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DOVE VAI, ITALIA?

If there are countries in Europe that have been particularly affected by the Covid-19 pandemic, Italy can certainly be included among them.

However, the latest Italian government weathered this storm and managed to set up a €190bn economic recovery plan under a European funding framework. Even in fighting the consequences of the war in Ukraine, Italy appeared pragmatic and progressive. Then came 21st July 2022, when the national unity coalition broke up. With new elections scheduled for 25th September 2022, investors are looking towards Italy nervously. We asked **Christophe F. Grosset, European Sales Director at Spectrum Markets**, who has spent many years of his career in Italy, to share his thoughts on where the country is heading.

Christophe, what was the reason for the collapse of the Italian government and were you surprised?

Well, the last Italian government definitely couldn't be accused for not moving things forward. Italy's economy grew by 4.6% in the second quarter of 2022 on a year-on-year basis. That was the sixth consecutive quarter of growth and the strongest growth among G7 countries. During the same period, the unemployment rate fell to a ten-year-low of 8.6%[1].

Italy took very early action to counteract the rise in energy prices, to ease the burden on companies and to boost purchasing power. The government cut mineral oil tax by 30 cents per litre and lowered electricity bills as early as in March this year. Highly energy-dependent companies were granted tax credits to better absorb the increased costs. In addition, Italian citizens with gross annual income of less than €35,000 received a one-off payment of €200.

Against this background, it seems very confusing that such a government should have to step down. Then again, there are party and electoral interests which are traditionally very pronounced in Italy and which made the mission of the governo unità nazionale[2] an ill-fated one.

Is there political instability and what are the economic risks in light of the robust figures you mentioned?

The prime minister is continuing to lead the government on an executive basis, so there is a government in place until a new one can be formed after the new election. Consequently, there is uncertainty over the direction that a new government will take. It is true that Italy made significant progress towards more economic prosperity recently. However, while rocketing energy prices have turned people's lives upside down elsewhere too, Italy's problems could become a bit more severe. One problem is the country's high dependency on natural gas imports. Another critical factor is wage development. According to figures from the OECD[3], wages in Germany and France increased by one third in real terms between 1990 and 2020, while in Italy they stagnated. So, inflation and energy shortages will hit the third-largest European economy harder. Don't forget that Italy is set to adopt a package of structural fiscal reforms.

Approval of those reforms by the European Commission being a precondition for releasing the funds from the NextGenerationEU recovery plan?

Yes, a new competition law, a tax reform and an overhaul of parts of the legal system designed to accelerate court trials, which are the slowest in Europe, are among the measures required by the EU in order to give their consent to a disbursement of funds from the recovery plan.

The strong figures from the second quarter of this year are a good sign but may actually not obscure the importance of the Piano Nazionale di Ripresa e Resilienza (PNRR)[4] for the future. Between 1999 and 2019, Italy's GDP grew by 7.9% while French GDP growth was over 32% and the Spanish economy grew by almost 44%.

On the one hand, there's a backlog of demand for reforms that should now be approved, and the current prime minister has a very ambitious programme to implement as many of the pending decrees before the end of his mandate. On the other hand, there are current issues the root causes of which are neither home-made nor limited to Italy but that constitute bigger challenges for Italy than for other countries. Climate change, as an example, is another area where Italy is particularly vulnerable. While heat waves or heavy thunderstorms are increasingly problematic for many European countries, Italy is disproportionately affected due to the number of people living in areas exposed to these environmental problems.

All of these issues have been explicitly addressed in the PNRR, a 273-page national recovery and resilience plan. Given the importance of implementing this plan, the coalition break-up is exceptionally inopportune.

Let's look at the Italian capital market – what is your view on recent developments and the need for reform there?

Expressed in terms of market capitalisation in relation to the GDP, Italy, with a share of 31% according to figures by the OECD, underperforms compared to other European economies. However, almost all developed economies will argue that the "capital market culture" in their home country is underdeveloped.

On the other hand, the impreditori - strong Italian SME networks, are still the engine of the Italian economy. And they expressed quiet confidence in terms of future investments at a recent top-level event in Cernobbio.

There's a strong correlation between a country's national pension scheme and the size and the maturity of its capital market. In other words, countries with well-funded pension systems are also those with a higher market capitalisation – as for example the USA and the UK. Conversely, countries with pay-as-you-go pension schemes tend to have lower capital market activity.

Interestingly, although – or perhaps because – pension schemes remain largely unchanged, there is another movement in Italian capital market activity. According to a report by Consob[5] Italian households' share of financial investments over the past ten years – despite not having grown overall – shows significant changes in the allocation of assets. There is a steady decline in holdings of bonds offset by an increase in mutual funds, foreign equities and derivatives. That can be considered a strong sign.

What about tax incentives, couldn't they play a more important role in developing the Italian capital market?

There are many fiscal measures that can help boost capital market activity, with tax incentives being one of them. Interestingly, Italy has done more than many other European countries here. In 2017, Italy introduced piani individuali di risparmio (PIR), an individual savings plan for retail investors incentivising investments in SMEs. Under this plan, investments in PIR products are exempt from capital gains tax and inheritance tax for at least five years. This is an initiative that can surely be developed and that may be adopted by other European countries, too.

Finally, what is your personal outlook – will Italy stick to the reform path chosen or will the country drift backwards after the elections?

I'm confident the former will happen. Very generally, it's fair to assume that no political party will successfully push through its electoral promises, thereby deviating too far or for too long from a reform path. While the current situation in Italy is judged very important in Europe, new elections also offer the chance for a new government to accelerate and sustain reforms.

1 According to L'Istituto nazionale di statistica (ISTAT), the Italian National Institute of Statistics
2 National unity government; a broad coalition government including all (major) parties in the legislature
3 Organisation for Economic Co-operation and Development
4 "NextGenerationItalia", the National Recovery and Resilience Plan
5 Commissione Nazionale per le Società e la Borsa, the Italian financial markets supervisory authority

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