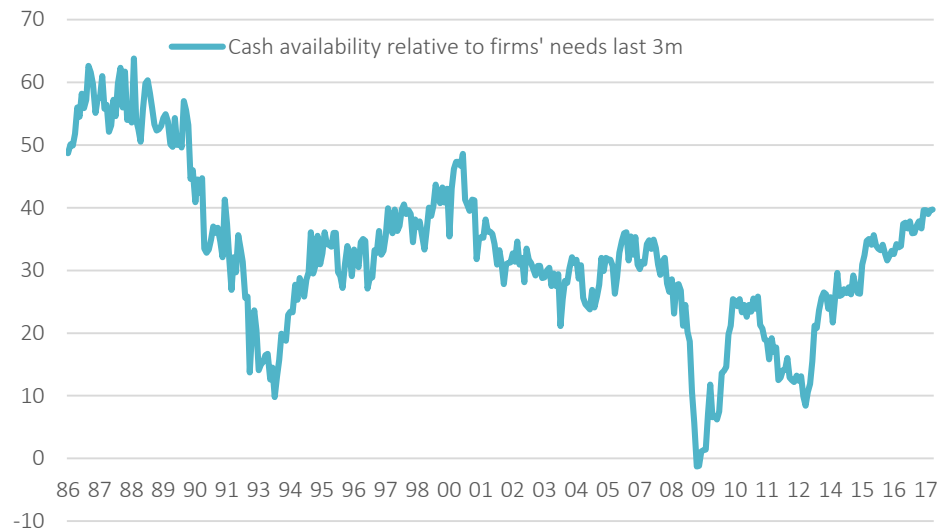
Factors limiting exports production



- Capacity constraints are rising, which should help with a modest recovery of investments. Companies that report limitations to exports are few in historical perspective and other constraints are seen at all time lows.

Industrial sector

Manufacturing sector liquidity



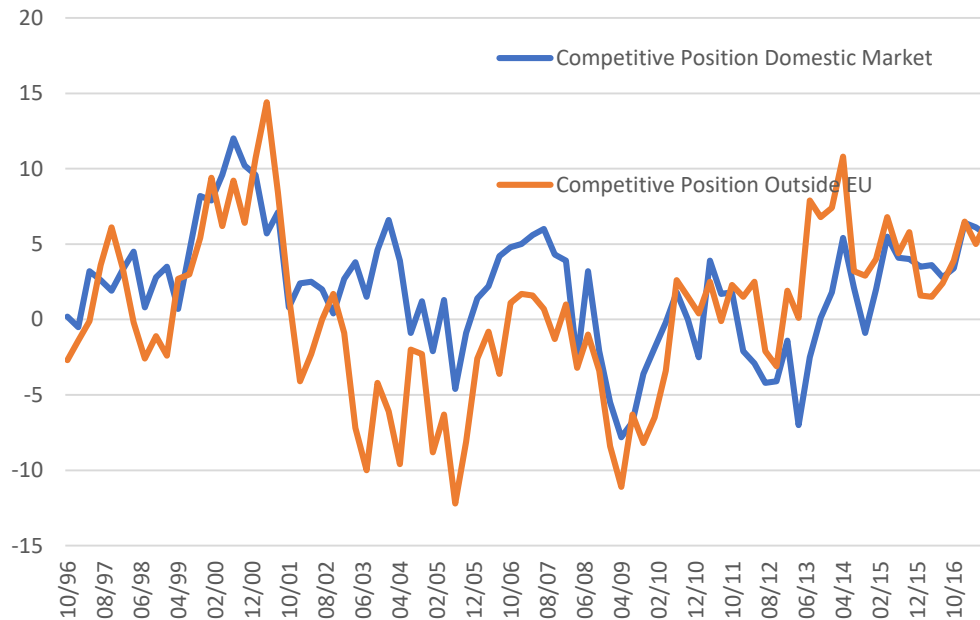
Hiring appetite



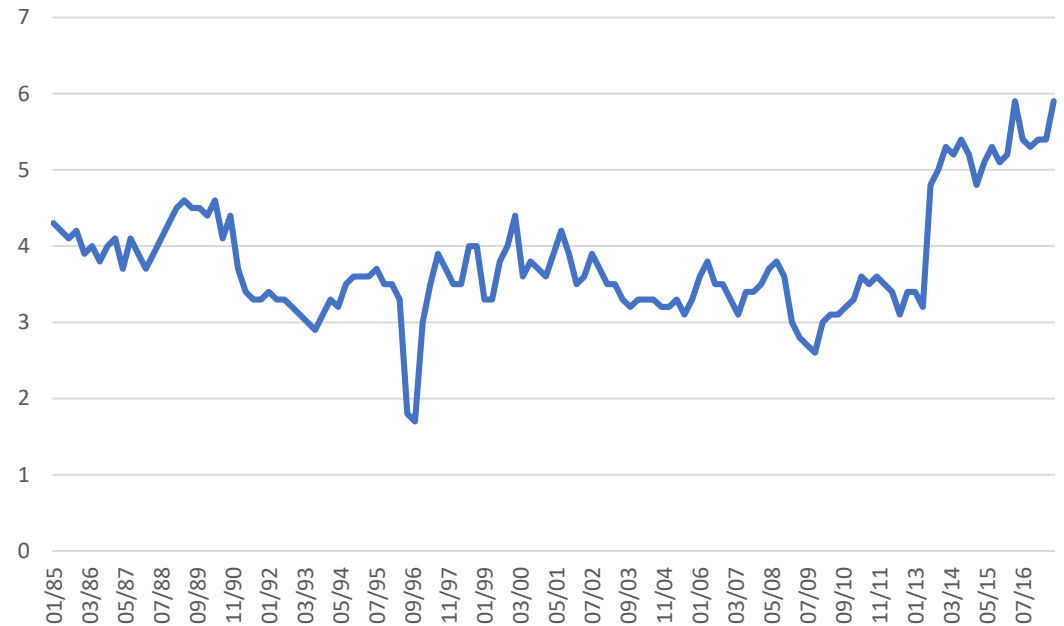
- Manufacturing sector balance sheet show a steady improvement in liquidity and a jump in hiring appetite.

Industrial sector

Competitiveness perceived domestically & abroad



Months of secured production

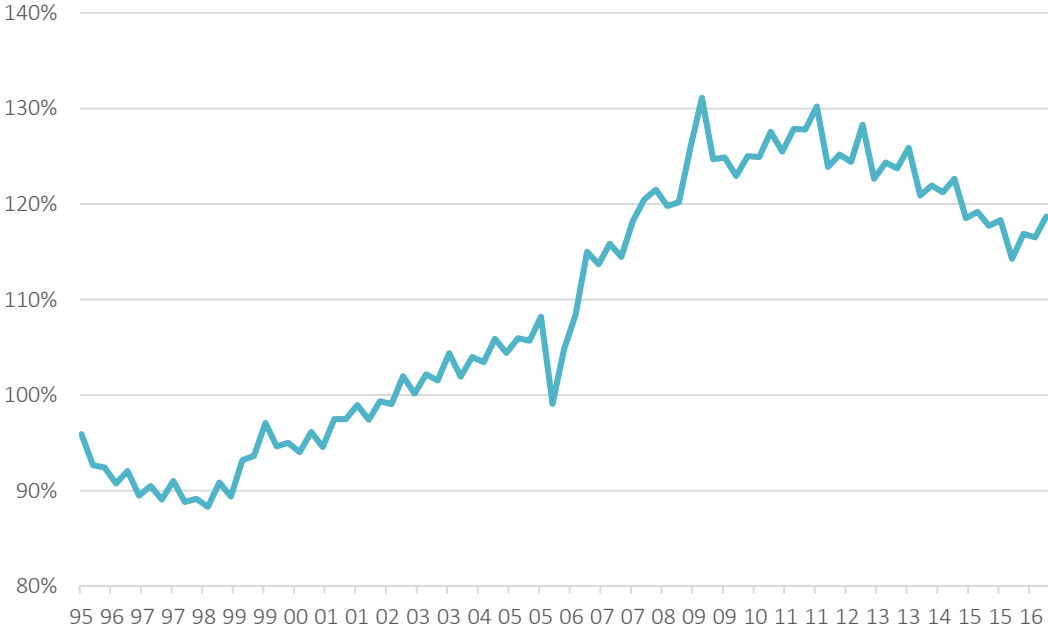


- Surveys reporting companies' perceived competitive position signal a steady improvement in recent years and a jump in the number of secured months of production, which in other countries has proved to be a key leading indicator of the turnaround in the recovery

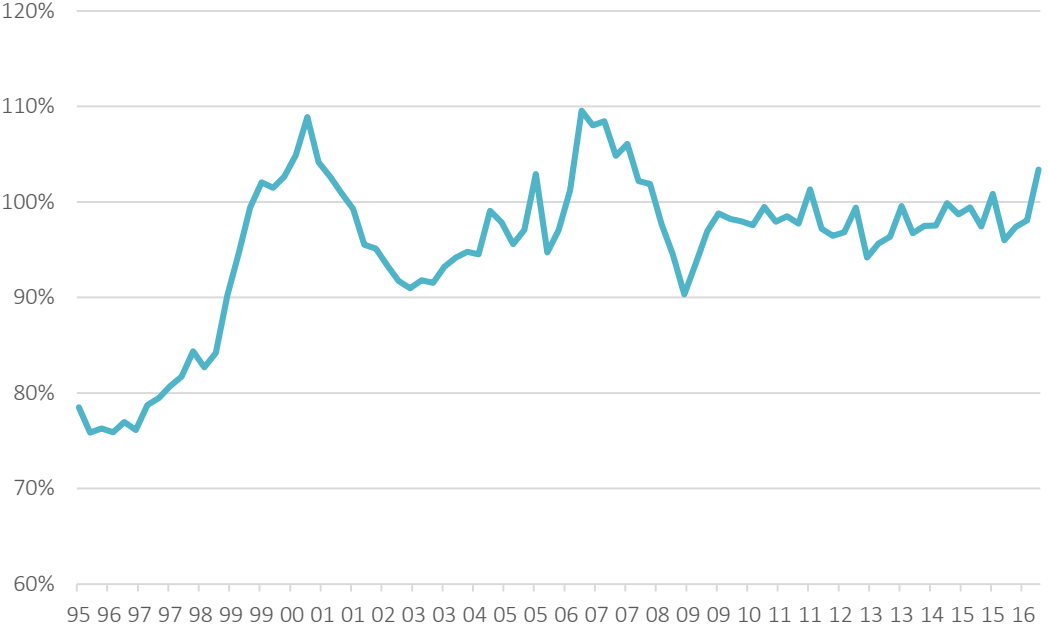
Sources: CEIC, ADA Economics

NFCs' balance sheets have improved

Debt-to-GDP ratio



Assets-to-GDP ratio

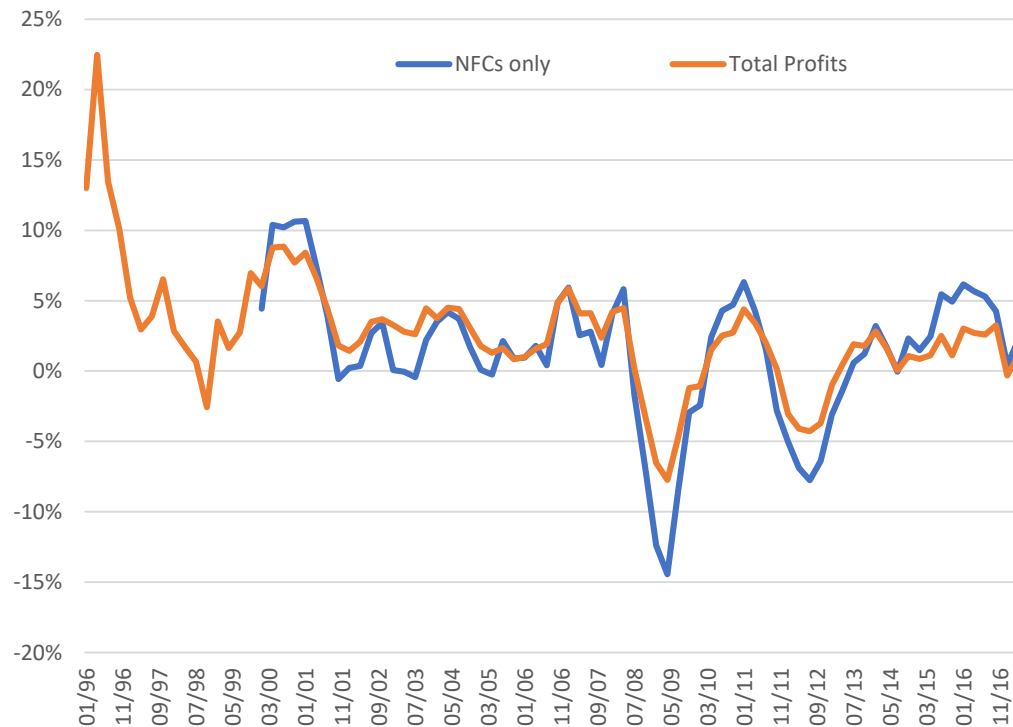


Sources: Macrobond, ADA Economics

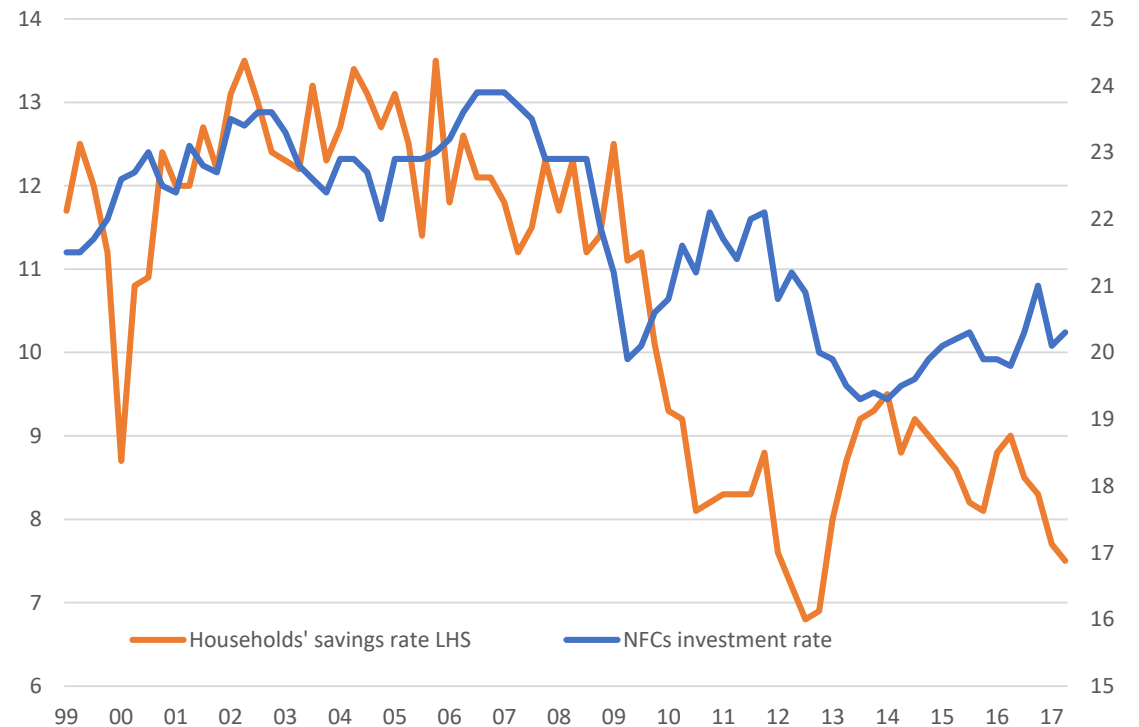


Profitability: better but not stellar

Profits are rising, but not that fast...



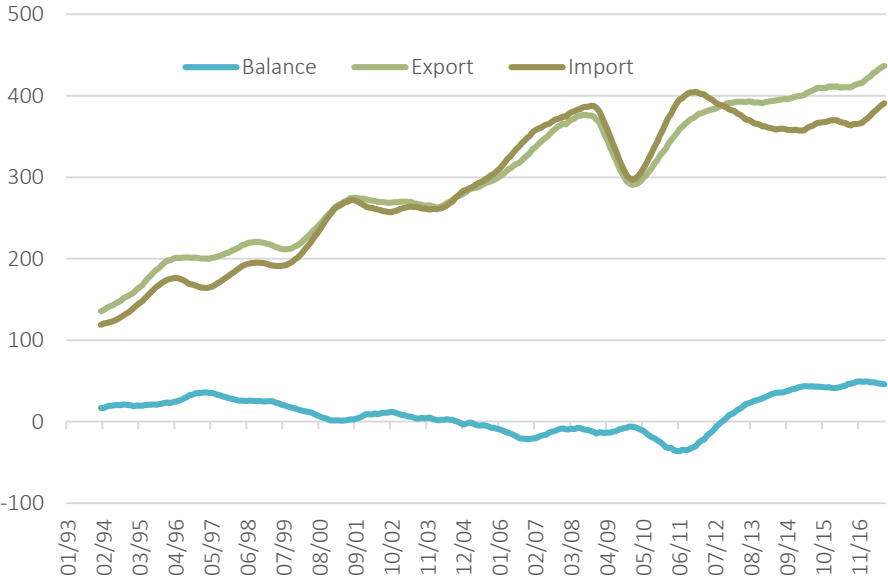
...but the investment rate is improving, while households continue to run down savings



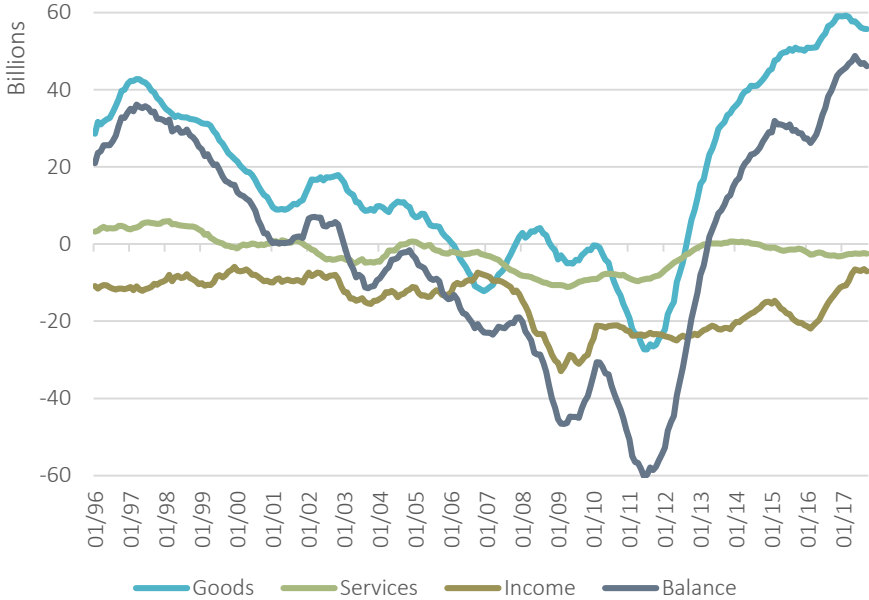
Sources: Macrobond, Eurostat, ADA Economics

External sector

Exports and imports dynamics (EURbn)



Current account breakdown dynamics (EURbn)

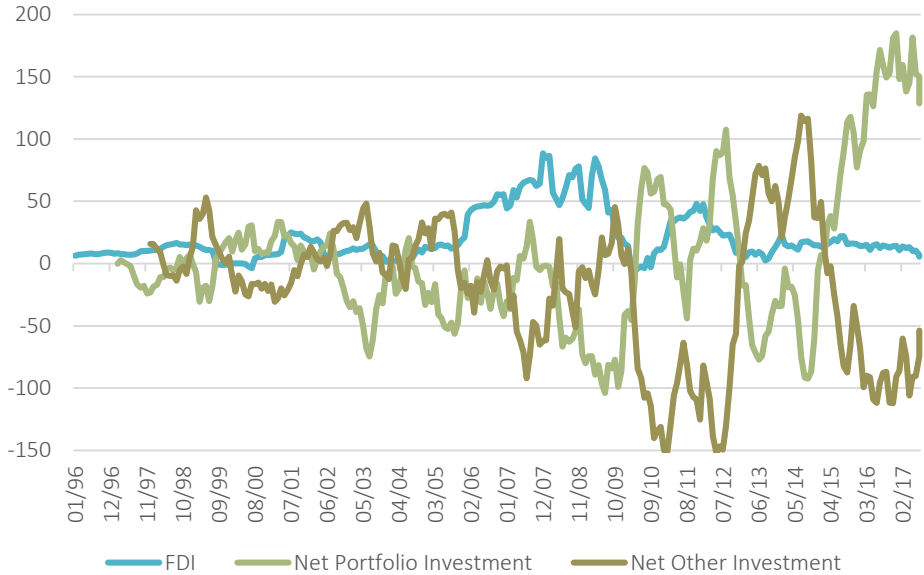


Sources: Macrobond, ADA Economics



External sector

Financing for the current account: large portfolio outflows persist



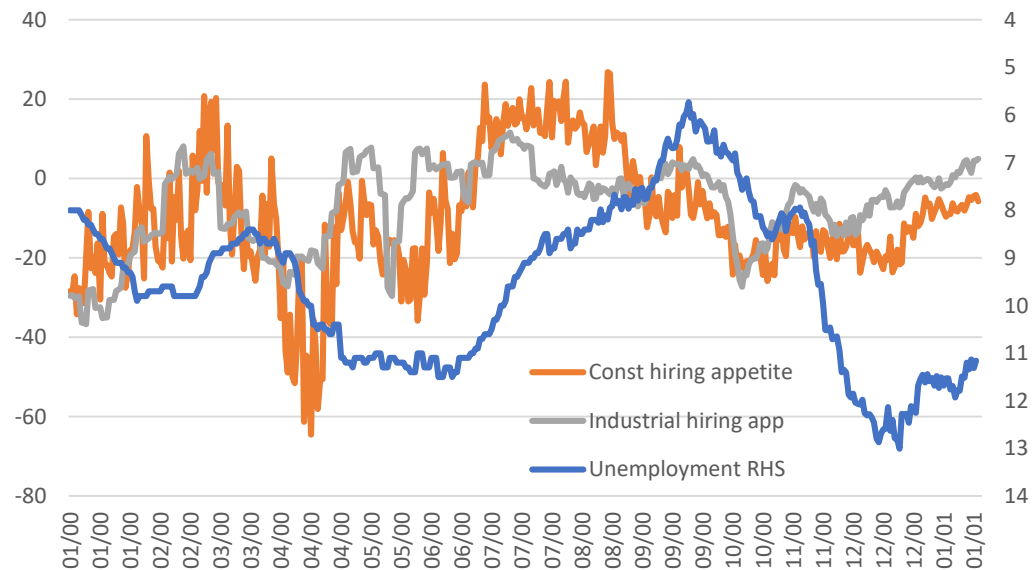
Less FDI abroad, but not yet a net inflow of FDI in Italy



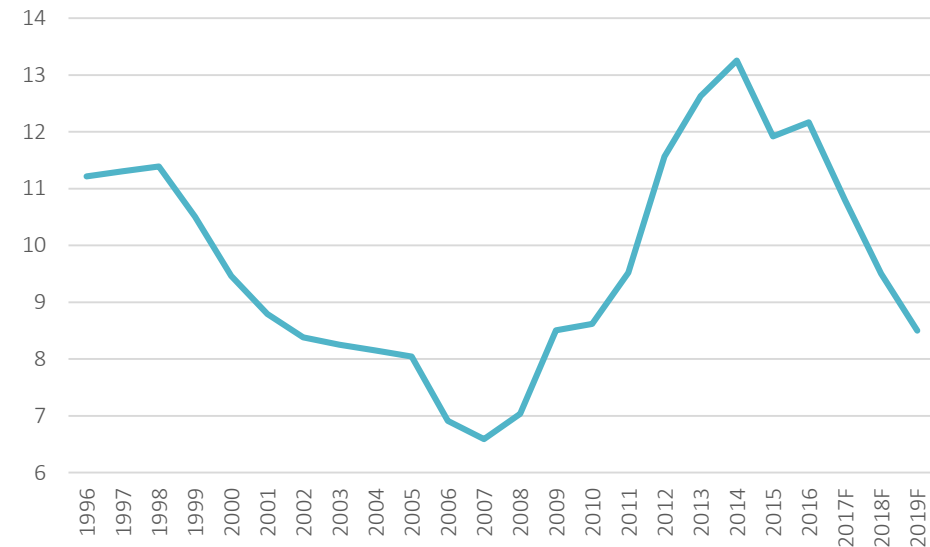
Sources: Macrobond, ADA Economics, EUR bn, 12m trailing sums

Labour market

Hiring appetite fairly high in historical perspective, but the unemployment rate is falling slowly



Projected change in the unemployment rate

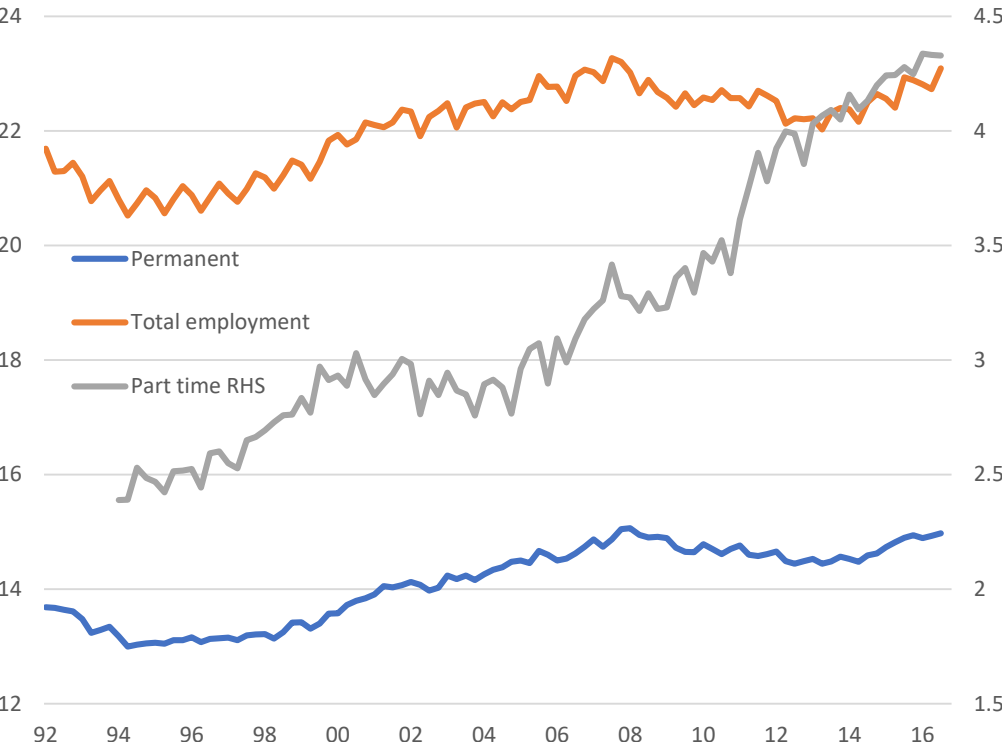


- The correlation between the unemployment rate and hiring intentions is not as close as in other countries probably because there is churning of labour (switching older/expensive with younger/cheap workforce) and the industrial sector overall is still shrinking, so the survey only picks up the optimism of the well-performing companies

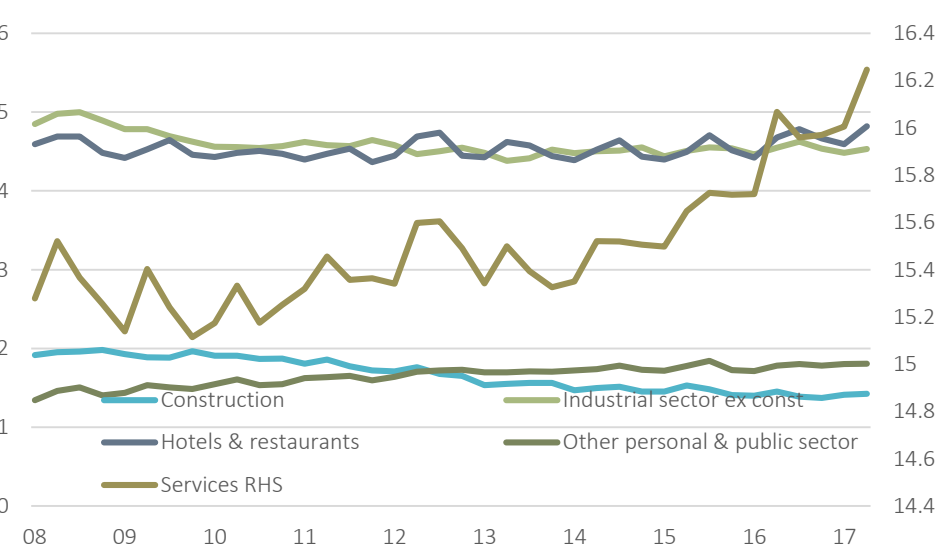
Sources: CEIC, ADA Economics

Labour market: a granular view

Job creation by type of contract (mn of workers)



Total employment by key sector (mn)

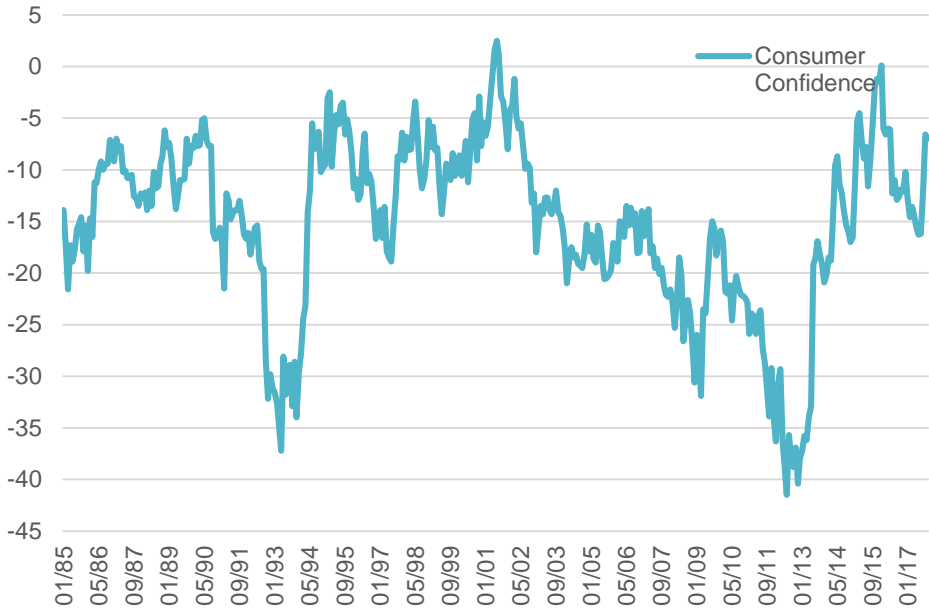


Sources: Macrobond, ADA Economics

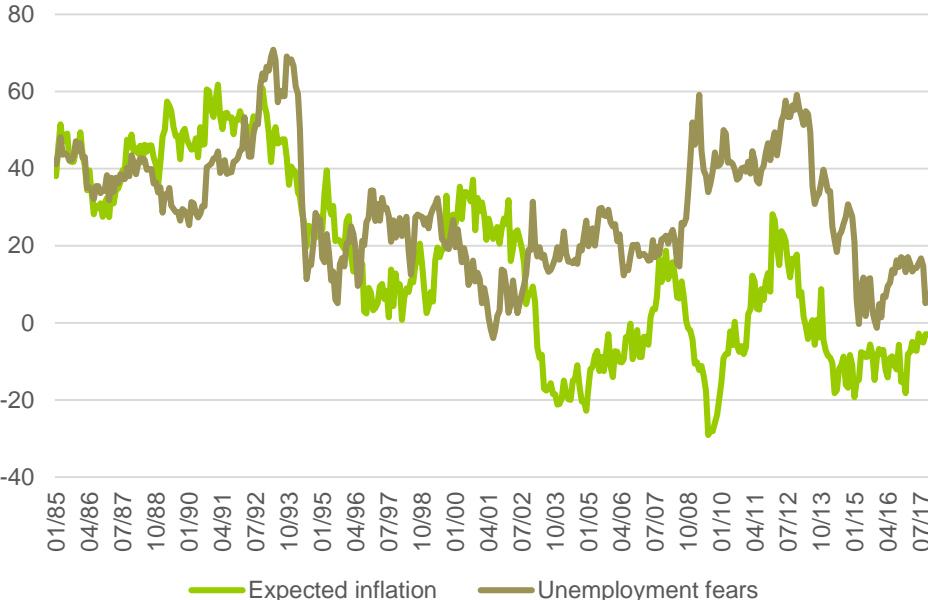


Household sector

Consumer confidence seems to be recovering



...consumers are less worried about prices than unemployment

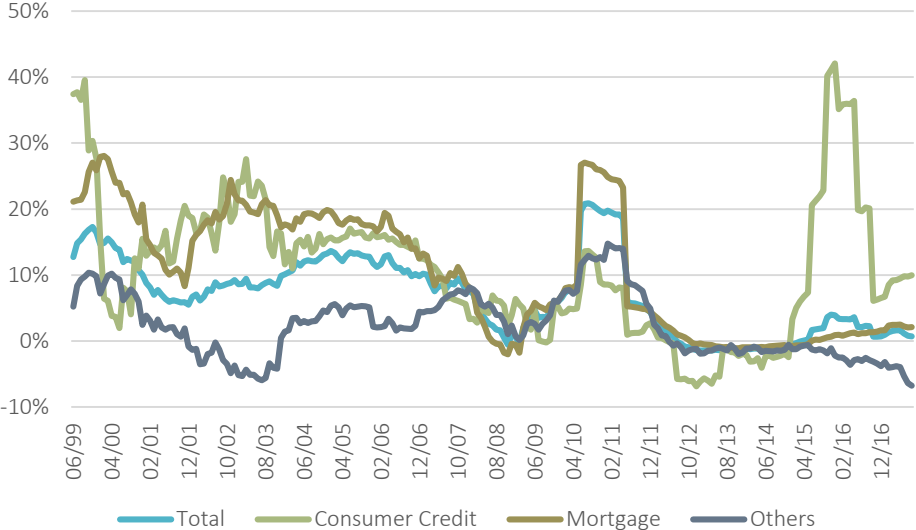


Sources: Macrobond, ADA Economics

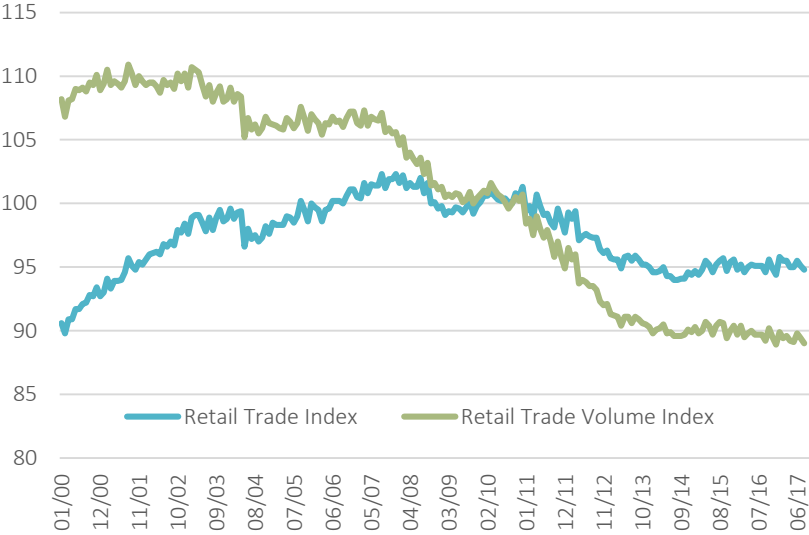


Household sector

Borrowing YoY by segment



Retail trade has stabilised in value terms, but volume is still falling)

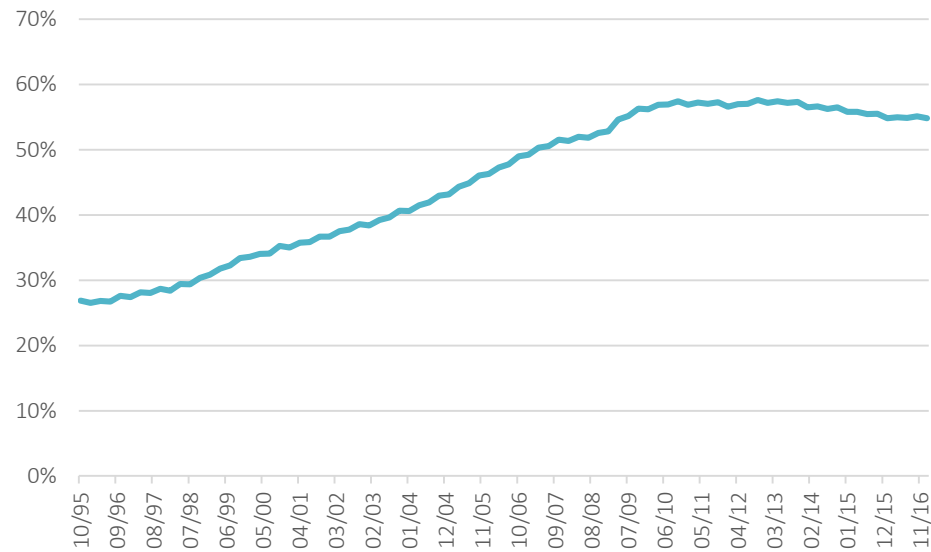


Sources: CEIC, Macrobond, ADA Economics

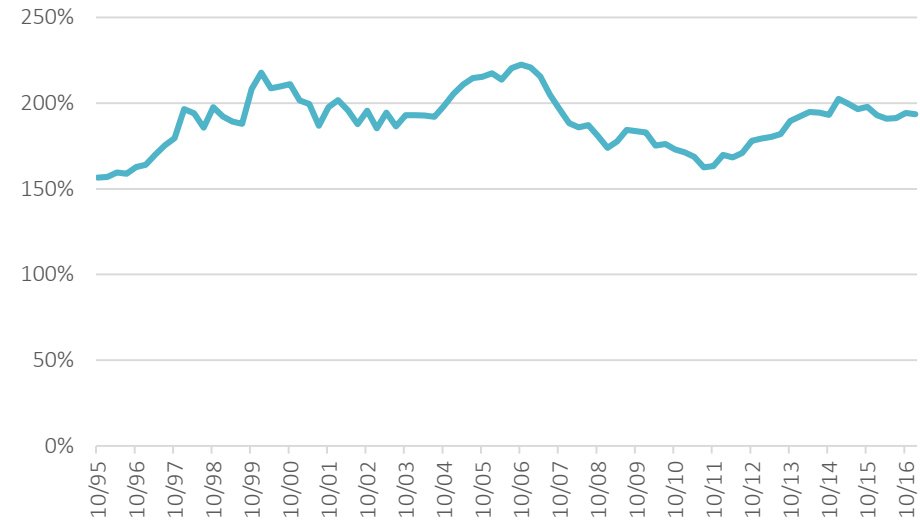


Household sector balance sheet

Debt to GDP



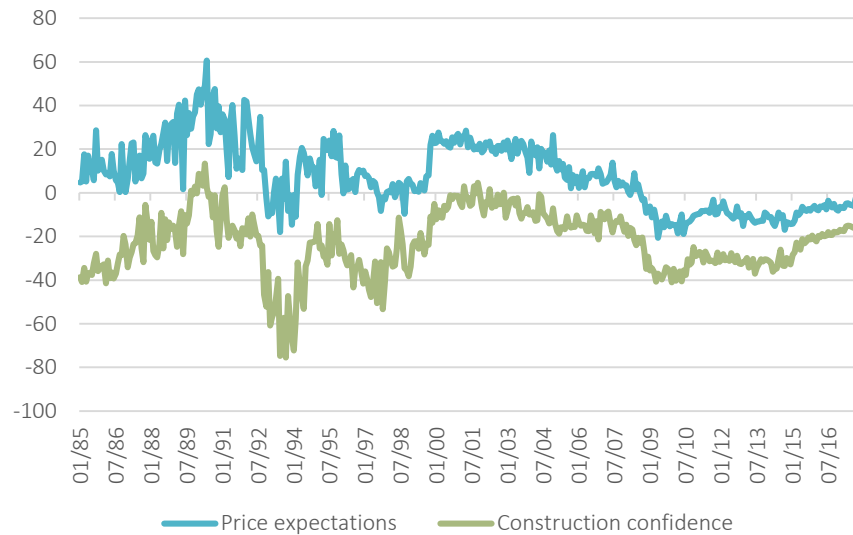
Net financial assets % of GDP



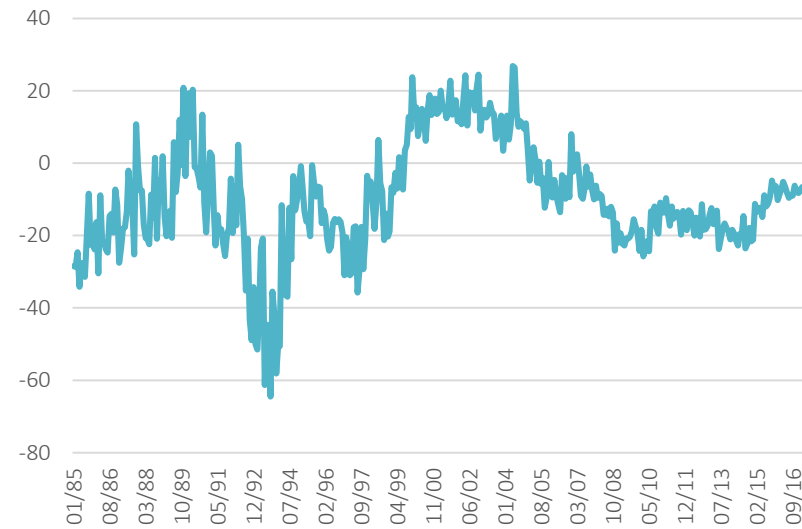
Sources: Macrobond, ADA Economics

Construction sector

Confidence and pricing power are coming back



...as well as hiring appetite



- A sustained recovery of the constructing sector would greatly speed up the drop in the unemployment rate

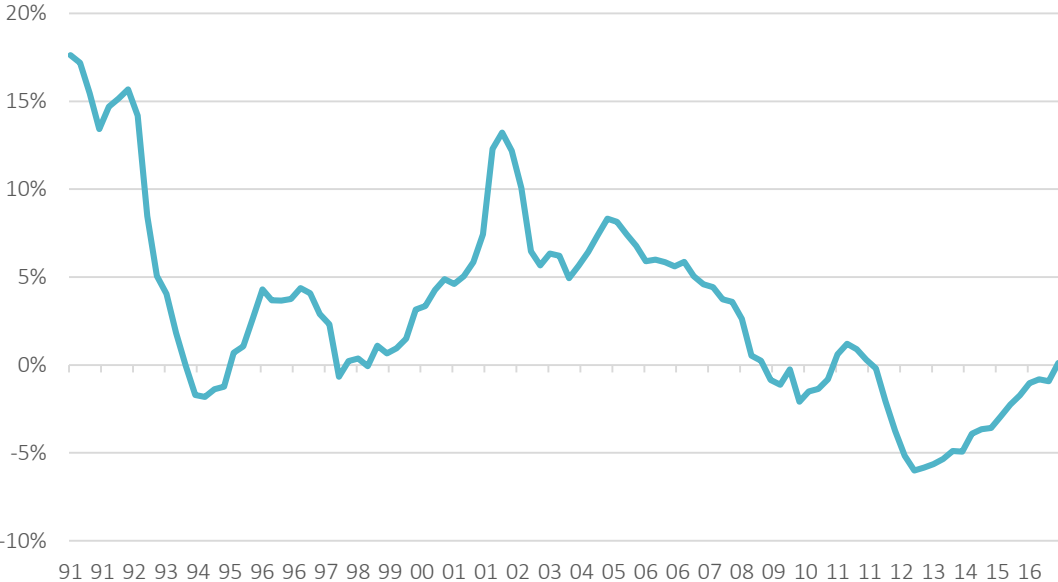
Sources: Macrobond, ADA Economics

Real estate

Residential and commercial transactions, YOY



YoY changes in Real Estate Prices Index

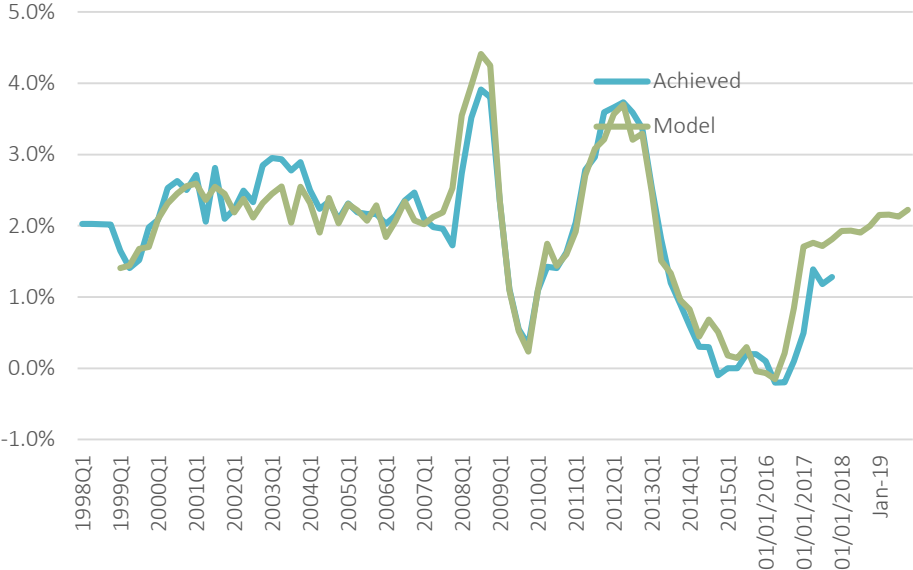


Sources: Macrobond, ADA Economics

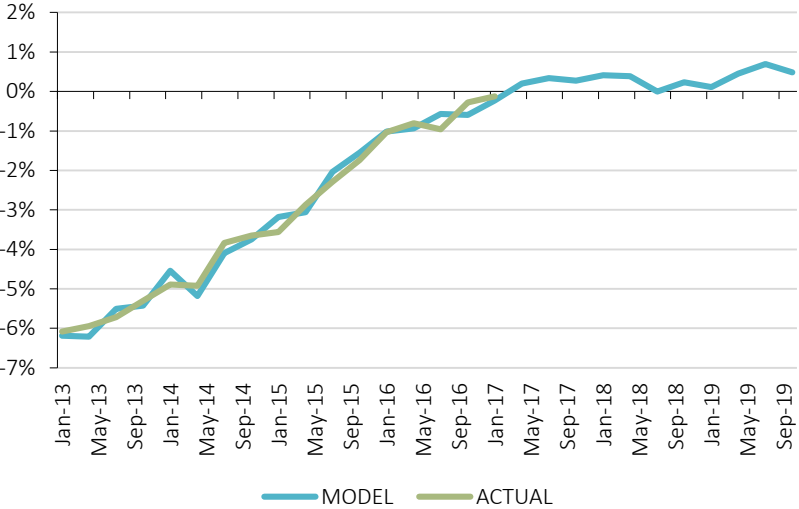


Inflation

Inflation recovering in coming years



Projected YoY changes in residential prices

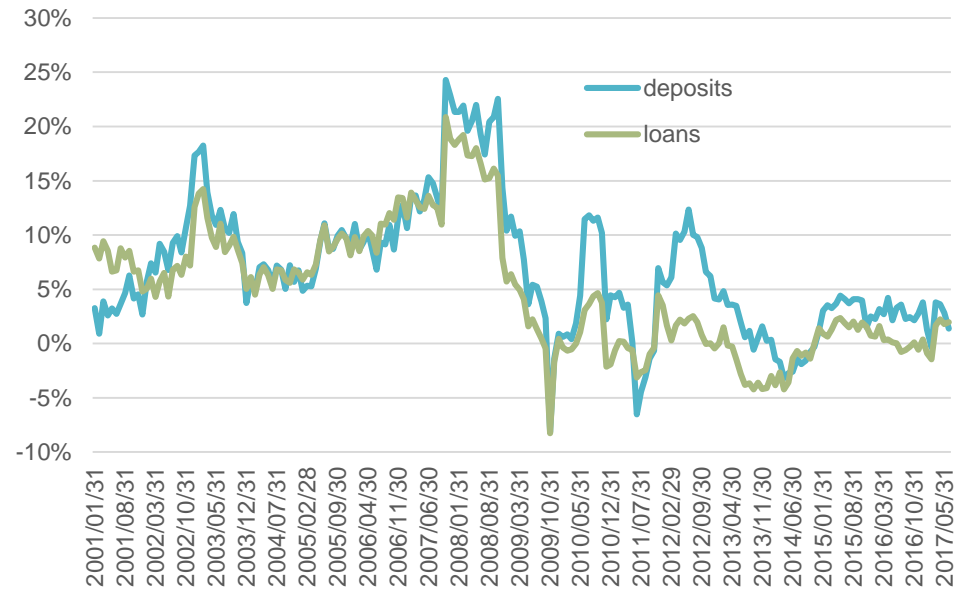


Sources: Macrobond, ADA Economics



Banking sector

Deposit and loan YoY growth



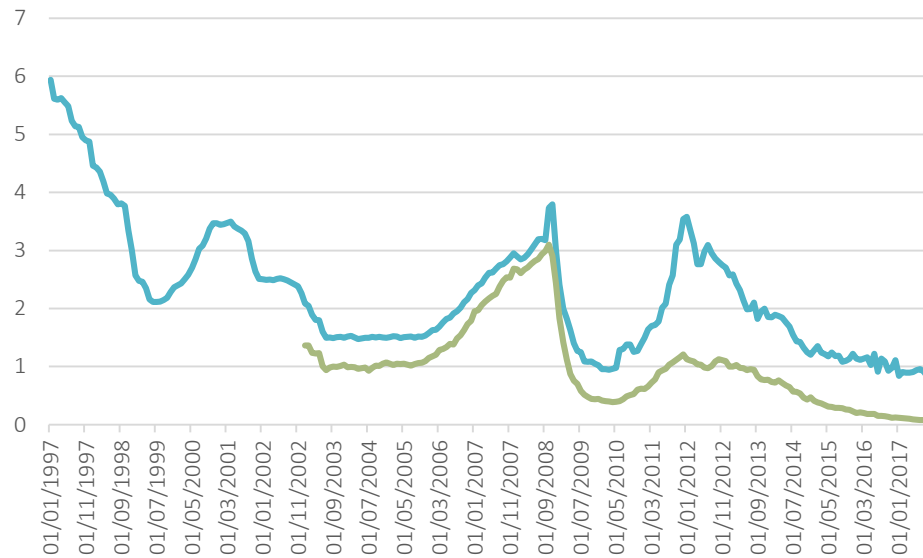
Loan to deposit ratio



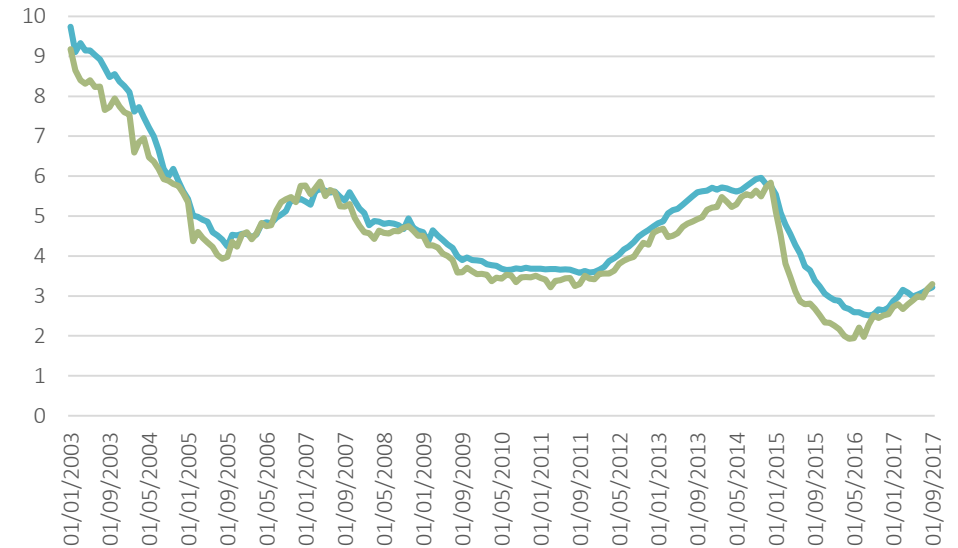
Sources: Bank of Italy, ADA Economics

Banking sector

Retail deposit rates, new business



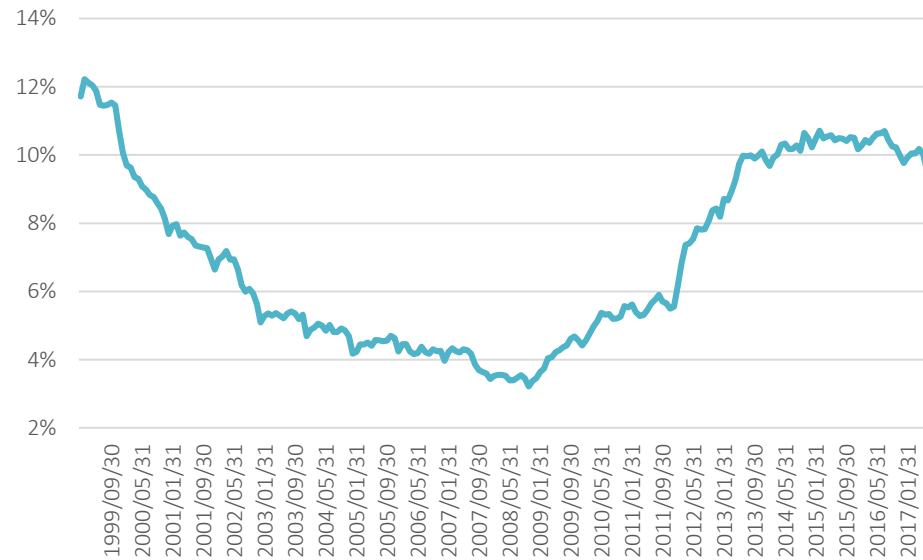
Retail lending rates, new business



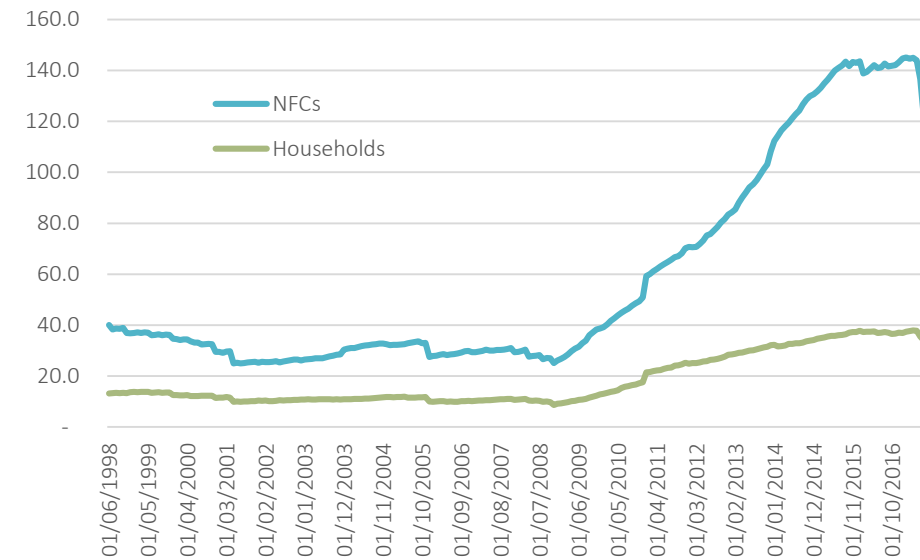
Sources: Macrobond, ADA Economics

Banking sector

Bonds as a share of total assets



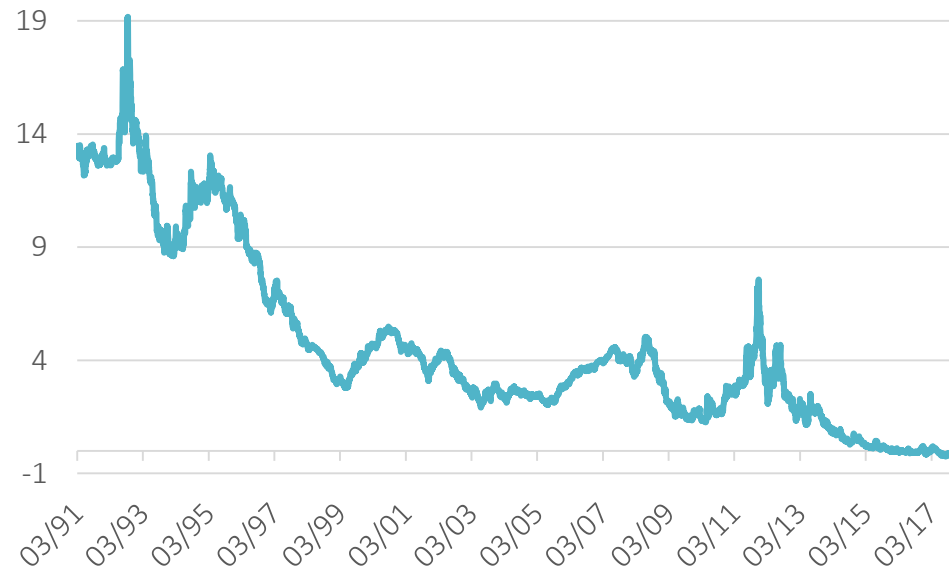
Non-performing loans (EUR bn)



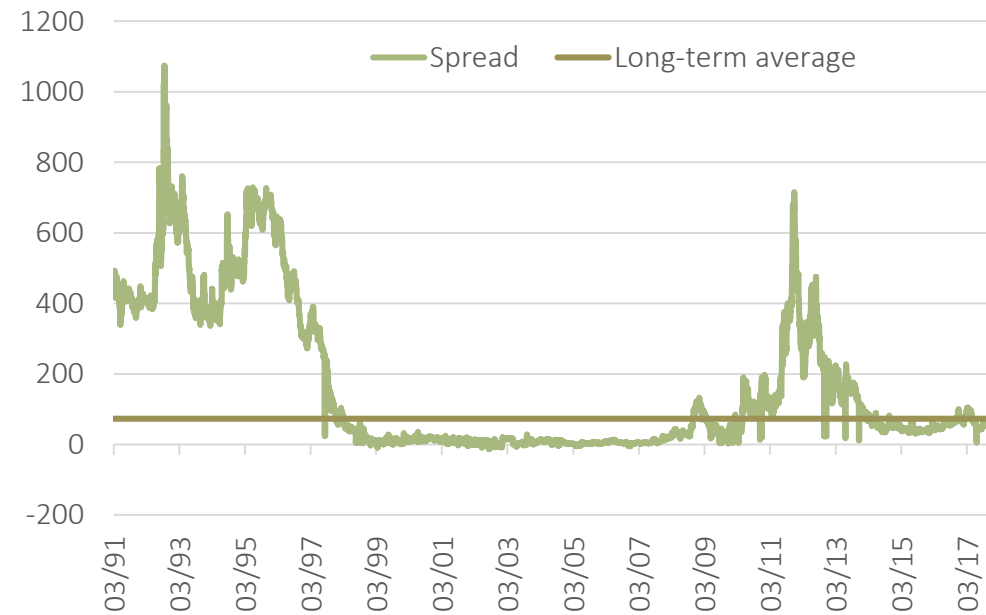
Sources: Bank of Italy, ADA Economics

Public sector

2-year sovereign bond yield



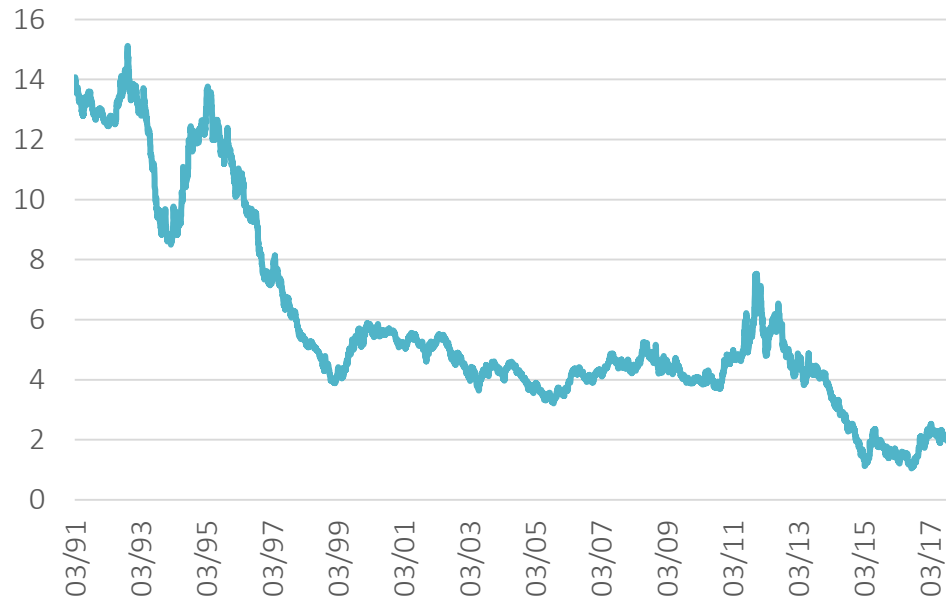
Spread over bund & 15 yr average of the spread



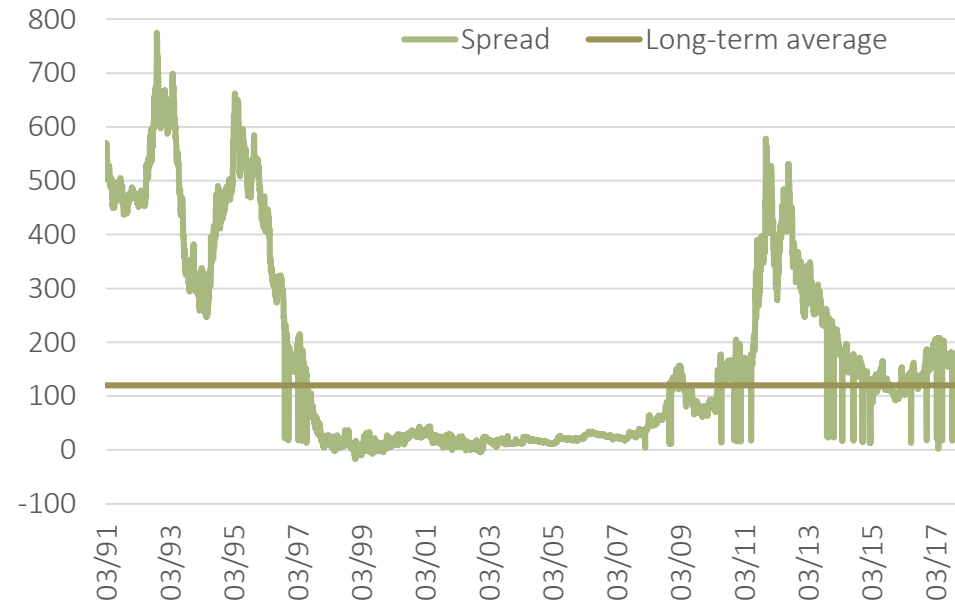
Sources: Macrobond, ADA Economics

Public sector

10 yr sovereign bond yields



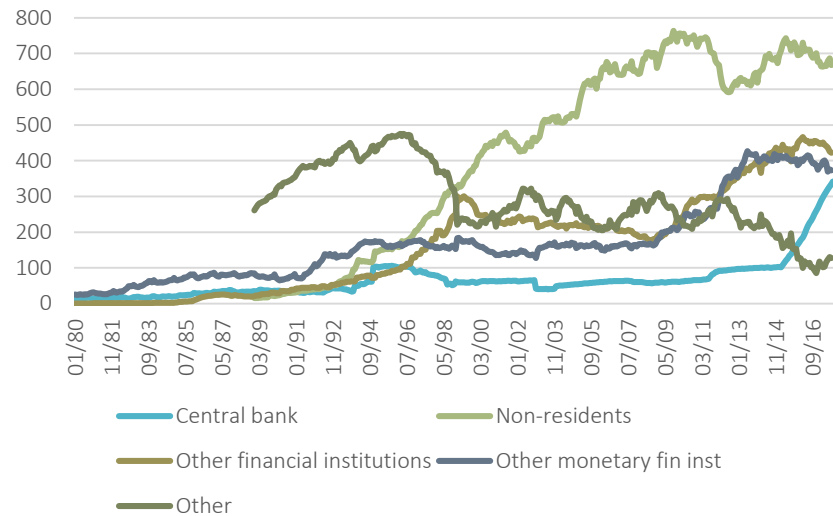
Spread over bunds and 15yr average spread level



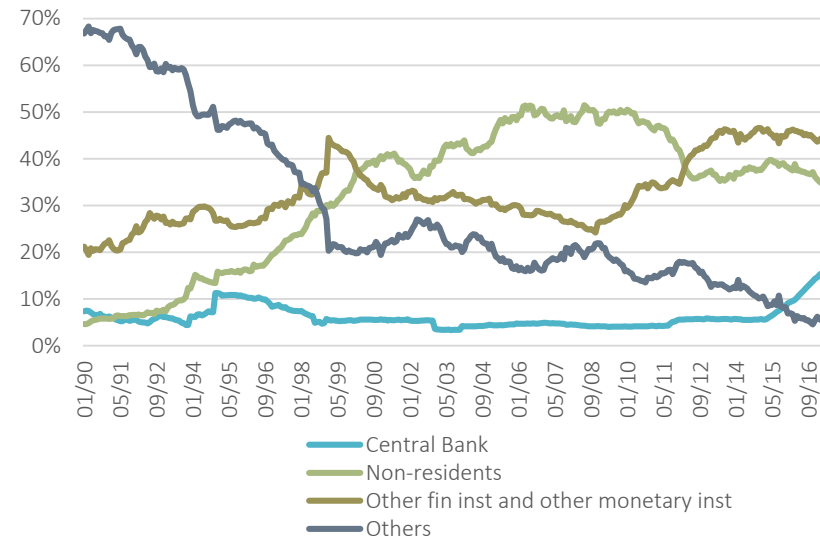
Sources: Macrobond, ADA Economics

Holdings of bonds

Levels, in billions of euros

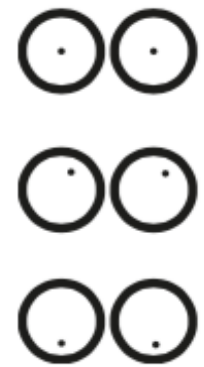


% of total securities

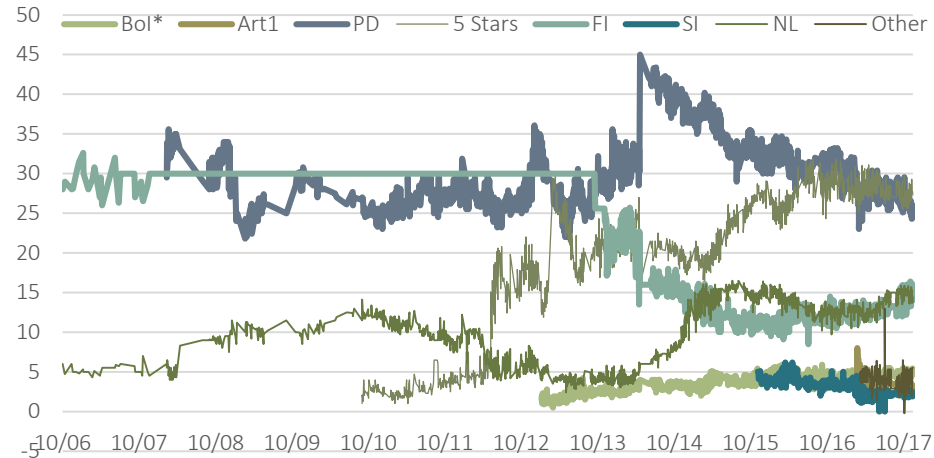


Sources: Macrobond, ADA Economics

Politics



Opinion polls

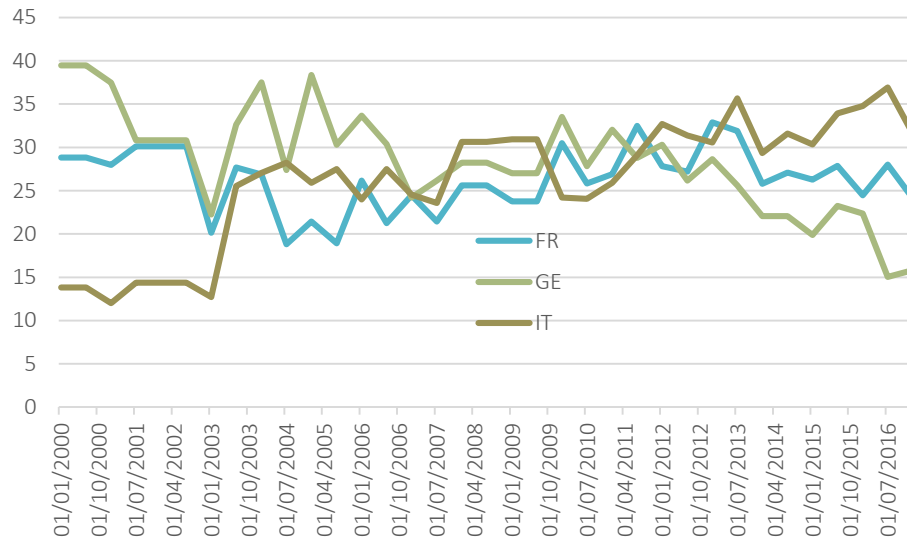


The opinion polls are showing an acceleration of centre right parties – driven by Northern League and Berlusconi’s Forza Italia, while the Democratic party is losing and M5 is stable.

Sources: Macrobond, sondaggipoliticoelettorali.it, ADA economics

Support for the EU and the euro

Eurobarometer: against the euro, %



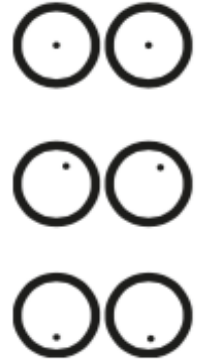
- Our surveys illustrate high disappointment of Italians and French in the EU, but a very small fraction *actually against the euro to the point of voting in favour of a currency change in a hypothetical referendum* – in fact we polled only 12% in France and 2% in Italy ready/eager to do so. In Germany support for the EU is more widespread: 40% saying it is definitely a positive influence on their lives and 40% torn between positive and negative. However, there is also a high share of those that regret losing the Deutschmark: 30%!

Sources: Macrobond, ADA Economics

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