crédito y caución
Atradius Group

Country Report

Italy – January 2013

Overview

General information

Capital:	Rome
Government type:	Parliamentary democracy
Currency:	Euro (EUR)
Population:	61.2 million

Most important sectors (% of GDP, 2011)

Services:	68 %
Industry:	28 %
Agriculture:	4 %

Main import sources (2011, % of total)

Germany:	15.7 %
France:	8.4 %
China:	7.4 %
The Netherlands:	5.3 %
Spain:	4.5 %

Main export markets (2011, % of total)

Germany:	13.4 %
France:	11.8 %
USA:	6.2 %
Switzerland:	5.6 %
Spain:	5.4 %

Key indicators

	2009	2010	2011	2012*	2013*
Real GDP growth (y-on-y, % change)	-5.5	1.8	0.6	-2.2	-1.0
Consumer price inflation (y-on-y, % change)	0.8	1.5	2.8	3.1	1.6
Real private consumption (y-on-y, % change)	-1.6	1.2	0.1	-3.2	-1.2
Retail sales (y-on-y, % change)	-2.5	-1.5	-3.7	-4.5	-3.3
Industrial production (y-on-y, % change)	-18.6	6.8	0.2	-5.9	-2.3
Unemployment rate (%)	7.8	8.4	8.5	10.7	11.4
Gross fixed capital investments (y-on-y, % change)	-11.7	2.0	-1.3	-8.4	-3.3
Real net exports (EUR billion)	-12.5	-17.5	3.1	36.6	39.3
Fiscal balance (% of GDP)	-5.4	-4.6	-3.9	-3.3	-2.3
Government debt (% of GDP)	116.0	118.6	120.1	125.9	128.8

*forecast Source: IHS Global Insight

Political situation: Uncertainty ahead of the February 2013 early elections

Head of state: President Giorgio Napolitano (since May 2006)
Head of government: Prime Minister Mario Monti (since November 2011)

Early elections (scheduled for February 24 and 25, 2013) became necessary after the resignation of Prime Minister Mario Monti on December 21, 2012, who did so immediately after both chambers of parliament had approved the budget for 2013. However, President Napolitano commissioned Mr Monti to remain in office as caretaker prime minister until the general elections are held. While Mr Monti is widely respected, his policies, including austerity measures, are not popular: the government's approval rating has plunged from 56 % to 32 % during his time in office.

Mr Monti´s decision came after the People of Liberty Party (Popolo della Liberta party, PDL - the party of his predecessor Silvio Berlusconi) had withdrawn its parliamentary support for his technocratic government in early December 2012. In a rather surprising move, given low opinion polls, Mr Berlusconi announced to run again as PDL candidate for prime minister.

End of December 2012 Mr Monti announced that he will lead a coalition of centrist political parties that support his agenda of fiscal austerity in the February 2013 elections, the so-called "Civic Choice". Early January 2013 Berlusconi's PDL reached an agreement with the Northern League (its former coalition partner) to run together in the February 2013 general elections.

The outcome of the forthcoming general elections is highly uncertain. Currently opinion polls suggest that the centre-left Democratic Party (PD) under Pier Luigi Bersani is in the lead (potential support of about 38 % of the voters), followed by the PDL/Northern League (about 28 %), while the Monti-led coalition accounts for about 15 % of the voters.

According to Italy's electoral rules, the winning alliance receives a bonus that guarantees it a majority in the Chamber of Deputies (the lower house). However, the same election law makes it difficult for a party to gain a majority in the Senate rather than in the Chamber of Deputies because it gives more weight to parties that have a strong regional base.

Economic situation: The contraction continues

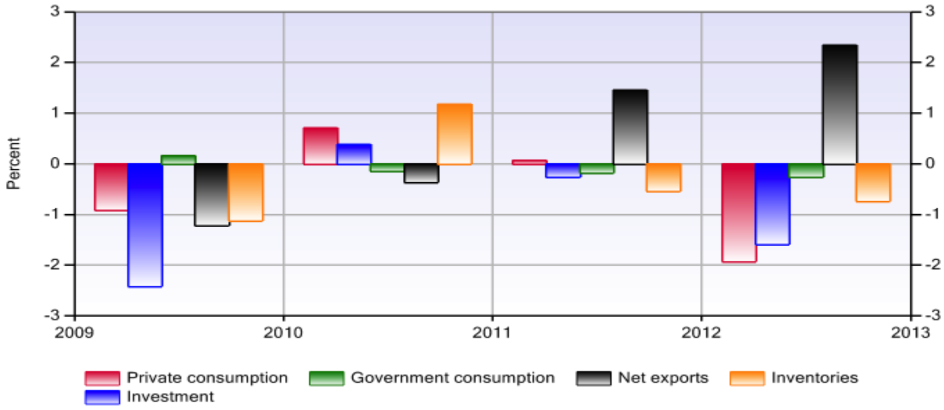
Economic performance weaker than expected

The Eurozone turmoil in late spring 2012, triggered by rising fears of a Greek exit from the Eurozone, hurt the Italian economy by reducing both external and internal demand, leading to lower business and consumer confidence and tougher constraints on credit. GDP projections have been reduced since our June 2012 country report on Italy: from -1.5 % to -2.2 % in 2012 and 0.1 % to -1.0 % in 2013. Private consumption (down 3.2 %), industrial production (down 5.9 %) and investments (down 8.4 %) are all expected to suffer this year and to continue to contract year-on-year in 2013 (see chart on page 2).

The importance of net exports to 2012´s economic performance

Contribution to GDP growth: Italy

(Chain-weighted basis; forecast data edge 2009)



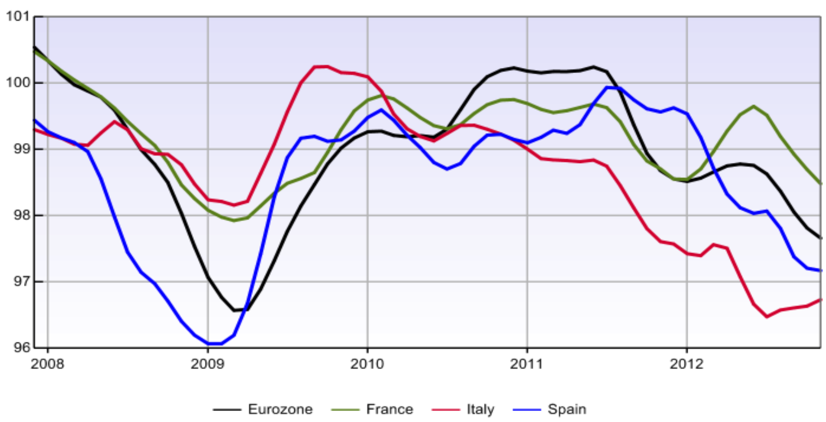
Source: DataInsight

Because domestic demand, amongst other factors, will contribute only minimally to economic growth, net exports will again assume added importance in 2013 and are expected to contribute more than 2 % to GDP growth. According to IHS Global Insight, after a EUR 3.1 billion surplus in 2011 and deficits in earlier years net exports will show a surplus of EUR 36.6 billion in 2012 and EUR 39.3 billion in 2013. This, however, is a sign of weakness rather than strength as we will discuss later.

Other components will drag down growth more sharply than envisaged earlier with private consumption down by 2 % and investments by 1.6 %. Low consumer confidence (see chart below), unemployment and tight financing conditions play a major role. The impact of fiscal consolidation is less pronounced, with a negative growth contribution of 0.2 %. This picture shows clearly the effect of the Eurozone crisis on domestic demand in Italy.

Consumer spending is hampered by the pressure on disposable income of rising unemployment and austerity measures. With lower consumer spending, IHS Global Insight expects retail sales to continue to fall: down 3.3 % year-on-year in 2013 after this year's 4.5 % decrease.

Consumer confidence: selected countries



Source: DataInsight

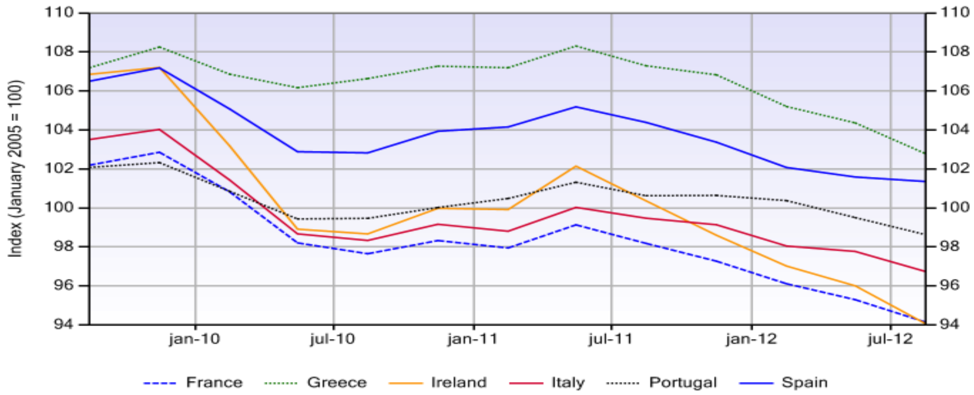
Decreasing international competeviness

There is little cause for complacency about the favourable net export contribution to GDP, as it is helped significantly by the depressed domestic demand that has led to lower imports. Italy has lost nearly 20 % market share in its export markets - particularly European markets - over the last couple of years.

This is borne out by Italy's Real Effective Exchange Rate (REER) development. The REER measures a country's international competitiveness as costs and prices change. Although, in absolute terms, Italy still has a favourable REER position, it compares poorly to some of its European neighbours and has deteriorated since its April 2011 peak position (see chart below). If this is not contained, Italian export performance will suffer further as demand turns towards cheaper countries.

Real Effective Exchange Rate (REER) fluctuations

(Trade weighted currency baskets adjusted for relative inflation)



Source: DataInsight

Lower inflation rates

After increasing to 3.1 % in 2012, due to higher energy costs and a VAT hike, inflation will decrease to 1.6 % in 2013, as demand weakens.

Rising unemployment

Unemployment rose to 11.1 % in November 2012: 25 % higher than a year ago. There are now 2.77 million people out of work. The number of jobless young Italians (i.e. those aged 15-24) has reached 600,000. This represents an increase from 28 % of that group to 37 % since May this year and is much higher than the Eurozone average. A new labour bill passed by parliament in June is of only limited help. While it seeks to make it easier for employers to hire and fire staff, it also retains firm protection for those workers with permanent contracts. Because, as newly hired staff with a permanent contract receive the same protection as someone who has worked for a company for 30 years, firms are still shying away from such contracts. But with many young employees on temporary contracts, productivity has decreased, not least because companies are less willing to invest in training temporary staff.

Restrained bank lending impacts economic performance

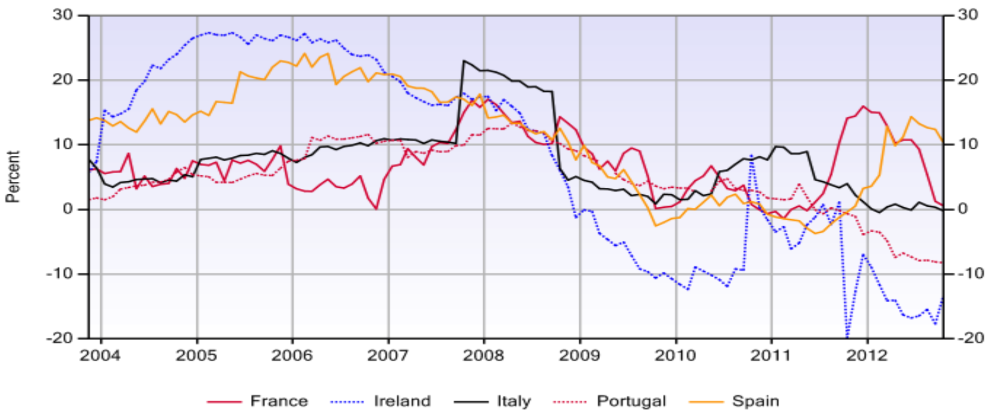
As the Eurozone crisis deepened in the first half of 2012, Italian banks had to rely increasingly on the European Central Bank (ECB) for funding, which by May stood at EUR 273 billion. However, the deposit base remained fairly stable, with a 0.4 % increase from December 2011 to April 2012, although there was substitution between foreign and Italian deposits. ECB support is likely to be needed for the EUR 140 billion debt that matures in 2013.

Impaired loans (i.e. bad, substandard, restructured and past due loans) stood at 11% in 2011, compared to 6 % pre-crisis, reflecting the weaker economic environment. Italian banks have increased their already high level of domestic bond portfolio following the ECB's EUR 1 trillion Long-Term Refinancing Operation (LTRO) facility in early 2012. This represents 7 % of assets compared to the 4 % average in the Eurosystem (EUR 267 billion) and simply adds to the vulnerability of the Italian banking system should the Eurozone crisis deepen and to the weakening of the economic environment.

This exposure, together with the need to increase the capital base, has pushed up lending rates to levels significantly above the Eurozone average. In turn this has led to tighter credit conditions and restrained lending: credit to non-financial businesses and households has decreased every month since February 2012 and by September was 2.9 % lower year-on-year. The negative impact on GDP is estimated to be 0.8 % in 2012 and 0.2 % in 2013.

Loans to the private sector

(Annual percentage change in total amount outstanding)



Source: IHS Global Insight

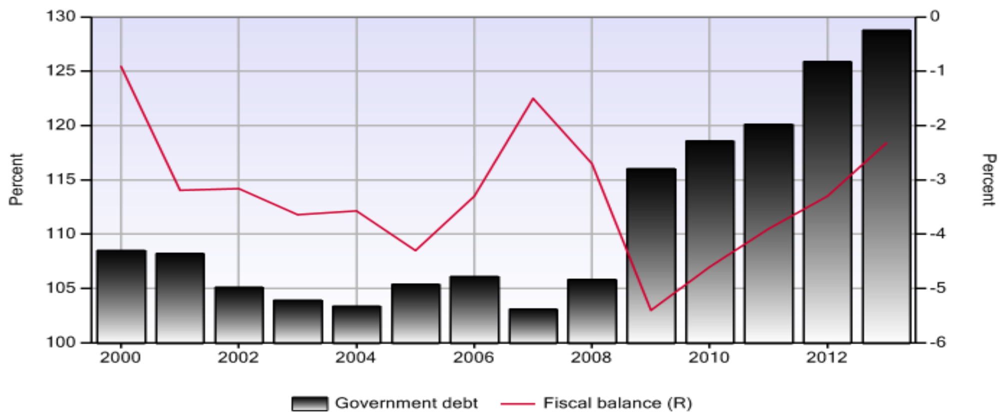
Fiscal consolidation is under way

The additional austerity imposed on the 2013 budget contains relatively mild expenditure cuts combined with a change in the tax mix that provides relief to the lower tax brackets but 1% higher VAT. This will result in a budget deficit of 2.3 % of GDP in 2013 (the 2012 forecast is 3.3 %), which compares well with other Eurozone countries. Fiscal consolidation is driven largely by the government debt to GDP level, which should peak at 128.8 % of GDP in 2013, after which it will gradually fall to 120 % in 2017.

Fiscal contraction will reduce growth by 1.5 % in 2012 and 2013. The public debt trajectory is not in the short or medium term very sensitive to spread widening or yield increases, as the average life of the bonds are relatively long. However, there is more sensitivity to growth and fiscal policy shocks. If nominal growth is 2 % and funding costs are 6 %, a debt-stabilising primary budget balance of 4.7 % of GDP is needed, but historically this has proved a difficult proposition.

Public debt and budget balance: Italy

(Government debt and budget balance in percent of GDP)



Sources: DataInsight, Italian Ministry of Finance

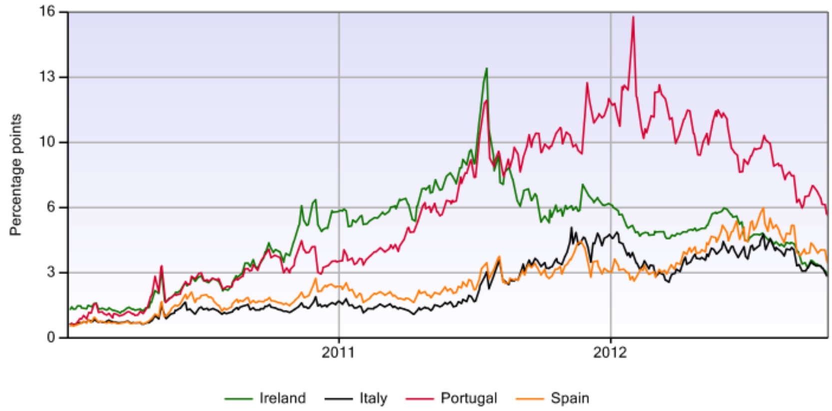
Financial markets: positive developments in the second half of 2012

With the European debt crisis intensifying since mid-2011, Italy's sovereign spreads and credit default swaps have come under scrutiny from financial markets, because of the country's high level of public debt and below-average economic performance.

Following fears of a Greek exit from the Eurozone in May 2012, Italian government bond spreads leapt quickly to levels considered unsustainable, as financial markets feared that Italy would be part of a Eurozone breakup. However, the June 2012 summit of Eurozone leaders confirmed a number of measures committing to a reinforcement of the Eurozone. Crucially, the ECB gave its backing by announcing that it would do 'everything it takes' to prevent a breakup, including a government bond purchase programme. Consequently, bond yields have decreased significantly since then, with the Italian spread at around 3% (see chart below).

Long bond yield divergence within the Eurozone

(10-year government bond yield spreads over the German Bund)



Source: DataInsight

Downside risks to the expected scenario

The main risk to the current economic outlook would be another escalation of the Eurozone crisis. With its very high sovereign debt level - more than 125 % of GDP - the Italian budget is vulnerable to higher funding cost, which would entail further fiscal consolidation. The direct impact of such additional budget reduction on economic performance is uncertain - something of which the government is well aware: hence its additional austerity measures of EUR 3.5 billion in June 2012 on top of the already announced EUR 10.3 billion for the 2013 budget.

The measures taken by the Monti government to address labour market rigidities, reduce barriers to business development and increase competition through privatisation, have all received praise - at least internationally. When fully implemented they should sustain GDP growth in the long term and help to achieve growth of 1 %. While modest, this is far higher than the 0.2 % average of the past decade. But the risk remains of further dilution or even an end to reform efforts if political uncertainty returns after the early elections in February 2013. Whatever happens, the structural reforms that have been introduced will need some time before they contribute to Italy's economic growth, which will probably remain low in the coming years.

For Italian companies, the short and limited economic recovery of 2010 and the first half of 2011 – following the sharp GDP deterioration of 5.5 % in 2009 – has not been enough to rebuild sufficient cash and capital reserves to cushion the double-dip crisis. The traditionally geared financial structure of Italian businesses has also contributed to this situation. We noted that many Italian businesses´ days sales outstanding (DSO) and days payable outstanding (DPO) did not improve in 2010 and 2011 – a sign that the funding of working capital remains an issue.

Italian businesses currently face difficulties caused by decreasing domestic demand and public investment, while demand from its main export partners like France and Germany is also slowing.

Liquidity problems are exacerbated by continuing bad payment behaviour, especially by the public sector. Moreover Italian companies, compared to their Western European peers, show a higher average gearing - especially short-term gearing. Many businesses suffer from the banks´ current restrictive loan policy.

However, the Italian economy still has some structural strengths, such as broad diversification (with some unchallenged market champions in the food, textile, metals, and engineering/machines sectors), strong local business districts and traditionally close relationships between banks and companies.

The insolvency environment

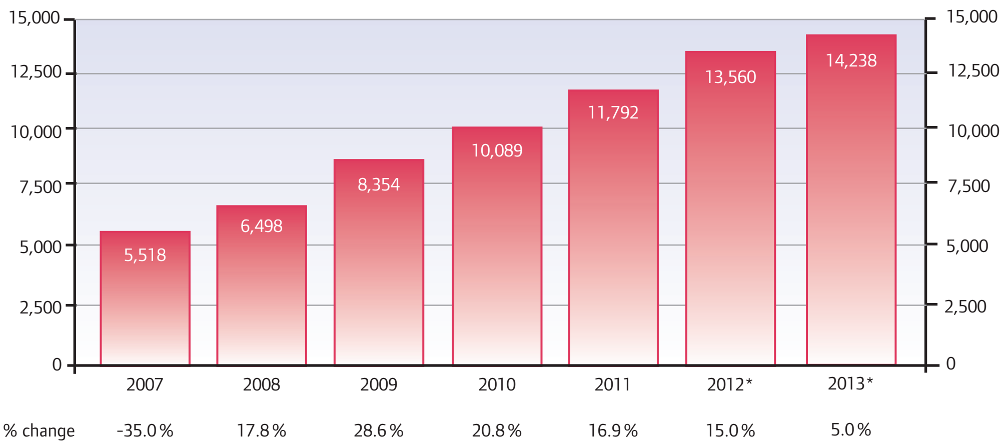
Corporate insolvencies expected to increase further in 2013

Since 2008, corporate insolvencies have increased at double-digit levels, and we expect business failures to increase further in 2012. In view of the deteriorating economic environment, we have revised our 2012 insolvency forecast upwards, from a 10 % increase to a 15 % increase, i.e. to around 13,500 insolvencies (see chart below). Geographically, central and southern Italy are worst affected, as payment behaviour there is on average worse than in the north of the country. The south is also affected by the fiscal pressure exerted by the new government, which is increasingly eroding soft financing and cash recycling opportunities: the privileged funding source for companies in the region.

2013 will see another 5 % increase in insolvencies, due to the continued economic contraction. In general, the main contributors to this tense situation are the current weak economic performance, austerity measures, tighter bank lending, the public sector's poor payment behaviour, increased energy prices, and decreasing demand from some major export destinations.

Italian business insolvencies

(year-on-year change)



Sources: National Statistics Office, Atradius Economic Research

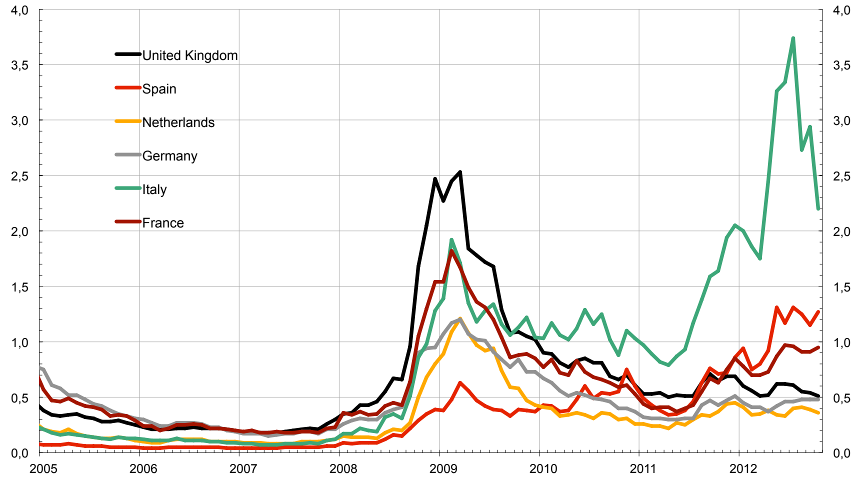
Note: Forecasts are based on the outcome of statistical models and expert opinion. The history of growth rates in the table represents estimates based on official insolvency statistics and model-based calculations. As such these rates should be treated as indicative. All views expressed here are those of Atradius Economic Research (date of final forecast: 10 October 2012)

Expected default frequency for Italian listed companies

Since July 2011 the Eurozone debt crisis has led to a massive deterioration in Italian EDF: the December 2011 EDF for Italy (205 basis points) was 112 basis points higher than in June 2011 and even higher than in the wake of the 2008/2009 global credit crisis. After a short recovery in early 2012, Italian EDF has made a steep climb since April 2012 as fears of a Greek exit and even a Eurozone breakup increased: reaching 374 basis points in July 2012. Since then, Italy's EDF has improved, with the October 2012 figure 154 basis points lower than last July. However, it remains very high, meaning that listed companies in Italy are facing a significantly higher default risk (see chart below).

Median EDF evolution by country*

(Expected default frequency, percentage points)

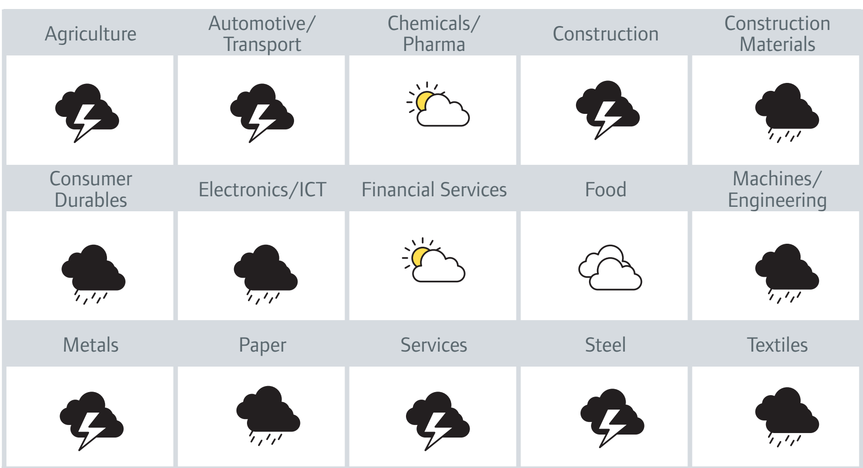


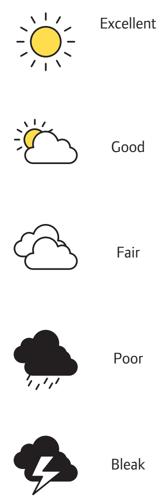
Source: KMV Credit Monitor and Atradius Economic Research

*The Expected Default Frequency (EDF) chart above is based on listed companies in the markets referred to, and the likelihood of default across all sectors within the next year. In this context, default is defined as a failure to make a scheduled payment, or the initiation of bankruptcy proceedings. Probability of default is calculated from three factors: market value of a company's assets, its volatility and its current capital structure. As a guide, the probability of one firm in a hundred defaulting on payment is shown as 1%.

Italian industries performance forecast

December 2012





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