A capital markets expert offers insight based on TAC ECONOMICS research.

The Market Insight

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Writer and commentator David Wigan offers his thoughts on the key trends revealed by TAC ECONOMICS quantitative models and insight.

Italy – the new Greece?

Italy and Greece share many things – including beautiful coastlines, warm Mediterranean climates and unparallel cultural histories. However, do they also share a propensity to financial meltdowns?

Last year Italy continued to struggle, both in its efforts to spur economic growth and its continuing dispute over fiscal policy with the European Union.

In the third quarter 2018, the Italian GDP growth contracted by -0.5% q/q, with positive net exports contribution unable to offset the contraction of domestic demand (private consumption and investment). TAC models predict a slight improvement in H1 2019, with growth hovereing around the 1% mark, before a recession hits in the latter part of the year.

Italy's problems run deeper than those of many of its European peers. It is burdened with high labour costs and relatively weak productivity growth, alongside entrenched public sector inefficiencies. The country's proposed 2019 budget offers some short-term relief, through fiscal expansion, but little to address longer-term problems.

Italian government borrowing rates rose 150bps from April to the end of 2018, which will offset the positive impact of fiscal expansion. Does that mean we are looking at a possible rerun of the problems that beset Greece? TAC believes not. For one Italy is less reliant on foreign investors that was Greece in the run-up to its debt crisis in 2010-2012. In addition, Italy has run a current account surplus for the past five years. In 2017 it was the third largest in the EU, after Germany and the Netherlands. In addition, government spending has fallen every year since 2013 (as a percentage of GDP).

TAC's view is that Italy remains safe until the country's 10-year yield rises above 4.5%. It was 2.84% in recent trade. As recently as 2015, the Greek 10-year yield was 19.3%. A different order of magnitude that suggests Italy's problems should not be too much of a concern in the months ahead.

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