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Global Economy

Some keys to the Italian crisis

Expansión (Spain)

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The fact that investors and the European Commission have turned the spotlight on the Italian economy as a result of Italy's presenting a budget with a public deficit target of a seemingly moderate 2.4% of GDP may seem paradoxical if certain differentiating factors that have accompanied this crisis are not properly understood.

The first is the change in fiscal stance. Italy has for decades had growth below the European average, stagnant per capita income and a very high public debt ratio, but one of its acknowledged strengths, along with a high domestic savings rate, was the relative fiscal prudence, which led its governments to limit the public deficit, aware as they were of the fragility entailed by such a high debt ratio. This has now changed. The new executive wants to implement fiscal stimulus measures that fly in the face of what had previously been agreed with its European partners and above all of the obvious fact that an economy that has been virtually stagnant for over twenty years has more serious problems than just lack of demand (particularly when the European economy as a whole is growing at above its potential).

The second differentiating factor is that of discourse. The anti-euro discourse of some of the new politicians in power was present in the electoral campaign, and is still intermittently present now. The sporadic references to plans to issue parallel pseudo-currencies, the initial (unsuccessful) push to appoint an extremely eurosceptic economist as minister of finance, and the more recent reactions of certain politicians to reasonable doubts expressed by the Commission or investors ("terrorist markets", "speculators", "European bureaucrats" and various other barbs) have not helped to generate trust. The moderation that many hoped for once the new government got down to work has not come about, partly because both main coalition parties are in pre-campaign mode for the European elections in May (which are very important for the League) and for a possible new general election, which cannot be ruled out given the tensions between the two parties, which basically come from the two opposite extremes of the political spectrum.

Another factor to which little attention has been paid but which also does not help to generate confidence in the new budget is the fact that some of the expansive measures proposed may further limit the economy's already very weak growth potential. Making early retirement easier when the demographics are stagnant and other advanced countries are increasing the retirement age looks like a reform in the wrong direction. And the living wage, a legitimate instrument cited in every debate on inequality linked to technological change, becomes in its Italian manifestation an extended unemployment benefit that may discourage legal work, especially if the promised conditions are not properly checked and enforced. Nor will the tax amnesty measures, of the essence to any self-respecting Italian government, strengthen the inclination to comply with future tax obligations.

The situation in the past few days, following the presentation of the budget, is one of very precarious equilibrium, with Italy's credit spread settled at above 300 basis points (but without approaching 400 bps, which could lead the government to retreat), the rating agencies cutting their ratings to the lowest level still within investment grade (Moody's has already done so), but without transferring it, and the EU's request for a new budget to be presented (which it seems that Italy is going to ignore). With the deficit paths presented (2.4%, 2.1% and 1.8% of GDP in the next three years), growth forecasts by the majority of economists at around 1% and risk premiums similar to the current ones, the debt ratio would not increase, but nor would it fall significantly as was foreseen in the last stability programme. And this continued high debt ratio makes the economy highly vulnerable to any future shock.

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