Italy Snapshot | Nov 11, 2019

MAIN DEVELOPMENTS

KEY STATISTICS

THE FAITH OF ALITALIA AND EX-ILVA

Conte threatens Mittal with legal battle, as government considers its options

Italy | Nov 08, 07:50

- **Return to extraordinary administration and nationalization are both on the table**
- **M5S is split on the reintroduction of ArcelorMittal's legal protection guarantees**

Lufthansa is only interested in a "restructured" Alitalia - CEO

Italy | Nov 07, 15:27

- **CEO Carsten Spohr insists on significant structural changes in the Italian airline**
- **Agreeing to sizable redundancy requests from both ArcelorMittal and Lufthansa in the space of a month may prove to be too costly politically**

Mittal wants to cut workers and production targets, insists on legal protection

Italy | Nov 07, 07:57

- **Conte offers to reinstate the penal shield, but is met with more conditions**
- **ArcelorMittal wants to cut worker numbers in half and lower production targets by 33%**
- **The company insists that the legal shield is restored and the operation of Blast furnace 2 is guaranteed**

ArcelorMittal wants to leave, even if legal protection is restored

Italy | Nov 06, 08:13

- **Company claims legal and operational uncertainty have compromised its ability to fulfil the contract**
- **Estimated annual impact on Italian GDP from the closure of the ex-Ilva plant would amount to some EUR 3.5bn**
- **PM Giuseppe Conte will meet the top management of ArcelorMittal Italy on Wednesday, but we do not expect a positive outcome**

ArcelorMittal withdraws from Ilva

Italy | Nov 04, 16:56

- **The government's decision to remove promised legal protection for ArcelorMittal may lead to severe job losses**
- **We expect that Minister of Economic Development Patuanelli will lose his post over these latest developments**

Delta may pull out of Alitalia deal

Italy | Nov 04, 08:43

- **Lufthansa may be willing to contribute twice as much as Delta**
- **Lufthansa's restructuring plan would be by far the most difficult to push through politically**

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LOCAL ELECTIONS 2019-2020

Di Maio concedes regional alliance has failed, as M5S halve support in Umbria

Italy | Oct 28, 16:20

- **Salvini's Lega registers 14pp increase in support with the PD going the other way**
- **We feel M5S might reevaluate the idea of common civic lists with the PD**

Center-right candidate wins Umbria in convincing fashion

Italy | Oct 28, 08:39

- **Lega Senator Donatella Tesei holds a significant 20pp lead in front of M5S-PD-backed Vincenzo Bianconi**
- **Lega is the most supported party, followed by the PD and FdI**
- **Zingaretti blames Renzi and budget 2020 quarrels, PD Senate leader Marcucci calls for a reevaluation of regional partnership with M5S**

Ruling parties converge on Umbria for an unexpected pre-election event

Italy | Oct 24, 14:54

- Di Maio, Conte, Zingaretti and Renzi are all expected to make an appearance

Center-right parties are working on a regional agreement

Italy | Oct 07, 08:37

- The center-right wants to present a more unified opposition in Parliament
- Renzi will support the M5S-PD civic candidacy of Bianconi in Umbria
- Lega, FdI and FI will all attend the demonstrations in Rome on October 19

M5S and PD find agreement on a civic candidate for President of Umbria

Italy | Sep 23, 08:36

- M5S-PD will unite behind local entrepreneur Vincenzo Bianconi, after Assisi mayor Stefania Proietti declined Di Maio's offer
- The Rousseau votes 61-39% in favor of "regional cooperation with other parties"
- Renzi's Italia Viva will not take part in the elections on October 27

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POLICIES OF THE M5S-PD GOVERNMENT

Stopping the VAT hike might cost more than initially expected

Italy | Sep 09, 15:38

- Tria's original plan to suspend the VAT hike involved cuts up to 6bn in tax deductions and exemptions
- VAT might still have to be raised on some goods and services, regardless of overall freeze
- The total fiscal impact envisioned in the M5S-PD program might reach 2.5% of GDP

Only 18% of Italians believe that the government will last until 2023 - Ipsos

Italy | Sep 09, 13:03

- 45% of Italians think Conte's second cabinet will only last a few months
- VAT hike suspension, tax wedge reduction and the minimum wage are seen as an urgent priority by 71% of voters
- A Tecne poll shows Lega is still losing votes, trend for M5S and PD is positive

M5S-PD will not remove quota 100 and citizenship income, TAV to go ahead

Italy | Sep 06, 12:52

- Most immediate actions and statements can be referred to PD-backed policies
- Di Maio promises frank and open dialogue with the EU
- The new government will not make changes quota 100 and citizenship income

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CONFLICT BETWEEN THE GOVERNMENT AND EC OVER BUDGET RULES

Italy’s DBP does not comply with the debt reduction benchmark - EC

Italy | Oct 22, 14:57

- EC has asked Italy to submit further information on the precise composition of the structural balance changes

- We expect the government to be receptive of Brussel's demands

Italy’s draft budget targets fiscal deficit of 2.2% of GDP in 2020

Italy | Oct 16, 15:20

- GDP growth is projected to accelerate to 0.6%, supported by private consumption
- Estimated revenues from tax evasion measures reduced from EUR 7bn to EUR 3bn
- The government will count on the new web tax to bring in some EUR 600mn
- We feel that the draft budget remains open to criticism and some of the measures may have to be revisited

Budget 2020 is already under scrutiny

Italy | Sep 02, 08:01

- EC expects the first draft of the 2020 budget by mid-October, may add "5-10 days"
- The government will ask for concessions from the EU
- Closing the fiscal gap (and stopping the VAT hike) will prove challenging

Italy to request greater budget flexibility from EC – Salvini

Italy | Aug 06, 16:36

- Negotiations with EC will be focused on flexibility for infrastructure spending
- Salvini aims to boost economic growth through tax cuts
- Salvini places conditions before M5S to allow minimal wage hike

Government shows much-needed realism with agreement with EC on budget

Italy | Jul 04, 14:55

- We see greater chance for relatively muted fiscal easing in 2020
- Ruling coalition might pay with a decline in support as it fails to deliver change to voters
- Snap elections remain a potential outcome, but become less likely

EC decides not to open EDP against Italy, to review case in autumn

Italy | Jul 03, 18:09

- FinMin Tria promises to make "significant structural adjustment in 2020"
- Deputy PM Salvini urges government to speed up flat tax adoption

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KEY STATISTICS

Retail sales increase by 0.7% m/m in September

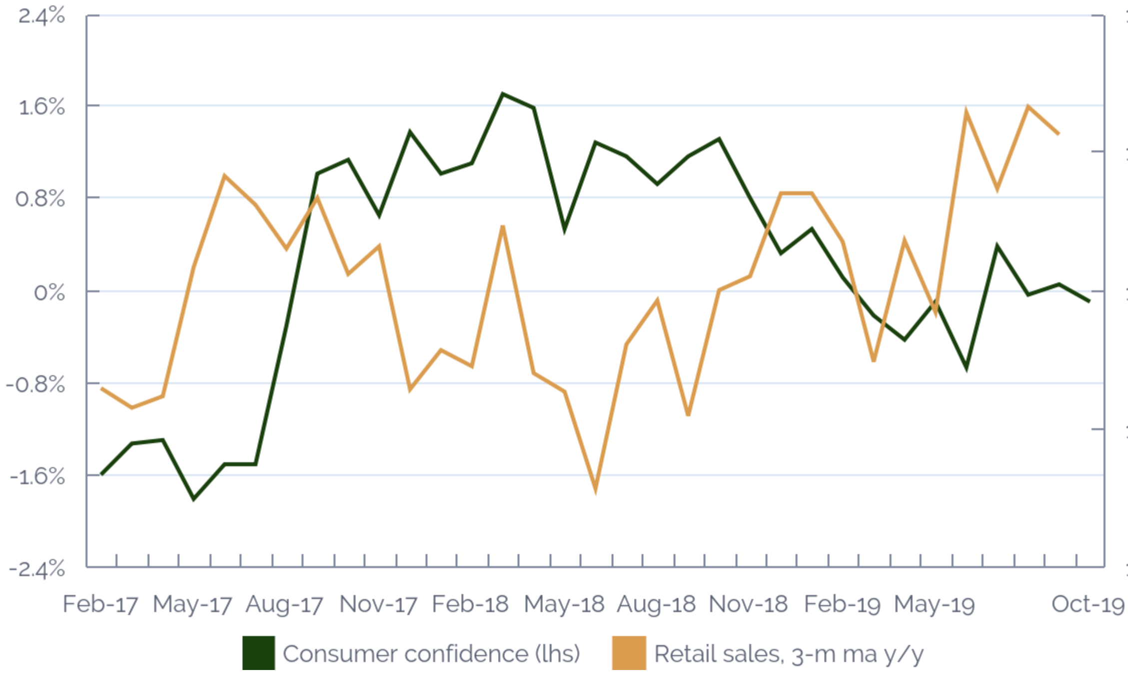
Italy | Nov 07, 12:46

- The volume of retail sales increased by 0.8% m/m sa, after two consecutive months of decline
- Large retailers register y/y and ytd increases, but the rest struggle to reach 2018 levels
- Declining business and consumer confidence may yet result in a flattish 2019 and a slow start of 2020

Retail sales increased by 0.7% m/m sa in nominal terms in September, at the back of two consecutive 0.5% m/m declines, Istat reported. In y/y terms, sales expanded by 0.9% in what was their fourth consecutive monthly increase. Despite the positive data, the change in the headline indicator remained below expectations both of a 1.1% m/m increase and of a 1.0% y/y gain.

Consumer confidence and retail sales

Source | Istat



Most product groups recorded y/y gains with computer sales picking up back to 5.1% y/y, after slowing down to just 1.0% y/y in August. Other categories of goods that returned to higher growth rates, after moderating in the previous month, were household appliances (2.2% y/y), clothing (3.6% y/y) and shoes, leather products and travel items (4.5% y/y). However, since the combined relative weight of these four categories amounts to just 21.2% of the headline index, the increase in overall sales remained moderate. On the flip side, the 0.5% y/y decline in the sales of pharmaceutical products, which was the fourth decrease in five months, had the most negative effect on total sales.

The volume of retail sales increased by 0.8% m/m sa, after two consecutive months of decline, with the increase including both food and non-food products. In y/y terms, non-food products were up 2.1%, but food products registered a 0.9% decline, resulting in a modest 0.7% y/y overall increase in the volume of retail sales. In line with expectations, the 3-mma moderated across all both segments, after the exclusion of the surprisingly strong June numbers, but still remain positive in y/y terms. Finally, most of the overall increase in sales (both in y/y and ytd terms) continues to be stemming from large retailers, as medium and small retailers have struggled to improve on last year's sales.

We expect retail sales to continue their modest expansion going forward, but see little prospects of a more sizable pick-up before the end of the year. Declining business and consumer confidence may yet result in a flattish 2019 and a slow start of 2020, as the government's leading measure targeted at supporting consumption (the tax wedge cut), will not kick off until mid-2021.

Retail trade (y/y, nominal and unadjusted data, unless specified)

	Mar-19	Apr-19	May-19	Jun-19	Jul-19	Aug-19	Sep-19
Retail sales	**-3.3%**	**4.2%**	**-1.8%**	**1.2%**	**2.5%**	**0.8%**	**0.9%**
Food products	-6.6%	8.9%	-1.1%	0.6%	3.2%	1.1%	-0.3%

Non-food products	-0.5%	0.5%	-2.2%	1.8%	1.9%	0.7%	1.7%
Pharmaceuticals	-1.9%	1.9%	-1.0%	-2.1%	0.3%	-1.2%	-0.5%
Clothing	0.7%	-1.4%	-4.9%	2.7%	1.2%	0.0%	3.6%
Furniture	0.1%	1.1%	0.0%	2.0%	2.7%	2.6%	1.3%
Computer and telecommunication equipment	-0.8%	4.6%	2.4%	6.9%	5.9%	1.0%	5.1%
Household appliances	-4.2%	1.8%	0.6%	2.8%	2.4%	-1.7%	2.2%
Household tools and hardware	1.3%	-0.6%	-3.3%	1.8%	1.9%	-0.9%	0.3%
Personal care items	-1.0%	3.5%	-0.8%	0.7%	2.2%	2.2%	0.9%
Retail sales, m/m sa real	**-0.2%**	**0.1%**	**-0.7%**	**2.1%**	**-0.7%**	**-0.6%**	**0.8%**

Source: Istat

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Central government deficit decreases slightly to EUR 52.7bn in Jan-Oct

Italy | Nov 05, 06:49

- **The EUR 2.5bn monthly surplus in October is mostly due to later collection of self-paid taxes**
- **Fiscal underperformance is mainly due to the economic slowdown, but some expenditures still increase**

The central government registered a EUR 2.5bn surplus in October, compared to a EUR 4.0bn deficit in Oct 2018, the Ministry of Economy and Finance reported. The main reason for the overall improvement was the later collection of self-paid taxes, as the 2019 deadline was pushed back, in line with the previous government's Growth Decree. The Ministry still reports higher INPS and central and regional government expenditures, as well as a EUR 240mn y/y increase in interest rate payments.

Central govt budget deficit (% of GDP)

Source | Finance Ministry

According to our calculations, the cumulative budget deficit decreased slightly to EUR 52.7bn in Jan-Oct, from EUR 53.3bn in the same period of 2018, but remained almost unchanged in relative terms, rounding to 3.0% of GDP. The ongoing relative underperformance in regard to the government's original fiscal targets is mainly caused by the unforeseen scope of the 2019 economic slowdown. While we still view the government's annual fiscal targets as achievable, it may be but a few instances of discretionary spending away from missing them.

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CPI inflation remains at a 3-year low of 0.3% y/y in October

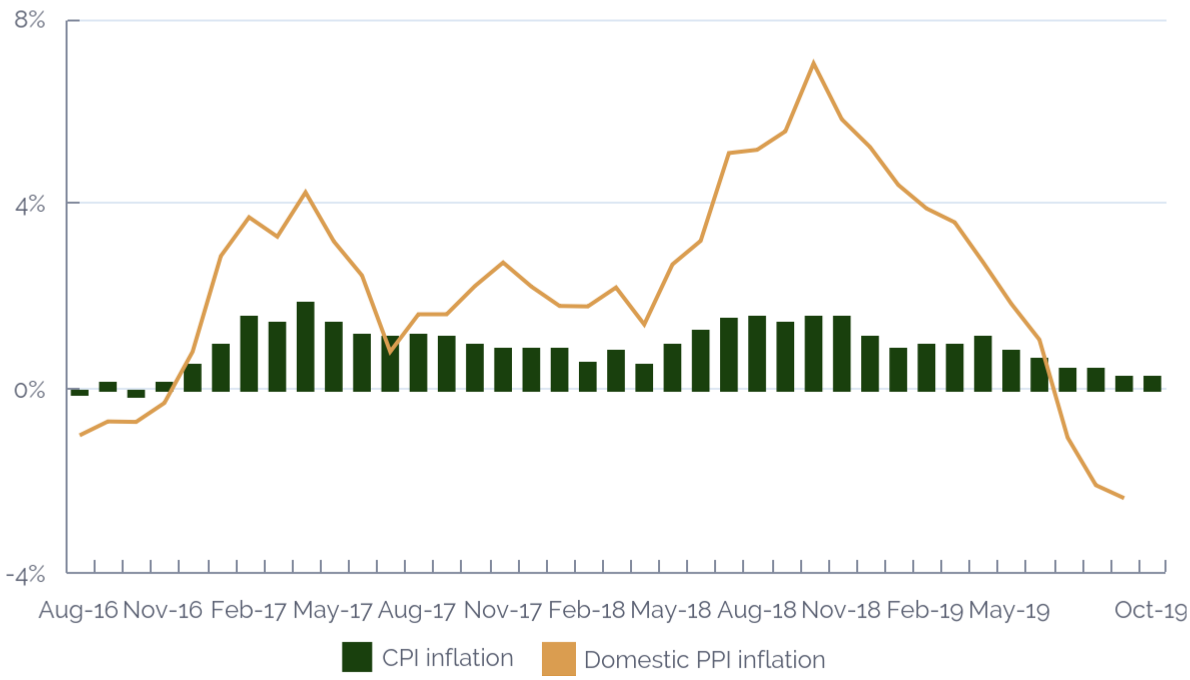
Italy | Oct 31, 15:29

- **Energy prices decline 4.7% y/y, putting pressure on headline CPI**
- **Core inflation picks up to 0.8% y/y**

CPI inflation remained at a three-year-low of 0.3% y/y in October, Istat reported. The general index was unchanged in m/m terms, as the initial September estimate of 0.4% y/y was revised down to 0.3%.

PPI and CPI inflation, y/y %

Source | Istat



Energy prices continued to decrease and are now down some 4.7% y/y, with the decline in administered prices (8.2% y/y) outpacing that of non-administered prices (3.1%). This has also pushed down the price of utilities to 1.9% lower y/y, while the price of transportation is flat y/y. Food prices continued their gradual rise and are now up 1.0% y/y, compared to 0.7% y/y in September. The price increase of clothing and footwear also accelerated slightly reaching 0.4% y/y for the first time since Jul 2017.

While the price of communication services continued to decline, it was unable to offset general upward price pressures in the service sector, resulting in an overall increase of the price of services by 1.1% y/y in October. As a result, core inflation settled at 0.8% y/y, which is the highest y/y rate of increase in the last 13 months. Despite this upward trend, we do not expect to see a significant simultaneous pick-up in CPI until the end of the year, as falling producer prices will probably spill into the consumer basket, as producers target higher demand.

Consumer price inflation

	Sep-18	Oct-18	Sep-19	Oct-19
CPI	**1.4%**	**1.6%**	**0.3%**	**0.3%**
Core CPI (excluding raw food and energy)	0.7%	0.7%	0.6%	0.8%
Energy	7.6%	10.1%	-2.8%	-4.7%
Administered prices	5.6%	10.7%	-5.3%	-8.2%
Non-administered prices	9.3%	9.5%	-2.6%	-3.1%
Food prices	1.7%	1.0%	0.6%	0.9%
Raw food	2.4%	0.8%	1.1%	1.1%
Processed food	1.2%	1.0%	0.2%	0.7%

Source: Istat

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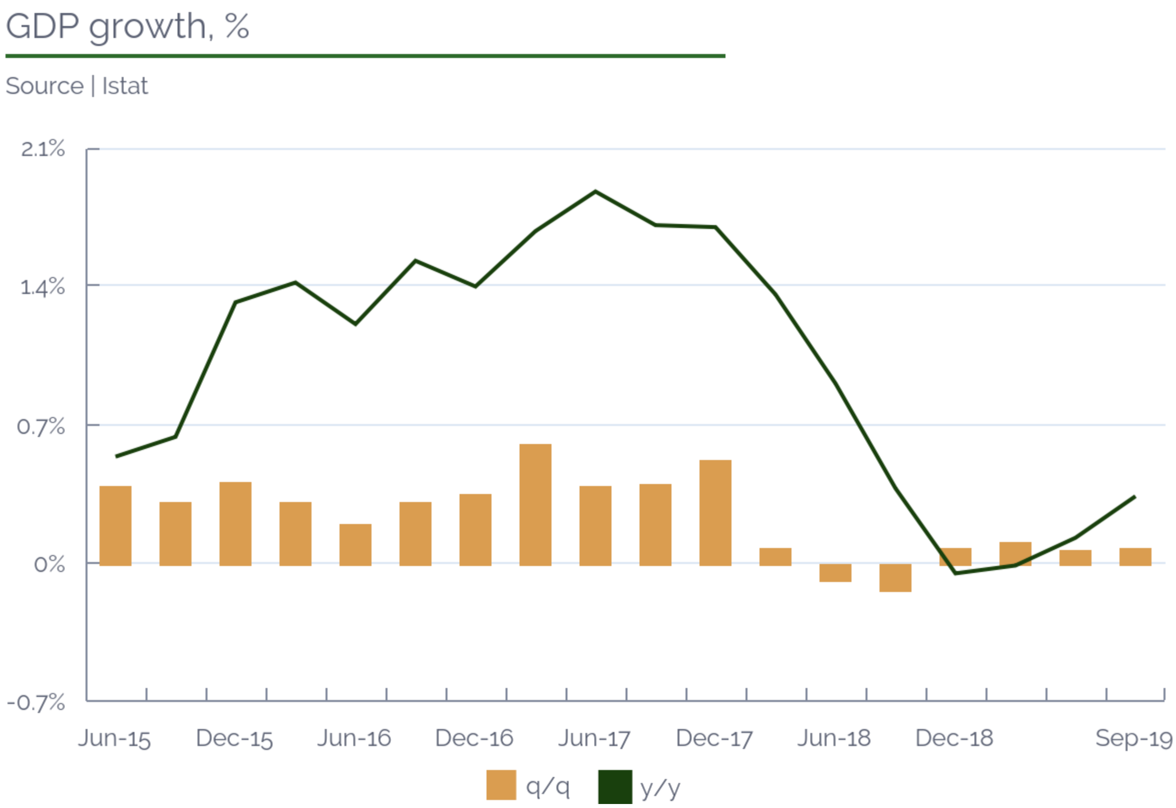
GDP growth accelerates to 0.3% y/y in Q3 – flash release

Italy | Oct 31, 14:13

- **Services and industry value added increase**
- **Domestic demand offsets negative q/q contribution of net exports**

GDP growth accelerated to 0.3% y/y in Q3, from 0.1% y/y in Q2, according to Istat's GDP flash release. In q/q terms GDP growth increased by 0.1% for the fourth consecutive quarter, beating the consensus forecast of a 0.1% q/q decline by economists polled by Reuters.



Istats supply-side assessment of Q3 GDP points to a small q/q increase in the value added of both industry and services, while agriculture subtracted from growth. On the demand side, domestic demand contributed positively, which offset the negative q/q contribution of net exports.

Overall, Istat's flash release shows that the economy has performed somewhat better than might have been expected, as the country spent much of Q3 in a state of political crisis. At the same, time there are clear downside risks to both the country's short-term export performance (especially EU exports), as well as the continuing increase of domestic demand, to the extent that the labour market expansion seems all but over.

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Unemployment rate increases to 9.9% in September

Italy | Oct 31, 14:09

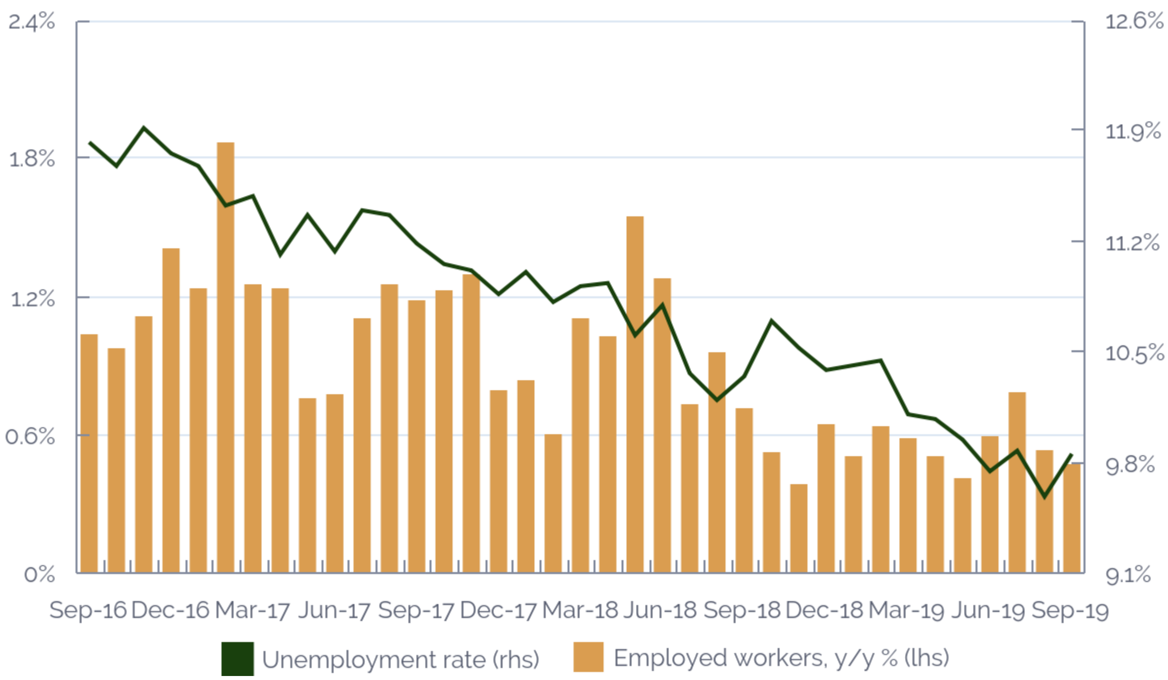
- **Employment remained at 59.1% for the third month in a row, maintaining a 0.5pps y/y increase**

We expect labour market performance to remain flattish until the end of the year

LFS unemployment rate increased to 9.9% in September from an 8-year low of 9.6% in August, Istat reported. This was some 0.3pps higher than the consensus forecast of a flattish m/m reading, as projected by economists polled by Reuters. The deterioration mirrors both a 32,000 drop in the number of the employed, as well as an increase of the unemployed by 73,000, with both indicators registering their worst m/m dynamics since Oct 2018.

Labour market data

Source | Istat



Employment remained at 59.1% for the third month in a row, maintaining a 0.5pps y/y increase throughout the entirety of the Jul-Sep period. Additionally, the number of the inactive people fell by 0.6% m/m but is only 1.0% lower y/y, as the expansion of the labour force has remained patchy throughout 2019.

While the headline employment and unemployment indicators are indicative of the underlying weakness of the Italian labour market expansion, some positive structural adjustments are still taking place. Despite the fact that most of the advance took place in H1, open ended employment has increased by 214,000 y/y, which is the most significant y/y shift since Sep 2016.

Overall, we maintain our view that the labour market has little to look forward to in the short-term, as business' employment expectations remain subdued, despite the slight pick-up in overall economic activity. We expect labour market performance to remain flattish until the end of the year, as unemployment looks more likely to finish closer to 10%, rather than 9%.

Labour market data, seasonally-adjusted

	Apr-19	May-19	Jun-19	Jul-19	Aug-19	Sep-19
Unemployment rate, total	10.1%	9.9%	9.8%	9.9%	9.6%	9.9%
Employment rate	58.9%	59.0%	59.2%	59.1%	59.1%	59.1%
Activity rate	65.7%	65.7%	65.7%	65.8%	65.6%	65.7%

Youth unemployment rate, 15-24 years	30.0%	29.6%	27.8%	28.9%	27.6%	28.7%
m/m (thousands)						
Labour force	13	25	-35	13	-92	41
Employed	20	56	19	-23	-6	-32
Unemployed	-7	-31	-54	35	-85	73

Source: Istat

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Current account surplus increases by 8.5% y/y in August

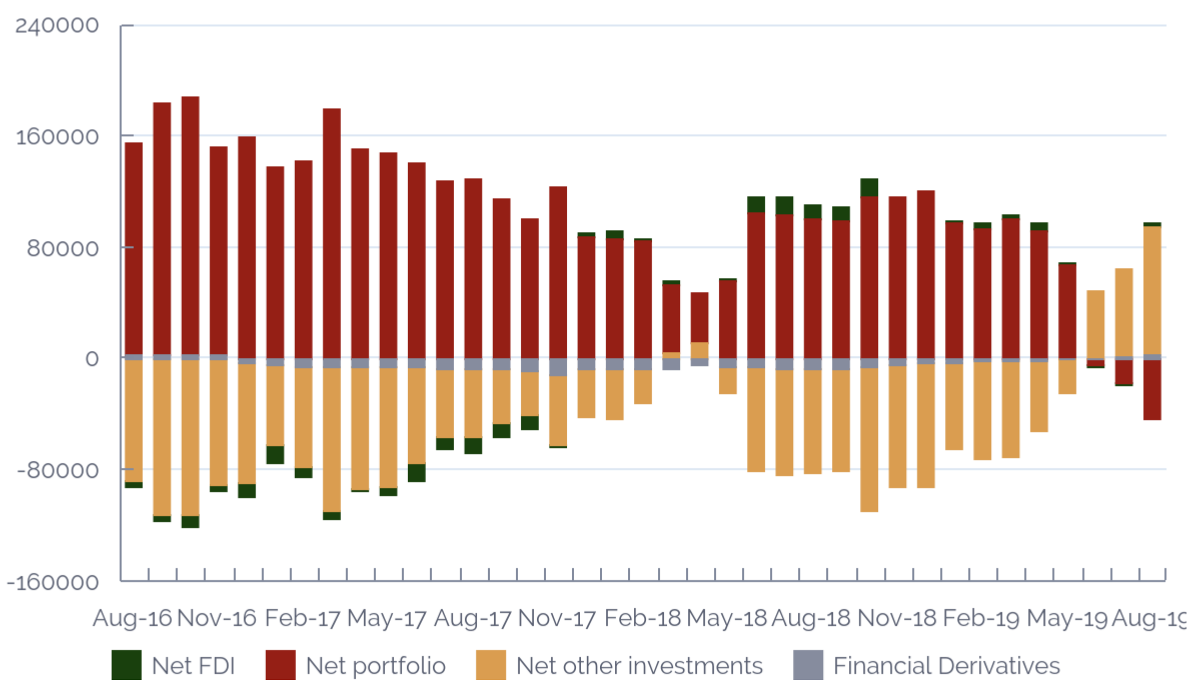
Italy | Oct 18, 14:34

- **The 12-m rolling current account surplus rose to EUR 50.6bn, which is 2.2% higher than the corresponding period of 2018**
- **Continuing improvement in primary income is somewhat offset by the slight narrowing of the goods surplus**

The current account surplus rose by 8.5% y/y to EUR 6.04bn in August, following a 14.0% y/y increase in June, the Bank of Italy reported. The 12-m rolling current account surplus rose to EUR 50.6bn, which is 2.2% higher than in the corresponding period of 2018 and amounts to 2.9% of GDP. The improvement in the 12-m rolling balances of primary income (25.8%) was partly offset by the slight narrowing of the goods surplus (-0.3%) and the higher secondary income deficit, which amounted to 18.7bn and is 23.4% above its 12-m rolling value in Aug 2018.

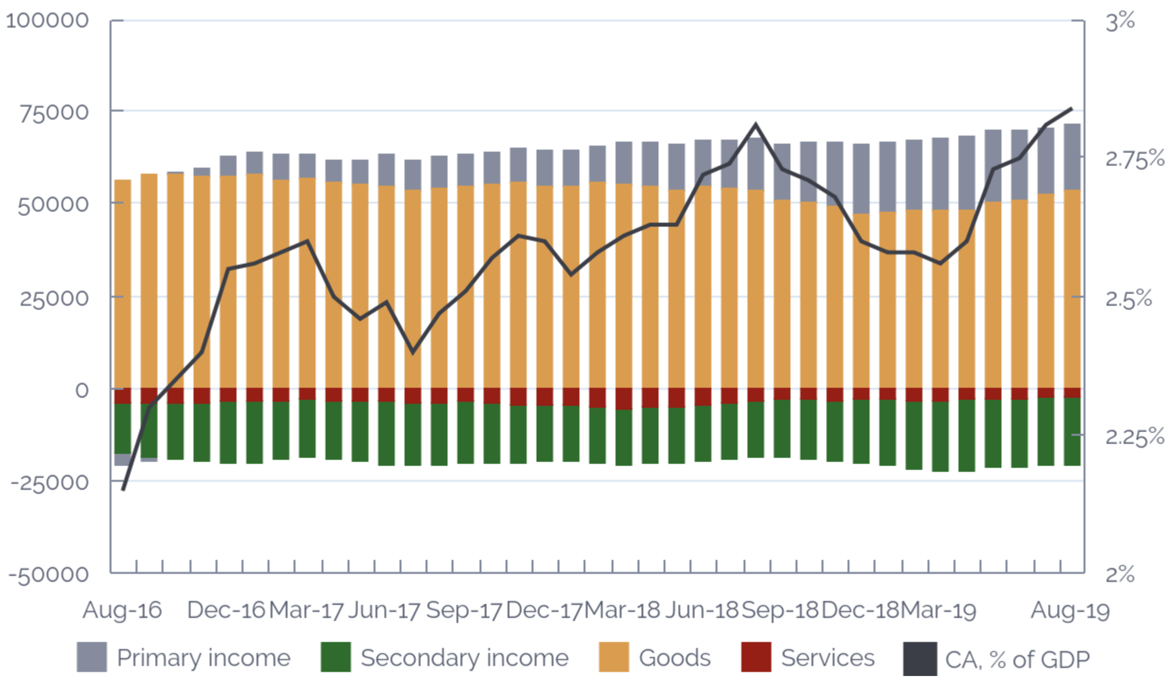
Financial account composition (12-m rolling)

Source | Bank of Italy



CA composition (12-m rolling), EUR bn

Source | Banca d'Italia



Looking at the financial account, we see a third consecutive month of net outflows amounting to some EUR 28.1bn in the June-Aug period. The Central Bank reports that Italian investors have purchased foreign portfolio assets of EUR 13.5bn in August, including both equity and long-term debt securities. Direct investment abroad and "other investments" also increased, while the purchase of local assets by non-residents declined across the board in y/y terms, despite registering nominal increases. In particular, foreign investors purchased some EU 10.5bn of public sector securities, as the attractiveness of Italian debt markets increased significantly during the observed period.

Balance of payments, EUR mn

	Aug-18	May-19	Jun-19	Jul-19	Aug-19
Current account balance	**5,563**	**4,477**	**6,289**	**8,537**	**6,037**
Goods balance	3,277	6,134	6,436	7,455	4,663
Exports, FOB	30,349	42,510	39,669	42,995	30,683
Imports, FOB	27,071	36,376	33,233	35,540	26,021
Services balance	1,281	528	759	1,639	1,039
Services: travel	2,468	2,079	2,240	3,013	2,431
Primary income	2,457	-1,739	236	758	1,764
Secondary income	-1,452	-446	-1,143	-1,316	-1,428
Capital account	**33**	**-282**	**-240**	**116**	**85**
Financial account	**4,532**	**-788**	**6,261**	**10,891**	**10,970**
Net FDI	-2,460	-3,721	4,434	-3,451	502
Net portfolio	31,491	10,832	-30,492	-22,706	5,609
Net other investments	-23,563	-9,165	32,199	35,712	5,216
Financial Derivatives	-911	569	556	414	470
Change in reserve assets	-26	696	-436	921	-827

Errors and omissions	**-1,065**	**-4,983**	**212**	**2,238**	**4,848**

Source: Bank of Italy

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Foreign goods trade surplus rises by 3.8% y/y to EUR 2.58bn in August

Italy | Oct 17, 13:46

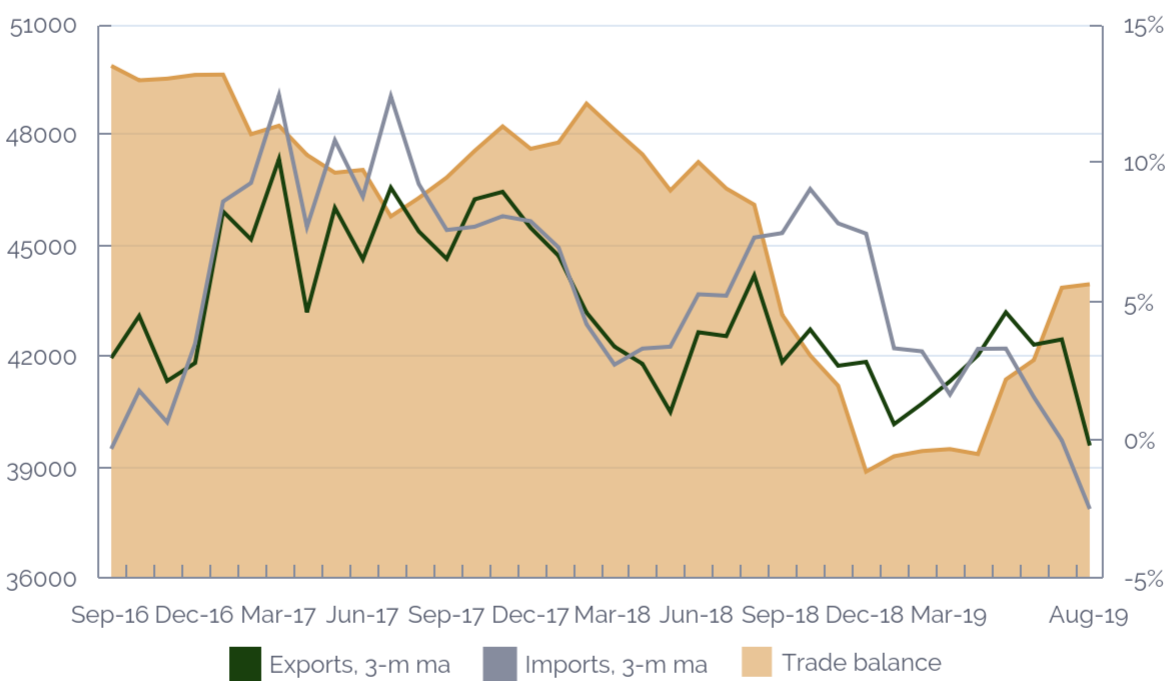
- **Exports to other EU countries decline by 5.2% y/y**
- **Import prices are 2.5% lower y/y, putting pressure on local producers**

Italy's merchandise trade surplus rose by 3.8% y/y to EUR 2.58bn in August, according to data released by Istat. This means that the 12-m rolling trade surplus remains unchanged m/m at EUR 43.9bn, which is some 4.7% lower than the value for Aug 2018.

The trade balance with the rest of the EU was barely positive at EUR 259mn, as Italian exports to the EU fell by 5.2% y/y in August, which is the sharpest y/y decline since July 2016. Meanwhile, the reduction in imports was much more moderate at 2.4% y/y. The nominal trade balance with the rest of the world stood at EUR 2.3bn, as imports declined nearly four times faster than the 1.4% y/y decline in exports, ultimately bringing the cumulative 2019 balance to EUR 20.2bn.

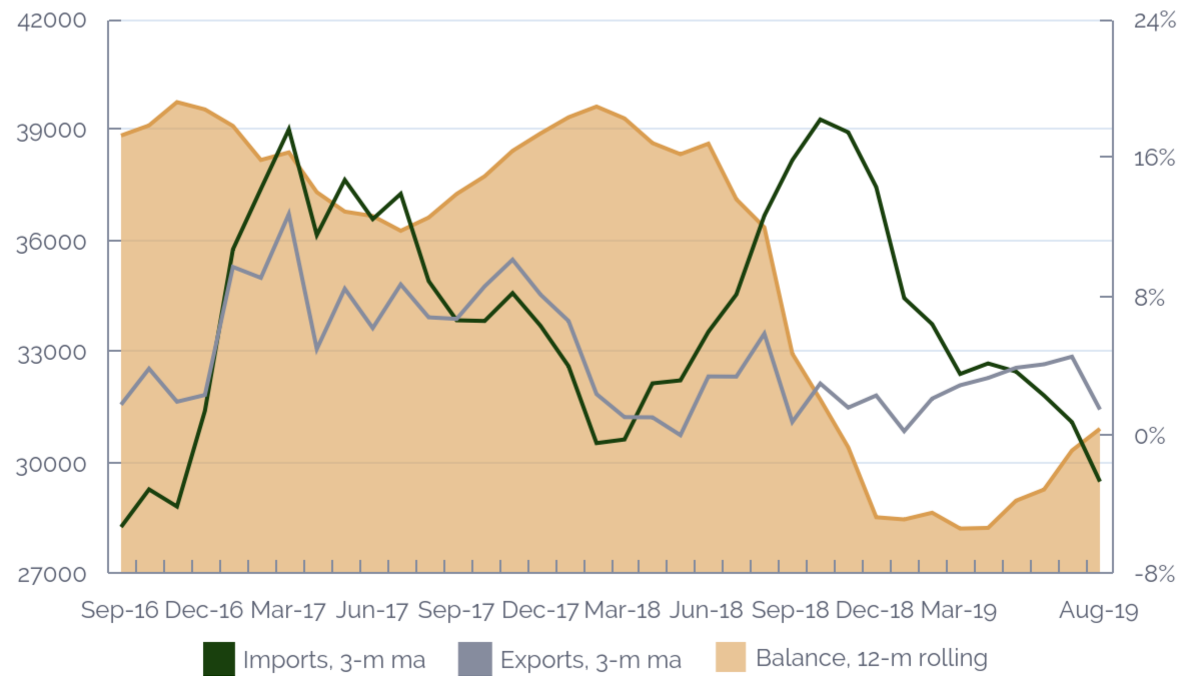
External trade of goods, EUR bn

Source | Istat



External trade of goods (non-EU)

Source | Istat



Exports of capital and intermediary goods fell by 7.6% y/y and 6.0% y/y respectively, confirming reports of deteriorating external demand amidst the observed slowdown of the European and global economy. Exports to Germany and France are down by 7.5% y/y and 5.9% y/y, respectively, while exports to Switzerland continued their recent robust performance and are up some 25% y/y. Exports of consumer goods also decelerated to 4.9% y/y, which is the lowest rate on annual increase since Dec 2018.

Among the products of the manufacturing industry the sharpes y/y decline was posted by the exports of electrical equipment (16.3%) and transport equipment (10.0%). On the flip side, pharmaceutical products posted a double-digit y/y growth for the sixth consecutive month.

Overall the latest Istat data confirms that the somewhat surprising July rebound in exports is unlikely to represent a turning point, as hopes of an export-led Q3 GDP expansion are quickly diminishing. Furthermore, the 2.5% y/y decline in import prices is bound to put further pressure on local producers to lower output prices.

Foreign trade data, y/y % unadjusted

	Feb-19	Mar-19	Apr-19	May-19	Jun-19	Jul-19	Aug-19
Imports, global	3.3%	-0.1%	6.8%	3.3%	-5.4%	2.1%	-4.1%
Exports, global	3.4%	0.0%	5.8%	8.0%	-3.5%	6.4%	-3.4%
Imports, non-EU	5.6%	-0.5%	7.4%	4.1%	-4.7%	2.8%	-6.2%
Exports, non-EU	6.0%	-2.8%	6.7%	7.8%	-2.1%	8.0%	-1.4%
Imports, EU	1.8%	0.1%	6.3%	2.8%	-5.9%	1.5%	-2.4%
Exports, EU	1.5%	2.2%	5.2%	8.2%	-4.6%	5.1%	-5.2%

Source: Istat

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Industrial new orders increase by 1.1% m/m sa in August

Italy | Oct 16, 15:55

- **Both domestic and external new orders increased slightly**
- **Industrial turnover decreases by 0.3% m/m sa and 2.2% y/y ca**

Industrial new orders increased by 1.1% m/m sa in July, after declining by 2.8% m/m in July, Istat reported. Domestic new orders increased by 1.1% m/m, following their 3.9% drop in July, while the m/m increase in external orders was slightly lower at 1.0%. Looking at y/y raw data, the most significant decline in new orders is once again registered by the manufacture of transport equipment (11.7% y/y), while only computers and textiles and apparel post marginal y/y increases. In nominal terms the 3-month ma of industrial new orders is now down 1.2% y/y (9.5% for external orders), thus erasing all of the relative improvement in the May-May period.

Ind new orders 3-mma, nominal % y/y

Source | Istat

Industrial turnover decreased by 0.3% m/m sa and by 2.2% y/y ca in August, as the deterioration continues to affect both domestic and non-domestic markets. Turnover of consumer goods continues to be positive y/y, despite the 0.1% y/y sa decline in non-durable goods in August. However, turnover of both capital and intermediate goods declined further, with the latter contracting by 4.7% y/y, which is the most significant decline since Dec 2018. These data are broadly supportive of the ongoing deterioration of operating conditions, as established by Markit's PMI. We do not expect that industrial production has managed to contribute to GDP growth in Q3 and a short-term turnaround seems unlikely.

Industrial sector statistics, m/m sa (unless otherwise indicated)

	Feb-19	Mar-19	Apr-19	May-19	Jun-19	Jul-19	Aug-19	Sep-19
Total new orders	-2.8%	2.0%	-2.3%	2.7%	-1.1%	-2.8%	1.1%	-
Domestic new orders	-0.5%	-0.7%	-0.8%	2.6%	0.9%	-3.9%	1.1%	-

External new orders	-6.1%	5.8%	-4.3%	2.9%	-3.9%	-1.0%	1.0%	-
Total industrial turnover	0.0%	0.4%	-1.2%	1.6%	-0.7%	-0.6%	-0.3%	-
Domestic industrial turnover	0.7%	-0.2%	-0.1%	1.3%	-1.3%	-0.7%	-0.5%	-
External industrial turnover	-1.1%	1.3%	-3.1%	2.0%	0.4%	-0.4%	-0.1%	-
Industrial production	0.7%	-1.0%	-0.8%	1.0%	-0.3%	-0.8%	0.3%	-
Manufacturing confidence (index)	101.7	100.9	100.7	101.8	100.7	100.0	99.6	98.8
Manufacturing PMI (index)	47.7	47.4	49.1	49.7	48.4	48.5	48.7	47.8

Source: Istat, Markit

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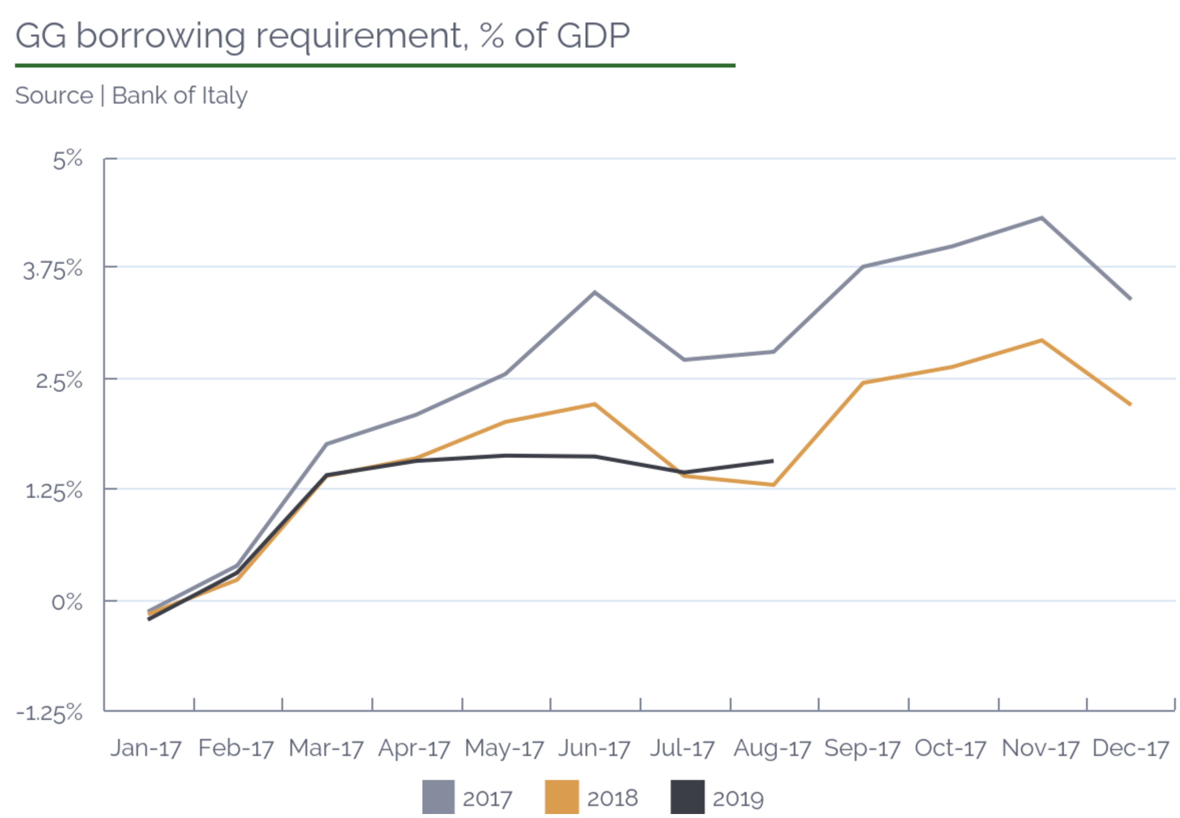
General government borrowing requirement increases to EUR 2.3bn in August

Italy | Oct 15, 15:15

- **The cumulative general government borrowing requirement increased by 21.2% y/y to EUR 28.1bn**
- **Cumulative tax revenues are down 0.3% y/y, while expenditures are up 8.1%**
- **Deficit targets still seem within reach**

The general government borrowing requirement in August amounted to EUR 2.3bn, compared to the EUR 1.7bn surplus registered in Aug 2018, the Bank of Italy reported. Thus, the cumulative borrowing requirement increased by 21.2% y/y to EUR 28.1bn, resulting in a borrowing requirement-GDP ratio of 1.6% in Jan-Aug 2019, compared to 1.3% in the same period of 2018.



Cumulative tax revenues remain some 0.3% lower y/y, but this relative underperformance should be offset by the later inflow of self-paid taxes, the deadline for which was pushed back to end-Sep. At the same time cumulative expenditures have increased by 8.1% y/y, despite lower capital expenditures.

While the government may still have some untapped revenue sources, recent economic activity data suggests that other revenue streams might fail to reach expectations. While the deficit targets remain well within reach, the relative underperformance in August has taken away much of the government's remaining fiscal space.

Borrowing requirement, monthly data

	Aug-18	Aug-19
Total central govt revenues	45,497	43,018
Current expenditure	27,064	28,763
Capital expenditure	1,880	1,000
Total central govt expenditure	28,944	29,763
Accrual-based central govt budget balance	16,554	13,256
Change in the balance of Treasury account	-14,696	-15,662
Central govt cash borrowing requirement	**-1,858**	**2,406**
Local govt cash borrowing requirement	152	-130
General govt cash borrowing requirement*	**-1,700**	**2,296**
Changes in Treasury's liquid reserves	14,901	5,293

Note: *similar to general government cash balance

Source: Bank of Italy

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Private sector lending slows to 0.6% y/y in August

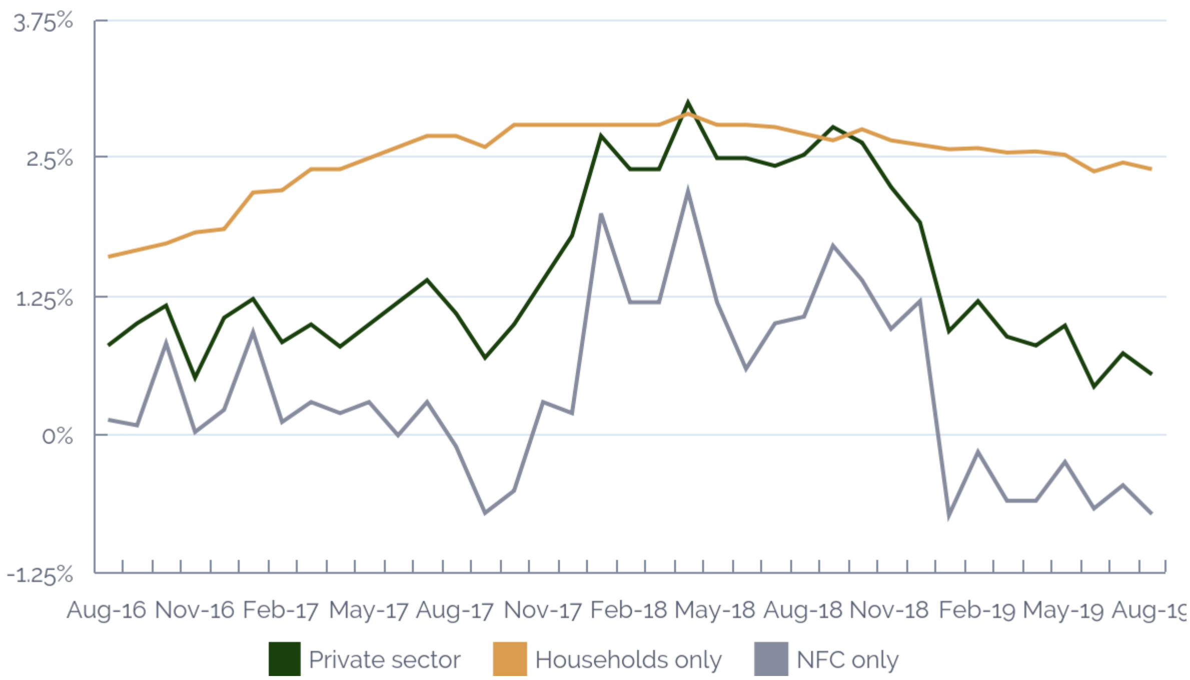
Italy | Oct 09, 16:48

- **Private sector deposits rise by 6.4% y/y, up from 5.1% y/y in July**
- **Composite interest rates for non-financial corporations reach an all-time low of 1.58%, but fail to fuel demand**

Private sector lending slowed down to 0.6% y/y in August from 0.7% y/y in July, the Bank of Italy reported. In line with the ongoing 2019 trend the decline was mostly driven by loans to non-financial corporations, which fell by 0.7% y/y. This was the eight consecutive month of declining loans to NFCs, despite the ongoing improvement in financing conditions, as reflected by the record low NFC composite interest rate of 1.58%. After the slight increase in July, loans to households eased back to June's 2.4% y/y levels, also suggesting an ongoing slowdown of credit demand in this particular segment of the market.

Private sector credit, % y/y

Source | Bank of Italy



The stock of existing loans to the productive sector declined by 6.7% y/y, led by a 16.1% contraction in construction sector loans and a 13.1% decrease in real estate activities. At the same time, loans to manufacturing companies declined more moderately by 3.3% y/y, while remaining the most significant among the main economic activities.

Meanwhile, private sector deposits growth accelerated to 6.4% y/y from 5.1% in July, despite the fact that rates on the outstanding amount of deposits were only equal to 0.37% in August. This was the fastest rate of y/y increase in deposits since June 2018. Growth of total funds raised also rebounded somewhat, reaching 2.2% y/y from 1.6% in July.

Finally, Italian banks increased their holdings of central government securities only marginally by 0.2% m/m to EUR 402.2bn, as much of the newly issued securities were purchased by non-residents. Despite that the government security holdings of Italian banks remain at their highest level since August 2016.

Overall Italian banks are still struggling to find willing borrowers, while signs of precautionary savings are becoming more and more visible. In light of the revision of most expectations of a significant H2 economic rebound and reports of deteriorating operational conditions in manufacturing, we do not expect lending to pick up any time soon.

Credit and deposit growth, y/y %

	Mar-19	Apr-19	May-19	Jun-19	Jul-19	Aug-19
Loans to private sector	**0.9%**	**0.8%**	**1.0%**	**0.4%**	**0.7%**	**0.6%**
Loans to households	2.6%	2.6%	2.5%	2.4%	2.5%	2.4%
Loans to NFCs	-0.6%	-0.6%	-0.2%	-0.7%	-0.5%	-0.7%
Total bank funding	**2.9%**	**1.6%**	**2.0%**	**1.6%**	**1.6%**	**2.2%**
Private sector deposits	3.3%	3.5%	3.5%	3.4%	5.1%	6.4%
Securities issuances	-8.7%	-7.7%	-6.9%	-4.9%	-2.6%	-2.5%

ECB financing operations	-3.0%	-3.0%	-2.1%	-2.1%	-2.5%	-2.6%
Interest rates (composite)						
Mortgage loans	1.82%	1.86%	1.86%	1.77%	1.70%	1.70%
Loans to NFCs	1.73%	1.78%	1.74%	1.66%	1.67%	1.58%
Short-term loans (NFCs and households)	1.69%	1.78%	1.72%	1.65%	1.68%	1.56%
Long-term loans (NFCs and households)	2.04%	1.85%	1.98%	1.84%	1.66%	1.80%

Source: Bank of Italy

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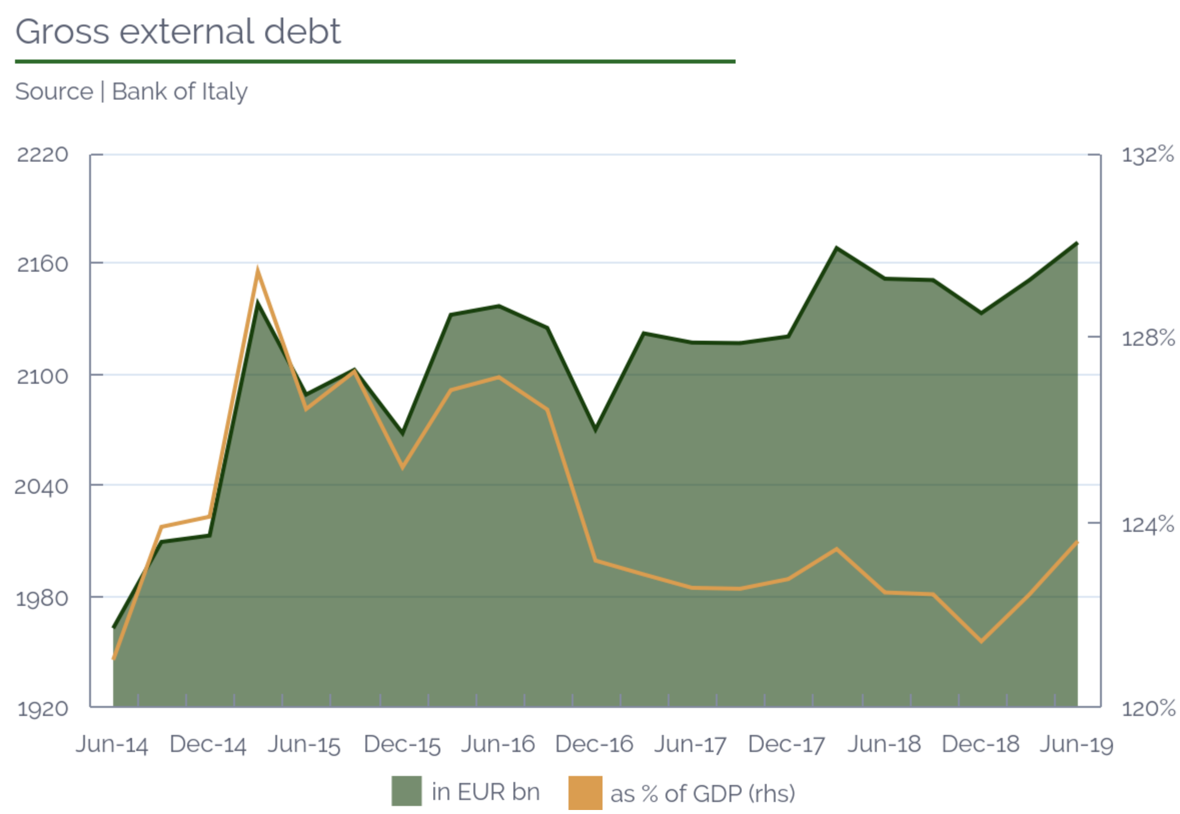
Gross external debt rises by 0.9% q/q in Q2

Italy | Sep 30, 16:54

- **NIIP remains negative, but contracts further to 2.2% of GDP**

Gross external debt rose by 0.9% q/q to EUR 2.17tn (123.6% of GDP) at the end of Q2, according to data released by Bank of Italy. The external debt of the general government increased by some EUR 47.3bn q/q, part of which may be attributable to the benchmark national accounts revision, carried out by Istat, as well as the Bank of Italy's own re-calculations in compliance with new Eurostat requirements on national debt.



Despite increasing government debt, the net investment position (NIIP) remained negative, but contracted further to EUR 38.2bn (2.2% of GDP), which amounts to a 36.1% decrease in comparison to Q1. This happened as residents continued to increase their holdings of assets abroad, while reserve assets increased by 5.4% q/q, reaching EUR 145bn. We feel that the overall dynamic of Italy's NIIP position remains favorable, in spite of relatively large external debt level, mainly due to the continued improval of the current account surplus.

External debt and international investment position

	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	y/y %	q/q %
Gross external debt	**2,152.0**	**2,152.0**	**2,134.0**	**2,152.0**	**2,172.0**	**0.9%**	**0.9%**
General government	759.0	737.0	721.0	744.0	791.0	4.2%	6.3%
Monetary authorities	496.0	504.0	496.0	485.0	458.0	-7.7%	-5.6%
Other monetary financial institutions	431.0	444.0	440.0	461.0	454.0	5.3%	-1.5%
Other sectors	323.0	319.0	329.0	312.0	314.0	-2.8%	0.6%
Direct investment	144.0	148.0	149.0	150.0	155.0	7.6%	3.3%
Net international investment position	**-100.0**	**-60.0**	**-83.0**	**-60.0**	**-38.0**	**-62.0%**	**-36.7%**
FDI	114.0	113.0	112.0	112.0	111.0	-2.6%	-0.9%
Portfolio investment	175.0	230.0	207.0	214.0	188.0	7.4%	-12.1%
equities	608.0	631.0	605.0	624.0	640.0	5.3%	2.6%
debt securities	-434.0	-400.0	-398.0	-409.0	-452.0	4.1%	10.5%
Other investment	-486.0	-501.0	-504.0	-486.0	-437.0	-10.1%	-10.1%
Financial derivatives	-29.0	-27.0	-31.0	-38.0	-45.0	55.2%	18.4%
Reserve assets	127.0	124.0	133.0	138.0	145.0	14.2%	5.1%

Source: Bank of Italy

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