



Ministero dell'Economia e delle Finanze
Dipartimento del Tesoro

Mercati finanziari, economia reale e politiche economiche nel contesto di crisi internazionale. E l'Italia?

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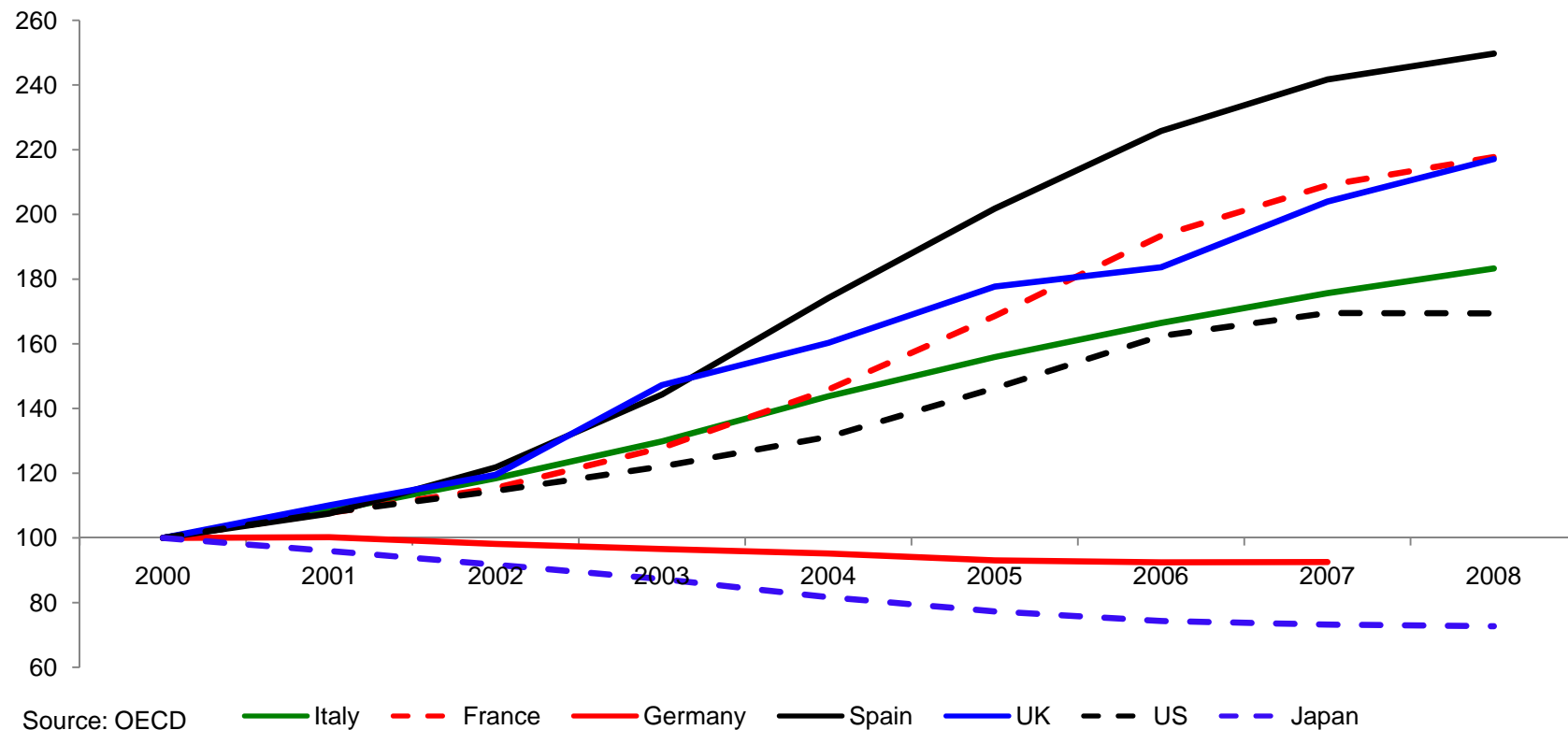
Analysis Meeting

Milan, January 19, 2009

Transmission channels and critical issues

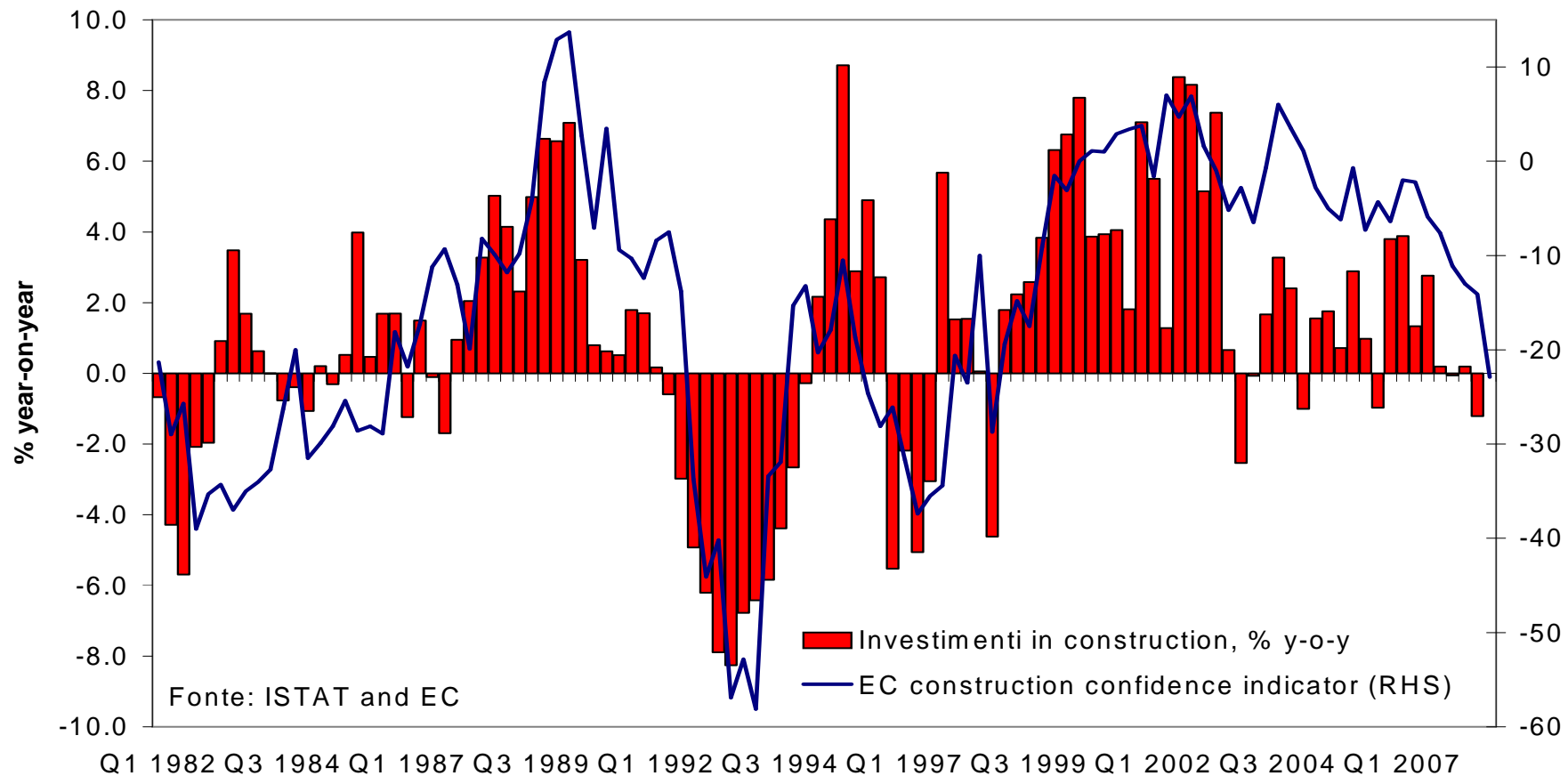
- n Housing market
- n Wealth effects
- n Credit crunch
- n Confidence
- n Foreign trade
- n Oil prices and the euro
- n Labour market
- n Productivity and structural issues
- n Fiscal sustainability

Moderate house price growth vs. other countries



Over the period 2000-08, house prices grew fast in most advanced countries (excluding Germany and Japan). Growth has been much faster in Spain, France and the UK than in Italy, where sharp adjustments seem unlikely.

The construction cycle has turned



The construction cycle has moderated long ago and construction confidence has declined since 2Q07. The 1992-93 downturn seems unlikely to repeat, although near-term contraction will probably be significant.

The construction sector is not oversized

Weight of construction sector over total activity in Italy (1983-2007)

	1983-1987	1988-1992	1993-1997	1998-2002	2003-2007
Investment in construction/GDP (%)	11,47	11,03	9,61	9,51	10,47
Contribution of construction to growth (pp)	0,00	0,06	-0,02	0,08	0,02

Source: Datastream

The share of the construction sector over total economic activity has not increased significantly over the years. Even in 1998-02, the contribution to GDP growth was modest. A negative contribution was recorded in 2003-07.

Housing sector demand and business cycle

Share of output variation explained by housing demand shocks

	Italy	US	UK	Germany
1970-1982	12.5	6.0	2.4	2.5
1983-2007	5.0	22.5	2.3	2.0

Source: IMF (weo, April 2008)

The share of output explained by housing demand in 1983-07, although significant by international comparison, decreased considerably versus 1970-82. The housing sector has not been a main driver of the business cycle in Italy.

Less vulnerable to a downturn in housing wealth ...

- § In Italy, the marginal propensity to consume out of housing wealth is slightly negative and weak by international comparison.
- § This is partly due to the limited development of the mortgage market and scarce opportunity to use housing wealth as collateral.
- § Thus, risks for Italy's private consumption via lower real wealth seem to be contained.

WEALTH EFFECTS

... as the marginal propensity to consume is flat

	Italy	US	UK	Germany
Marginal propensity to consume out of housing wealth	-0,01 (0.02)*	0.14	0.07	0.06
Mortgage Market index	0.26	0,98	0.58	0.28

Source: IMF, WEO (April 2008)

* Muzzicato, Sabbatini, Zollini, (Bank of Italy), "Prices of residential properties in Italy: constructing a new indicator"

Consumers are vulnerable to swings in financial wealth

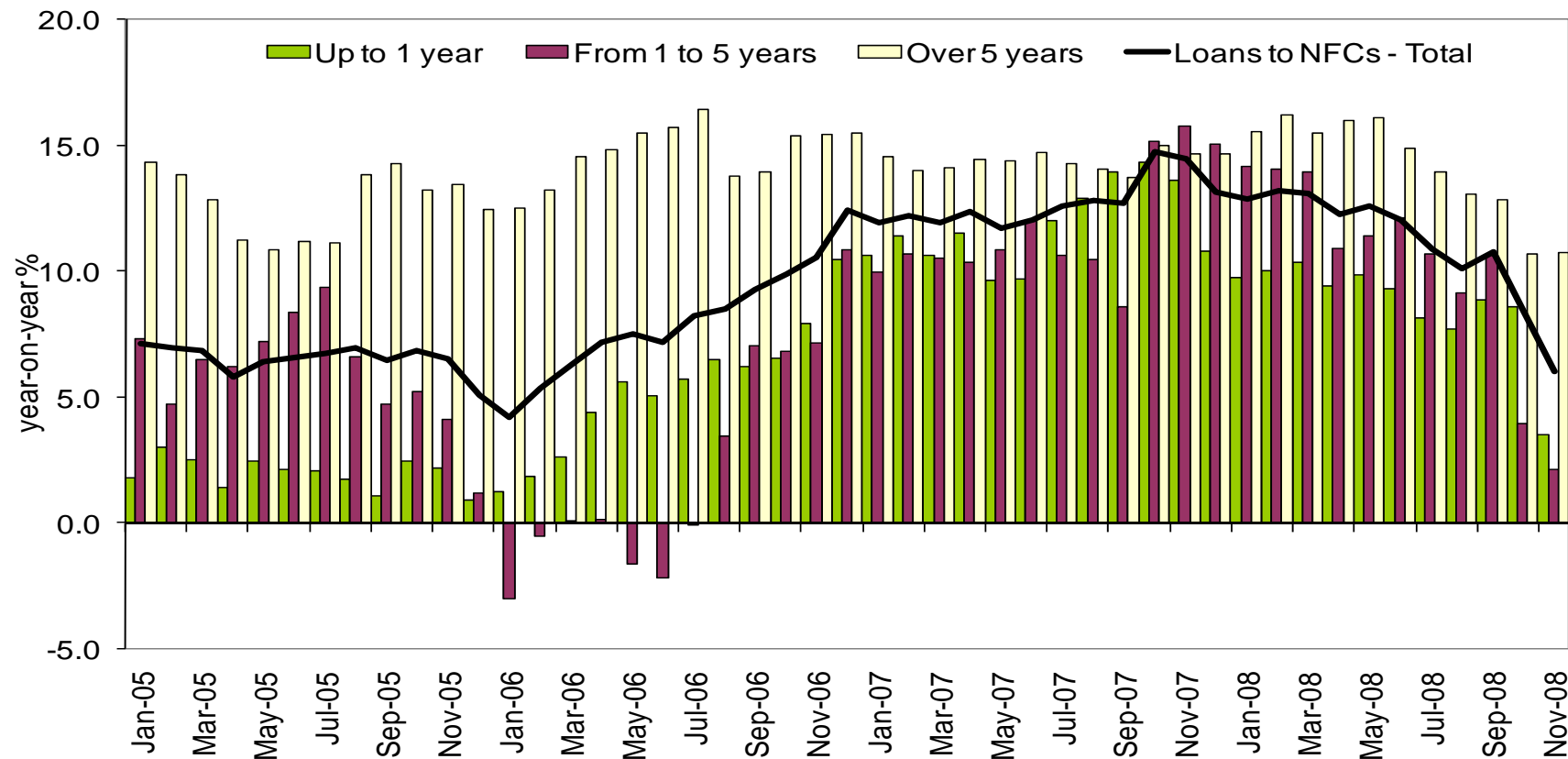
- n According to the Bol, Italy's marginal propensity to consume out of financial wealth (about 6%) is in line with that in Anglo-Saxon countries.
- n In 2Q08, Italy's total financial wealth declined a bit more than in other countries:

Financial wealth year-on-year percentage change in 2008Q2

	Italy	France	Germany	UK
Currency and deposits	7.5	4.1	5.0	8.1
Bonds and securities	10.1	4.7	0.7	-36.5
Shares and other equity	-27.6	-21.4	-17.8	-12.8
Mutual fund shares	-29.0	-12.5	-1.3	0.3
Insurance technical reserves and others	-3.1	3.6	2.1	-5.3
Total financial wealth	-7.0	-2.6	4.4	-3.0

Source: Prometeia

Moderation but no collapse for now in credit to firms ...

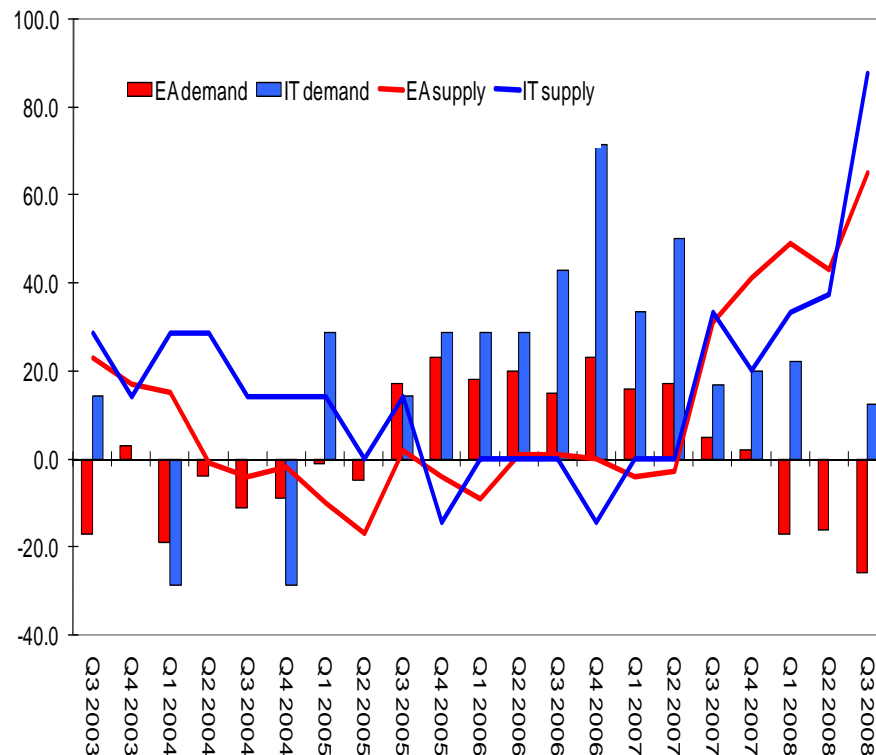


Source: Bank of Italy

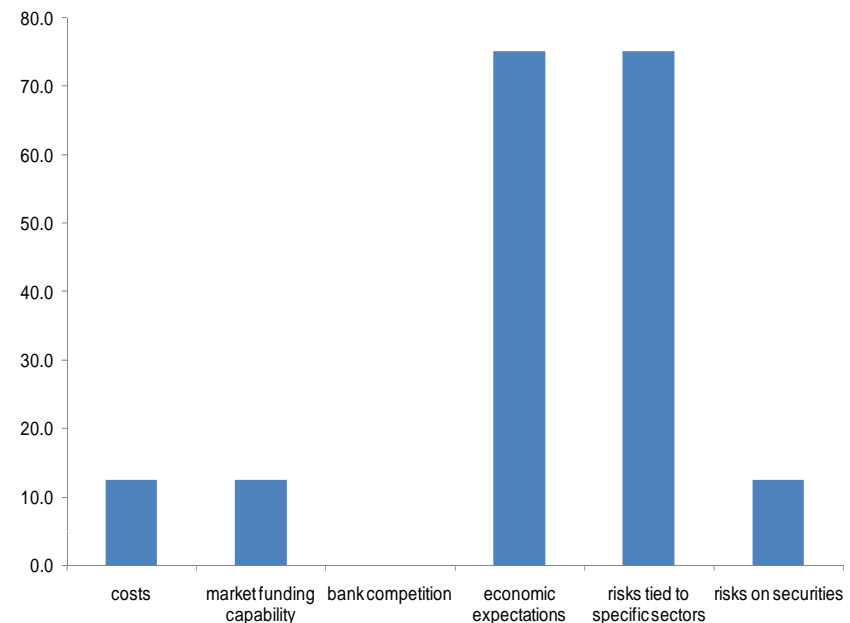
Total credit to non-financial firms moderated from 14.5% yoy in October 2007 to 6.0% in November 2008. Short- and medium-term credit declined markedly recently.

CREDIT CRUNCH

... although survey evidence is more worrying



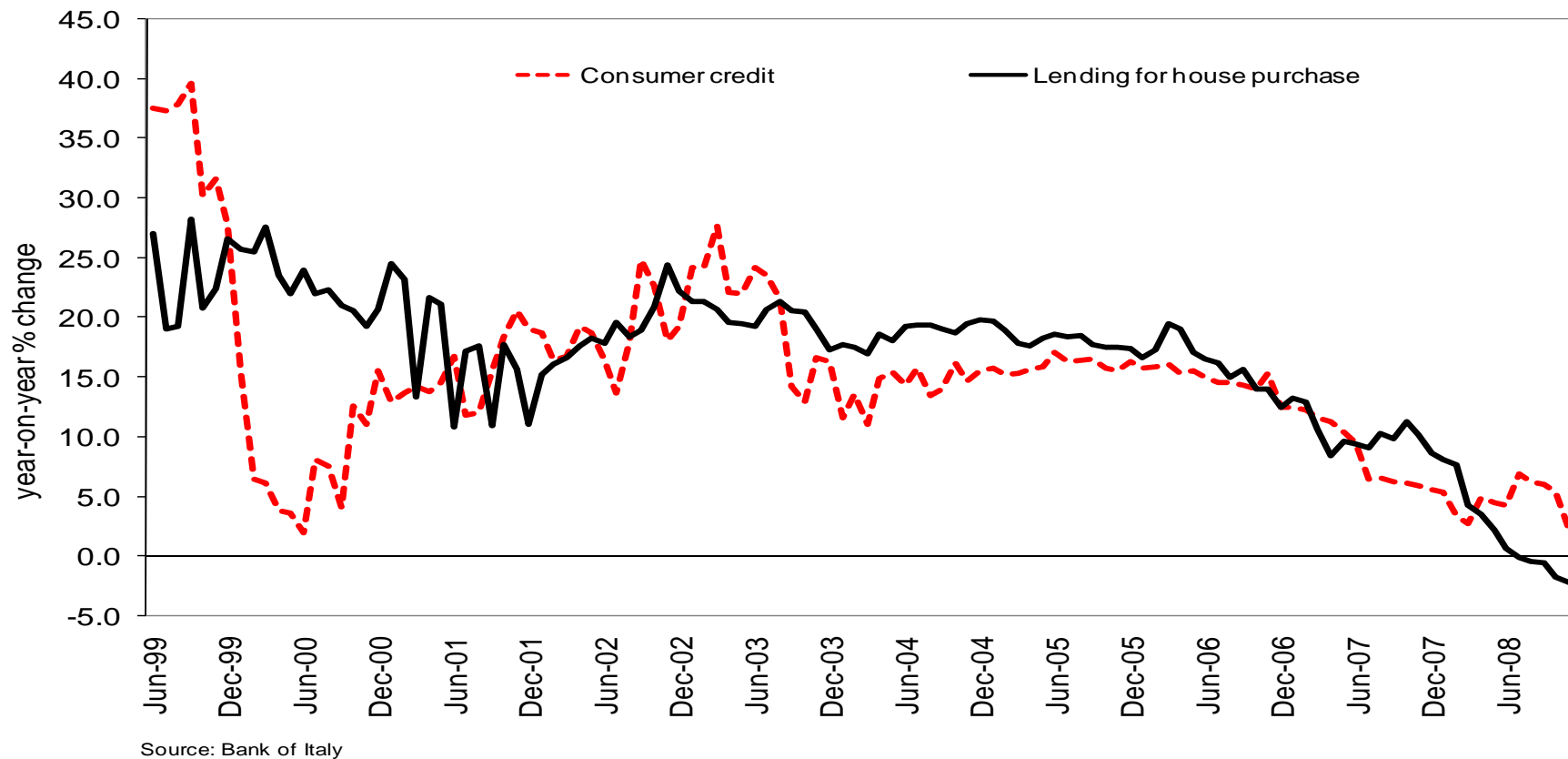
Factors affecting net tightening in Italy in 3Q08



In 3Q08 tightening in credit standards for firms was stronger for Italy than for the Euro area. Firms demand for credit rose in Italy while it declined in the Euro area. Risks related to general economic activity and specific sectors were the two main factors affecting net tightening (and gaining importance over time).

CREDIT CRUNCH

Consumer credit and mortgages have weakened as well

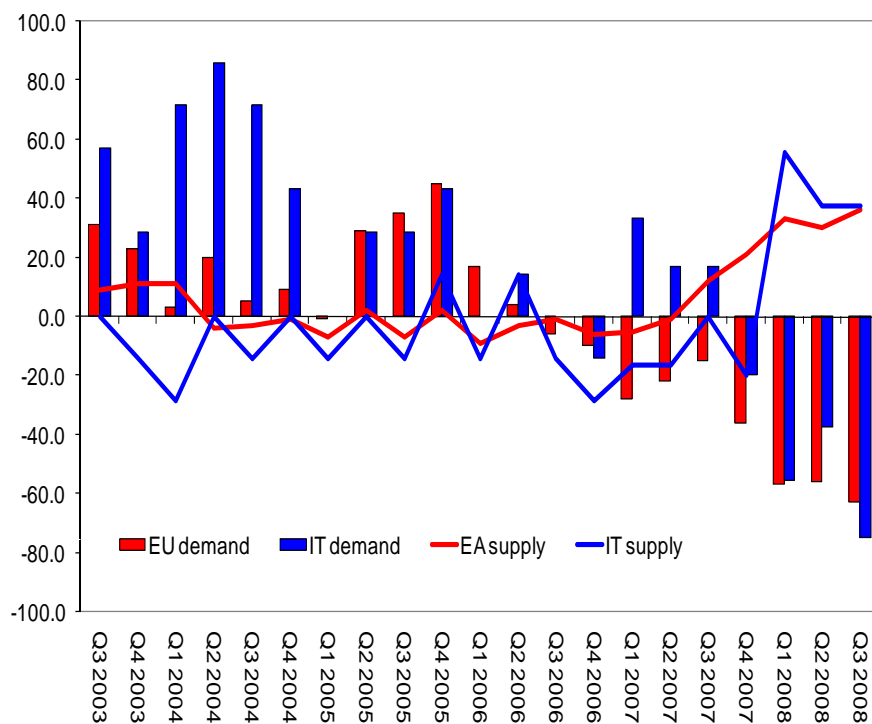


The yoy change in loans to households turned negative in November 2008, pushed down by the contraction in mortgages. Growth in consumer credit, which accounts for only a small fraction of total credit, was still positive although decelerating.

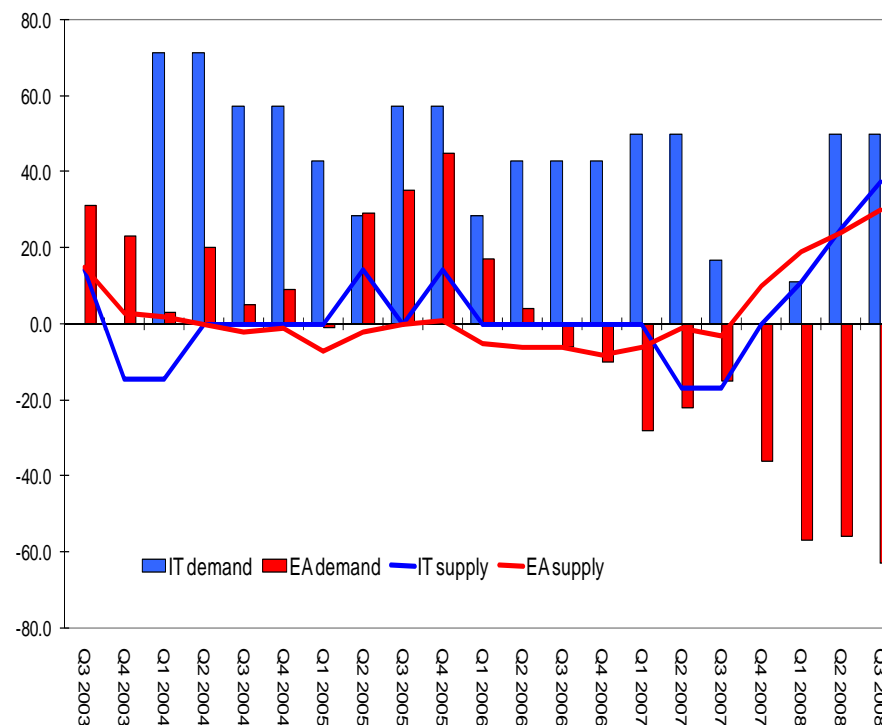
BANK LENDING TO HOUSEHOLDS

Credit to households

Mortgage loans

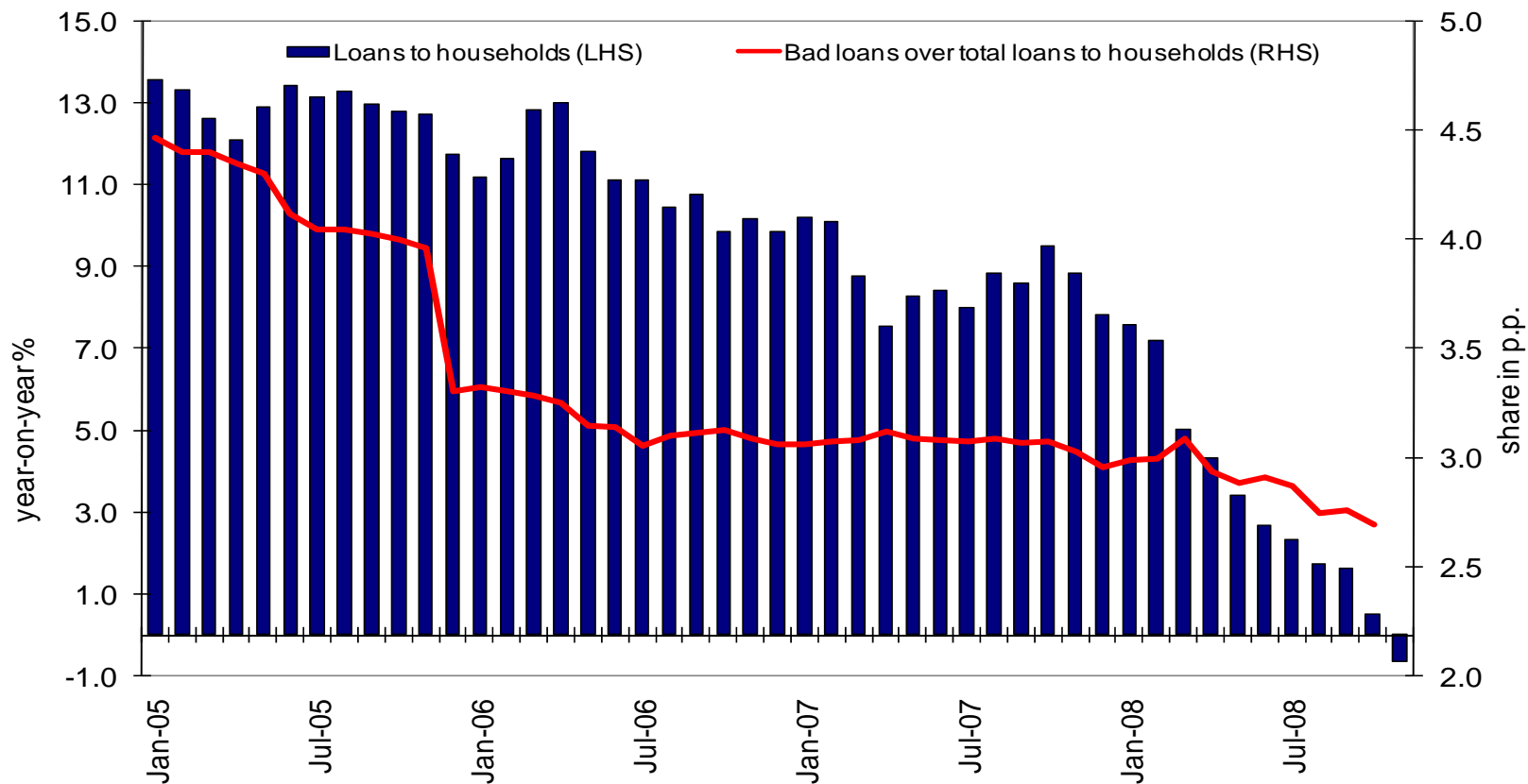


Consumer credit



Some tightening in credit standards to households is underway for both mortgages and consumer credit, in Italy and in the Euro Area. In Italy, demand for mortgage loans has declined over the past few quarters, while demand for consumer credit has increased.

Bad loans remain low



Source: Bank of Italy

The share of bad loans over total credit to households has dropped since mid-2006.

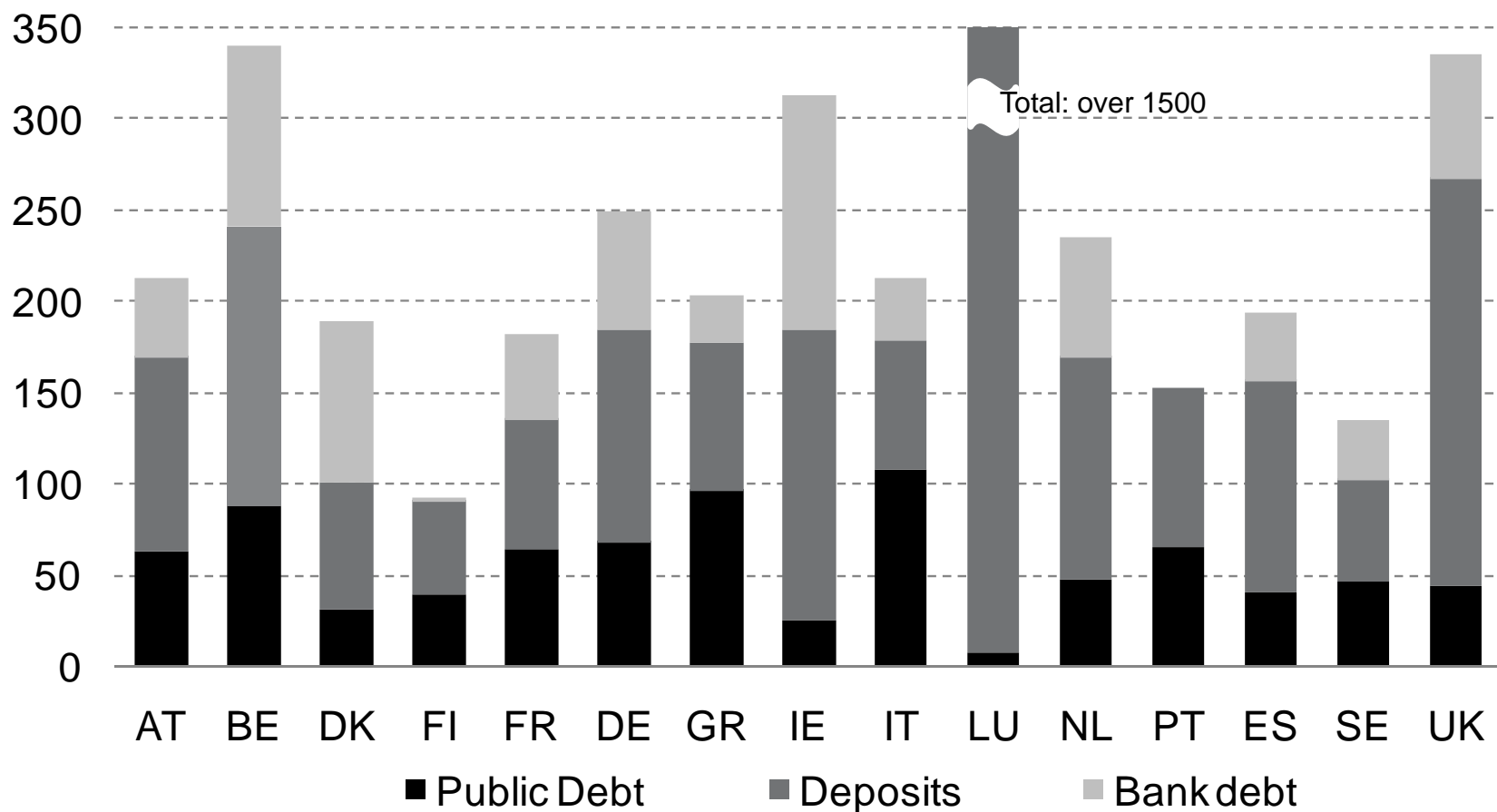
What about Italy's banking system?

- According to the IMF, the pro-cyclicality of bank leverage in a country depends on the structure of the banking system and its role inside the financial system ("arm's length or relation-based system").
- On historical basis, downturns following financial stress tend to be deeper and more prolonged the higher the pro-cyclicality of bank leverage and household and business indebtedness.
- The degree of financial innovation and level of bank and household indebtedness are lower in Italy. Hence, the negative impact of the financial crisis should be smaller and shorter than in other economies.

	Italy	US	UK	Germany
Arm's length	0.44	0.74	0.56	0.38
Procyclicality of leverage	0.02	0.27	0.38	0.14

Source: IMF, Weo (October 2008)

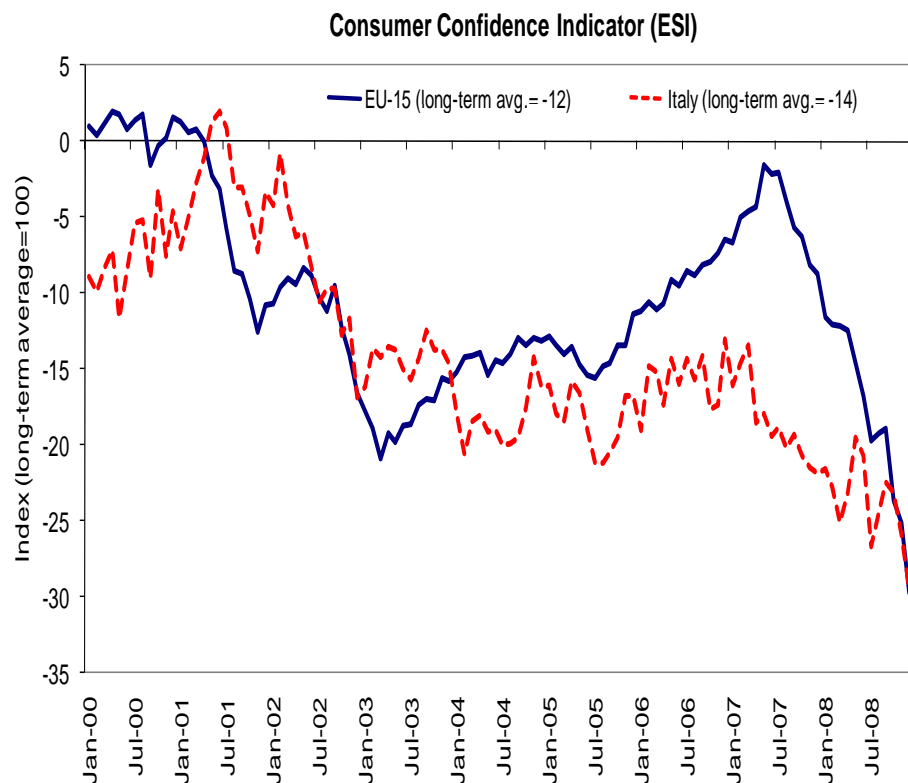
Public liabilities to rise, although risks are contained for Italy



Sources: Eurostat, European Banking Federation

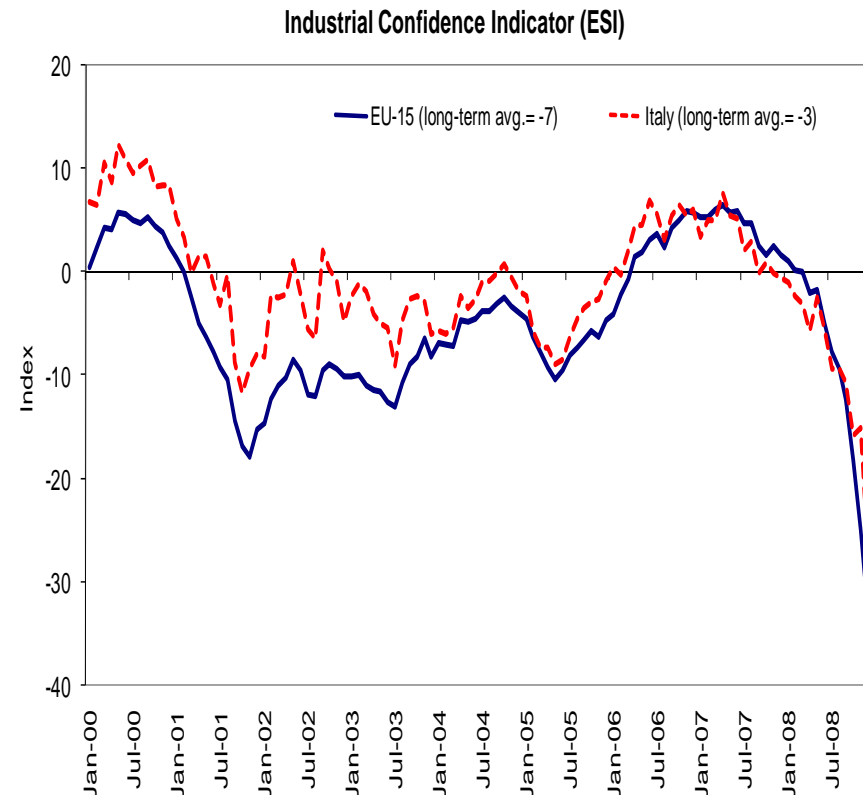
CONFIDENCE

Italy's business sentiment broadly in line with Eurozone's



Source: European Commission

Note: The long-term average is considered since January 1990.

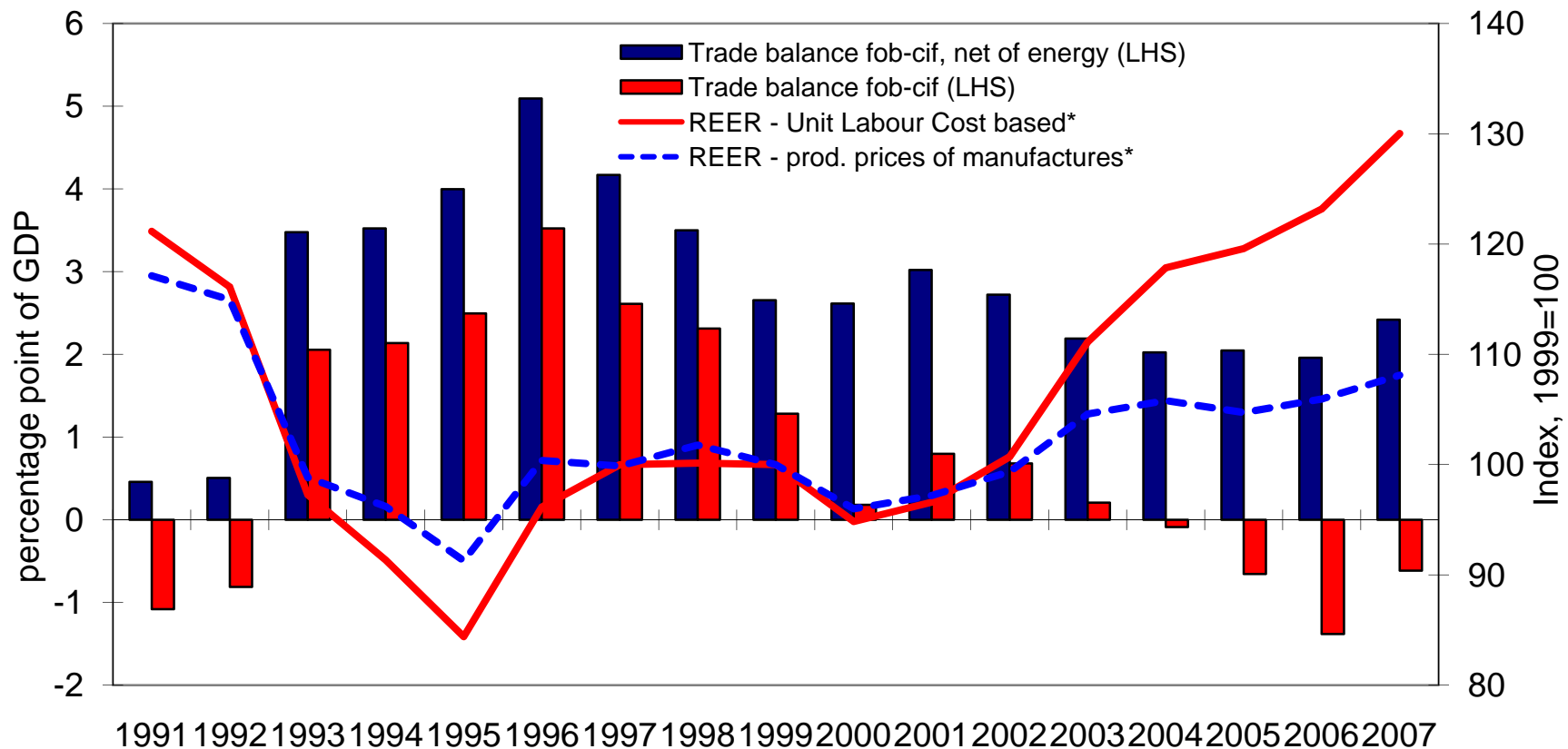


Source: European Commission

Note: The long-term average is considered since January 1990.

In December, consumer and industrial confidence declined to historical lows both in Italy and in the Euro area. Amongst major European countries, Italy recorded the second largest deterioration of ESI (-9.9 points) in December.

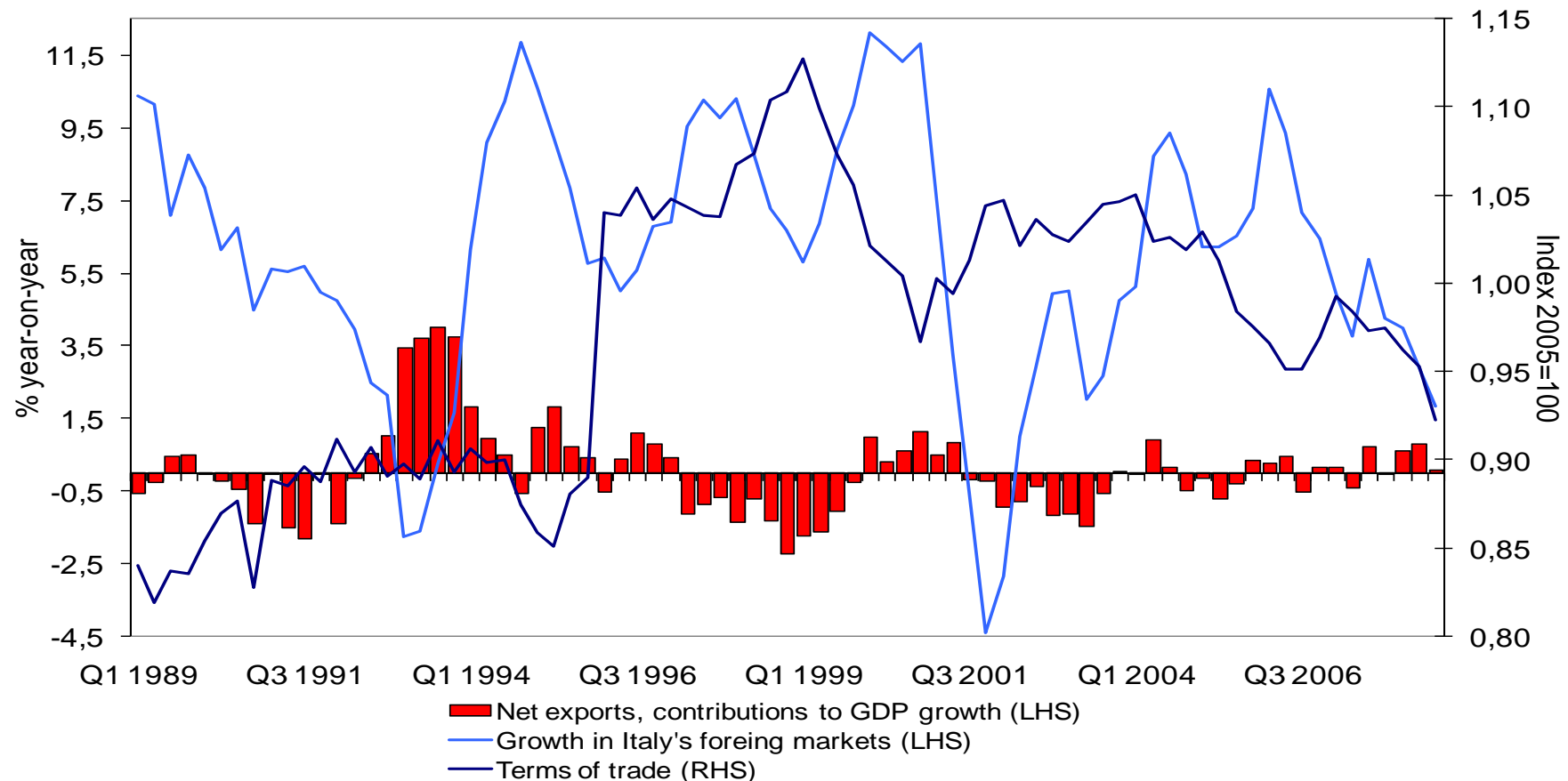
Ex-oil trade balance not deteriorating



Net of energy the trade balance stabilised in recent years, and even improved in 2007, despite deteriorating competitiveness. The degree of the competitive loss is dependant upon the index chosen (a recent IMF WP underlines somewhat lower real appreciation for Italy, cp. WP/08/240).

FOREIGN TRADE

Weaker impulse from external demand

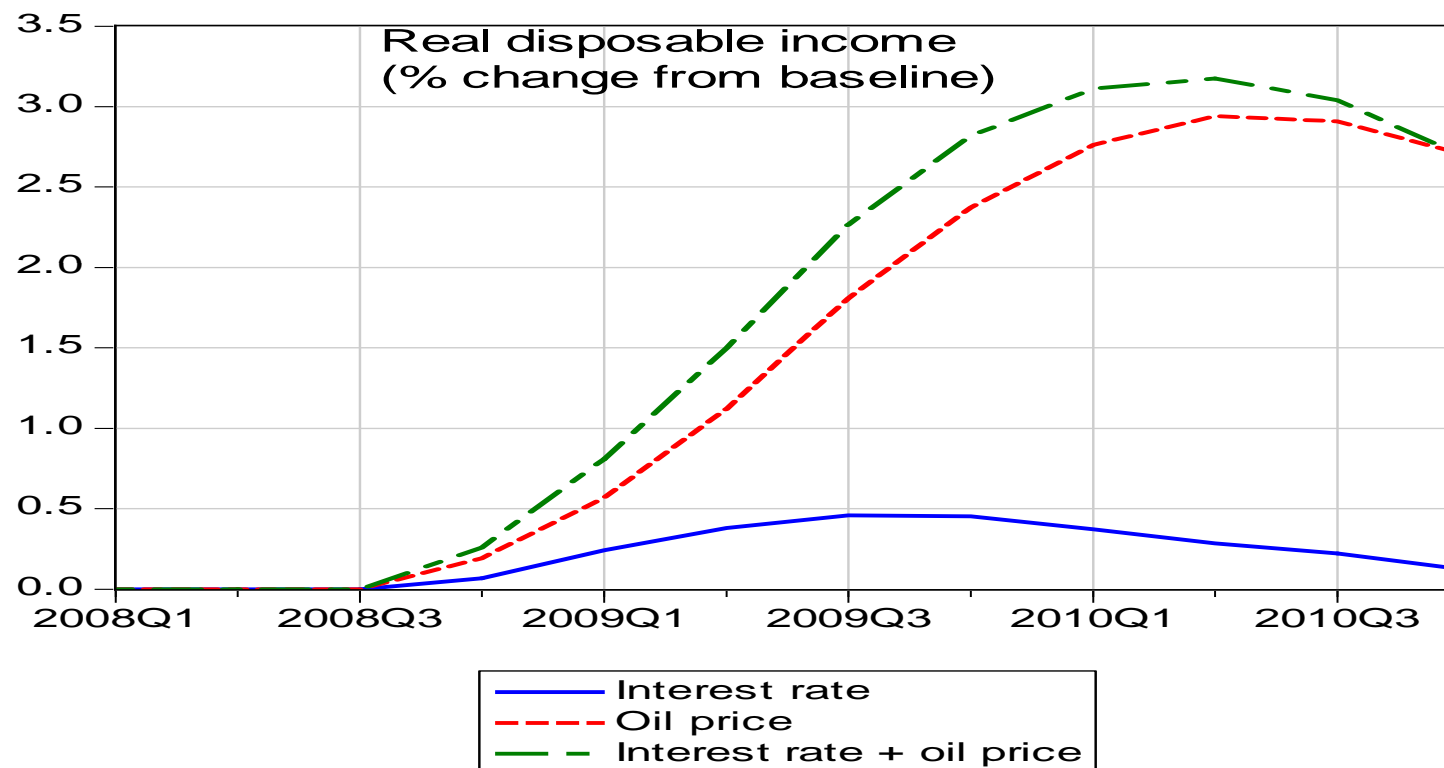


Growth in Italy's foreign markets has declined markedly over the past few quarters, while terms of trade have deteriorated. The contribution to GDP growth by net exports was almost flat in 3Q08 and may turn negative thereafter.

Weaker Euro and lower oil prices: more benefits for Italy

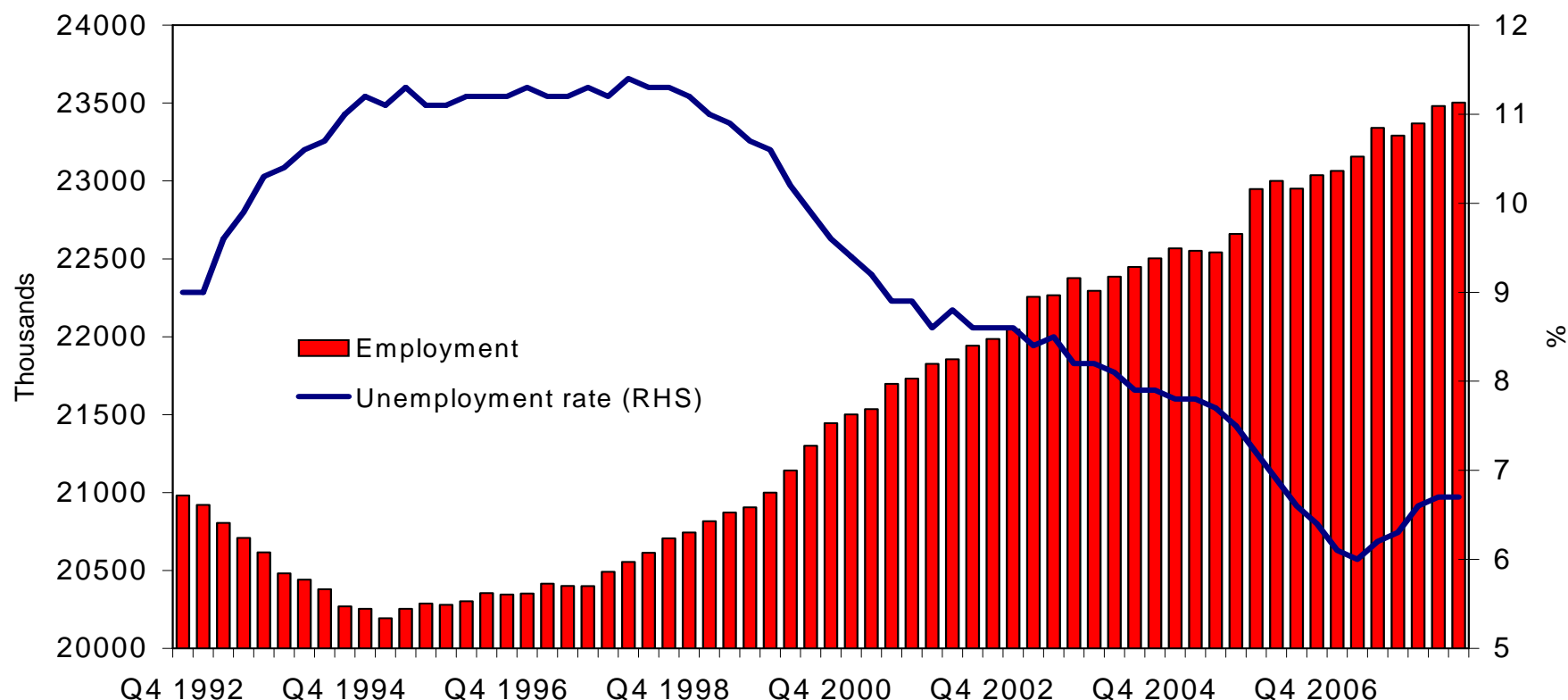
- Italy should benefit more than other countries from the recent depreciation of the Euro versus the main currencies.
- Given Italy's dependency on energy imports, the recent decline in oil prices may produce a larger beneficial effect on the Italian economy compared to that expected on other non-oil-producing countries.

Real disposable income to benefit



According to simulations, the oil price reduction is expected to play a key role in supporting real disposable income for six quarters ahead while lower interest rates (playing a more limited impact) are projected to mainly affect the first 3 quarters of 2009.

Only some slowdown in employment growth for now ...

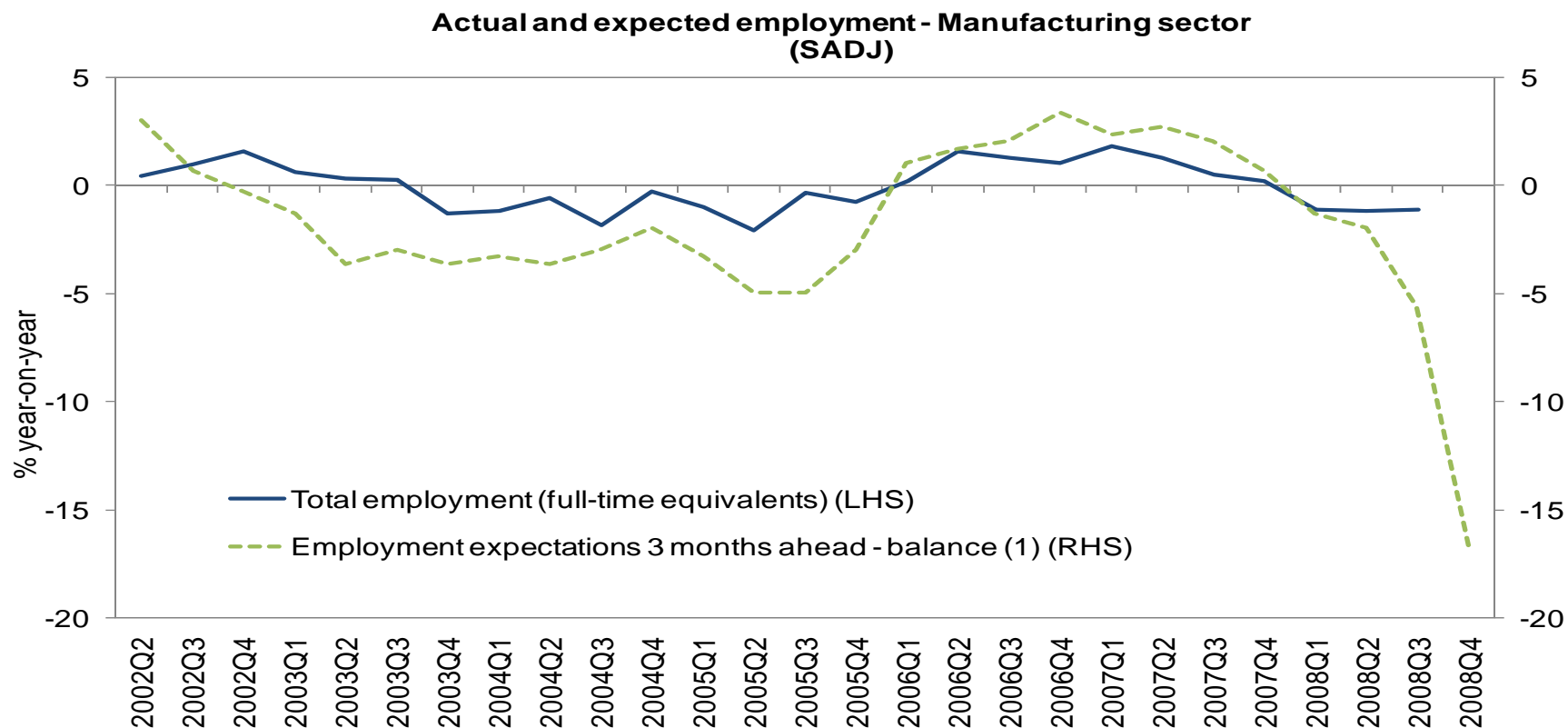


Source: ISTAT, LFS

In 3Q08 labour force stagnated, employment decelerated and the unemployment rate was stable at 6.7% over the previous quarter (seasonally adjusted data). The increase in employment is due to strong growth in part-time contracts, female and immigrant work.

LABOUR MARKET

... but the outlook is worsening



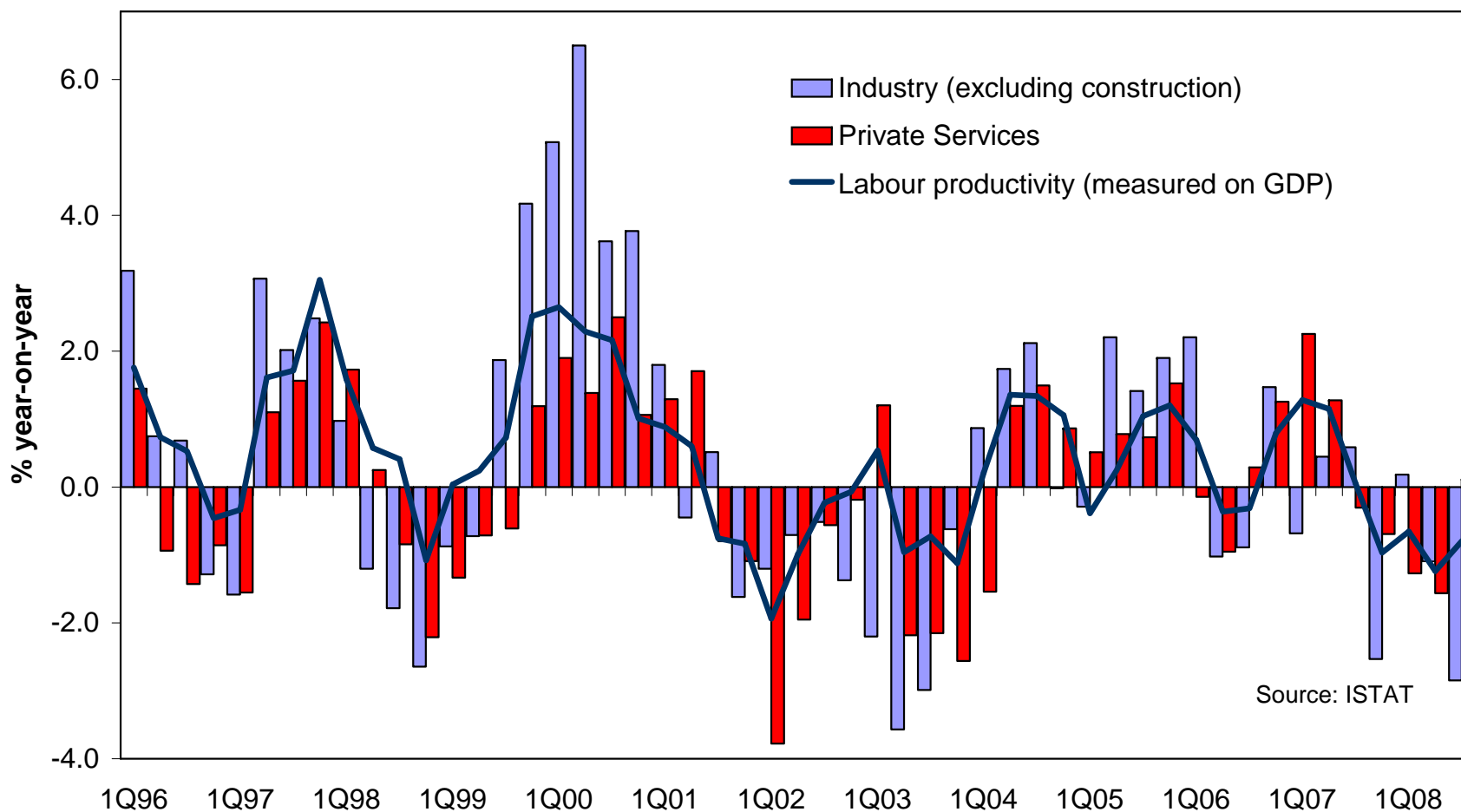
Source: Our calculations based on ISAE and ISTAT data, *Labor Force Survey*

(1) The balance is the percent of responses indicating rise less the percent indicating fall.

Employment expectations have sharply worsened over recent months.

PRODUCTIVITY

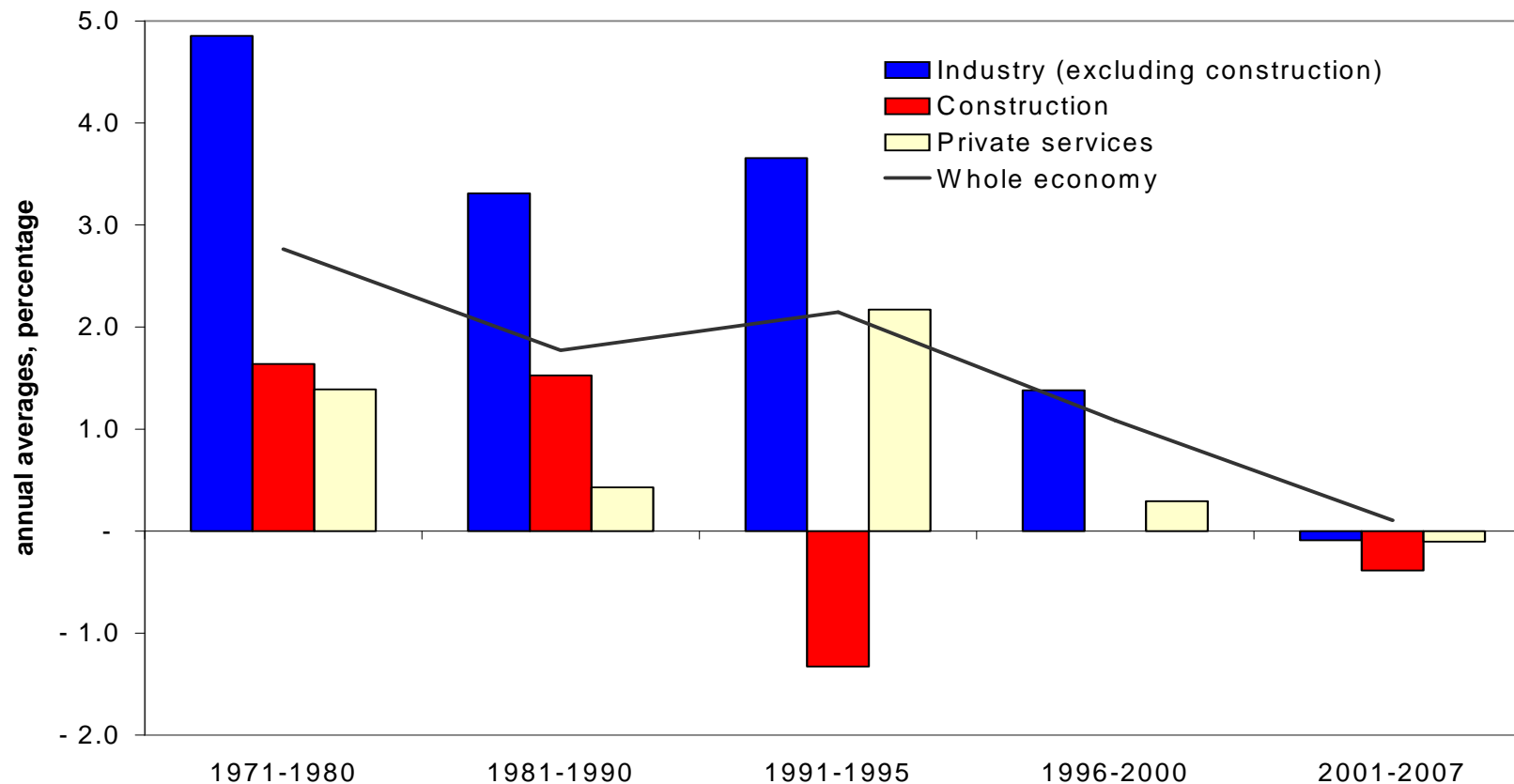
Labour productivity growth has continued to decline ...



In 2008, labour productivity fell in line with the cyclical downturn. Low productivity growth remains one of most important structural challenges.

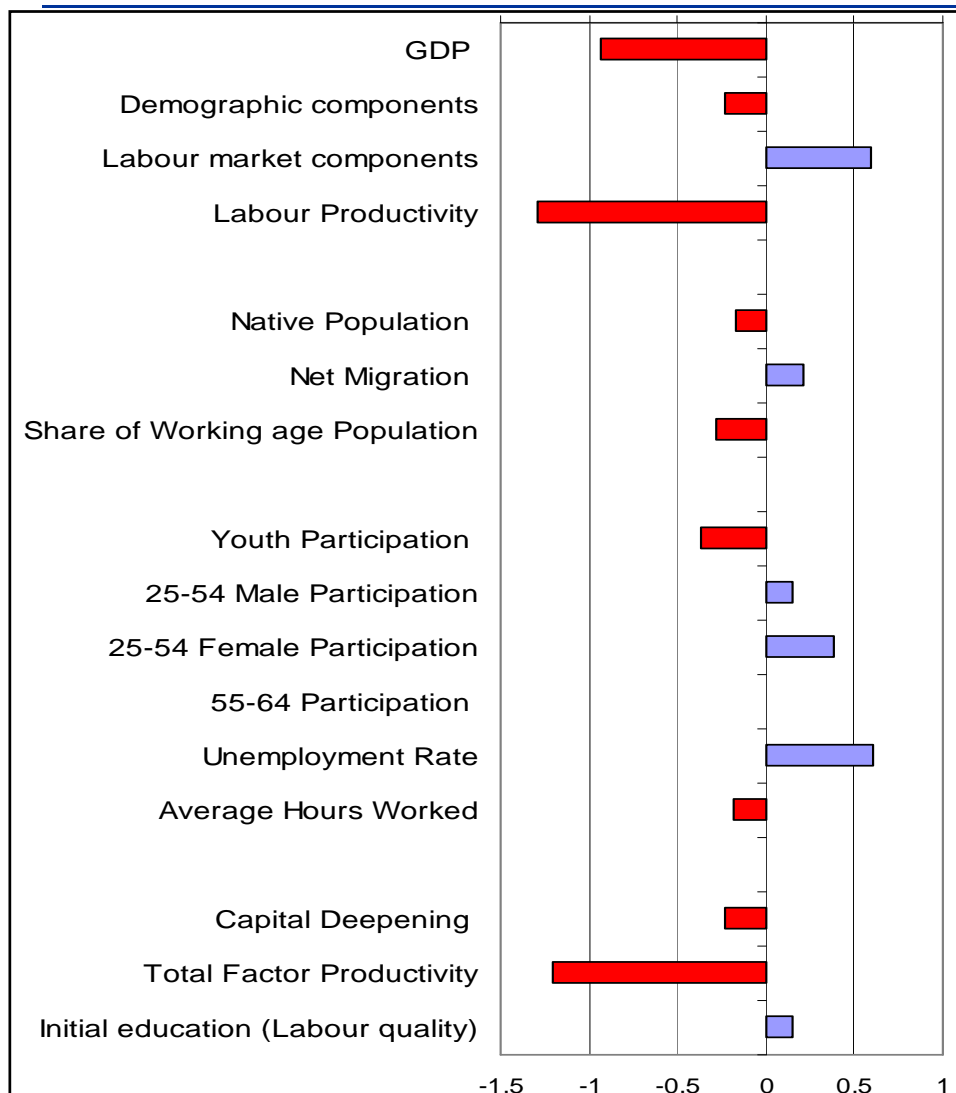
PRODUCTIVITY

... with a clear deterioration over the past 10 years



Productivity has markedly weakened since the turn of the century in almost all economic sectors. Growth-accounting exercises underlined the negative role played by TFP in 2001-2006.

Growth versus the EU-15 in 2001-2006: the TFP issue



Italy's GDP grew on average by 0.9 p.p. per year less than the EU-15 average.

The increase in the gap was mainly due to labour productivity and, to lesser extent, demographic components.

While TFP made a positive contribution to growth in the EU-15, in Italy TFP recorded a contraction, reducing GDP growth by an annual average of 0.7 p.p..

Capital deepening rose, but at a slower rate than the EU-15 average.

Some progress is shown on labour quality (initial level of education).

The horizontal axis shows by how many percentage points each component contributed more/less to growth than in the EU-15.

Limited leeway for deficit spending

