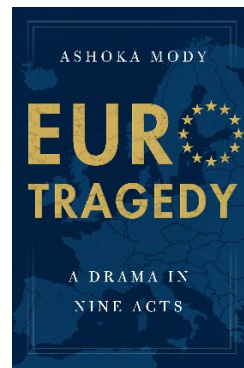


# For Italy, all economic and financial trends are going in the wrong direction

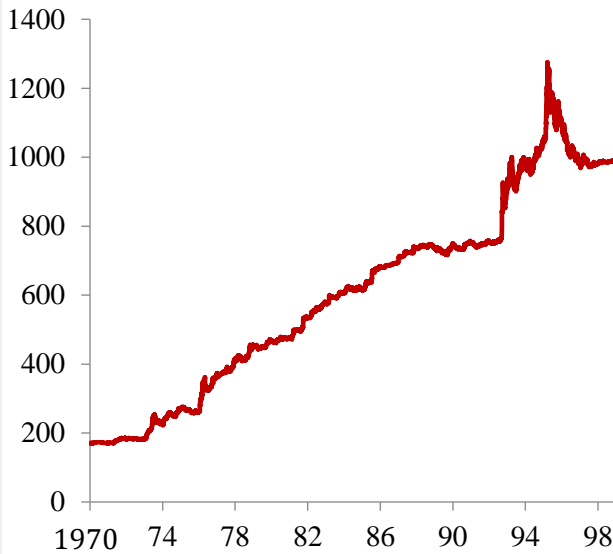
Ashoka Mody



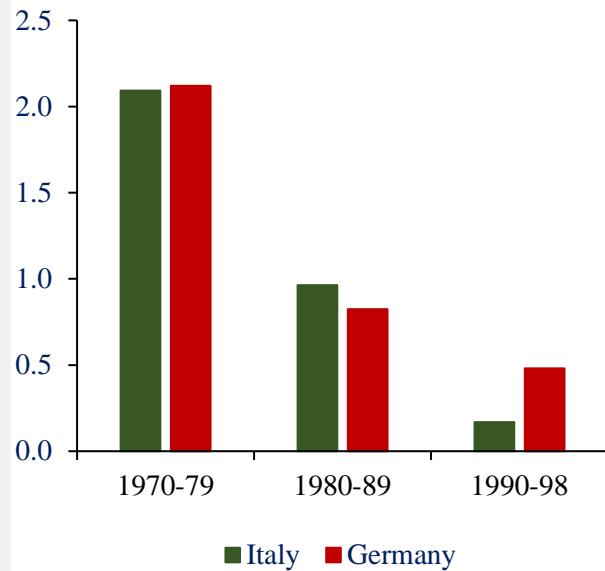
Based on *EuroTragedy: A Drama in Nine Acts*, New York: Oxford University Press, June 2018.

## Italy needed—and needs—the crutch of a depreciating currency to offset its abysmal productivity growth.

The depreciating lira, 1970-1998  
(Number of liras for one D-mark)



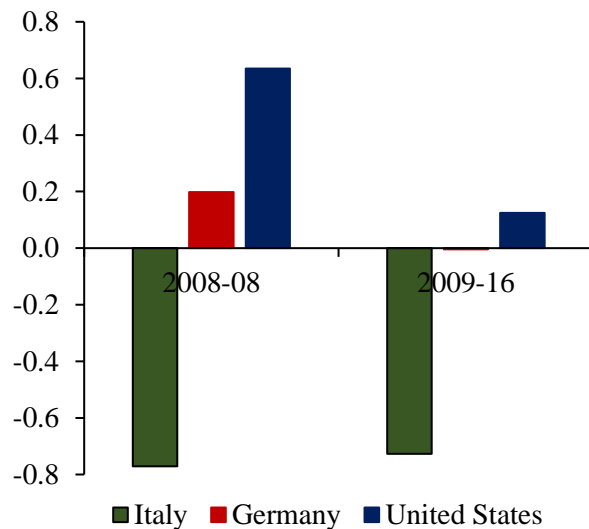
Italian productivity fell relative to German  
(annual total factor productivity growth)



US Dollar/Euro exchange rate is back where it began, 1999-2018

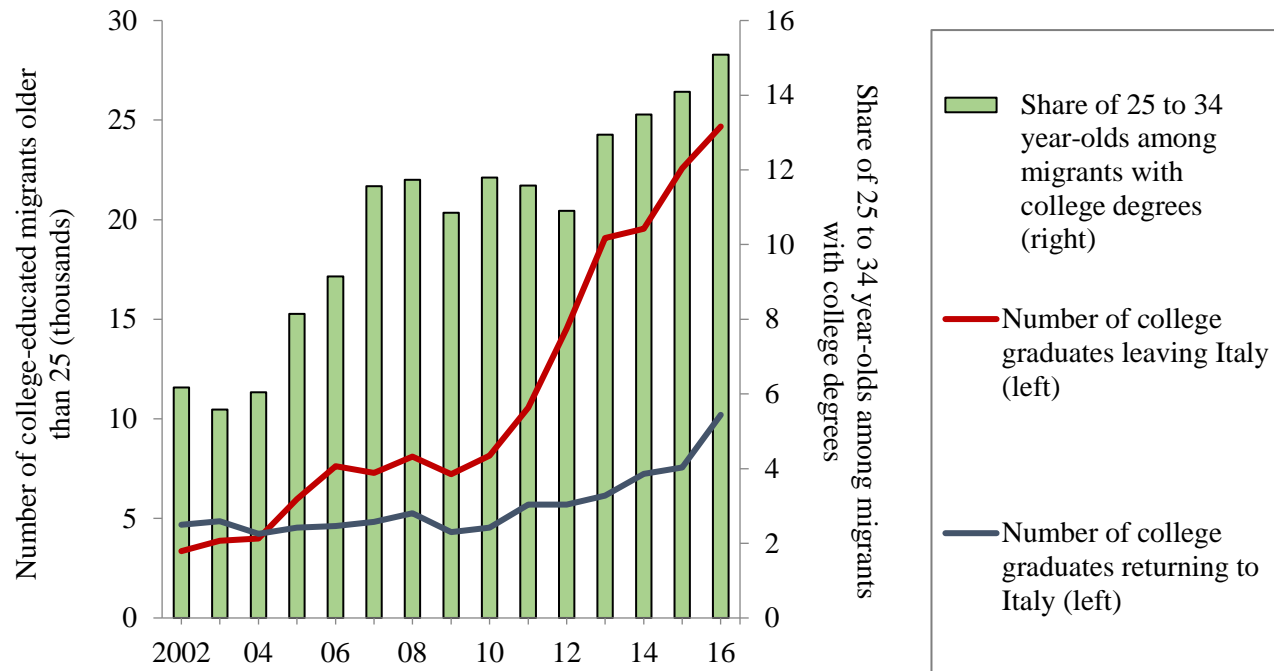


Italian productivity collapsed while even German fell behind the U.S.  
(annual total factor productivity growth)



Source: Top left panel: Banca d'Italia, <https://tassidicambio.bancaditalia.it/timeSeries>; top right panel: ECB data warehouse [https://sdw.ecb.europa.eu/quickview.do?SERIES\\_KEY=120.EXR.D.USD.EUR.SP00.A&periodSortOrder=ASC](https://sdw.ecb.europa.eu/quickview.do?SERIES_KEY=120.EXR.D.USD.EUR.SP00.A&periodSortOrder=ASC); bottom left and right panels: The Conference Board, <https://www.conference-board.org/data/economydatabase/index.cfm?id=27762>.

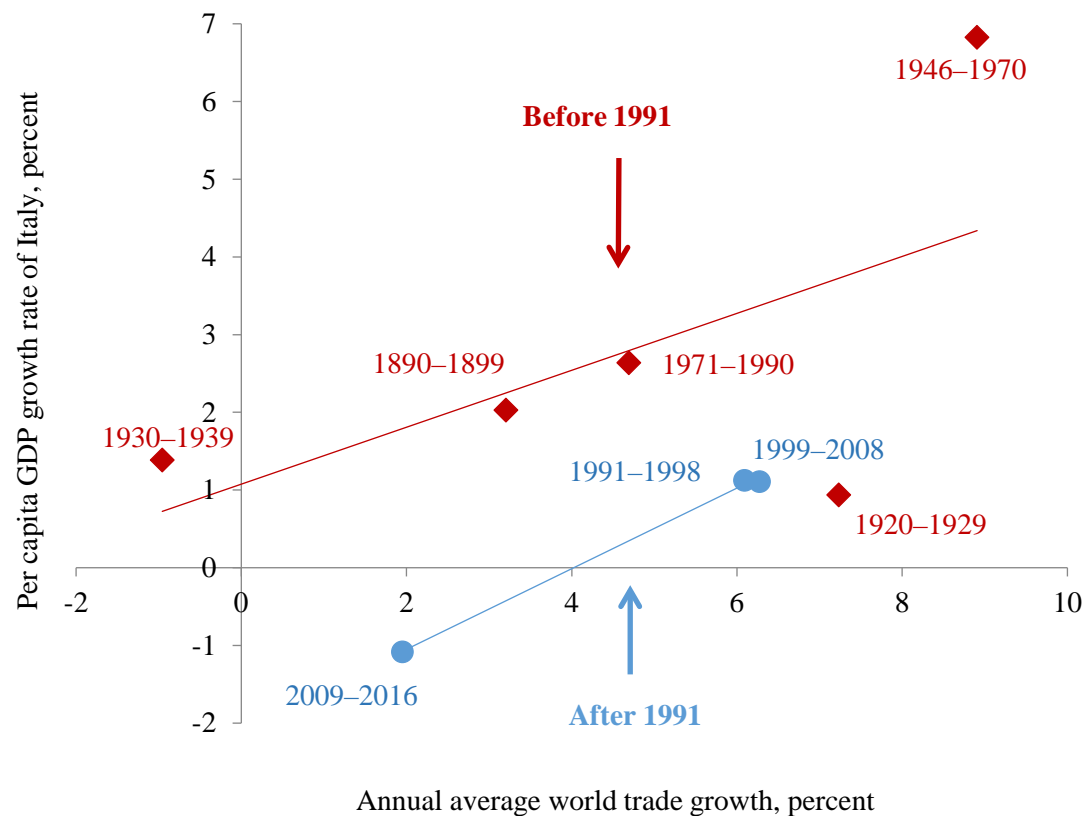
## Young college-educated Italians leave Italy in growing numbers.



Source: Italian National Institute of Statistics.

***Italy's low growth trap: poor opportunities, the educated leave, R&D remains weak, and opportunities remain poor.***

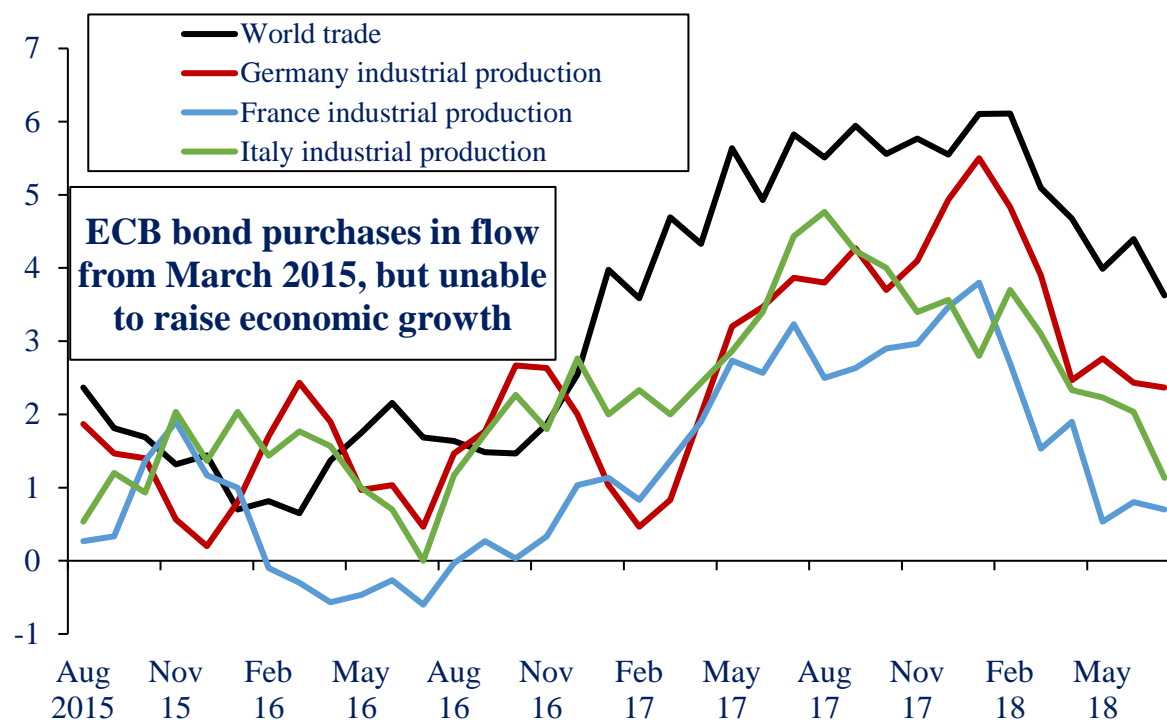
**Italy's immediate growth problem:  
Like rest of the euro area, Italian economy beats to the drum of world trade  
growth—but does even worse when world trade slows.**



Sources: Real per capita GDP growth rates: Angus Maddison, “Historical Statistics of the World Economy: 1–2008 AD,” <http://www.ggd.net/maddison/oriindex.htm>; Penn World Tables 8.0, <http://www.rug.nl/ggd/>; International Monetary Fund, World Economic Outlook Database, <http://www.imf.org/external/pubs/ft/weo/2014/02/weodata/index.aspx>. World trade: League of Nations, Monthly Bulletin of Statistics; CPB Netherlands Bureau for Economic Analysis, World Trade Monitor, <https://www.cpb.nl/en/data>.  
Note: The periods 1914–1919 and 1940–1945 are missing due to a lack of wartime trade data.

## Predictably, Italian growth is slowing with deceleration of world trade growth.

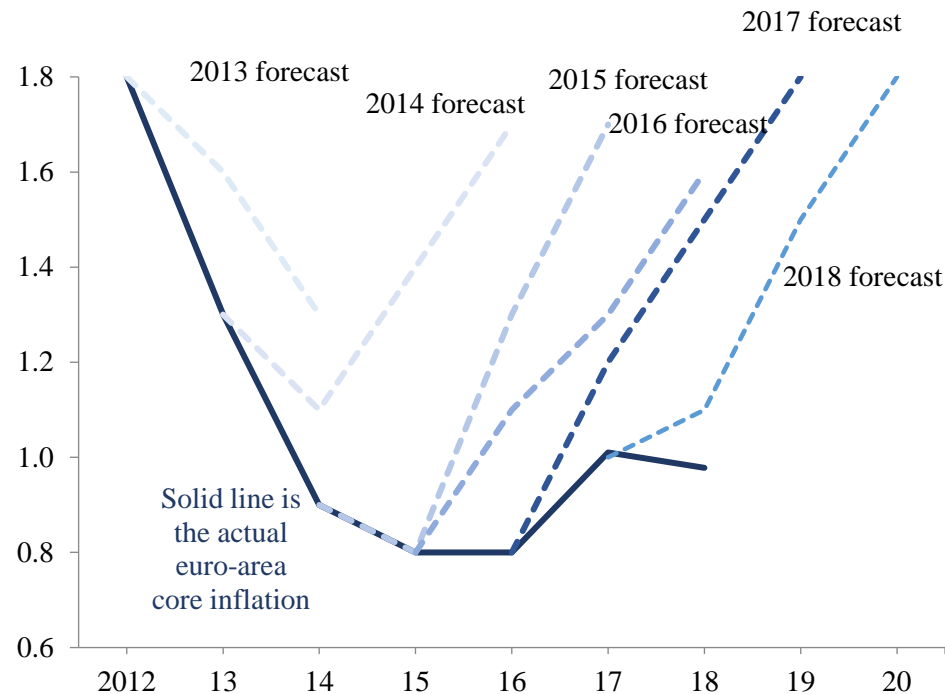
(Annual growth rates, percent; three-quarter moving averages)



Source: For world-trade growth data World Trade Monitor, <https://www.cpb.nl/en/data>; for the industrial production of Germany, France and Italy Eurostat, code [sts\_inpr\_m]. Note: The three-month average of growth over the same three months in the previous year.

## Italy's ECB problem:

**The ECB keeps forecasting a rise in inflation, but has lost credibility with its errors, chronic delays, and half-measures**

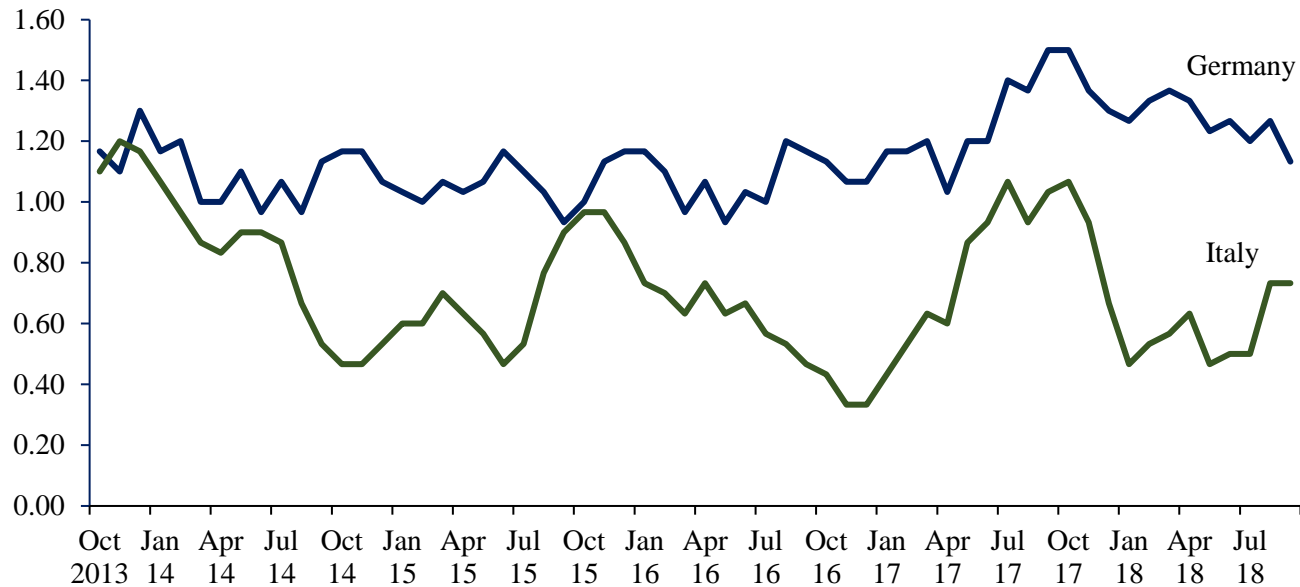


Sources: ECB's Macroeconomic Projections made in March of the year,  
<https://www.ecb.europa.eu/pub/projections/html/index.en.html>.

Note: 2018 core inflation is the average of months January to September 2018.

**A single monetary policy causes inflation divergence:  
Italy's low inflation causes high real interest rates.**

(Annual core inflation, three-month moving average, percent)

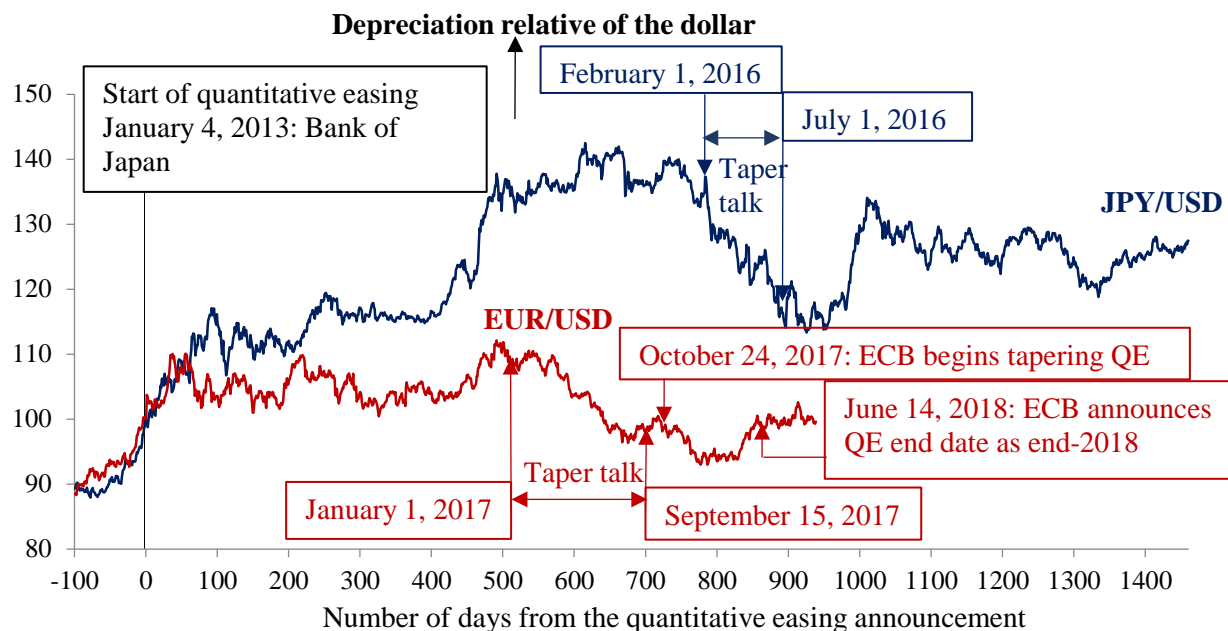


Source: Eurostat. Note: Core inflation is the annual percentage change in the Harmonized Index of Consumer Prices excluding energy, food, alcohol and tobacco.

*With current 10-year government bond yields near above 2.8 percent, Italian real interest rate is just above 2 percent.*

*As growth decelerates and low inflation persists, Italian real interest rates will remain too high for a country with such low growth.*

**With even weaker commitment than the Bank of Japan's, ECB bond purchases have done little to weaken the euro to boost demand and inflation**  
**Withdrawal of bond purchases, a special problem for Italy.**



Note: Exchange rate for JPY/USD equals 100 on January 4, 2013 (date of the announcement of quantitative easing by the Bank of Japan) and exchange rate for EUR/USD equals 100 on January 22, 2015 (date of the announcement of quantitative easing by the ECB).

Source: For USD and Japanese Yen, <https://www.investing.com/currencies>, for USD and Euro rates ECB, [https://sdw.ecb.europa.eu/quickview.do?SERIES\\_KEY=120.EXR.D.USD.EUR.SP00.A&periodSortOrder=ASC](https://sdw.ecb.europa.eu/quickview.do?SERIES_KEY=120.EXR.D.USD.EUR.SP00.A&periodSortOrder=ASC).



## Italy's financial problems: The government-bank "doom loop," always latent, has reemerged.



Sources: FTSE Italia All-Share Financial Index: Global Financial Data, ticker IT8300 Index; FTSE Italia All-Share Index: Global Financial Data, ticker FTSEMIB Index; Italy ten-year bond yield: Datastream International, code S310DT. Notes: The graph presents the relative performance of financial stocks and the Italian 10-year bond yield from 2 January 2015 to 18 September 2012. The relative performance of financial stocks for Italy is the ratio between the FTSE Italia All-Share Financial Index and FTSE Italia All-Share Index.

## **The future ain't what it used to be.**

- With world trade slowing down, the entire euro area—even the German economy—is slowing, quicker than most realize.
- With QE tapering, the euro can only strengthen and real interests can only rise.
  - Both will further squeeze an anemic Italian economy.
- For Italy, everything is going in the wrong direction:
  - Slower European and world economy.
  - Higher real interest rates
  - Stronger euro
  - **Hence, likely soon q-o-q GDP growth about zero.**
- Italian government debt levels are high; the chaotic banks have large volumes of non-performing loans and thin margins.
- OMTs could crack under political limits.