

## Italy: 4Q data unlikely to swing election result

Economic data from Italy on Friday is unlikely to tip Sunday's vote. But from Monday, as negotiations to form a government kick off, the economy will become a significant theme in political debate, with a particular focus on fiscal promises



Source: istock

### Private investment and exports the main growth drivers in 4Q17

The recent set of Italian economic data releases point to a continuation of the ongoing economic recovery. Earlier today, Istat released the complete set of GDP data for 4Q17, which confirmed that the Italian economy has expanded by 0.3% QoQ (1.6% YoY) in 4Q17. The main focus of the release was the detailed demand breakdown, which broadly confirmed our expectations.

- Private investment was indeed the main driver (0.3% QoQ contribution), along with stronger than expected net exports (0.3% contribution), fuelled in turn by strong exports.
- As expected, private consumption (0.1% contribution) came in on the soft side, as did inventory accumulation, which acted as a drag (-0.4% contribution).
- The supply side angle confirmed the prevalent role of manufacturing in value added generation, with services following at a distance and value added in agriculture in

contraction.

## 2018 data points to continued recovery

What's in store for 1Q18? Soft and hard data on 1Q released year to date have consistently shown a continuation of the current recovery.

- In January and February, business confidence data, while showing some volatility, has confirmed that the business community remains upbeat.
- Manufacturer confidence, which is hovering around recent highs, is being corroborated by December order book data and points to accelerating orders, with the export drive and the domestic component now more balanced.
- Service sector confidence, which is better correlated to domestic demand, rebounded in February after backtracking in January. Declining confidence among retailers possibly reflects the ongoing structural shift towards e-commerce rather than a deteriorating consumption environment.

To be sure, recent labour market data has not been particularly supportive. In January, employment increased only marginally (+0.1% MoM) and unemployment rose (+2.6% MoM, the first increase in six months) translating to an increase in the labour force. As usual, while the flow from the pool of inactive workers into that of the unemployed might be seen as a sign of increased confidence in finding a job, the parallel increase in the unemployment rate to 11.1% (from 10.9% in December) has been grabbing the headlines. That's not good for incumbents two days before the elections.

All in all, we remain confident that in 1Q17 the Italian economy will continue expanding at a 0.3/0.4% with a pattern of growth that should broadly confirm that of 4Q17.

## Recent economic and fiscal data should not swing the vote but will regain relevance from Monday

The set of data released today is unlikely to tilt the balance of votes in Sunday's elections. It represents food for thought from Monday onwards, when economic themes will re-gain relevance in the negotiations to form a new government. We expect the labour market theme to take centre stage here, as recent trends in employment creation have been dominated by unpopular fixed-term contracts over the open-ended format.

Even more crucially, the post-vote political debate will have to re-focus on fiscal issues. Istat data released yesterday on 2017 annual aggregates was rather comforting: Italy posted a lower than expected 1.9% headline deficit/GDP, which built on a bigger than expected primary surplus of 1.9% of GDP (from 1.5% in 2016). Together with a declining interest rate bill, this helped to bring the debt/GDP ratio down to 131.5% (from 132% in 2016). According to our calculations, the 0.5% decline should be enough to prompt Eurostat to classify as public debt some of the public money put in compulsory administrative liquidation from the two Venetian banks Veneto Banca and Banca Popolare di Vicenza.

The decline in the debt/GDP ratio should be safely in the bag and will likely be a key starting point for any future discussion on the Italian fiscal policy stance. After a vocal campaign with eye-catching tax-cut promises, observers will be keenly monitoring whether and how these can be matched with the hard reality of internal and external constraints. The chances of Italy playing

any role in the construction of a new European governance will also depend on how its fiscal dilemma will be resolved.

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