

# Italy Business Forecast Report Q1 2015

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## Abstracts

### Core Views

After another full-year contraction of real GDP in 2014, Italy will return to modest growth of 0.4% in 2015. Real GDP will remain below pre-2008 levels for the foreseeable future and growth will be insufficient to drive a rapid improvement in Italy's labour market conditions, with youth unemployment remaining a major problem facing policymakers.

We view positively the urgent structural reform agenda of new Prime Minister Matteo Renzi, and note that promising progress has been made so far. However, we are sceptical he will be able to avoid the same pitfalls that have impeded past efforts and watered down previous reform packages.

Lack of significant structural reform in previous years seriously jeopardises Italy's long-term growth trajectory and raises the risks that the public sector debt burden will become unsustainable. Even if reforms aimed at addressing Italy's decline in productivity growth and external competitiveness are passed, an ageing demographic profile will make debt consolidation efforts over the long term exceedingly difficult.

### Major Forecast Changes

We have revised down our real GDP growth forecast in 2015 to 0.4% year-on-year (y-o-y), from 0.6% previously.

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Weakening Mandate Threatens Renzi's Reform Agenda

The failure of Italy's economic recovery to shift into a higher gear will weaken Prime Minister Matteo Renzi's mandate for reform and bolster support for far-right parties. Nevertheless, Renzi's Democratic Party remains by far the most popular in the country and his legislative agenda appears broadly on track despite mounting risks.

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Regardless of subsequent government's ideological leanings, Italian policymakers will be constrained by Italy's massive public debt load and will be forced to enact unpopular austerity measures over the next decade. This will limit the government's ability to tackle poverty and social discontent, with the north-south socio-economic divide widening. We also expect Italy's regional and global standing to decline, and finally, we see populist and xenophobic parties gaining momentum over the coming years.

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European Central Bank monetary easing and a waning fiscal drag will lend modest support to an Italian recovery in 2015, but the economy remains on a very low growth trajectory. Fiscal and monetary policies are inadequate substitutes for the major structural overhauls needed to boost productivity, and reform momentum has been too slow to offer a significant boost to growth potential in 2015.

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A weak economic recovery will push Italy's current account surplus wider in 2015 as import demand remains subdued. However, weak global demand and relatively high labour costs will limit export growth in the coming years and the current account will begin gradually narrowing beyond 2015.

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## Fiscal Policy

### Low Growth Puts Debt Reduction Out Of Reach

Italy's budget deficit will remain within the EU's 3.0% of GDP threshold in the coming years, but the government will resist demands for further austerity in light of a stalled economic recovery. Whether it can avoid EU sanctions will likely depend on more progress in its structural reform agenda in the coming quarters. Either way, substantial long-term debt reduction will prove elusive due to a low nominal growth trajectory.

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Member by member, the eurozone is abandoning fiscal targets amid political pressure. The main exception is Germany, which further illustrates the profound schisms within the euro area. We expect the European Central Bank (ECB) to become increasingly interventionist as official policy relies heavily on monetary stimulus.

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We believe the Italian economy will continue to face a very modest rate of growth over the longer term, weighed down by lower credit availability, a weaker external environment, and waning global competitiveness. We also warn that major challenges, such as the government debt load, a deteriorating demographic profile, structural decline in productivity and potential political instability, pose threats to longer-term economic prosperity.

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