The Italian economy on the eve of the national elections: and after?

A short Overview[1]

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For more than two decades, the Italian economy has swung between stagnation, recessions, and very slow growth (a few decimal points every year). Faced with crises, the Italian recessions were almost always the deepest and longest in the EU, and the recoveries the slowest. Some observers (including an Italian finance minister) have spoken of a kind of secular stagnation.

Today things seem to be different, as you can see by looking at the following slides.

In the second quarter of 2022, compared to the second quarter of 2021, the Italian GNP, driven by export and investment, increased by **4.7%,** more than the French one (**4.2%)** and the Eurozone average (**3.9%),** and much more than the German (**1.5%),** and the U.S. GDP (**1.7%).** In June 2022 the employment rate rose to **60.4%,** a level not reached since 1977, and the unemployment rate fell to **7.9**%, the minimum since 2009.

Several positive factors (or actors) have convergently worked, this time, to accelerate the exit from the crisis and the recovery:

- the proper functioning, during the crisis, of the social safety nets (layoffs);
- the strong recovery of export of goods and of the industrial production, especially of that part of Italian manufacturing which has in the last years regained, through technological and organizational innovation, a leadership position on international markets (not only in niche segments);
- a large set of public interventions to support the liquidity of companies, especially the SMEs, through guarantees, postponement of tax payments, credit moratoriums;

[1] Update on the Italian political and economic situation presented during a meeting of a leading international investment company's global advisory board (Paris, September 2022).

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- a strong recovery of tourism, after the lockdown, and of the construction sector, thanks to huge government incentives for renovation and energy efficiency of buildings;
- a considerable growth of credit supply to firms and households by a largely restructured and recapitalized Italian banking system, in a context of persistently low financial debt of households and businesses;
- the expectation of a huge injection (over 200 billion euro) of public investments through the National Recovery and Resilience Plan, able to drive private investments with significant multipliers;
- and, last but not least, the policies of a broad coalition government led by a person of great authority and competence like Mario Draghi, who has guaranteed the country international credibility and has wysely used public resources to mitigate the impact of the pandemic and the energy crisis on household and business budgets.
- without underestimating, of course, the role played by the ECB with the timely adoption and implementation of accommodative monetary policies, and by the European Union with its basket of tools and resources to face the impact of pandemic crisis and promoting and supporting the recovery (activation of the Stability Pact escape clause, temporary framework for the ban on state aid Next Generation EU, SURE,).

The convergence of these positive factors has this time overwhelmed several persistent critical factors that the country has been trying in vain to overcome for years, first of all:

- aging of the population due to a very poor birth rate
- undersizing and undercapitalization of SMEs (which represent a comparatively higher share of the Italian production system than that of any other major European country)
- stagnant total factor productivity (except for large and medium-sized manufacturing companies)
- high public debt and increase of sovereign yields
- strong influence of corporations and vested interests hindering the liberalization of the services market (and other structural reforms)
- length of trials and unpredictability of criminal, civil and administrative justice
- heavy bureaucratic burdens on households and business activities
- inefficiency, backwardness, and poor digitization of many public administrations, central and local

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Many of these critical issues are now addressed by the reforms envisaged by the Draghi Government's National Recovery and Resilience Plan (NRRP). Thus, among the economic operators and in the markets, the expectation has spread that, thanks to these reforms and related investments, most of these critical issues can finally be resolved.

In fact, the Draghi government has leveraged the virtuous constraints imposed by Next Generation EU (significant financial resources attributed to the Member States and above all to Italy in exchange for reforms and investments capable of structurally increasing the national growth potential) in order to obtain the green light from Parliament for a number of reforms. However, these reforms have yet to be implemented (and it is always in their implementation that the reforms face, in Italy, insurmountable opposition and obstacles). Anyway, in recent months, the widespread expectation of a solution to these historical critical issues has already produced interesting results. Let's take the example of the debt-to-GDP ratio's evolution. Thanks to growth and inflation, but also to this positive expectation, the Italian debt-to-GDP, after the peak reached in 2020 (155.6%), has immediately embarked on a path of rapid reduction at a good rate of 4/5 points per year; and in the first half of 2022, the state sector borrowing requirement amounted to half that for the same period of 2021.

* * *

Notwithstanding these good data, the forecasts for the short to medium term are very uncertain if not negative. Some of the positive factors that favored the post-pandemic recovery have faded or are failing:

- The monetary policy of the central bank is becoming much less accommodative,
- the rise in interest rates is weighing down the burden of public debt, and the general escape clause of the Stability Pact will not be further extended after 2023,
- a global stagflation scenario could penalize the Italian economy which is heavily dependent on exports,
- the rise in the price of gas and the envisaged interruptions in its supply could severely hinder the business of most of the Italian firms,
- many companies will have to face serious bottlenecks in the supply of raw materials and components and in the availability of qualified workforce,
- and, above all, the Draghi government had to resign, before being able to complete the arduous task of approving and implementing the structural reforms and to carry out the investments envisaged by the Recovery and Resilience Plan.

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The strength of the Draghi government consisted not only in the acknowledged authoritativeness, wisdom, and international reputation of its president, but also in the breadth of its parliamentary majority which excluded the possibility of any party to veto government decisions. The government that will arise from the elections of 25 September will not enjoy these favorable conditions.

It is almost certain that the right-wing coalition will win. This coalition, formed by the Lega (led by Salvini), Forza Italia (led by Berlusconi) and Fratelli d'Italia (led by Giorgia Meloni), is stable in the polls around 45-47 %, a percentage of votes sufficient to obtain a large majority in the two Houses of the next Parliament, considering that its competitors are divided into three camps and that the current electoral law favors winning coalitions (38% of the seats will be assigned with the first past the post single-member majority method, the remainder being assigned with proportional division among all parties exceeding the threshold of 3% of the votes cast). The leadership will go by far, according to the polls, to Giorgia Meloni, who will probably play the role of prime minister.

Giorgia Meloni's actual ability to govern remains an unknown, since she has never had the leadership of a public administration; but she has headed a national party for many years, taking it from 4% of votes to 25% of voting intentions, and is the chair of a European party of no small importance.

In recent times, Mrs. Meloni has toned down her initial Eurosceptic, sovereigntist and nationalist positions, and has shared, albeit from the opposition, the Draghi government's main choices and actions in support of the Ukrainian resistance, and in strengthening the Atlantic alliance and the EU. She has also adopted a responsible approach to public finance problems, distinguishing herself during the election campaign from her allies who are promising high tax cuts and heavy spending measures. Only the next years will reveal whether it is just an electoral positioning or a real change of her mind.

Judging by the programs and the electoral campaign, her coalition and her parliamentary majority will be traversed by considerable divisions not only on public finance guidelines, but also on foreign and European main political issues (Salvini and Berlusconi have repeatedly criticized the sanctions against Russia and have tried to stop or brake the Italian military support to Ukraine, although modest if compared to that of the USA and other European countries).

There is convergence instead between Mrs. Meloni party and the Lega in strengthening state intervention in the economy (first and foremost, but not only, when the country's strategic interests are at stake) and in in the slowdown in the

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liberalization of markets of goods and especially of services: this latter convergence could of course hinder the implementation of some of the reforms, which Italy is committed to make as part of the Recovery and Resilience Plan.

In any case, it seems clear to me that the real test for Giorgia Meloni, her new government and her majority will be precisely the carrying out of the NRRP, the implementation of the reforms it envisages, and the execution of the investments it has planned: an arduous undertaking, which the Draghi government has put on the right path but has not been able to complete: its success or failure will be decisive for the future of the Italian economy.

* * *

It is difficult to predict what the relationship between Mrs. Meloni and the European Union will actually be.

Today Mrs. Meloni affirms that with her Italy will play a leading and more proactive role in Europe and will steadily assert national interests, as France and Germany have always done in Brussels.

But Mrs. Meloni is president of the European conservatives and reformists party of which the ruling Polish Law and Justice party is a leading member: it is likely that Mrs. Meloni's Italy will support Poland in countering the thrusts towards a closer political and economic integration and towards the progressive adoption of the qualified majority rule in the European institutions. Moreover, Giorgia Meloni shares with the Poles their aversion to any drift of the European construction in the federal sense, opting, rather, for a confederation of sovereign states on the basis of an extensive application of the subsidiarity principle.

Not good news for those who believe that the challenges of this century, from climate change to growing threats to security and democratic freedoms, can only be faced by a more cohesive and more integrated Europe; and who are convinced that, consequently, Europe needs to be led by common institutions endowed with greater central fiscal capacity and the ability to rapidly and effectively take the decisions needed to defend the security and strategic interests of the Continent.

However, the toughness of the challenges that Europe and its Member States have to face is such that, in the end, Giorgia Meloni too could be convinced to set aside her ideological prejudices, adopt a more pragmatic approach and contribute to the strengthening of the European Union. The next few months will tell if this is a reasonable forecast, or a wishful thinking destined to be disproved by the facts.

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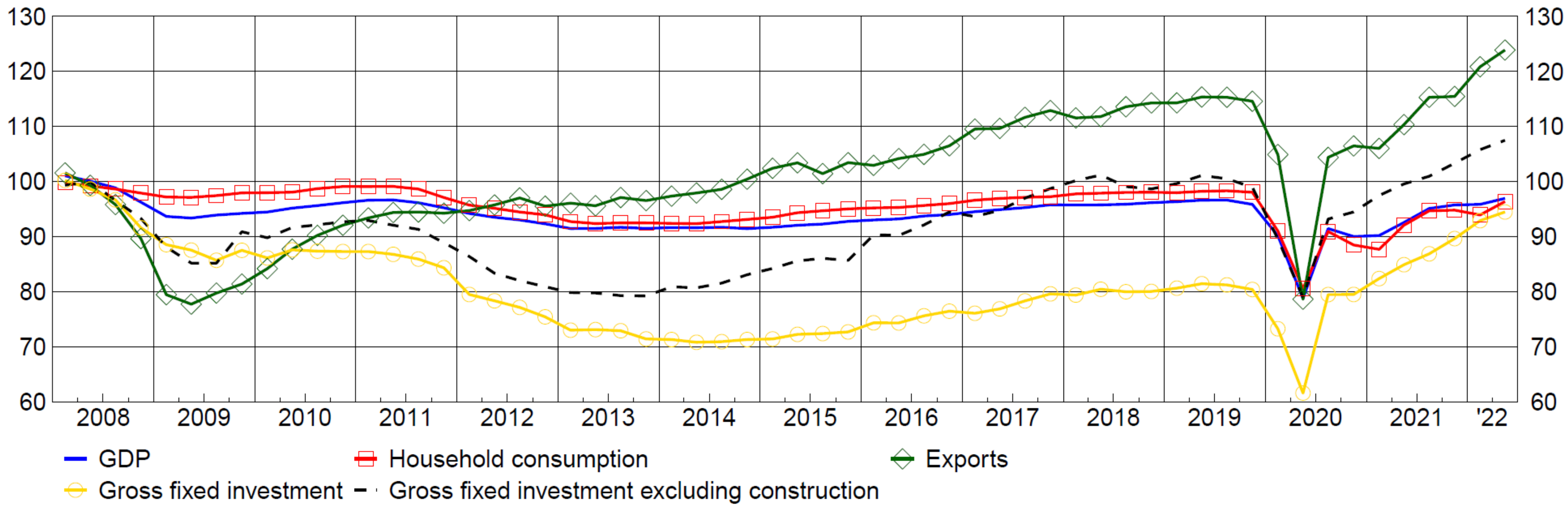
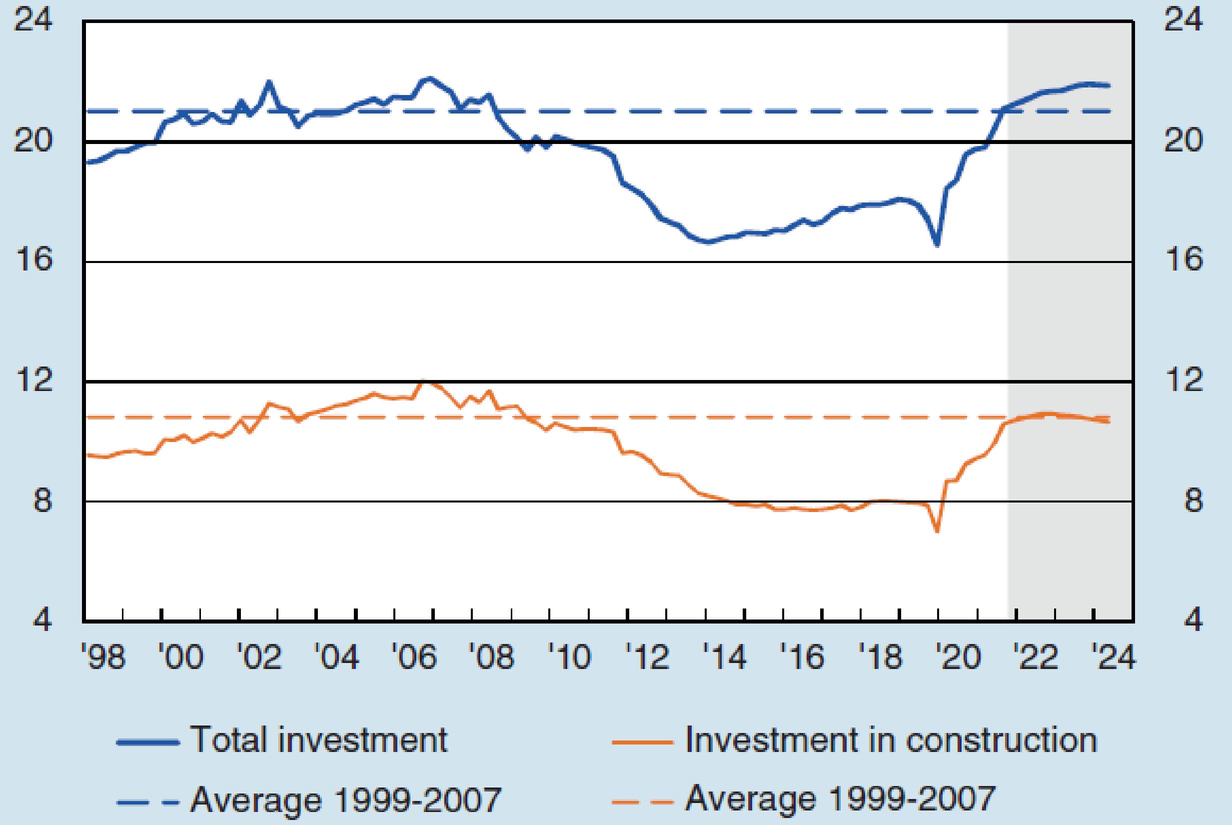
GDP and the main components of demand (1)



Source: Based on Istat data.

(1) Chain-linked volumes adjusted for seasonal and calendar effects.

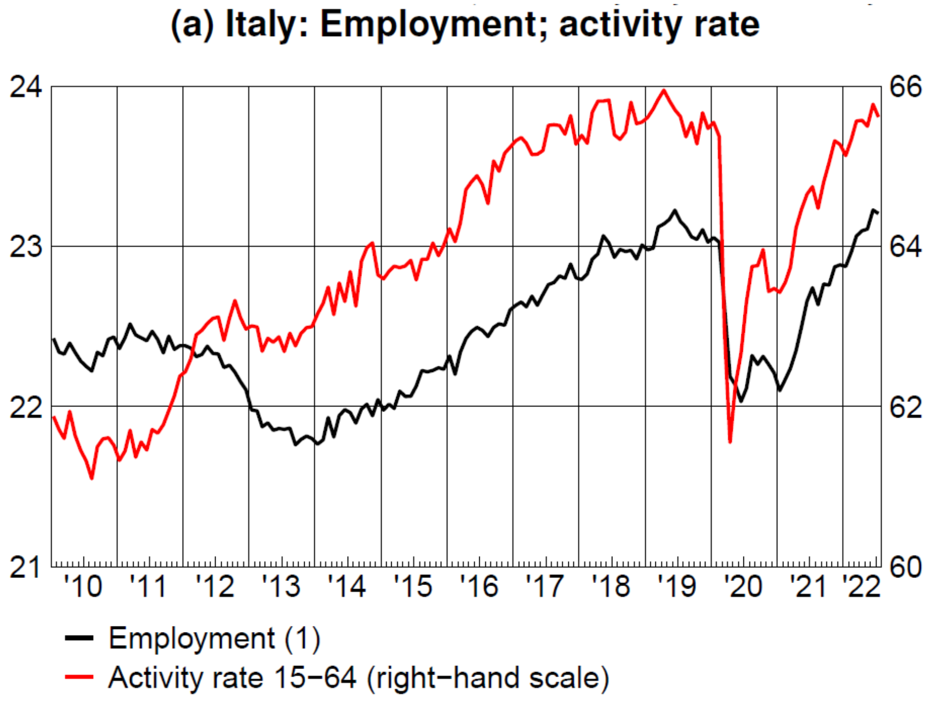
Investment as a percentage of GDP (1)
(quarterly data)

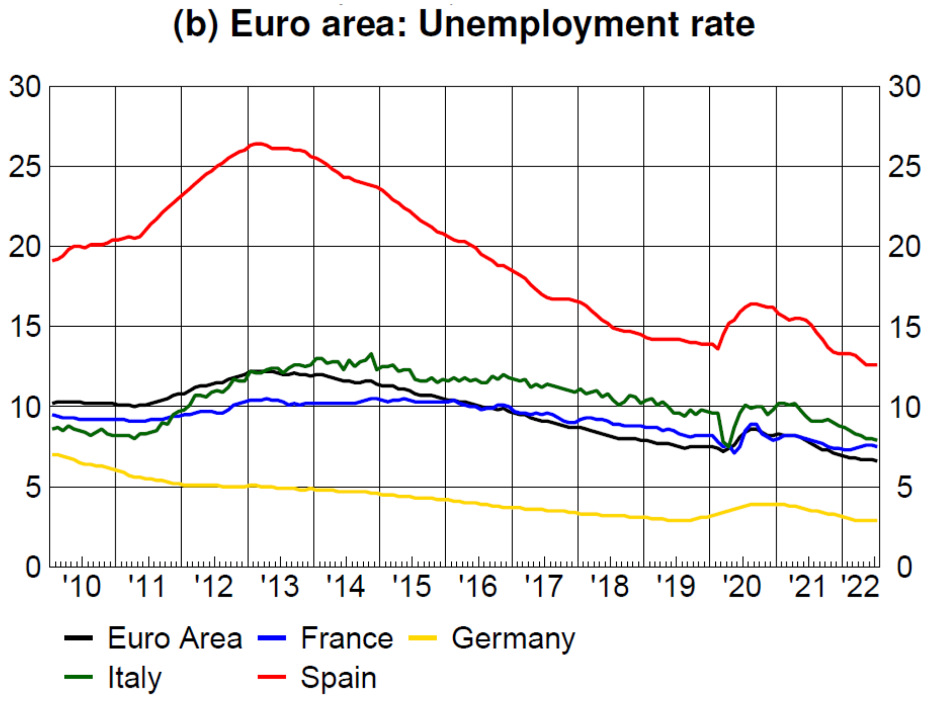


Sources: Based on Bank of Italy and Istat data.
(1) Data seasonally and calendar adjusted.

Main labour market indicators

(seasonally adjusted monthly data; per cent, unless otherwise specified)

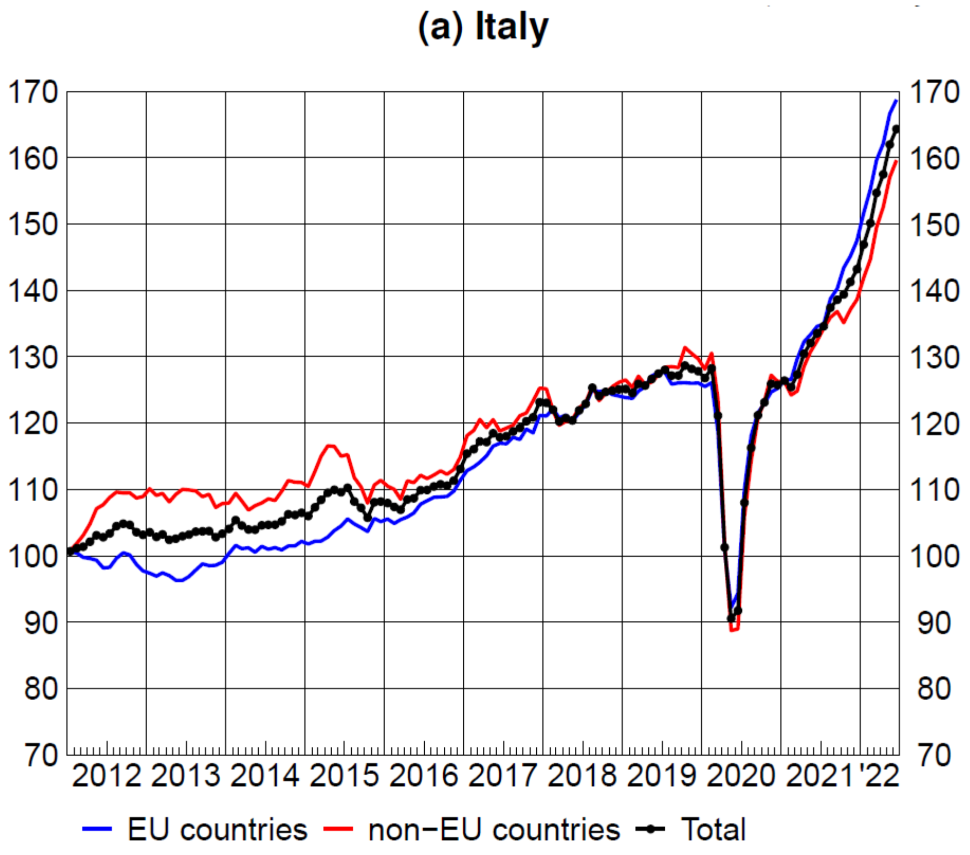


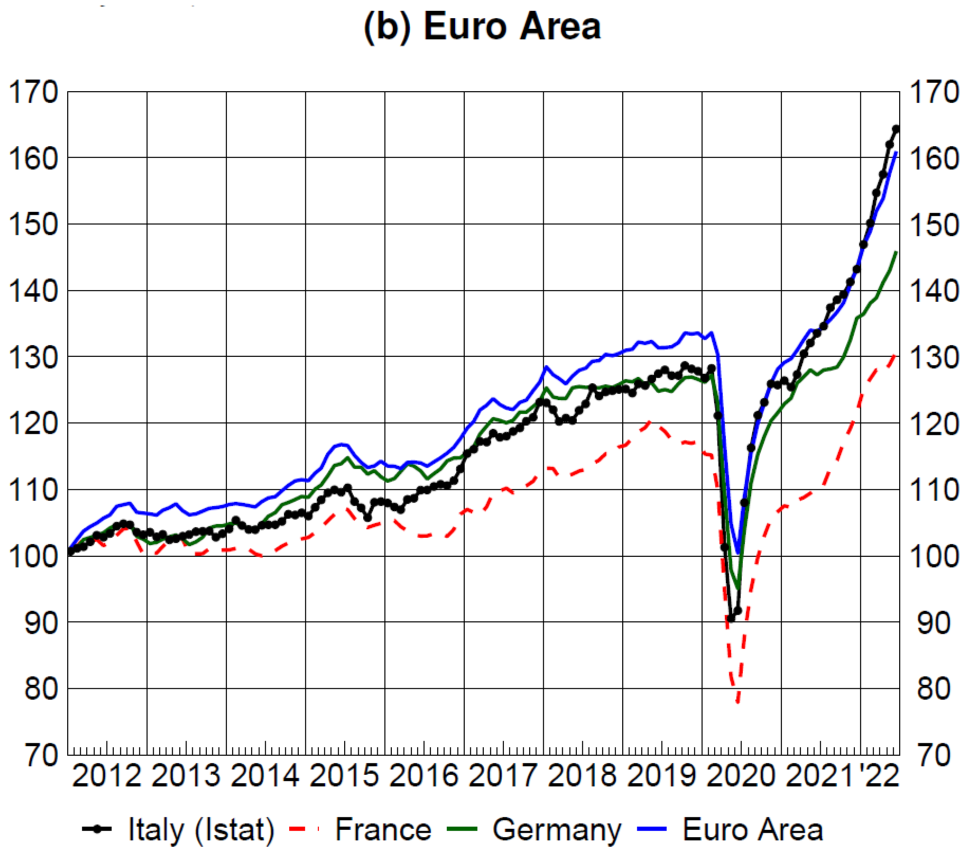


Sources: (a) Istat's labour force survey; (b) Eurostat; for Italy, Istat's labour force survey.
(1) Millions of persons.

Value of goods exports (1)

(seasonally adjusted monthly data)



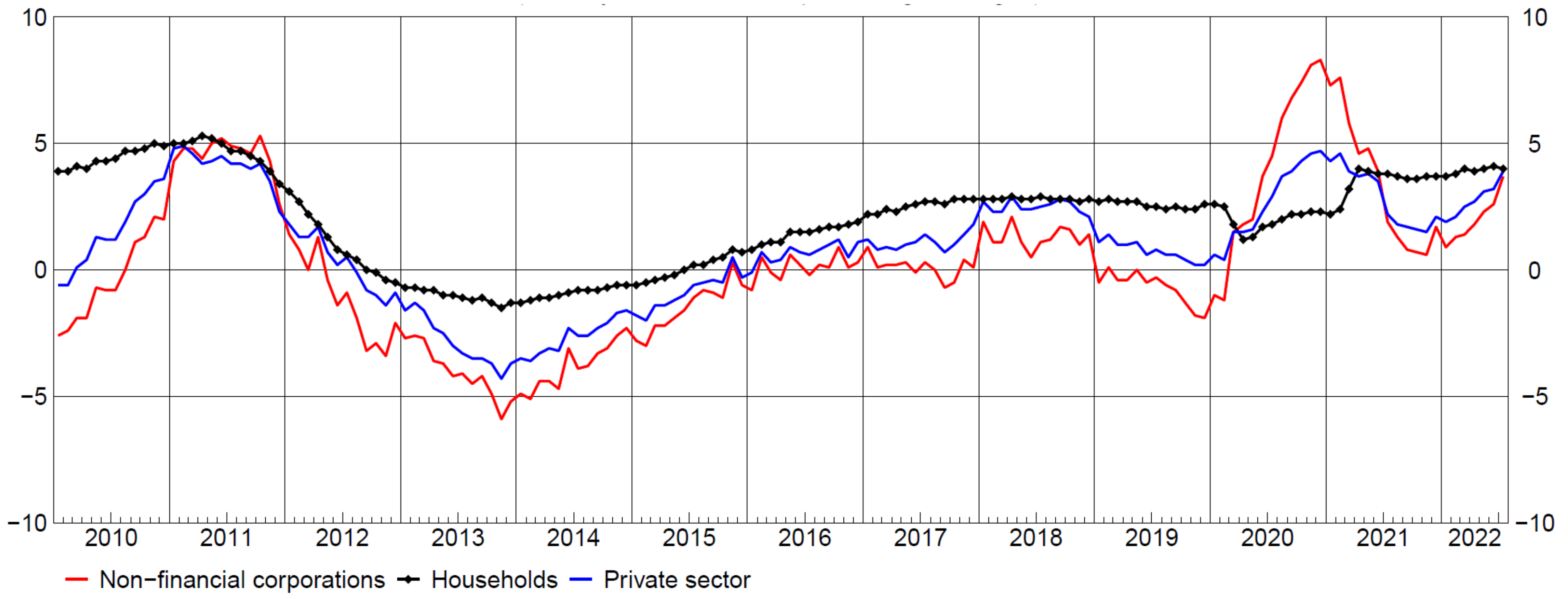


Source: Based on Eurostat and Istat data.

(1) Indices: Q4 2011=100; 3-month moving averages. Starting from February 2020, the United Kingdom is included in the non-EU aggregate.

Bank lending to the private sector (1)

(monthly data; 12-month percentage changes)

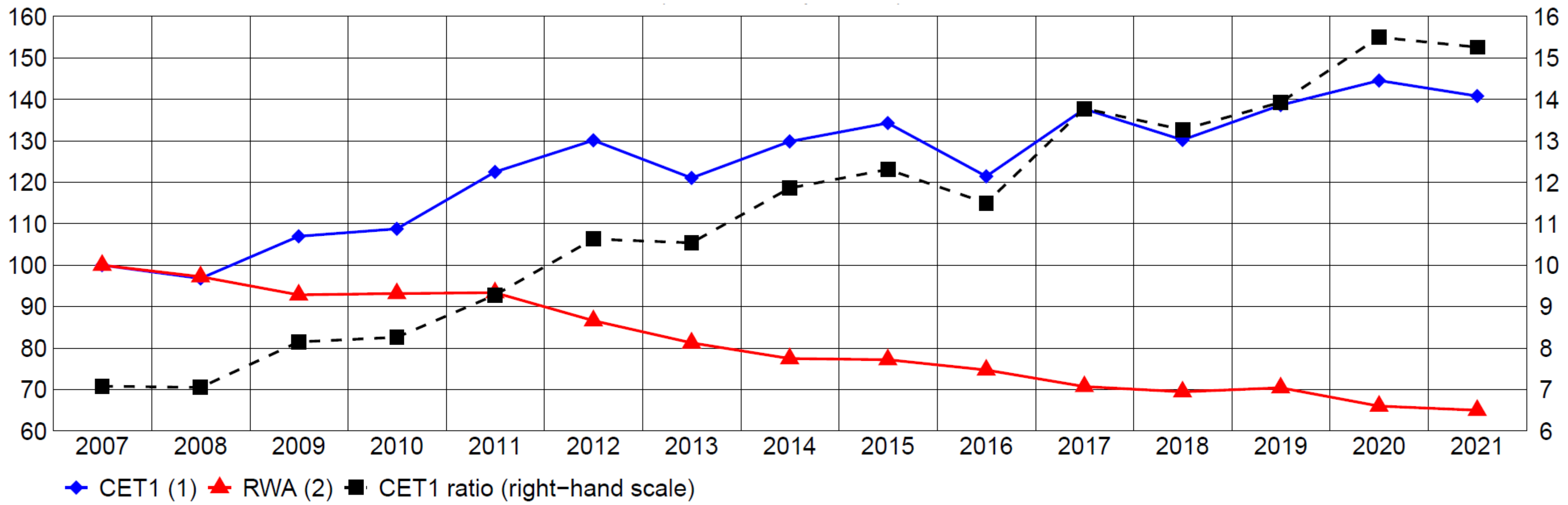


Source: Supervisory reports.

(1) Includes bad debts, repos and loans not recorded in banks' balance sheets because they have been securitized. The percentage changes are net of reclassifications, exchange rate variations, value adjustments and other variations not due to transactions; operations concluded with central counterparties are excluded.

Capitalization of banks and banking groups

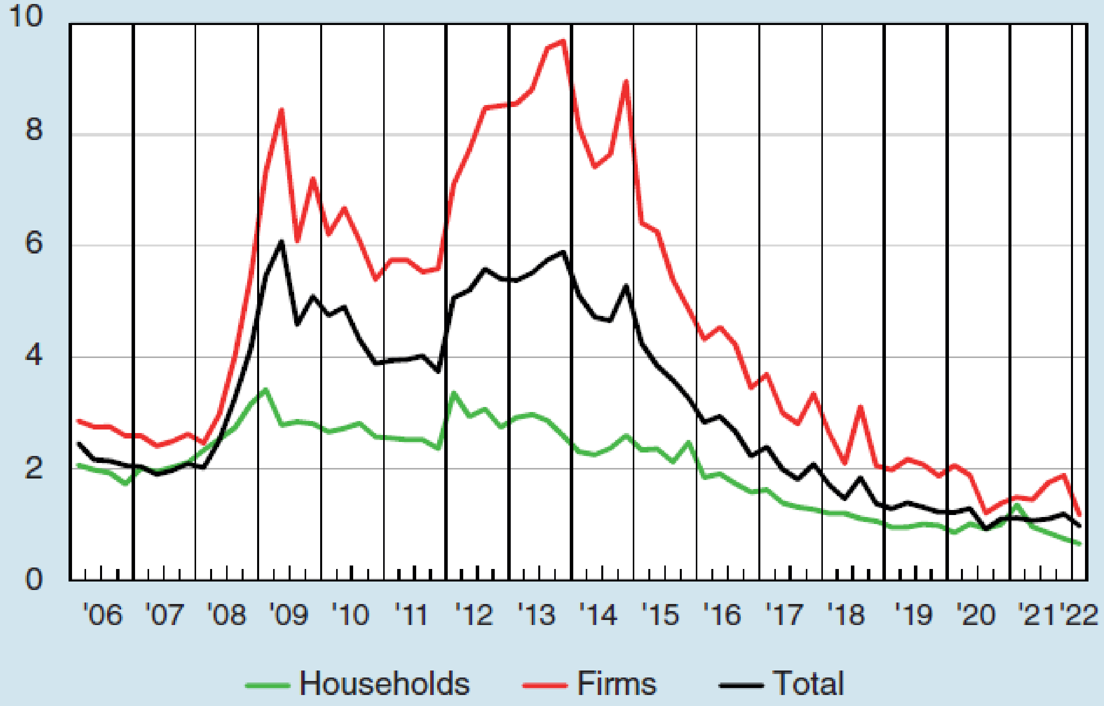
(indices and per cent)



Sources: Consolidated supervisory reports for banking groups, individual supervisory reports for stand-alone banks.
(1) Up to December 2013, the highest-quality capital component was the 'core tier 1'; from March 2014 it corresponds to CET1 ('common equity tier 1'). Index: 2007=100. – (2) 'Risk-Weighted Assets'. Index: 2007=100.

New non-performing loan rates (1)

(quarterly data; per cent)

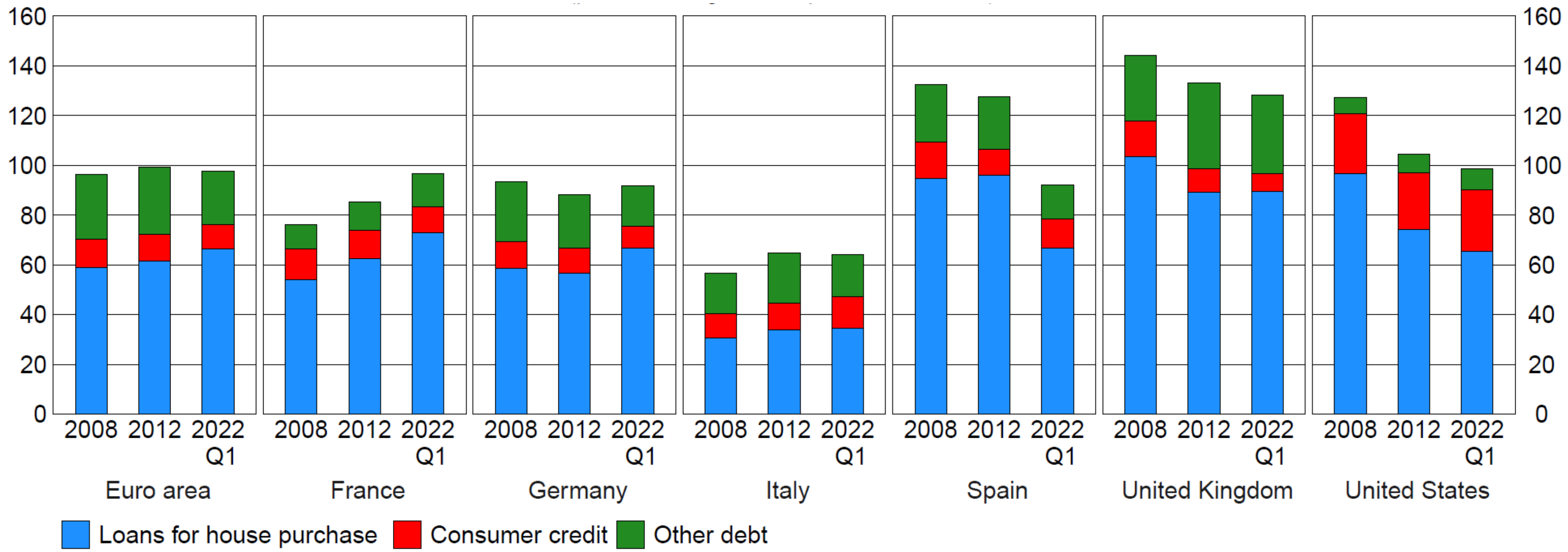


Source: Central Credit Register.

(1) Annualized quarterly flows of adjusted NPLs in relation to the stock of loans at the end of the previous quarter, net of adjusted NPLs. Data seasonally adjusted where necessary.

Financial debt of households (1)

(per cent of gross disposable income)

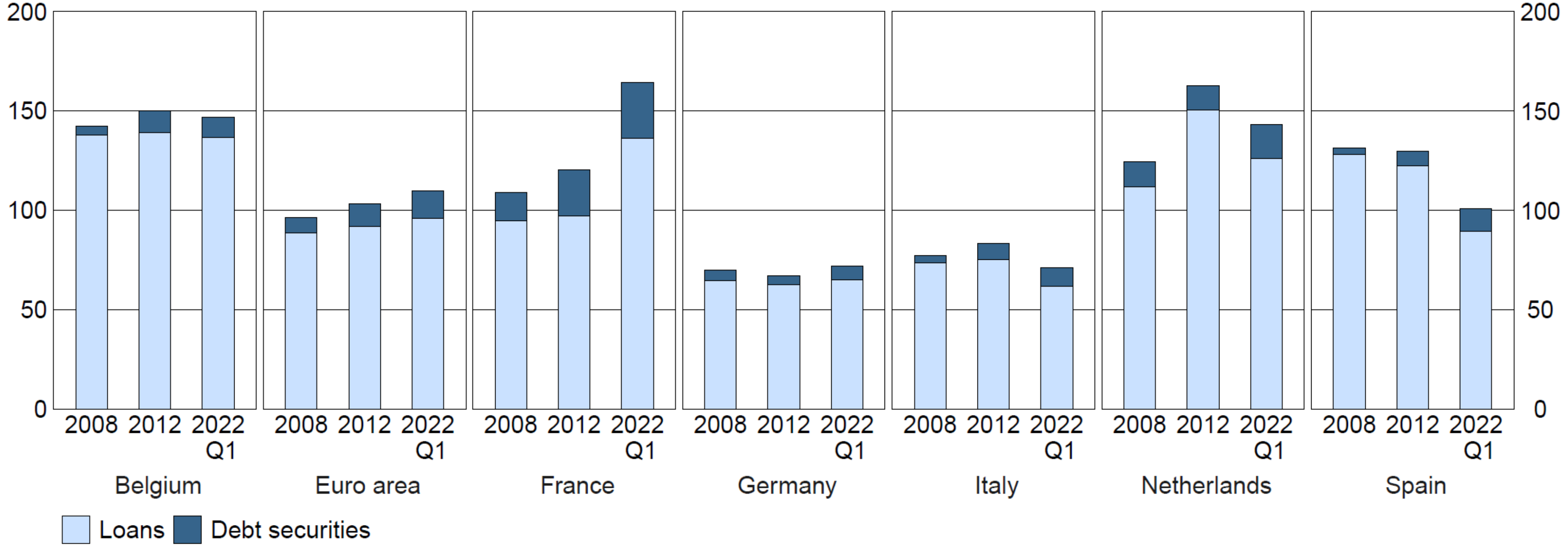


Sources: Bank of Italy and Istat for Italy, ECB for euro-area countries, Office for National Statistics and Bank of England for the United Kingdom, Federal Reserve System - Board of Governors and Bureau of Economic Analysis for the United States.

(1) Data refer to consumer and producer households; for the United States data refer to only consumer households. End-of-period data.

Firms' financial debt (1)

(as a percentage of GDP)

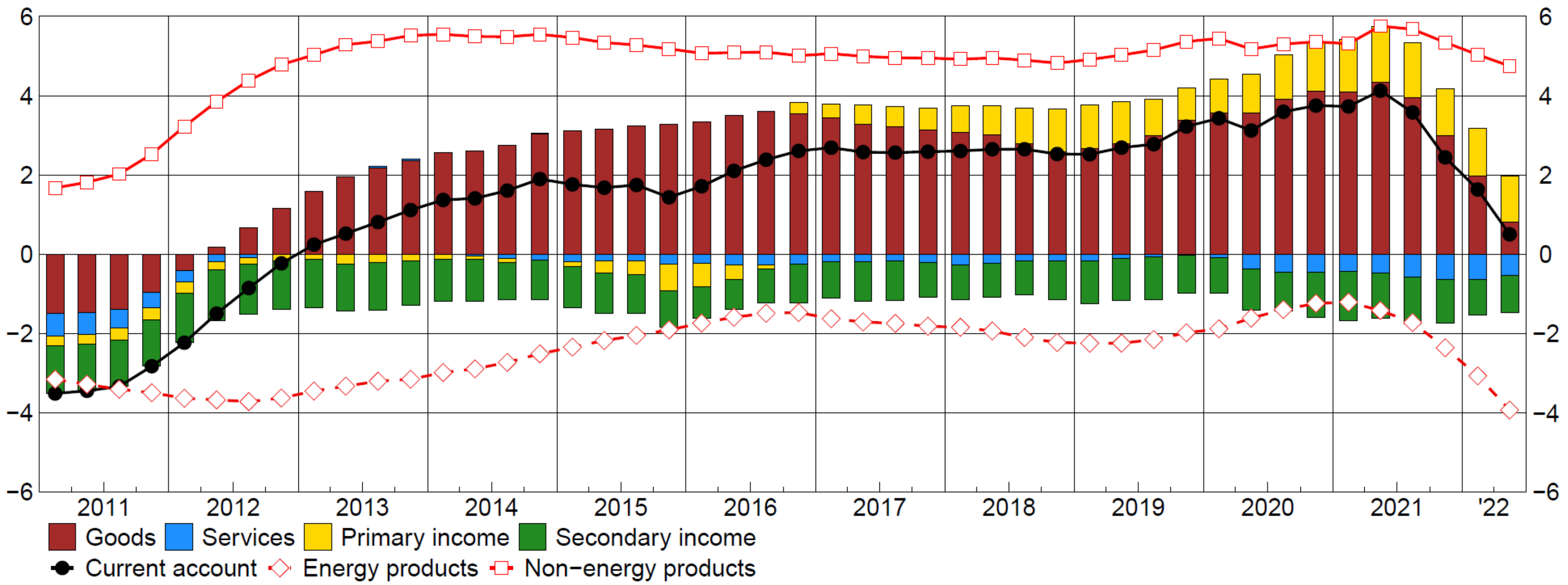


Source: based on ECB and Eurostat data.

(1) The data refer to the non-financial corporations sector. End-of-period data.

Current account balance and its main components

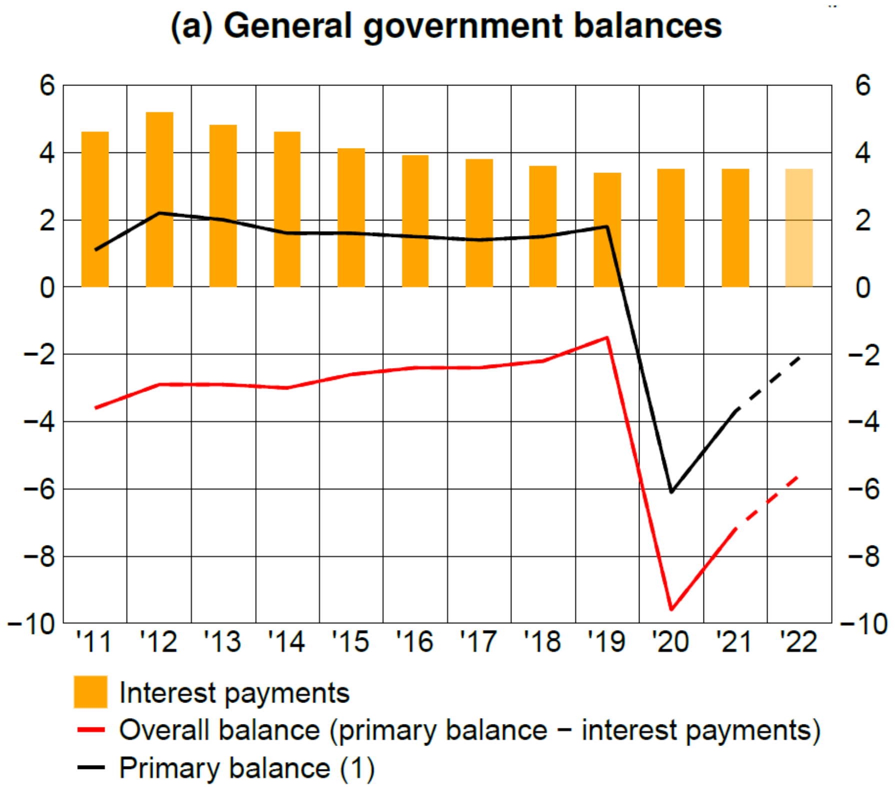
(per cent of GDP; 4-quarter moving average)

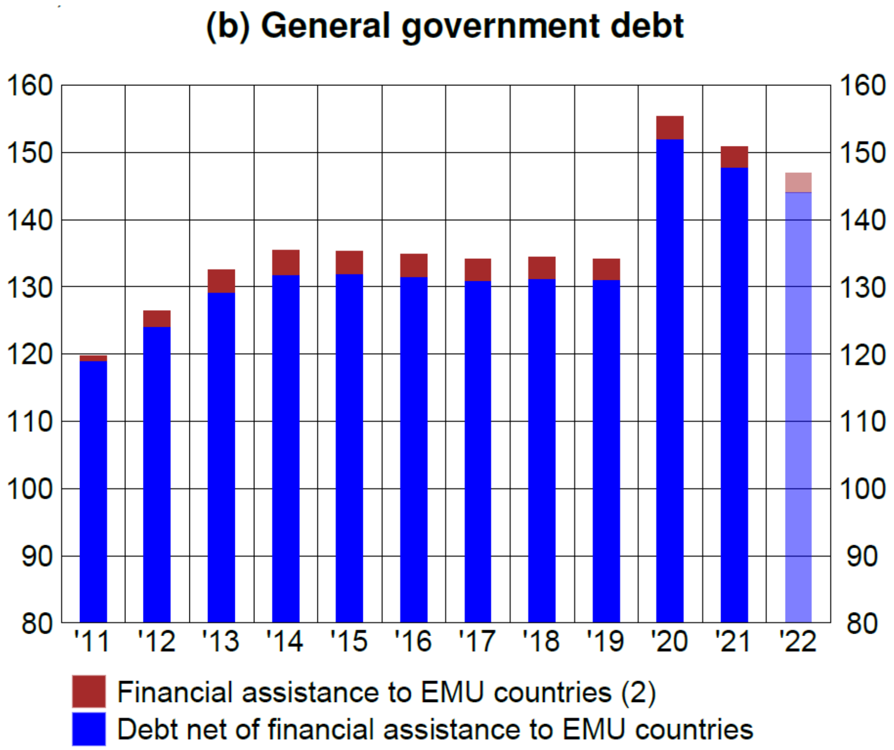


Source: Istat for GDP; based on Istat foreign trade data for the breakdown between energy and non-energy products.

Main public finance indicators

(per cent of GDP)





Source: for the period 2011-2021 Istat (for the items of general government consolidated accounts and GDP) and Bank of Italy (for debt); for the 2022 official targets Ministry of Economy and Finance – Economic and Financial Document (April 2022).
(1) Overall balance net of interest payments. – (2) Loans granted to countries belonging to the EMU, both bilaterally and via the European Financial Stability Facility (EFSF), and contribution to the European Stability Mechanism's (ESM) paid-in capital.

Main public finance indicators (European comparison)

(per cent of GDP)

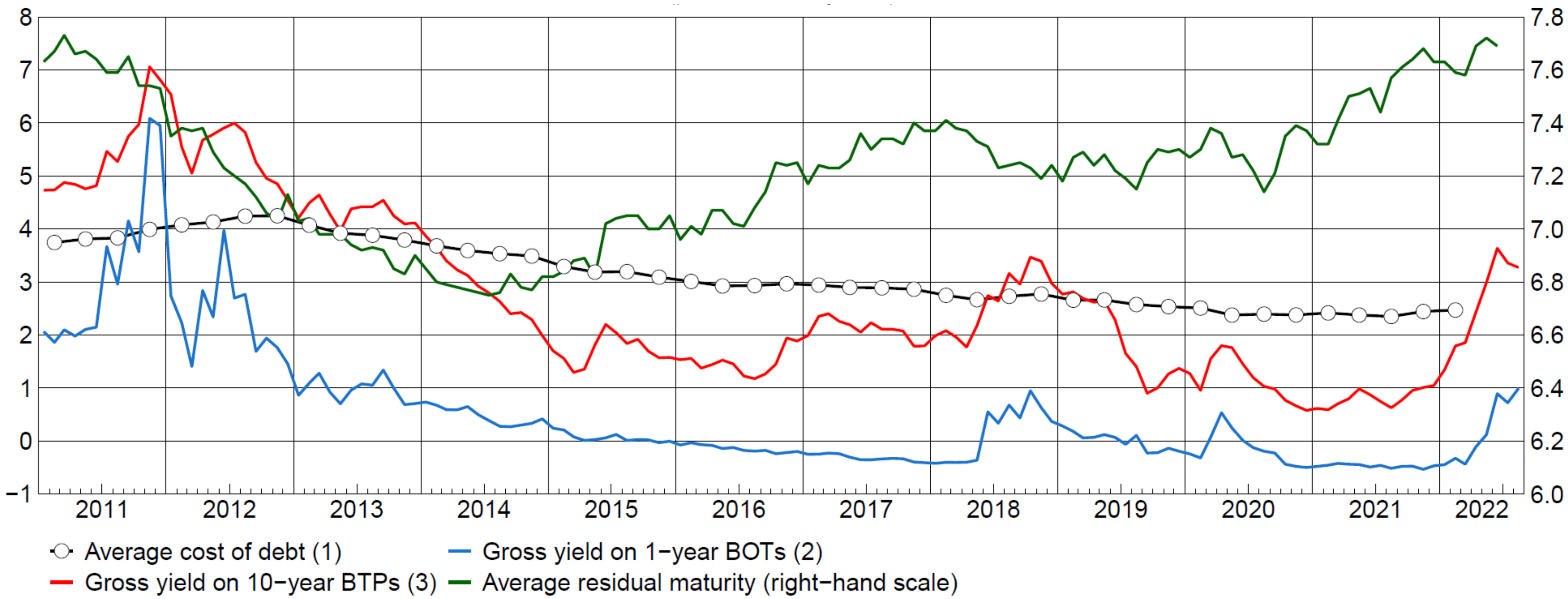
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Overall balance													
Italy	-3.6	-2.9	-2.9	-3.0	-2.6	-2.4	-2.4	-2.2	-1.5	-9.6	-7.2	-5.6	-3.9
France	-5.2	-5.0	-4.1	-3.9	-3.6	-3.6	-3.0	-2.3	-3.1	-8.9	-6.5	-4.6	-3.2
Germany	-0.9	0.0	0.0	0.6	1.0	1.2	1.3	1.9	1.5	-4.3	-3.7	-2.5	-1.0
Spain	-9.7	-11.6	-7.5	-6.1	-5.3	-4.3	-3.1	-2.6	-3.1	-10.3	-6.9	-4.9	-4.4
Euro area	-4.2	-3.8	-3.1	-2.5	-2.0	-1.5	-0.9	-0.4	-0.7	-7.1	-5.1	-3.7	-2.5
Primary balance (1)													
Italy	1.1	2.2	2.0	1.6	1.6	1.5	1.4	1.5	1.8	-6.1	-3.7	-2.1	-0.8
France	-2.4	-2.4	-1.8	-1.7	-1.6	-1.8	-1.2	-0.6	-1.6	-7.6	-5.1	-3.2	-1.7
Germany	1.6	2.3	1.9	2.2	2.4	2.3	2.4	2.8	2.3	-3.7	-3.1	-2.0	-0.5
Spain	-7.3	-8.5	-3.9	-2.6	-2.3	-1.5	-0.6	-0.2	-0.8	-8.0	-4.7	-2.8	-2.4
Euro area	-1.2	-0.8	-0.3	0.1	0.3	0.6	1.0	1.4	1.0	-5.6	-3.6	-2.3	-1.1
Gross public debt													
Italy	119.7	126.5	132.5	135.4	135.3	134.8	134.2	134.4	134.1	155.3	150.8	147.0	145.2
France	87.8	90.6	93.4	94.9	95.6	98.0	98.1	97.8	97.4	114.6	112.9	111.2	109.1
Germany	79.4	80.7	78.3	75.3	71.9	69.0	64.6	61.2	58.9	68.7	69.3	66.4	64.5
Spain	69.9	90.0	100.5	105.1	103.3	102.8	101.9	100.5	98.3	120.0	118.4	115.1	113.7
Euro area	88.3	92.9	95.3	95.5	93.4	92.5	89.9	87.8	85.7	99.2	97.4	94.7	92.7

Source: for Italy for the period 2011-2021 Istat (for the items of general government consolidated accounts and GDP) and Bank of Italy (for debt); for the 2022-2023 official targets Ministry of Economy and Finance, Economic and Financial Document (April 2022). For other countries and for euro area: AMECO, European Commission, Spring 2022 Economic Forecast (16 May 2022).

(1) Overall balance net of interest payments.

Average cost and average residual maturity of the public debt

(per cent and years)

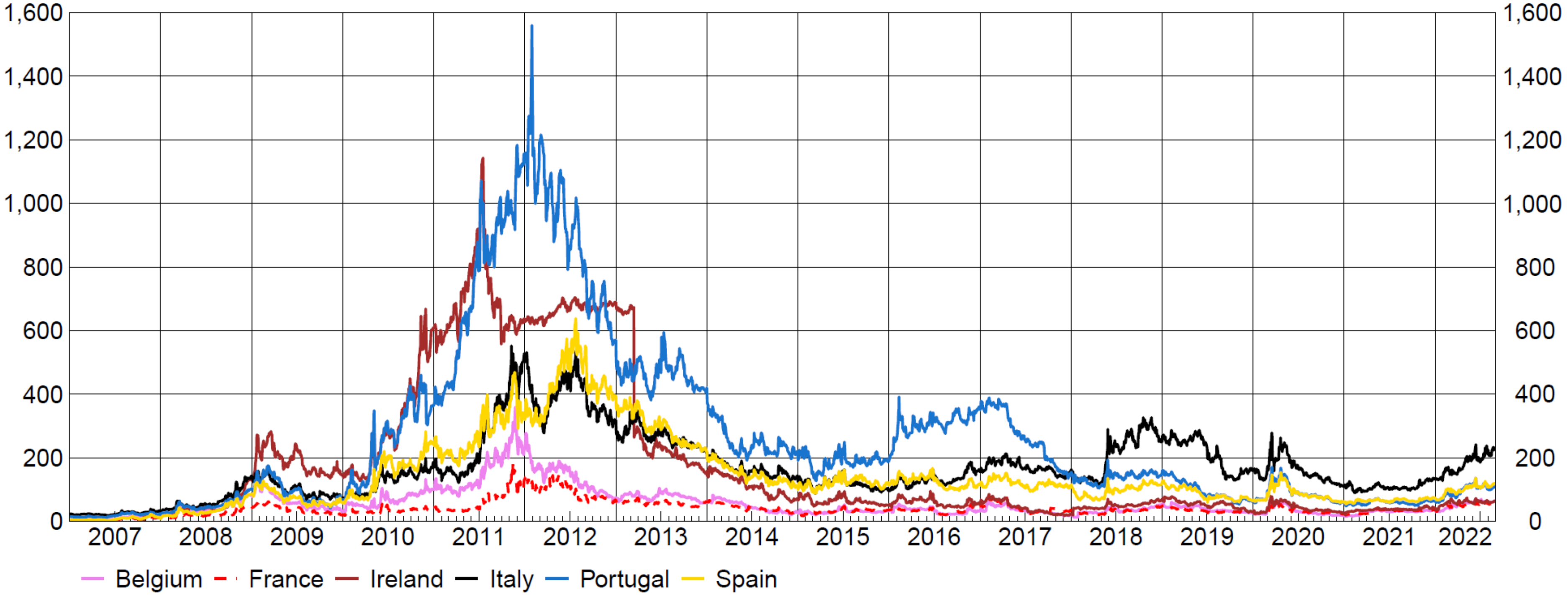


Source: Istat, for interest expense.

(1) Ratio between interest expense in the preceding 4 quarters and the stock of the debt at the end of the year-earlier quarter. – (2) The yield at issue is the average, weighted by the issue amounts allotted, of the compound allotment rates at the auctions settled during the month. – (3) Average monthly yield at maturity of the benchmark traded on the online government securities market.

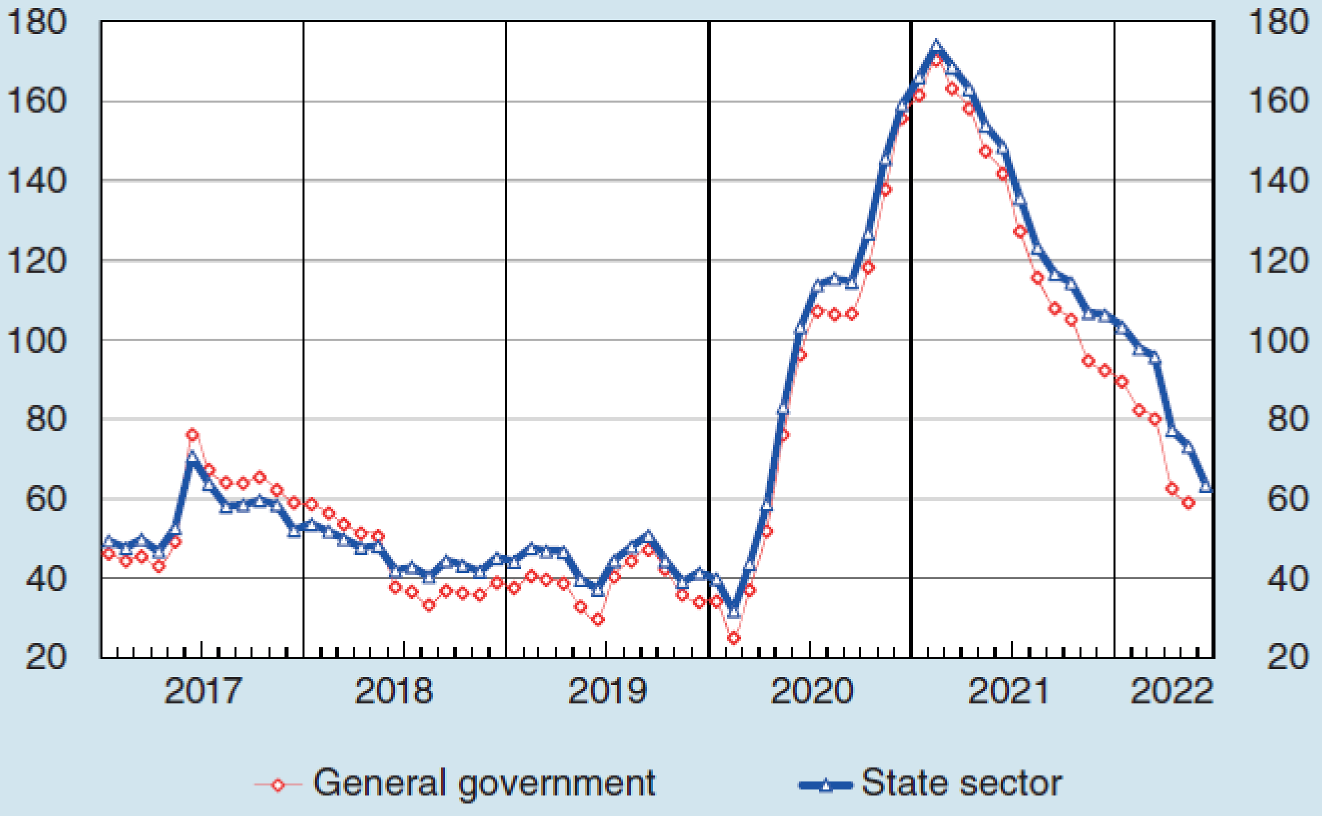
Yield spreads between euro-area countries and German 10-year government bonds

(daily data; basis points)



Sources: Based on Bloomberg data.

12-month cumulative borrowing requirement
(monthly data; billions of euros)



Source: For the state sector, Ministry of Economy and Finance (MEF).