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Italy: Rising fiscal concern despite robust economy

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Italy's economy is undergoing stable expansion. As exports show high levels of growth and industrial production continues its moderate recovery, employment and income conditions are improving, with unemployment falling to 11.0% in November (table 1). Real retail sales, which had been weakening, are at last showing signs of bottoming out. In terms of sentiment indicators, composite PMI (Purchasing Managers Index) is on an increasing trend following export order growth in sectors such as manufacturing, maintaining a level considerably above the benchmark of 50, which indicates economic expansion (50<) or contraction (<50). Consumer confidence also continues to improve.

In political side, after revisions to electoral law and 2018 budget were approved, the President Mattarella dissolved the upper and lower houses of parliament on 28th December 2017, and a general election was called for 4th March 2018. Recent opinion polls show that the election is likely to be tightly contested: the approval rating of the ruling Democratic Party (PD) has fallen to between 20-25%, whereas the populist Five Star Movement (M5S)'s approval rating has risen to the 25-30% range, and right wing Forza Italia (FI) to around 15-20%. This situation means that it will be difficult for any one party to claim a majority of seats, and coalition talks to form a government and subsequent management of the political administration are sure to be difficult.

As the election race is predicted to be tight, there are concerns that the main parties might announce tax cuts or other "pork-barrel spending" in their manifestos to attract voters. Italian government debt, at 130% of nominal GDP, far exceeds the EU debt target of 60% (chart 1). In November 2017, the European Commission announced that it would reassess Italy's debt reduction strategy and forecast in spring 2018. If the new government planning to implement "pork-barrel spending" pledges comes into conflict with the European Commission regarding fiscal policies, this could stir up domestic anti-EU sentiment. Furthermore, there is concern that this could cause higher bond yields, increasing the burden of interest rate payments on the government, and setting off a downward spiral stalling improvement in the fiscal balance. This situation needs to be monitored, as contrary to Italy's robust economy, levels of political and fiscal uncertainty run high.

Table 1: Italian Main Economic Indicators

	2017						
	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Exports (YoY,%)	6.7	5.1	8.8	8.3	9.3	8.8	-
Industrial production (YoY, %)	5.2	4.4	4.4	2.4	3.3	2.3	-
Unemployment (%)	11.1	11.3	11.1	11.1	11.1	11.0	-
Contractual hourly wage (YoY,%)	0.3	0.4	0.6	0.6	0.7	0.7	-
Real retail sales (YoY, %)	0.2	-0.3	-0.4	1.0	-1.8	0.3	-
Composite PMI	54.5	56.2	55.8	54.3	53.9	56.0	56.5
Consumer confidence (balance)	-16.3	-16.2	-12.1	-6.6	-7.0	-7.8	-6.4

Source: Istat, Eurostat, Markit, European Commission,
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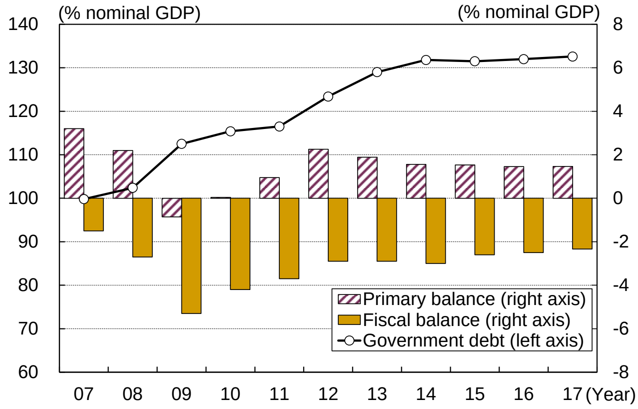
Chart 1: Italian Fiscal Balance and Government Debt



Note: 2017 "Budget balance" uses data from September,
2017 "Government debt" uses data from November
Source: Istat, BTMU Economic Research Office

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