

# Italy's Macro Outlook

Q4 - 2016

# Summary

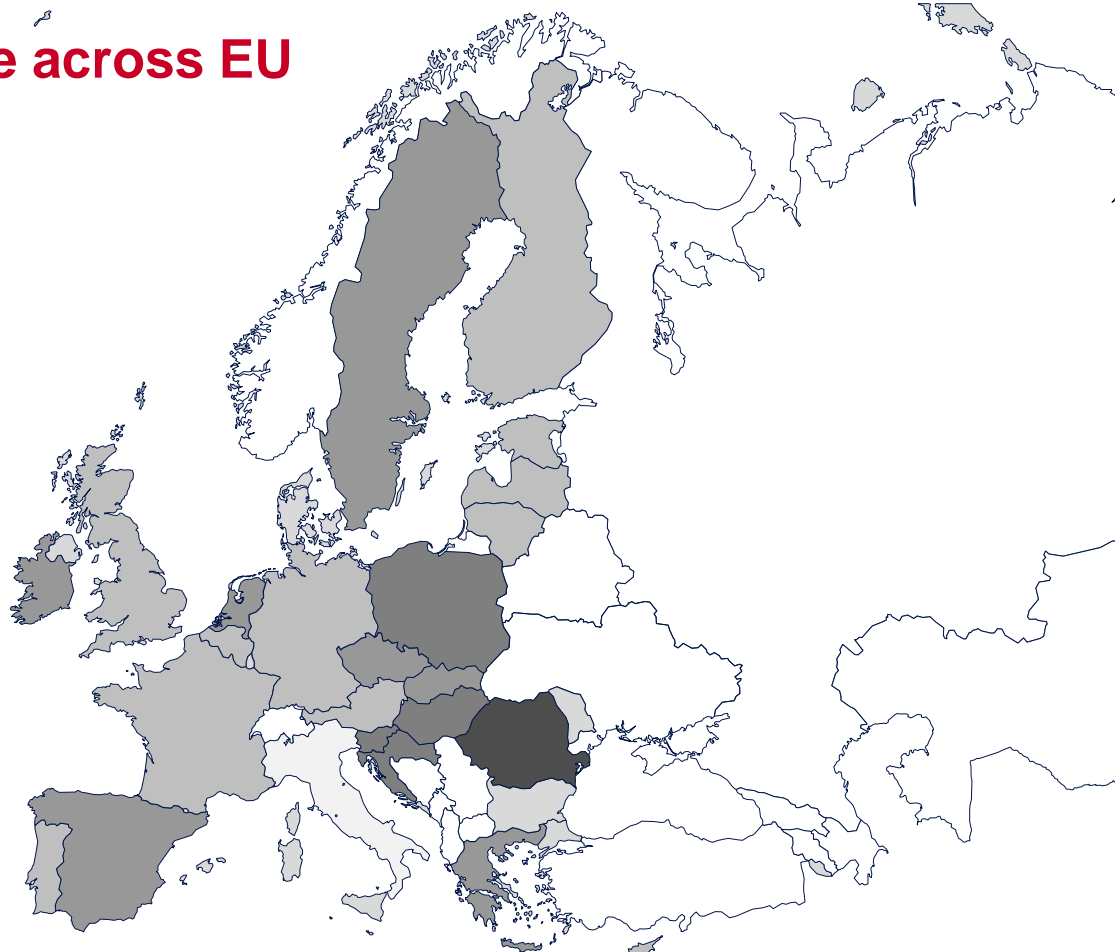
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- 3 Focus – Non Performing Loans

# The Macroeconomic Context

# Real GDP Growth Rate across EU

(Forecast 2017, %)



Source: European Commission

# Quarterly Contribution to GDP Growth

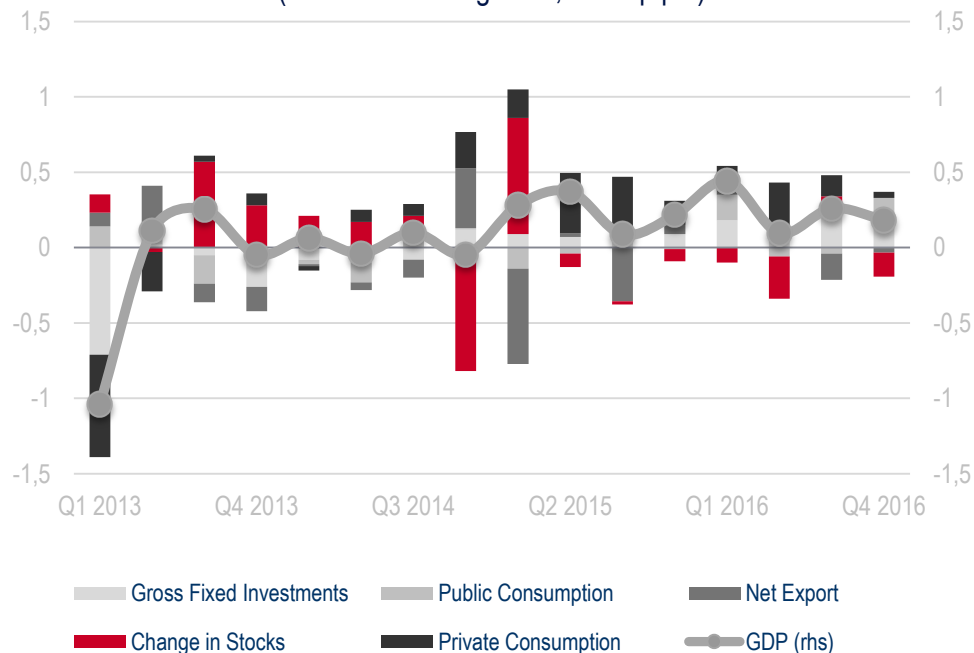
National Demand consolidating as the backbone of the economic recovery

- Italian Economy **accelerated in 2016** (+0,9%), mainly driven by **national demand**
- Gross Fixed Investments, largely on the spotlight for past negative performances, were **the leading contributor**, alongside private and public consumption
- Net export contribution was **slightly negative in 2016**, because of the recovery of import offset the positive performance of export

Source: Istat

## GDP Growth and breakdown by contribution

(Lhs: % share of growth; Rhs: q/q %)



# Italian Macroeconomic performance in a nutshell

Future economic growth will be sustained by national demand with upside risk from net export

	<b>Curr. Prices</b>	<b>% GDP</b>	<b>97-12</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
<b>GDP</b>	€ 1,642	100	0.6	0.9	0.9	1.1
<b>Private Cons</b>	€ 1,002	61	0.8	1.4	0.9	1.2
<b>Public Cons</b>	€ 311	19	0.8	0.6	0.2	0.4
<b>Gross Fix. Inv.</b>	€ 273	17	0.3	1.9	2.4	3.1
<b>Export</b>	€ 494	30	2.2	1.5	3.0	3.2
<b>Import</b>	€ 443	27	2.7	2.1	3.9	4.3
<b>HICP</b>			2.3	-0.1	1.4	1.3

Source: European Commission

# Public Debt – A race with primary surplus

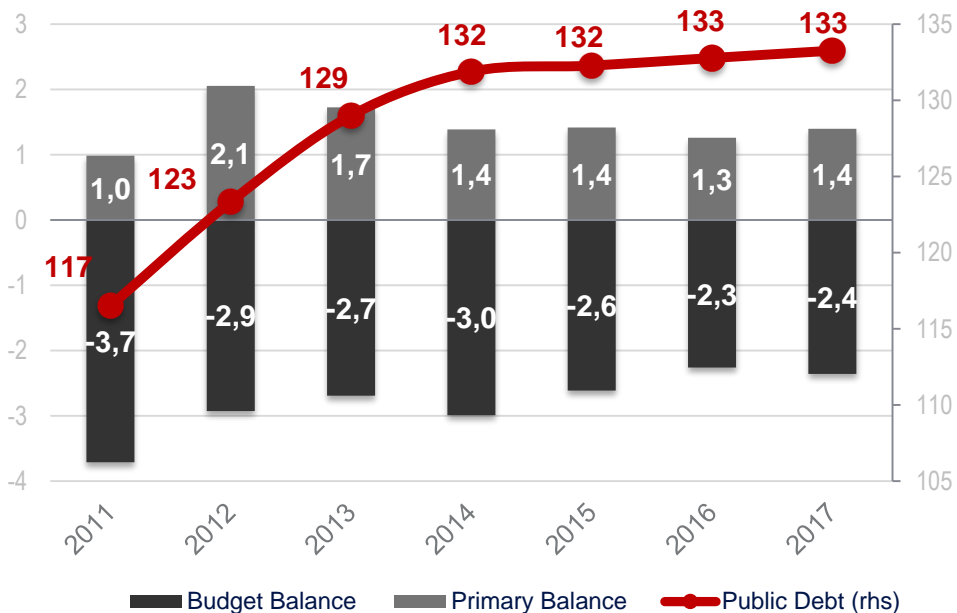
High stock of Public Debt locks policy alternatives

- Italy's ability to run a **large primary balance** is vital to keep public finance under control, in light of the high interest expenditure (**4% of GDP**)
- **Downside:** excessive surplus can hamper the already fragile economic recovery
- Despite large primary surpluses and contained budget deficit, Italian public debt to GDP ratio remain **very high** and is expected to slowly decrease from 2017, thanks to a **higher nominal growth**

Source: European Commission

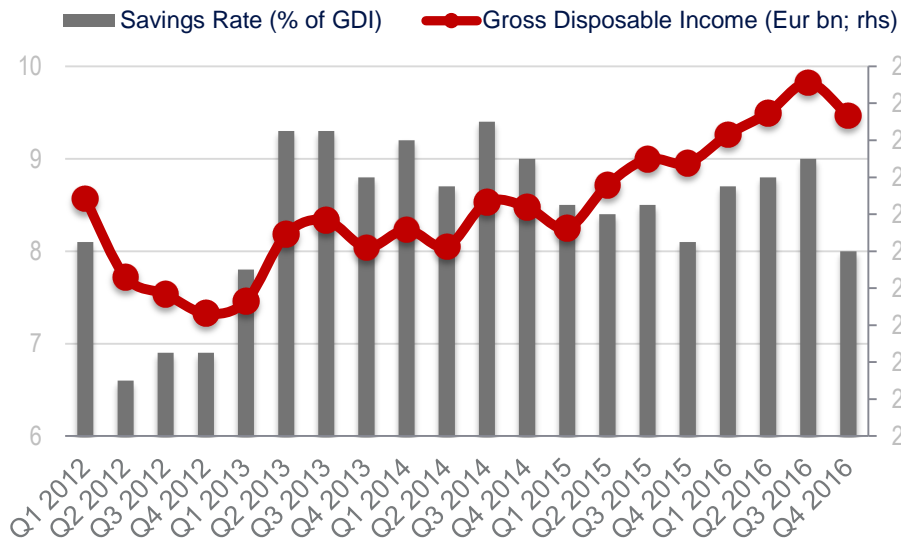
## Public Debt and Deficit

(% of GDP)



# Confidence may be a driver of future economic growth

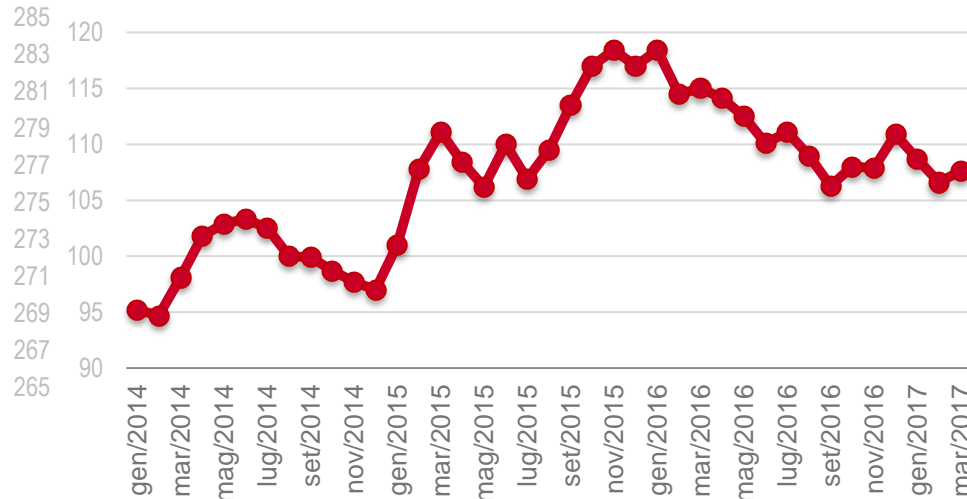
A large part of growth in GDI is set up by Italian families



Source: Istat

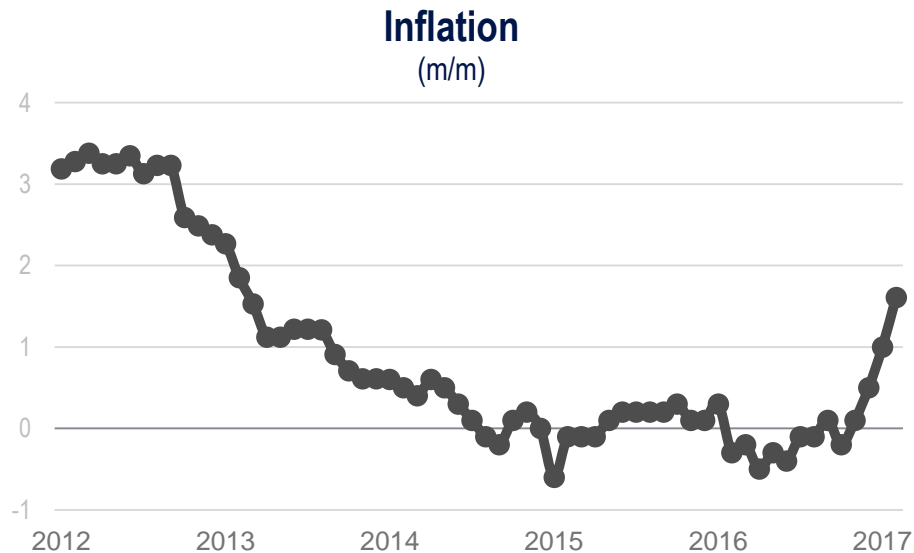
- Growth of **private consumption** is sustained by growth in real gross disposable income (increasing households' purchasing power)
- However, on the back of a **subdued confidence** in the perspective of the national economy, such an increase in the GDI was turned into savings

## Household Confidence Index

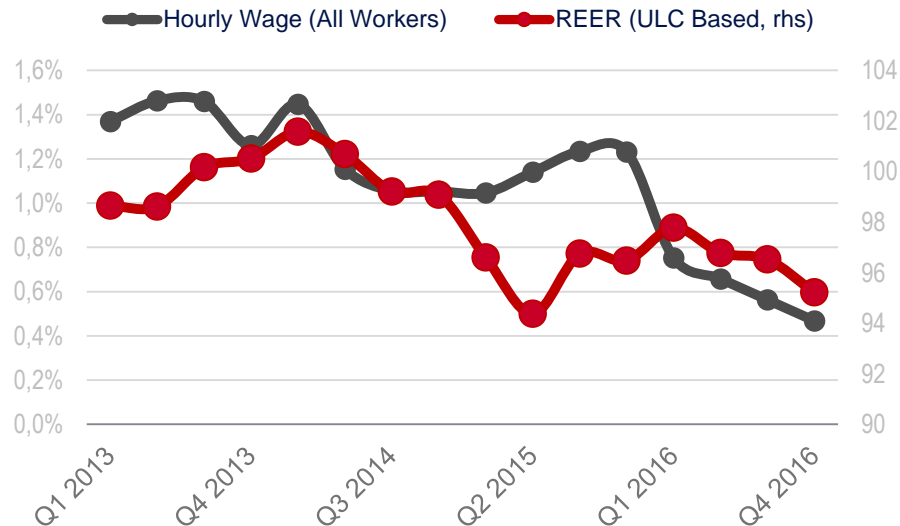


# Inflation on the rise

Commodity prices are leading the rise in inflation, despite low growth of hourly wage



Source: Istat

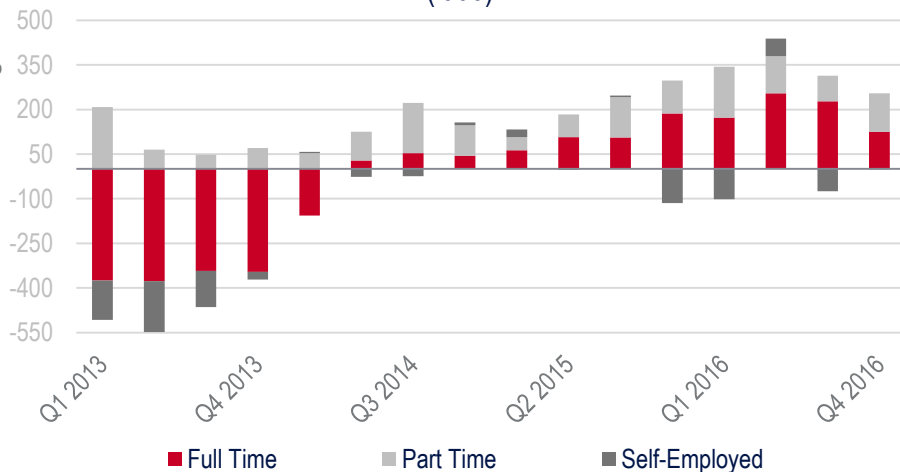


- In the first quarter of 2017, the headline inflation **rebounded**, mostly due to a recovery of the oil price. Core inflation is still below the ECB target in Italy as well as in the rest of the Euro Area
- Italian competitiveness is increasing on the **international markets** (as shown by the REER), partly because of **wage moderated growth rate** and **euro depreciation** (weaker than expected) against main currencies

# The Job Market – an all time high participation

Consolidation of job market

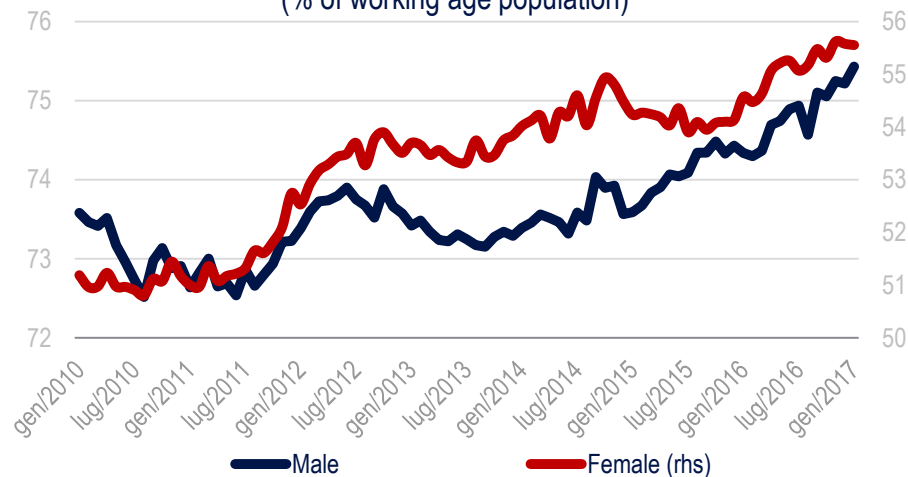
## New Hiring (‘000)



Source: Istat

## Participation rate

(% of working age population)

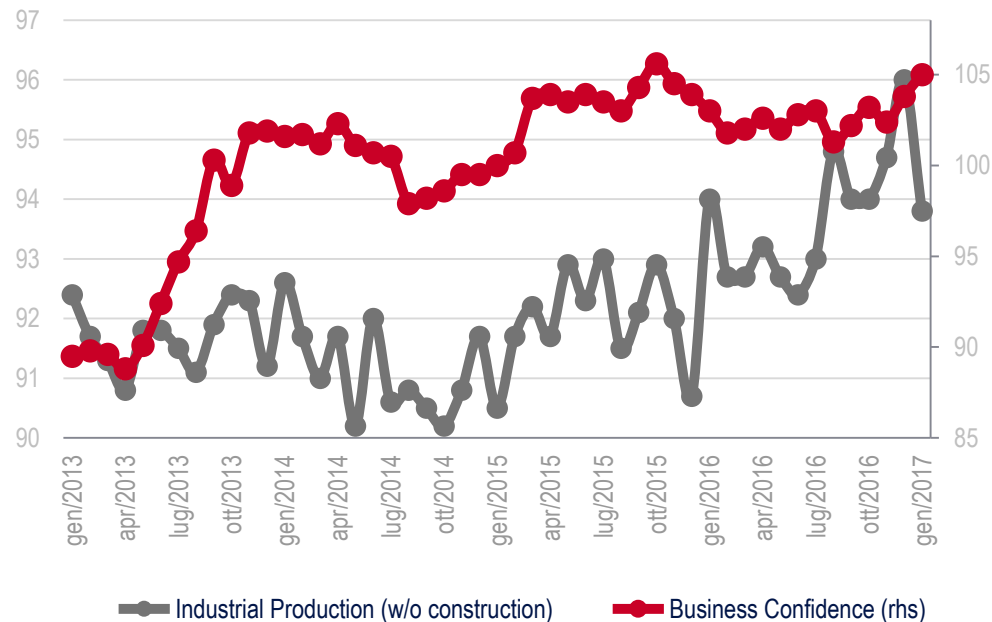


- The job market continues on a **consolidation path**, driven by permanent hirings
- The workforce participation is at an **all time high**, a **highly important** element in negotiating flexibility with EU Commission. Nevertheless, women participation rate is still among the lowest rates in EU

# Industrial production is slowly recovering pre-crisis level

Total production still 20% far from pre-crisis peak, but business confidence is keeping the beat

- ▶ In 2016, the Italian **business confidence** index has recovered 2015 record levels
- ▶ **Industrial production** in Italy showed signs of **recovery** in the second half of 2016, but **decelerated** in the first month of 2017
- ▶ Despite a growing trend, industrial production is still far **below pre-crisis peak** (-20%)

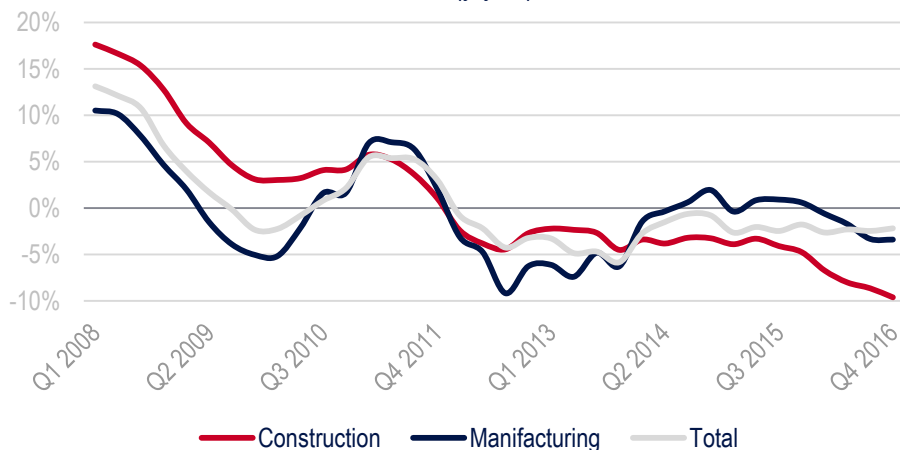


Sourc: Istat

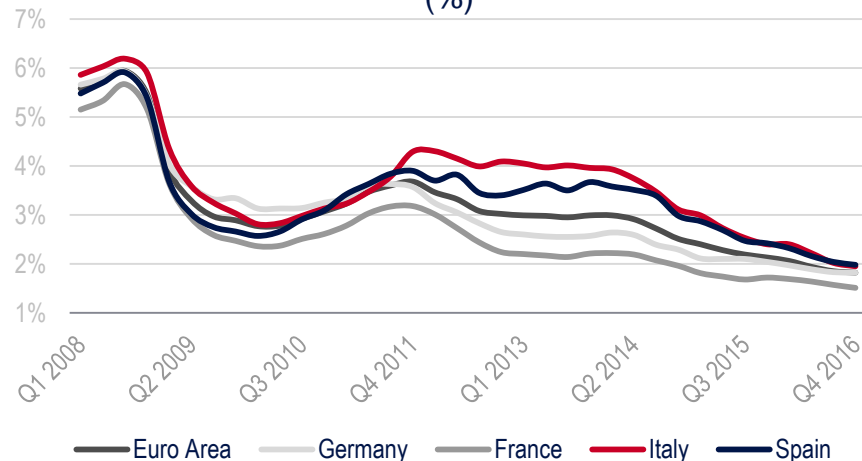
# Banking channel still weak...

Despite low borrowing cost, the new loans to NFC are not recovering

## Loan to NFC growth rates (y/y %)



## NFC Borrowing Cost - Composite (%)



Source: ECB

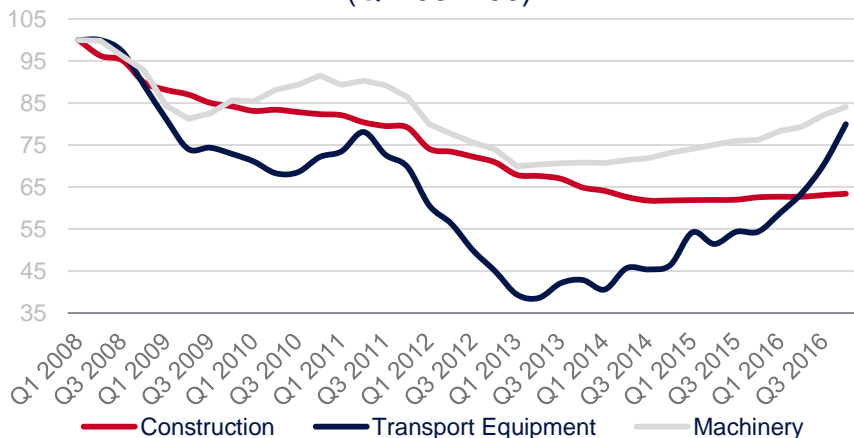
- Loans growth rate to Italian NFC remains **negative**, despite low borrowing costs
- Loans to industrial companies are struggling to grow at pre-crisis levels, partially compensated by positive growth in the tertiary sector

# ...weighing on investment performances

Government incentives will sustain recovery in productive sectors

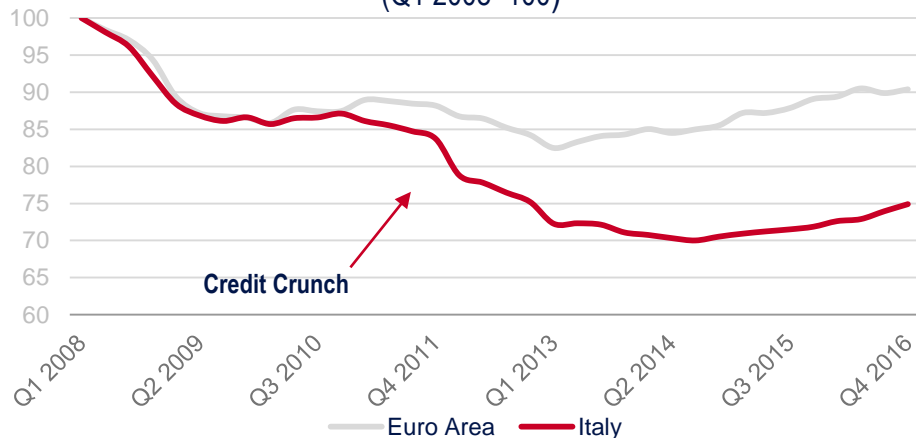
## Italy Investments main components

(Q1 '08=100)



## EA vs Italy Investment level

(Q1 2008=100)



Source: Istat, AMECO

- The stock of Italian real investments is still **25% lower than pre-crisis levels**, while EA average is 10% below
- More productive components of investments (machinery and transport equipment) are recovering at a **faster rate** than construction

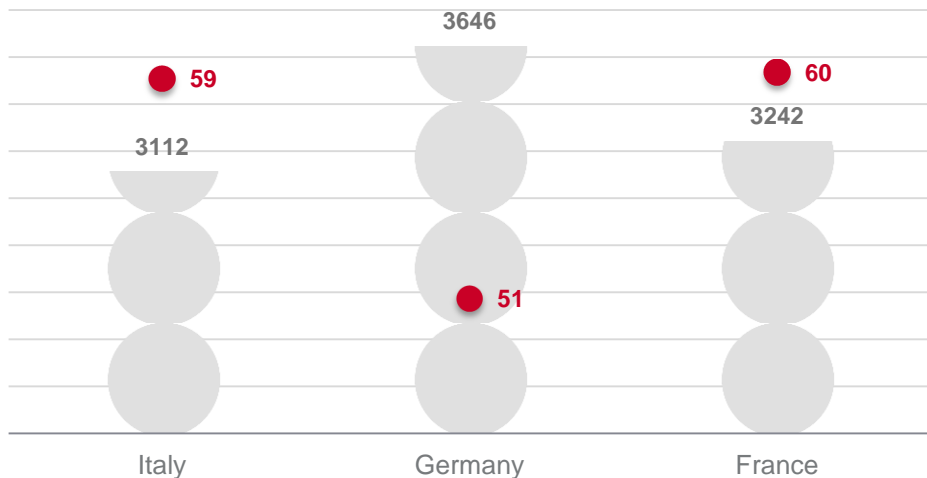


# Italian Economic Fundamentals

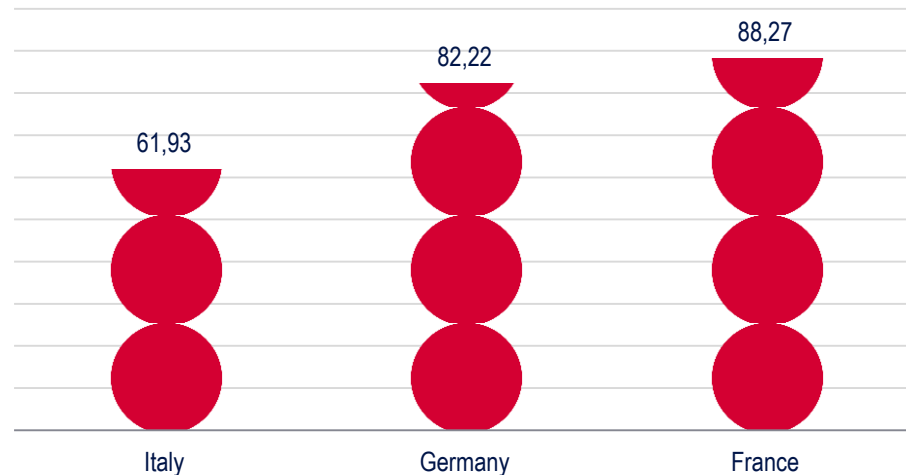
# The Origin of Italian resiliency (i)

Italian households have a net financial wealth on par with Germany and France, but are much less indebted

- Household Aggregate Net Financial Wealth (EUR Bn)
- Net Financial Wealth per Adult (EUR thousands)



## Households debt (2015, % of GDI)

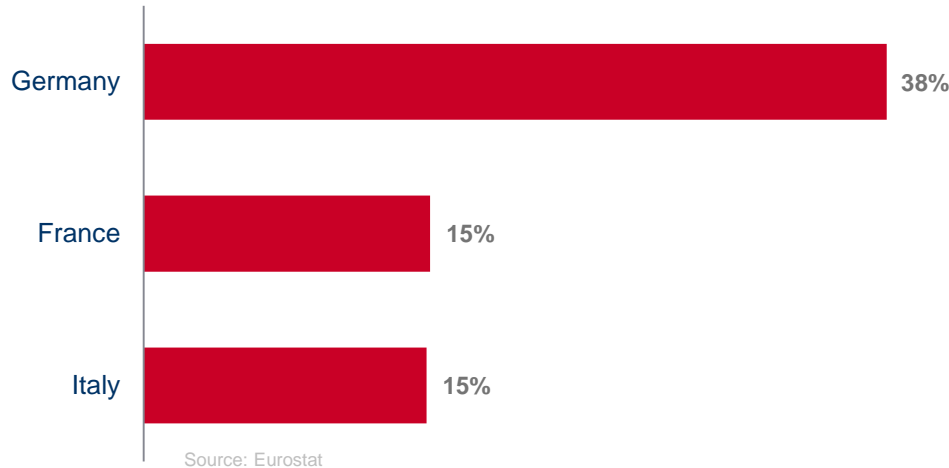


Source: ECB, Banca d'Italia, Deutsche Bundesbank, Banque de France

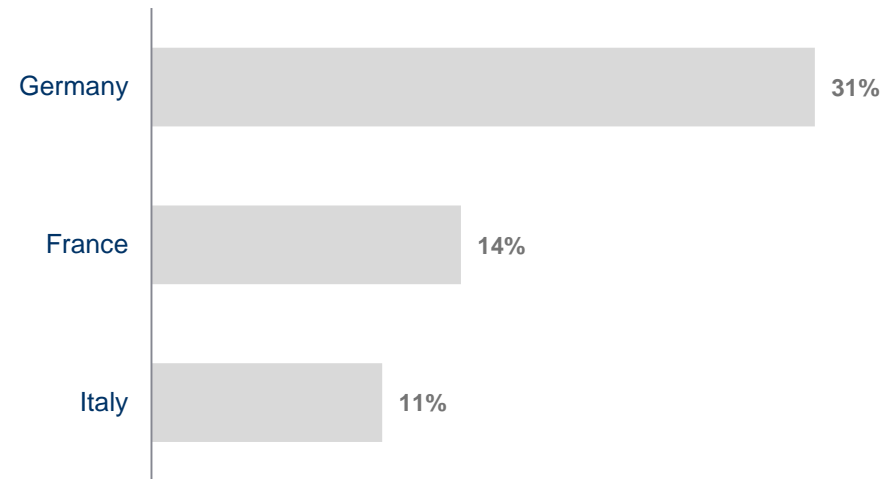
# The Origin of Italian Resiliency (ii)

Italian Manufacturing Value Added is third best in Europe

**Manufacturing – G. Value Added**  
(2016, % of Euro Area)



**Export**  
(2016, % of Euro Area)

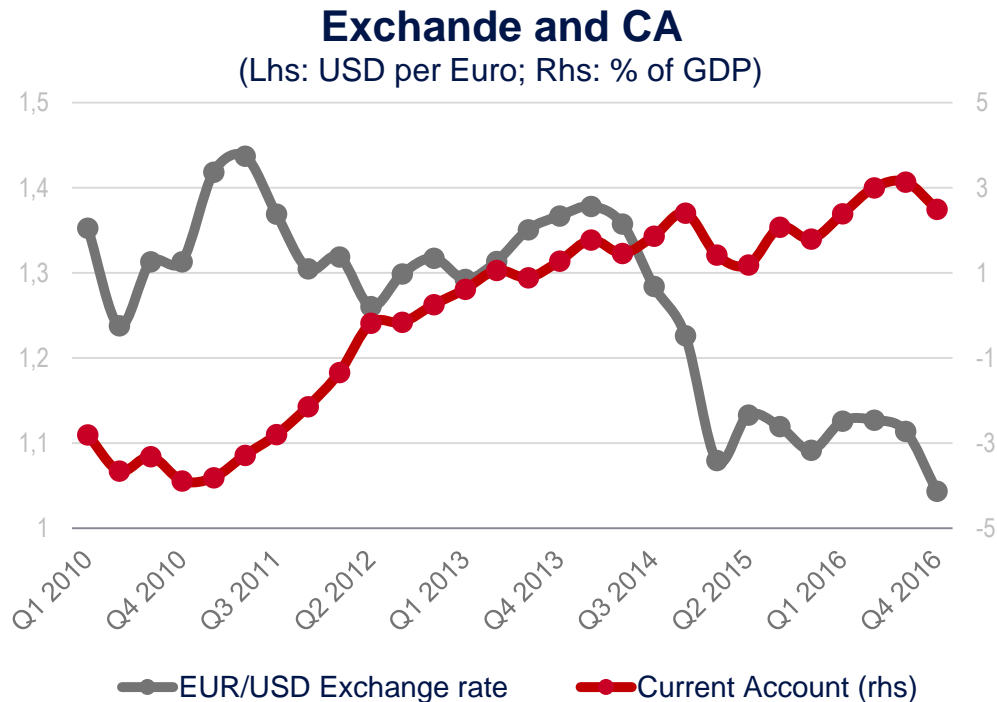


- Despite the ongoing recovery of national industrial sector, Italy has lost the second position in the Euro Area ranking in terms of manufacturing value added
- At the same time, in 2016 the Italian agricultural sector has become the most relevant in the Euro Area (21% of EA value added)

# The Origin of Italian Resiliency (iii)

Italian Competitiveness on international markets is slightly correlated with EUR depreciation

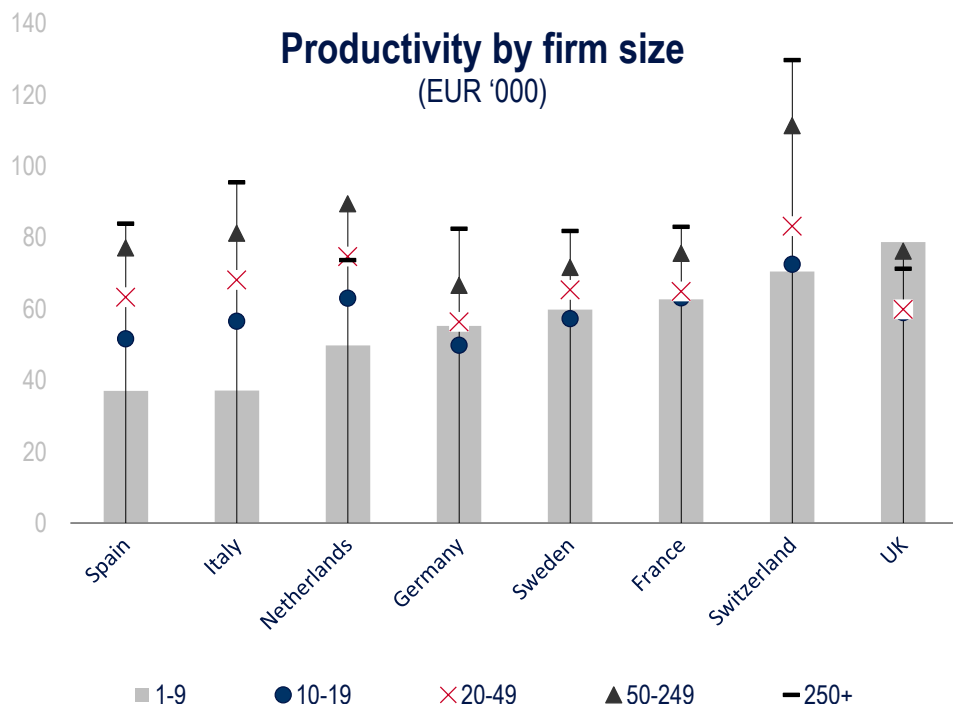
- ▶ The surplus of the Italian current account is **among the highest** in EU (+2,5% in Q4 2016). The strong export performance confirms the **competitiveness** of the national entrepreneurial system
- ▶ The Italian current account has **performed well** also with a less favorable exchange rate



Source: Eurostat, Datastream

# The Origin of Italian Resiliency (iv)

Medium and Large Enterprises are the most productive across Europe



Source: OECD

- The largely debated productivity issue should be addressed considering the overall picture
- In fact, large Italian companies rank among the **most competitive** across comparable European economies
- Relatively **low productivity** of Italian micro-firms is problematic when coupled with the breakdown of the employment by firm size
- Nearly **half of total Italian employment** is within very small firms, which is the **highest percentage** across other large economies in Europe

# Focus – Non Performing Loans

# Non Performing Loans – an overview

NPLs weigh on Italian economic recovery, but conditions are slightly improving

- In the first six months of 2016 the stock of gross non-performing loans fell by €4 billion, to €356 billion; net of provisions, the reduction was more pronounced, falling by **€6 billion to €191 billion**.
- Since the end of 2015, the coverage ratio has increased by 1% to **46.4%**, **slightly higher than the average** for the main EU banks.
- In the first nine months of 2016, banks sold or wrote off about **€6 billion** of gross bad debts, compared with just over **€1.7 billion** in the same period in 2015

	Gross Exposure	Net Exp	Gross % Share	Net % Share	Cover.e Ratio
Total loans	2,016	1,383	100	100	8.8
Performing	1,659	1,649	82.3	89.6	0.6
N.Performing	356	191	17.7	10.4	46.4
Bad debts	214	88	10.6	4.8	59
Likely to default	131	72	6.6	5.2	28.3
Past Due	11	9	0.6	0.5	17.7

Source: Banca d'Italia

# NPLs across significant and less significant Banks

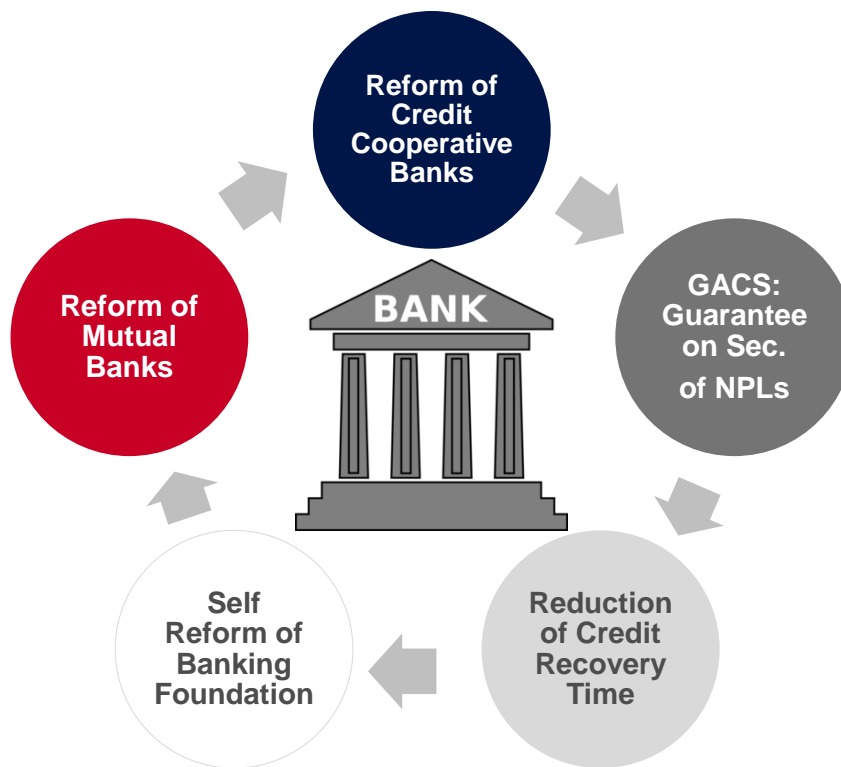
Recovery rate differ between significant and non significant banks

Significant Banks	Gross Exp	Net Exp	Gross % Share	Net % Share	Cover.e Ratio	Non Significant Banks	Gross Exp	Net Exp	Gross % Share	Net % Share	Cover.e Ratio
Total loans	1,517	1,383	100	100	8.8	Total loans	314	285	100	100	9.3
Performing	1,246	1,239	82.1	89.5	0.6	Performing	251	249	79.8	87.5	0.7
N.Performing	271	145	17.9	10.5	46.6	N.Performing	63	36	20.2	12.5	43.6
Bad debts	163	67	10.8	4.9	58.8	Bad debts	37	16	11.8	5.5	57.6
Likely to default	101	72	6.6	5.2	28.5	Likely to default	23	17	7.3	5.9	26.3
Past Due	7	6	0.5	0.4	21.6	Past Due	4	3	1.1	1.1	9.1

Source: Banca d'Italia

# Key Reforms of the Banking Sector (i)

How the Italian Banking System is changing



Source: Ministry of Finance

# Key Reforms of the Banking Sector (ii)

A better governance in a better regulatory framework

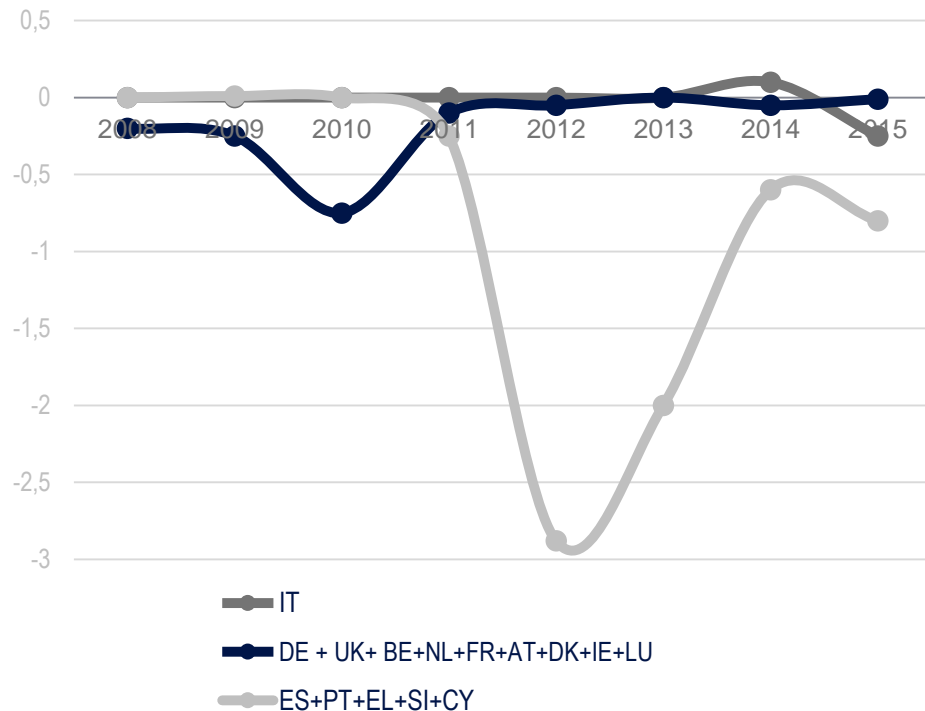
- **Consolidation of the banking sector**, through the reform of the largest mutual banks, the reform of the banking foundations, and the reform of the cooperative credit banks. These reforms will enhance the governance of these banks, fostering a **market oriented management model**
- **Reduction of the timing for credit recovery**, which has historically been longer in Italy than elsewhere among developed economies. These measures reduce credit-recovery costs and improve the potential price of the doubtful credits in the event of a sale, **closing the gap between bid and ask price for securitization**
- **The Guarantee on Securitisation of NonPerforming Loans (GACS)**, an instrument that the Treasury has made available to banks and financial companies so as to facilitate the dismantling of non-performing bank loans. This is a guarantee that the Treasury provides to requesting intermediaries. The State **guarantees only the senior tranches of securitisations**

Source: OECD

# Government interventions in the EU

Different waves of public support to the banking sector

- Government decision to put aside funds (**€20bn**) let Italy join the club of other EU Countries which already invested money in their banking system
- As of now about **€6bn** of public money will be injected in MPS' capital as a precautionary measure allowed by the EU regulation

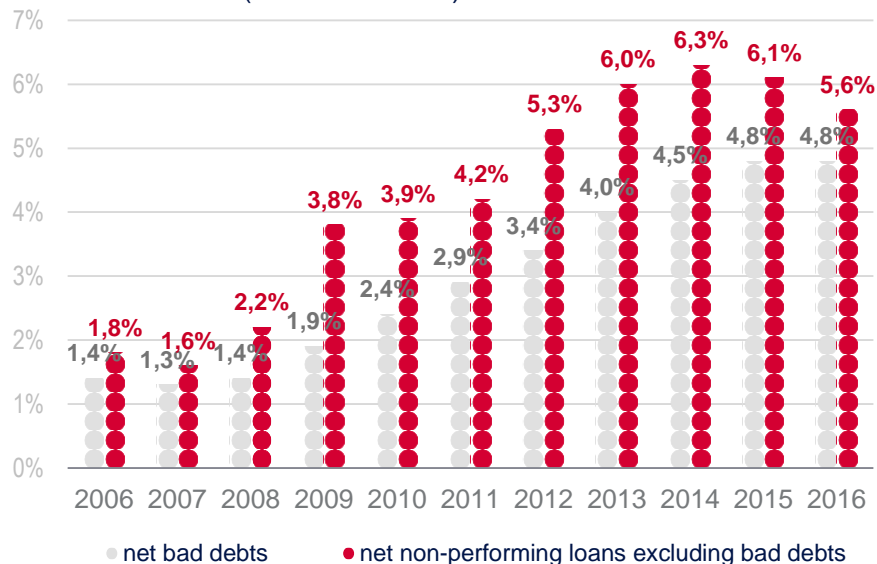


Source: AMECO

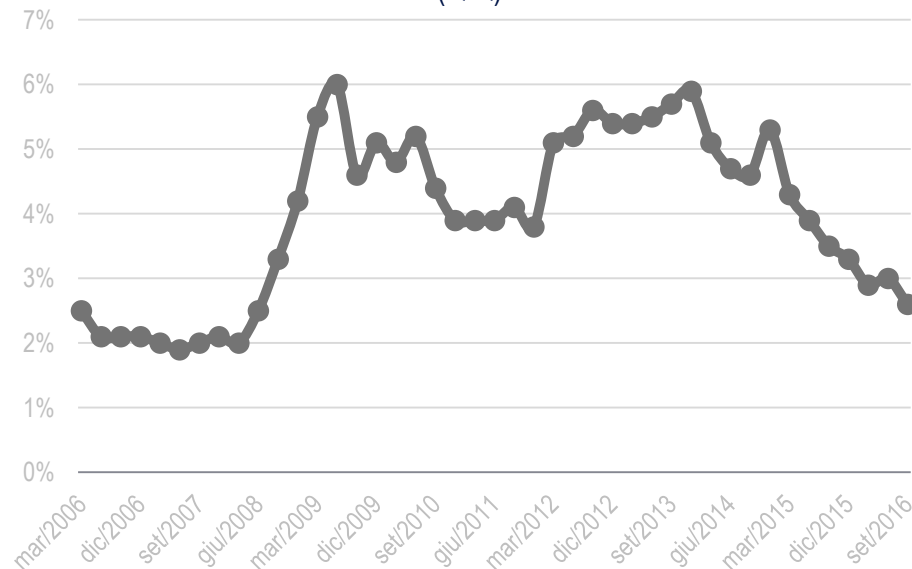
# The Weight of NPLs and its Perspectives

The rate of new NPLs is substantially declining, as the business cycle accelerates

## NPLs ratio (% of total loans)



## new non-performing-loan rate (Q/Q)



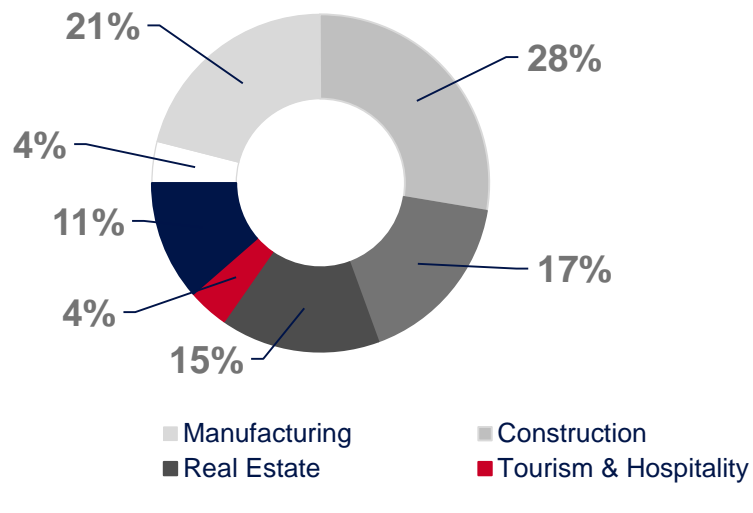
Source: Banca d'Italia

# Corporate NPLs

The Construction Sector make up almost 1/3 of the outstanding Corporate NPLs

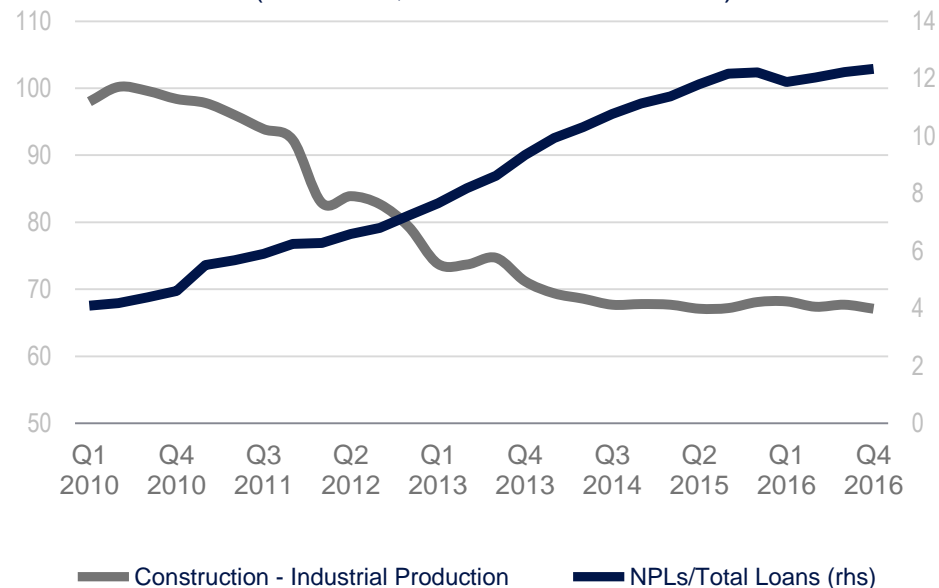
## NPLs across NFC sector of activity

(January 2017)



## Construction Production and NPLs

(Lhs: m/m; Rhs: % of Total Loans)



Source: Banca d'Italia and Datastream

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