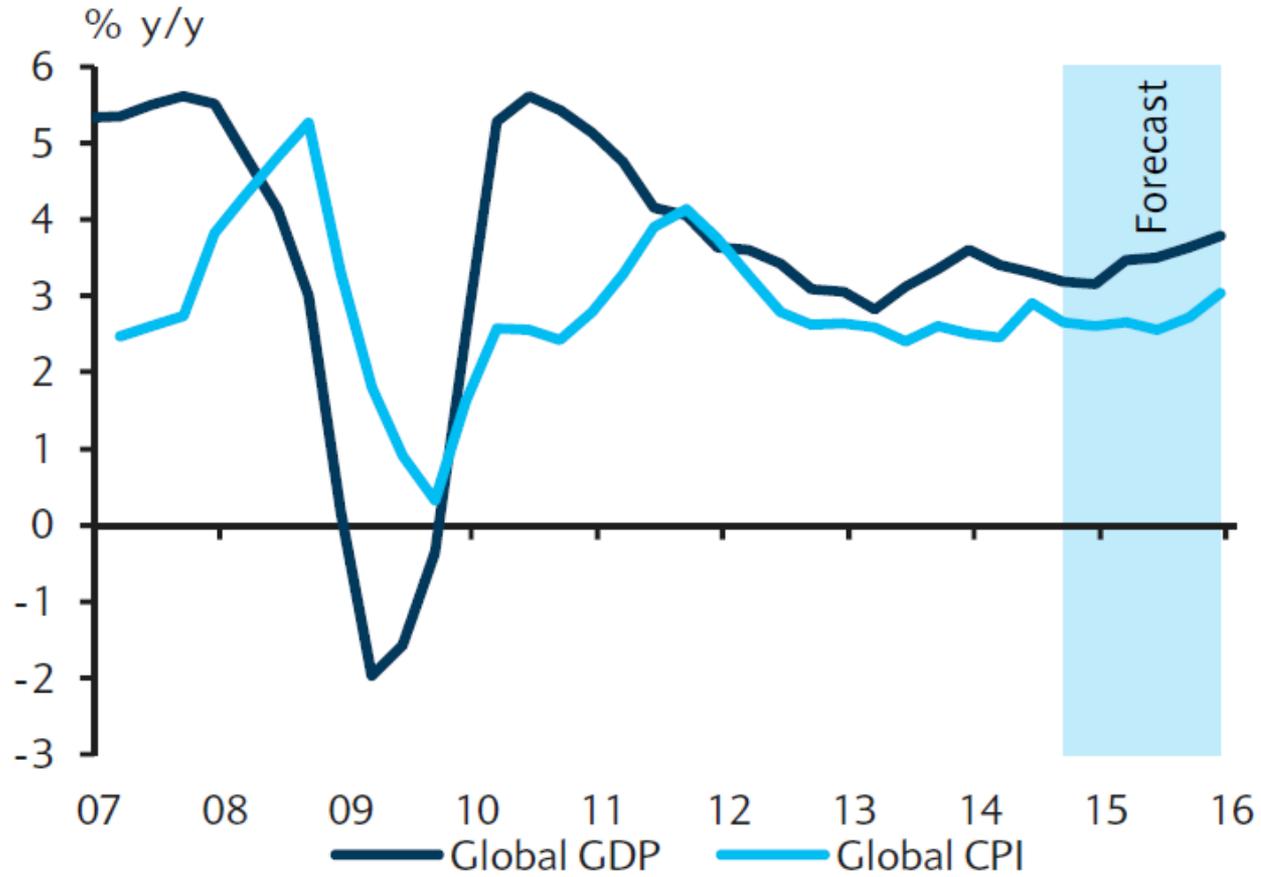


The European and Italian Economies at the crossroads

Carlo Secchi

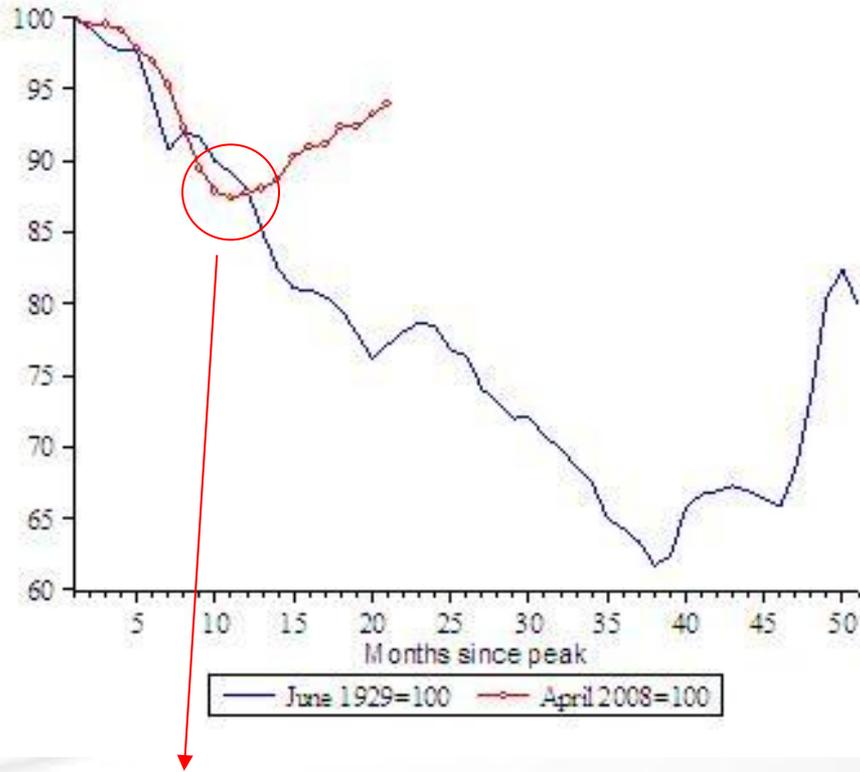
Keio University, 10 September 2015

Global outlook: from crisis to (partial) recovery

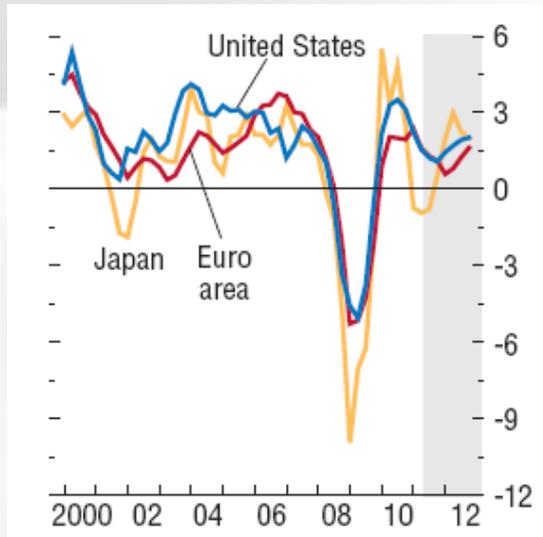
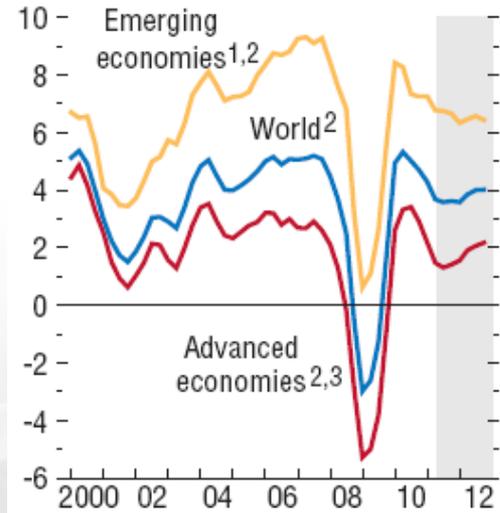


Source: Haver Analytics, Markit, Barclays Research

Great Depression 2 escaped...

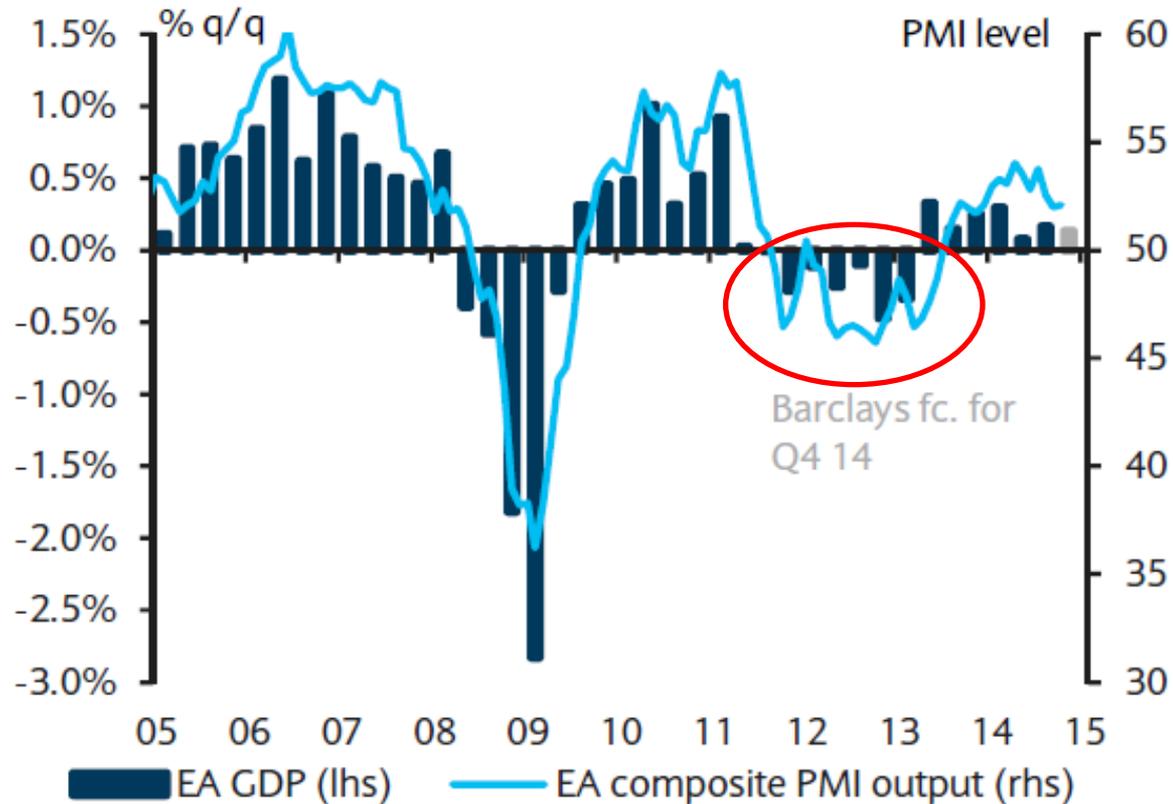


The combination of extraordinary strong and worldwide coordinated monetary and fiscal stimulus has allowed the world economy to escape the fate of “Great Depression 2”



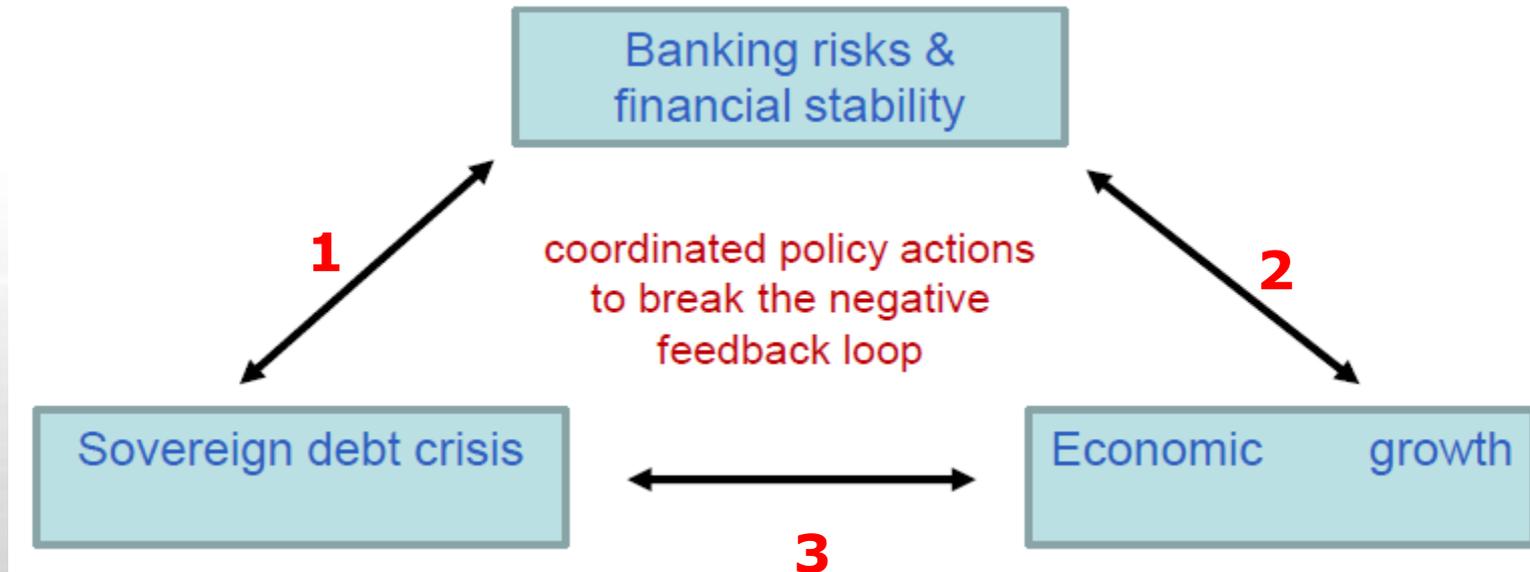
Recovery lost momentum in Europe in 2011/12: why?

GDP growth and composite PMI



Source: Eurostat, PMI-Reuters, Barclays Research

The bank-sovereign negative feedback loop in EU



1. Rescuing banks (and fiscal stimulus) increases deficits, worsening the sustainability of debt.
2. If banks already have sovereign assets in their portfolio, the latter generates a further bank deleveraging leading to less credit to the economy and lower growth
3. Lower growth worsens the sustainability of debt...

Crisis management vs. Crisis resolution

Management: ok since 2012

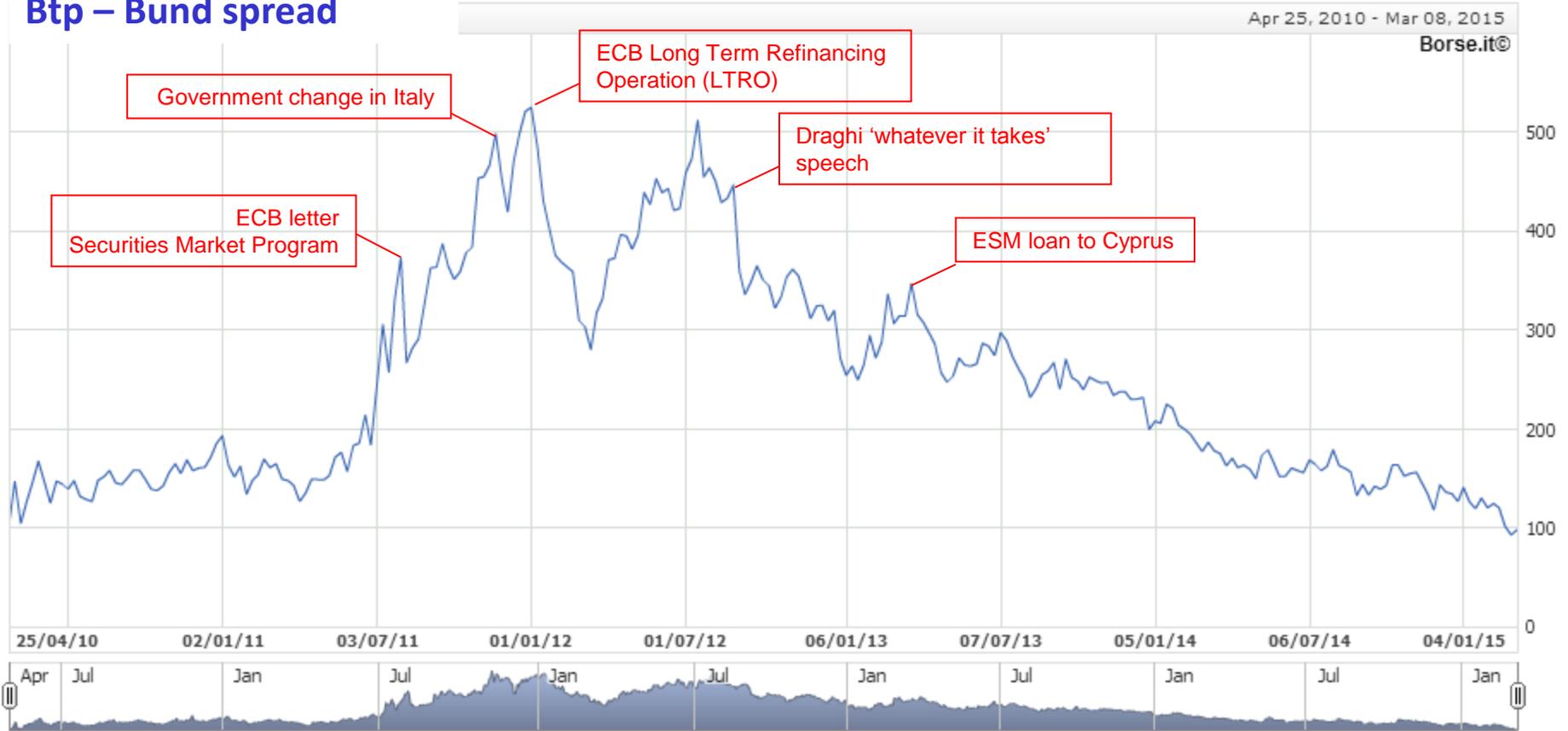
- The **Long Term Refinancing Operation** organized by the ECB lends 490+530 Bln to **banks** at 1% for 3 years, providing liquidity, easing the credit crunch and lowering the rates on public debt
- A new '**fiscal compact**' Treaty agreed by Member States (with **European Semester** for coordinating reforms and EU '**Six Pack**' reforming the Growth and Stability Pact) leads the way to **debt consolidation**, paving the way for the implementation of the **European Stability Mechanism** in July (replacing EFSF)
- After the famous "whatever it takes" speech by Mario Draghi (26 July 2012, video [here](#)), the ECB starts the new **Outright Monetary Transaction** programme to reduce spreads of sovereigns in the market (replacing SMP)

Resolution: just started

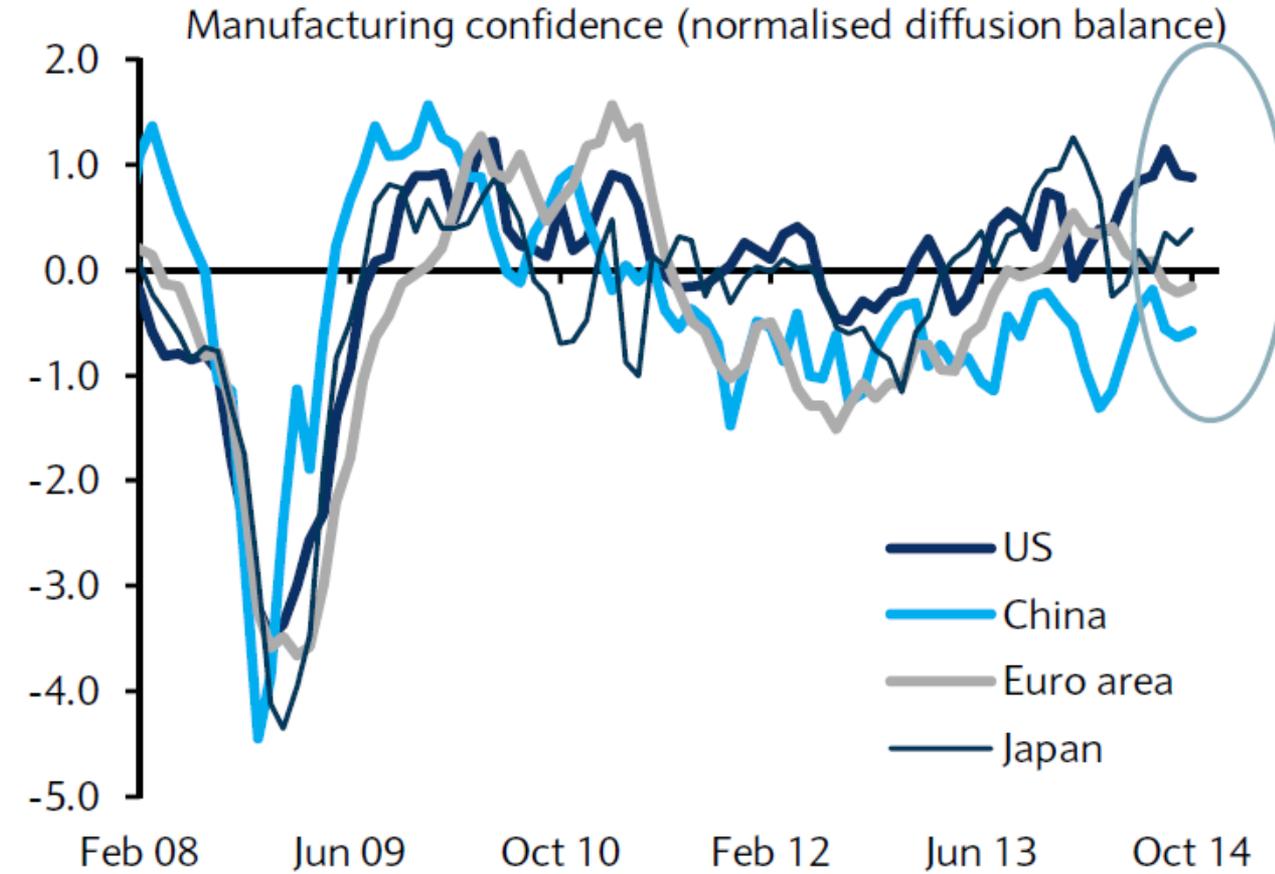
- Dysfunctional inter-banking market with negative or stagnant (after the fall) erogation of credit to NFIs until 2014 =>
- Recession in Europe for 2012 and 2013, with negative feedback also on 2014 =>
- Low growth puts pressure on public debt and deficit =>
- Call for more austerity under the Fiscal Compact further depressing growth
- Stagnation leading to deflationary pressures => negative effect on real rates => pressure also on private (corporate) debt
- 'Political' risk of implosion of the euro-area if benefits to citizen are ultimately not delivered

Crisis management in Europe: the “Italian” crisis

Btp – Bund spread

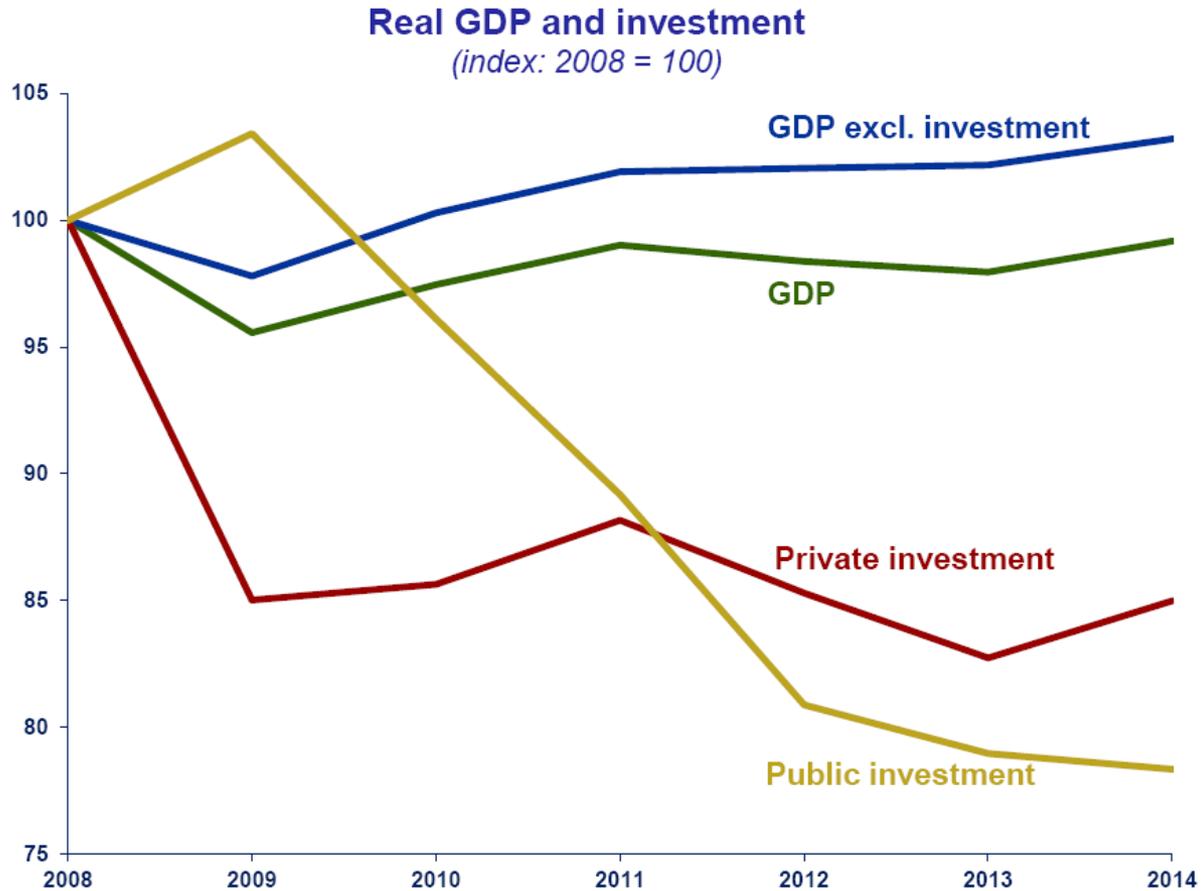


Divergence in business cycles



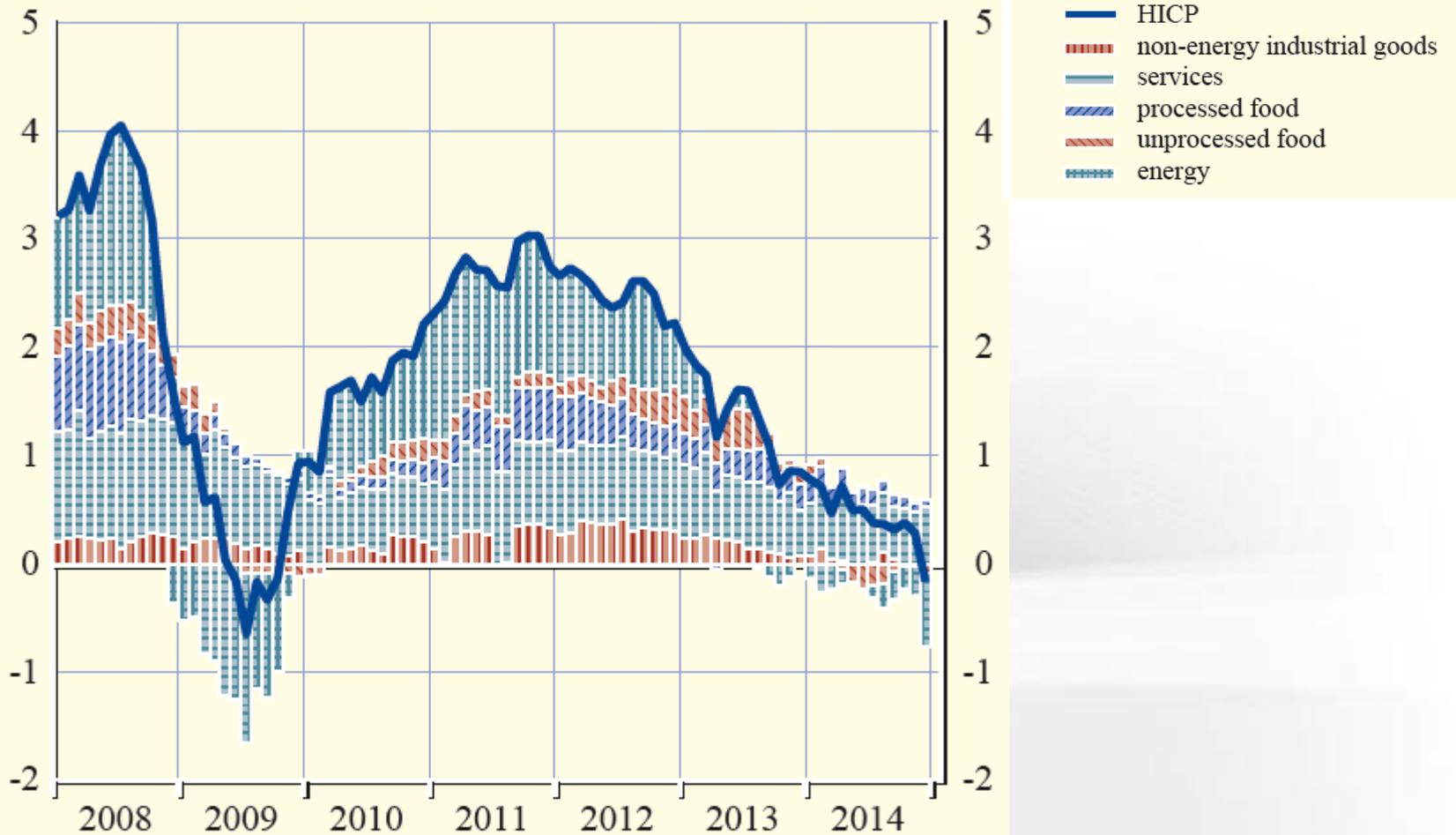
Source: Haver Analytics, Markit, NBS, ISM, Barclays Research

Negative EU cycle mainly induced by investment



Sources: ECB calculations and European Commission.

Leading to a deflationary trend



Sources: Eurostat and ECB calculations.

Note: The latest observation refers to December 2014.

Crisis management vs. Crisis resolution

Management: ok since 2012

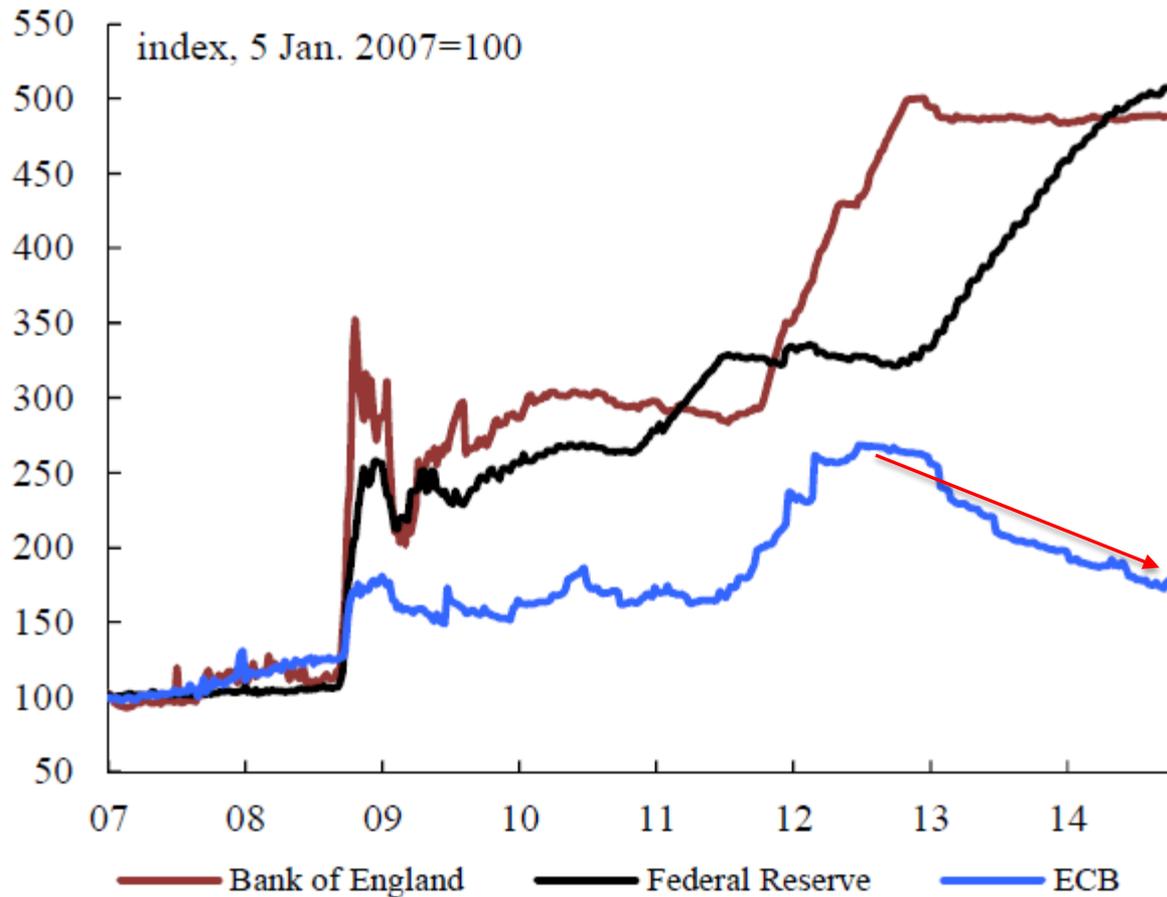
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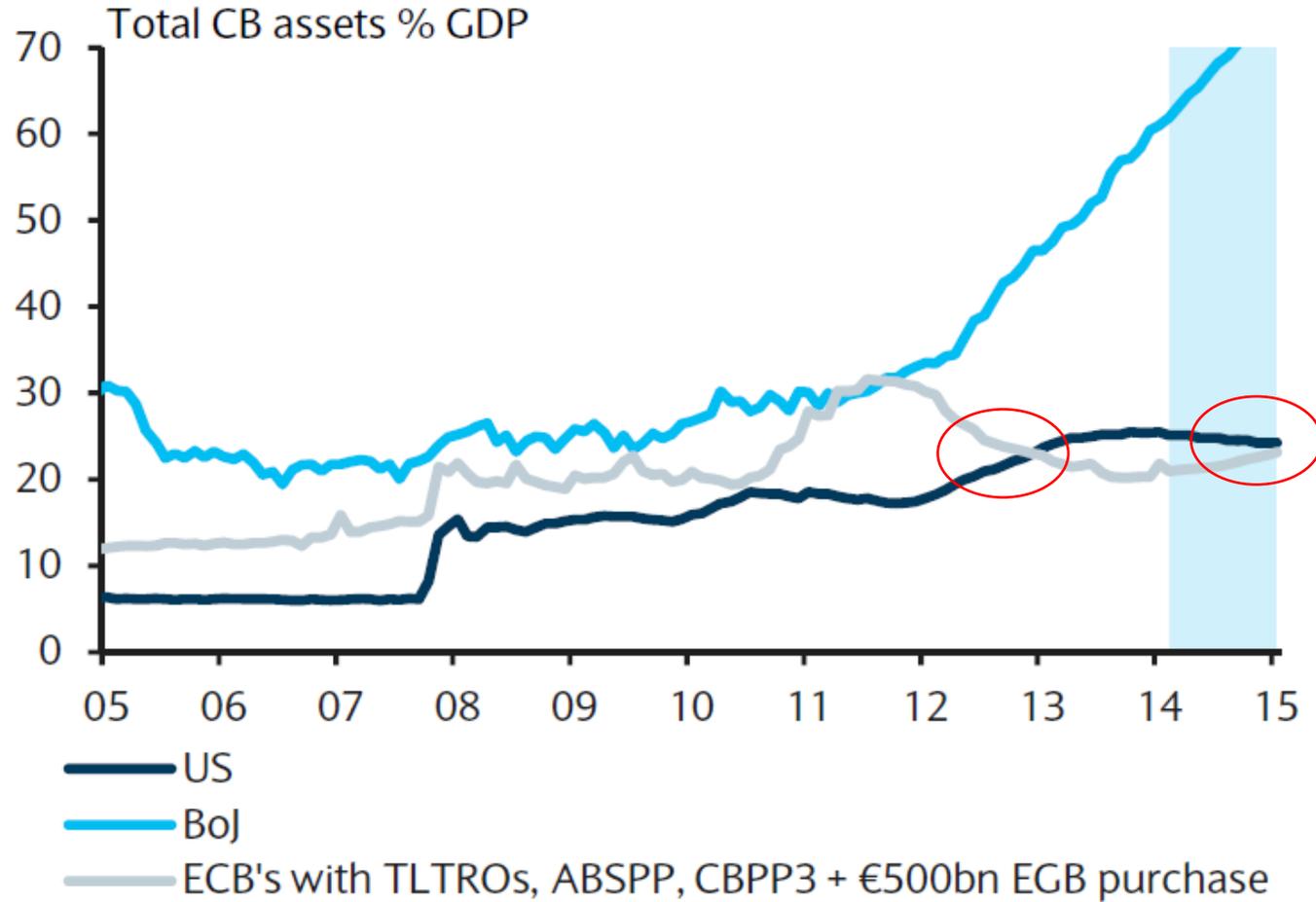
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Monetary trends in Europe: restrictive since 2012

Graph I.10: Central bank balance sheets, euro area, UK and US

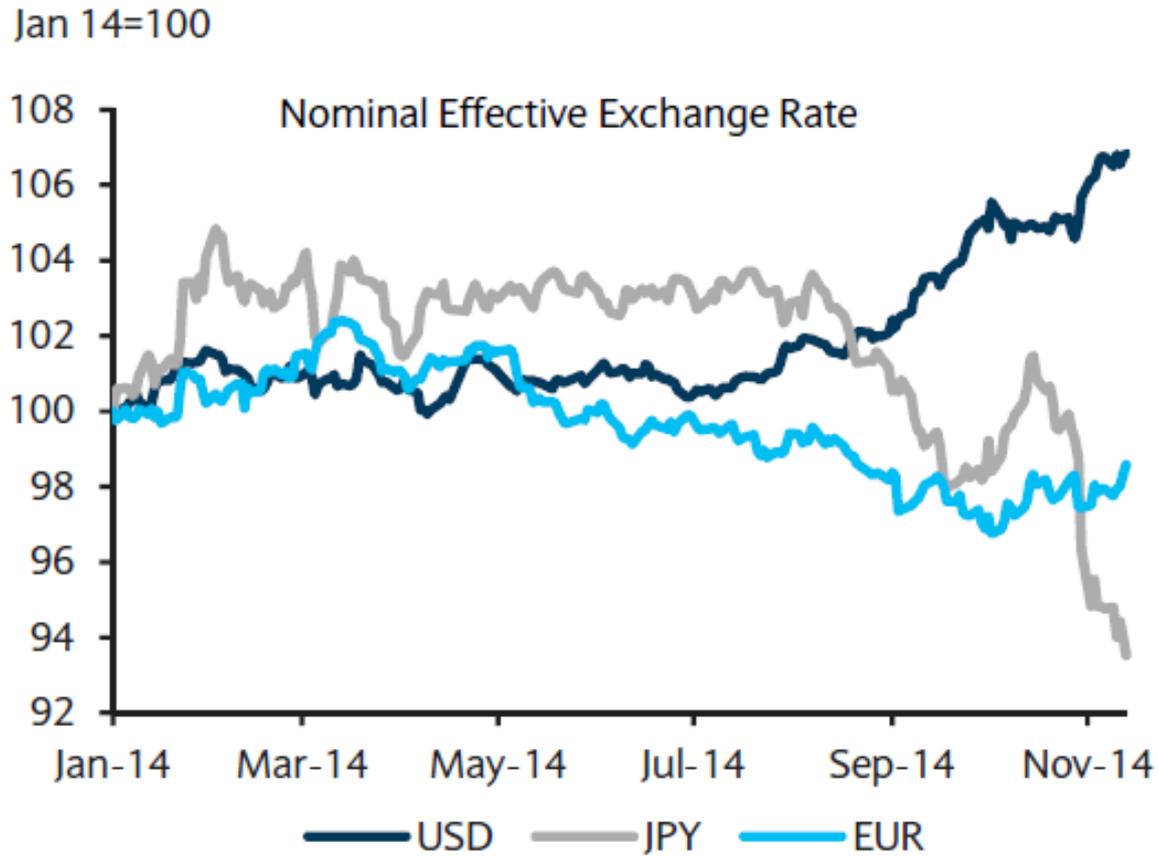


...then followed by QE also by ECB



Source: Bloomberg, Barclays Research

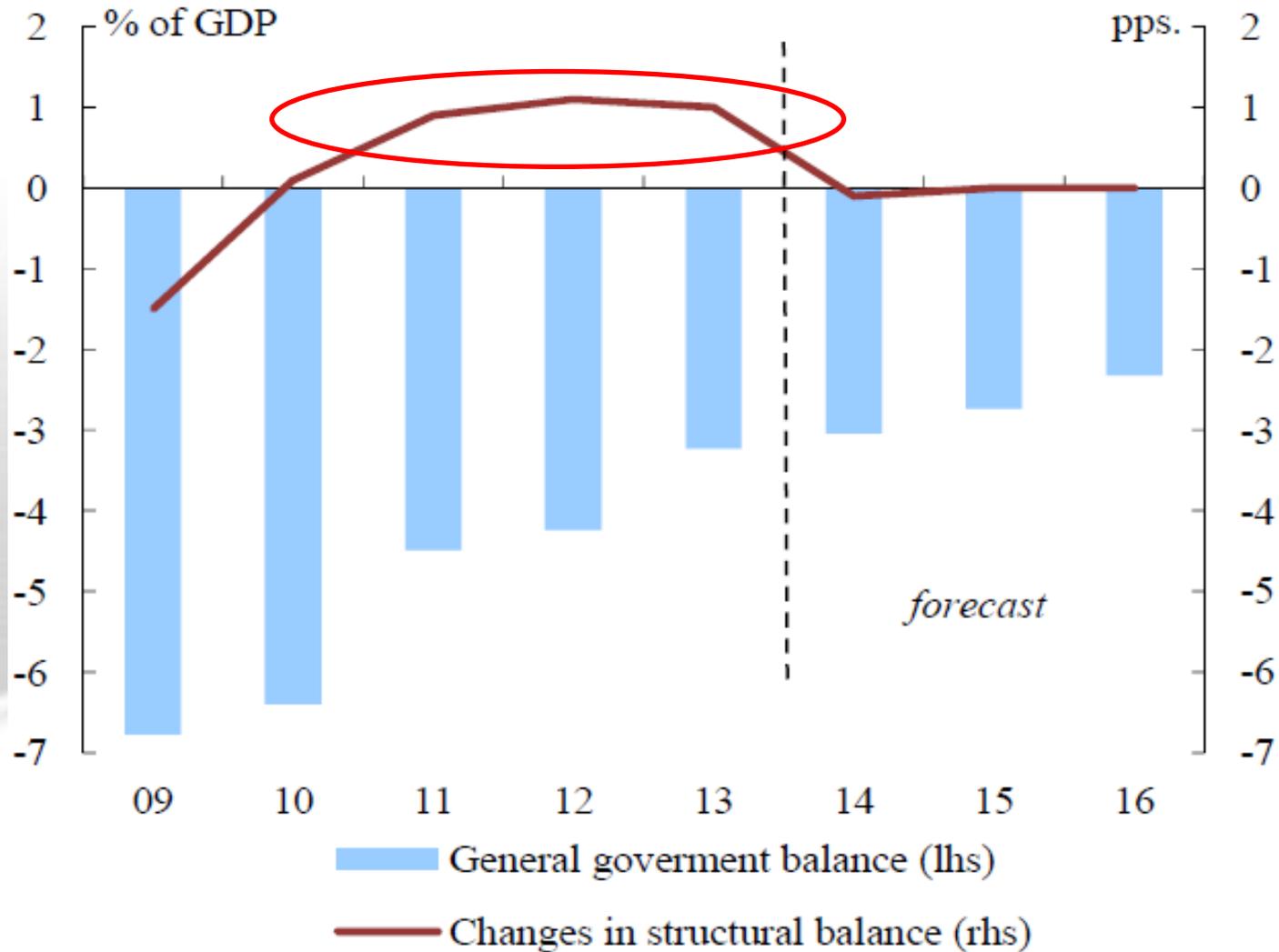
Monetary policy divergence generates volatility of exchange rates



Source: Bloomberg, Barclays Research

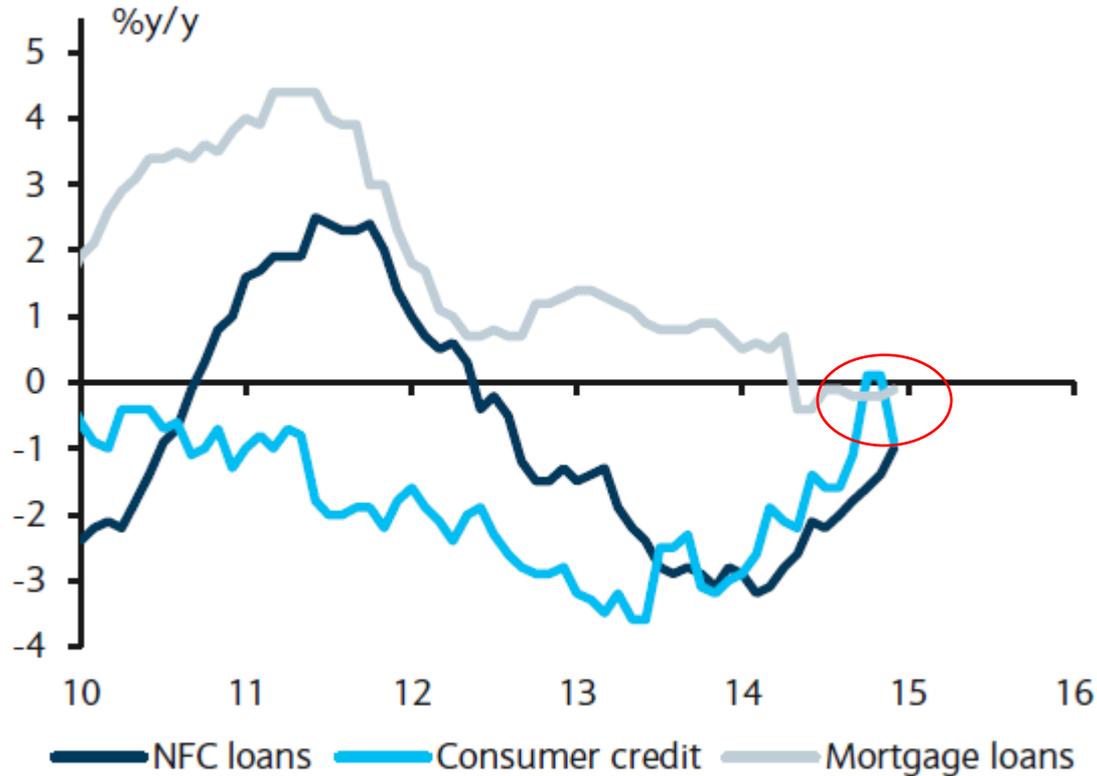
Fiscal policy in Europe: restrictive since 2011

Graph I.36: Budgetary developments, EU



Asset Quality Review (Bank Union) has 'frozen' credit

Bank loans growth by component

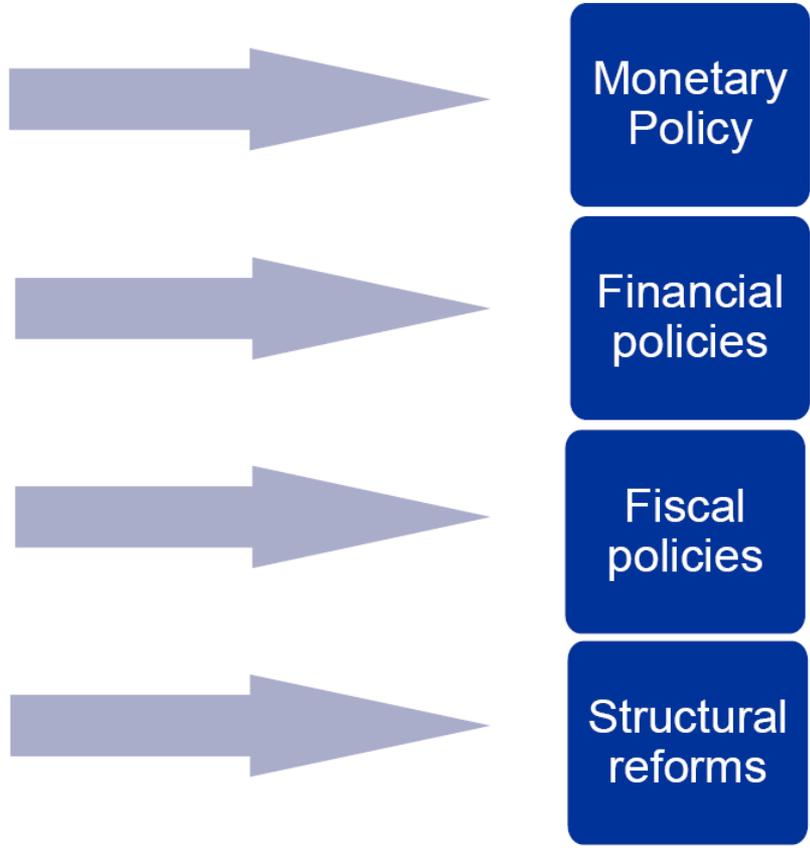


Note: NFC loans data are only available since 2010.

Source: ECB, Barclays Research

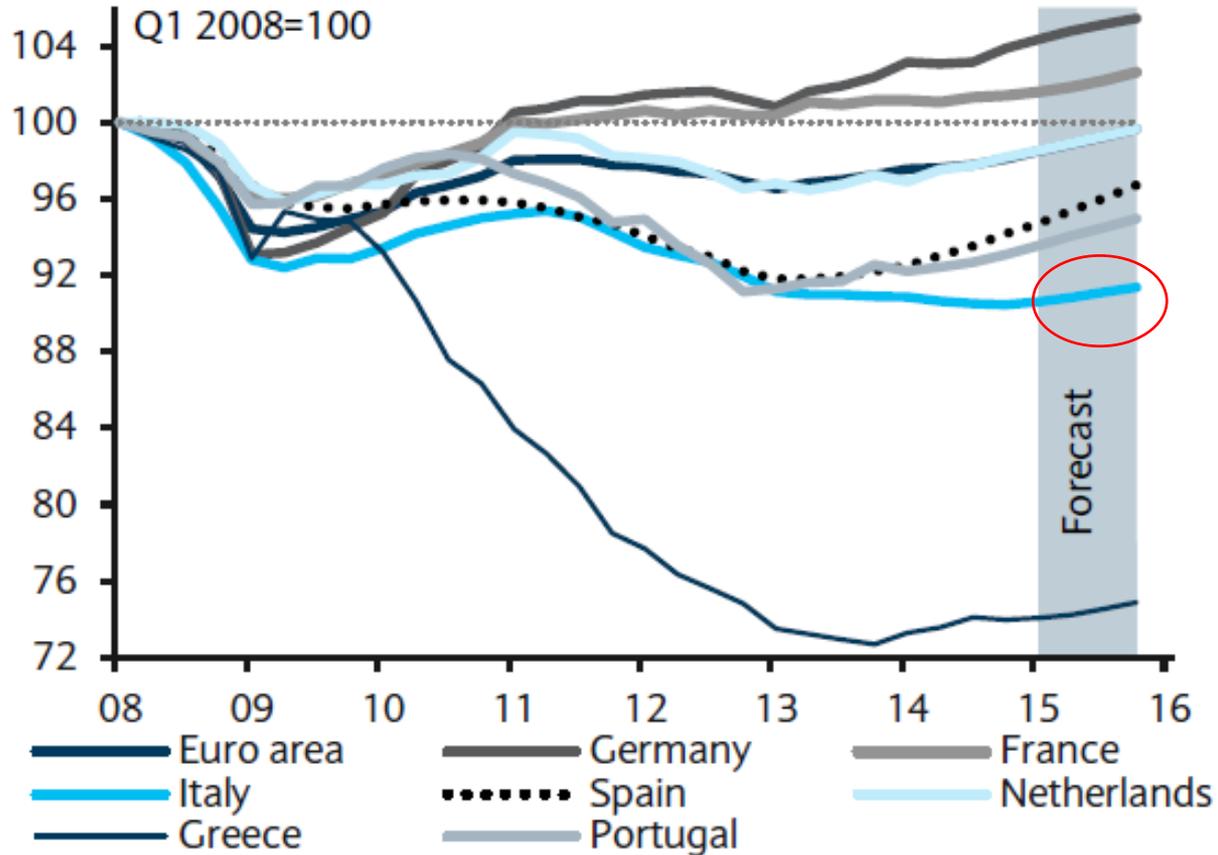
The need of a joint solution: the EU 'Four Arrows'

Coherent Strategy



- Monetary => revamp inflation dynamics (ABS / CB purchases + + QE by ECB)
- Banking Union and credit easing (TLTRO)
- Fiscal => trade-off flexibility with reforms / common EU Investment Plan
- Supply-side => structural reforms to revamp productivity especially in labor markets

Different speeds of recovery persist in the euro area

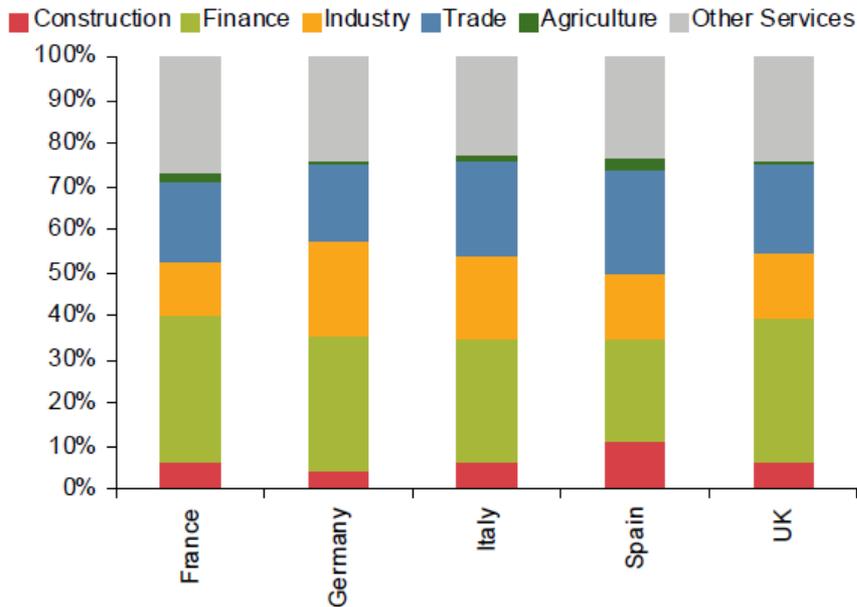


Source: Haver Analytics, Barclays Research.

The structure of the Italian economy

Italy is focused on manufacturing, like Germany

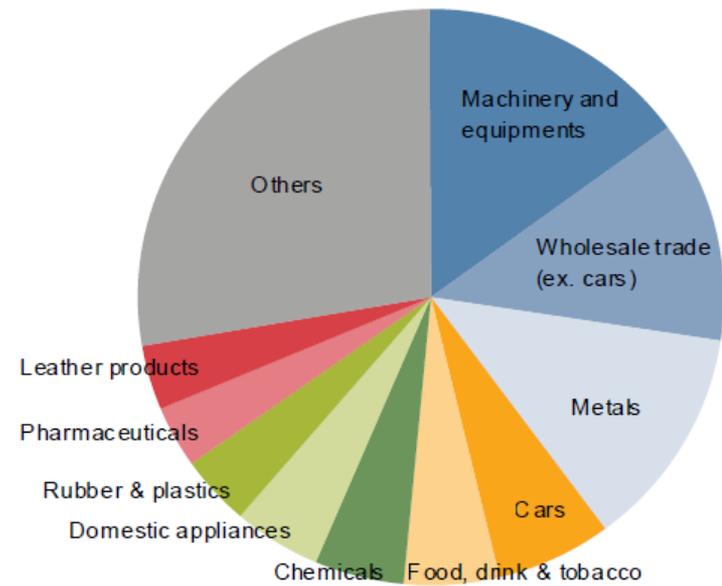
Gross Value Added by sector, % total GVA



Source: RBS Credit Strategy, Eurostat

Made in Italy

Exports by product type, % total



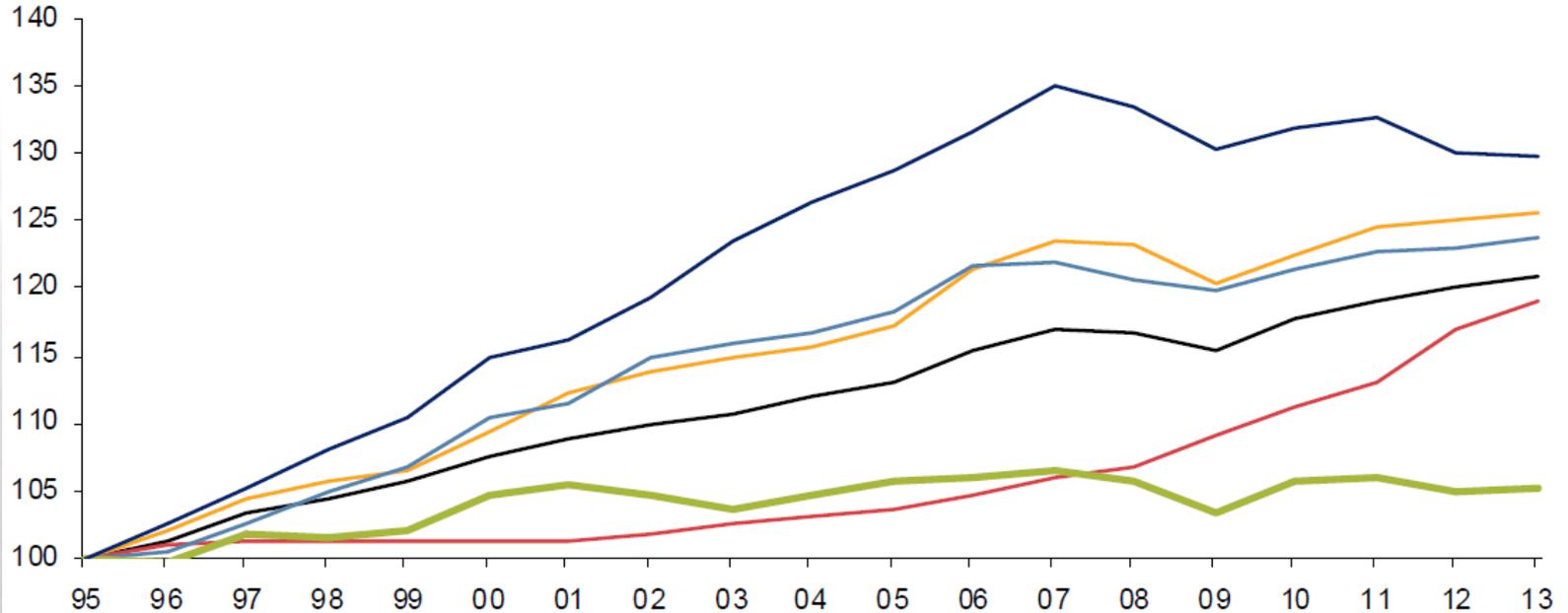
Source: RBS Credit Strategy, IMF.

Note: Metals exports one-off effects from gold exports to Switzerland over the past few years

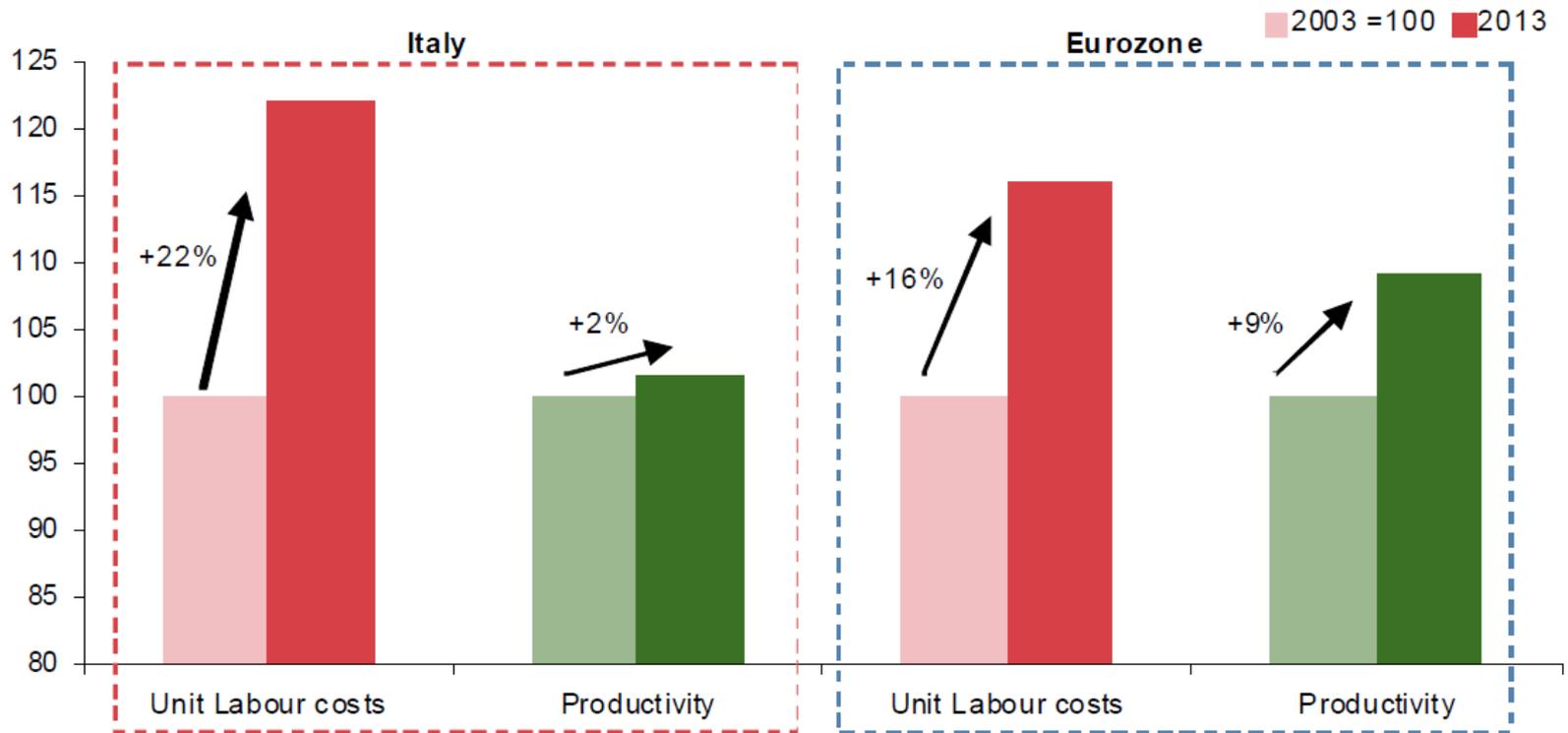
Productivity growth remains 'the' challenge...

Real labour productivity per hour worked (1995 = 100)

— EMU — Germany — Spain — France — Italy — UK

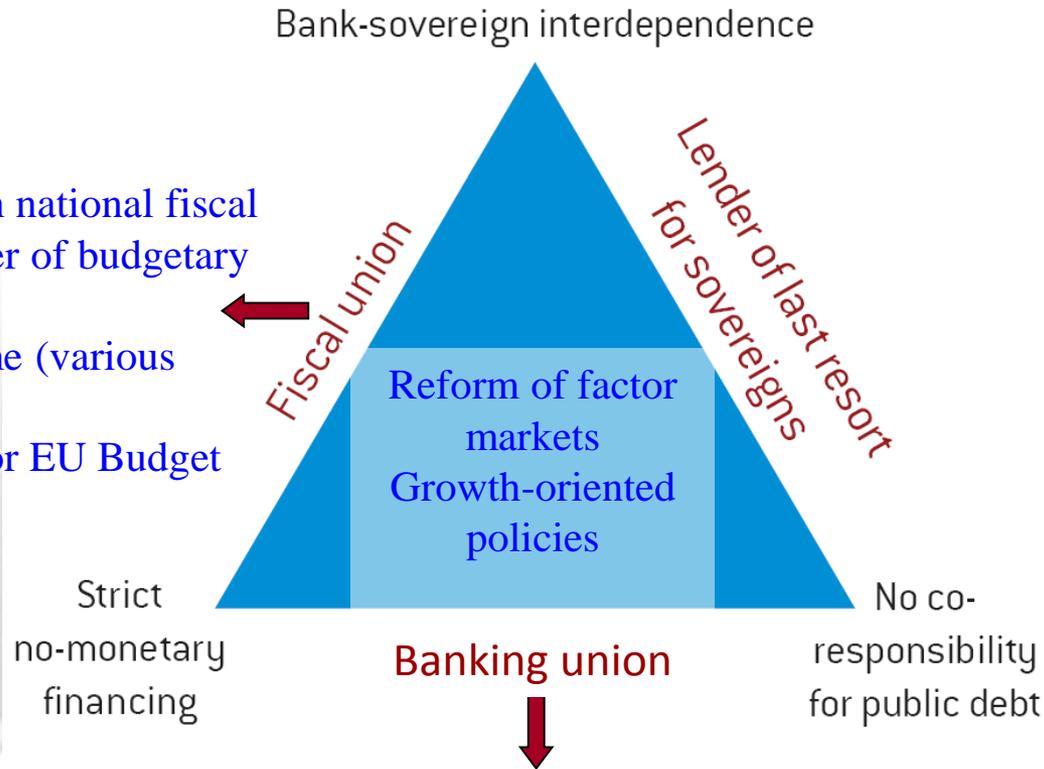


...together with the reform of the labor market



The long-term way out

EU veto rights on national fiscal policies: surrender of budgetary sovereignty.
 Euro-bond scheme (various proposals)
 Fiscal capacity for EU Budget



- Capital Requirement Regulation/Directive (=> Basel 3)
- Single Supervision Mechanism (=> ECB)
- Single Resolution Mechanism (=> bail-in)
- Single Resolution Authority (approved in March '14)
- Pan-European deposit guarantee scheme (still under discussion...)

The ongoing debate

- Fiscal discipline (austerity) vs. growth-policies in the EU
- Strengthening the European Union
 - Institutional reforms & decision-making
 - The role of the ECB
 - Banking Union and Fiscal Union (Euro area vs. EU)
- Structural reform processes in Member countries