Euler Hermes Economic Research

Economic Insight

Expo Milano 2015: Made in Italy *alla grande*?

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Executive summary

- The Expo will have a limited but positive contribution of 0.1pp to Italian GDP this year. In total, including first-round effects, the Expo could bring up to 0.4 point of GDP from tourism (15 million visitors), export revenue (+10% in some sectors), additional output (EUR6bn) and jobs (~100,000).
- Company turnover in key sectors will get a welcome temporary support in 2015: +0.4% for hotels and restaurants (-0.5% in 2014), +0.5% for wholesale and distribution (+0.1% in 2014); 0% for business services (-1% in 2014).
- However, 2016 could see a setback for insolvency risk: 2,500 companies in 2017 (1 out of 4 for the 10,000 newly created companies), and 1,500 in 2018 could go bust as activity returns to normal post-Expo.
- Last but not least, the Expo should strengthen the 'Made in Italy' brand through imported innovation, extra revenue from tourism and new export routes However, restoring competitiveness and increasing R&D spending will be essential for these benefits to come true.

Italy to exit recession; Expo Milano will give a short (and temporary) boost

Finally, after three years of recession we anticipate Italian GDP will rise by +0.4% in 2015 and +0.9% in 2016. There are five reasons behind this slight pickup:

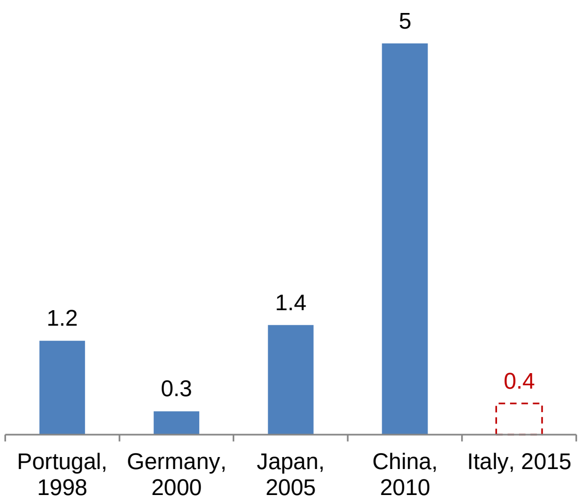
(1) Confidence is rising and domestic private consumption should follow suit. Lower oil prices will provide support through additional private consumption (EUR1.8bn);

(2) The lower Euro (expected at 1.08 against the USD in Q4 2015) will drive EUR6bn of additional exports in 2015;

(3) Financing constraints are expected to ease with both real interest rates on loans to SMEs to steadily decline (already down by -50bp in February to +4.5%) and credit demand to recover thanks to improved economic sentiment. Nominal growth should turn slightly positive and support turnovers: They should stabilize in 2015 and increase by +1% in 2016;

(4) The lower energy bill and the IRAP tax rate cut will push corporates' margins by +1.4pp to 41% of value added in 2015;

Chart 1: Expo impact (incl. first-round legacy effects), pps of GDP



Sources: Official sources, Euler Hermes

(5) Expo Milano will positively impact the Italian economy in the short-run by 0.1pp (in real terms this year) and by 0.4pp overall (chart 1), through three channels.

(i) **Tourism and export revenue:** 15 million tourists (to date close to 10mn tickets sold; 1mn from China) are expected with an average per day capita spending of EUR150. The flow of tourists is estimated to feed extra exports of up to 10% for several good categories. We expect agrifood and textile will be the main winners in terms of exports for which we expect additional demand in 2016 of EUR2bn and EUR1.4bn respectively.

(ii) **Production for the Expo:** ~EUR6bn over 2013-15 out of which EUR4bn in 2015. Looking at past similar mega-events, we estimate that more than two thirds of the additional production in 2015 will come from (1) tourism and accommodation, (2) business services, (3) wholesale and distribution and (4) construction. For the latter, support will be only temporary, driven by ongoing work to finalize the pavilions. The activity generated by the Expo will support turnovers for companies in these sectors: Hotels and restaurants (+0.4% after -0.5%), business services (flat after -1% in 2014), wholesale and distribution (+0.5% after +0.1% in 2014). See Chart 2.

(iii) **Jobs:** 100,000 jobs should be created (30% in the pre-event period). They should remain limited in duration (3-6 months) and magnitude (only 0.4% of labor force and low-skilled in construction and tourism services).

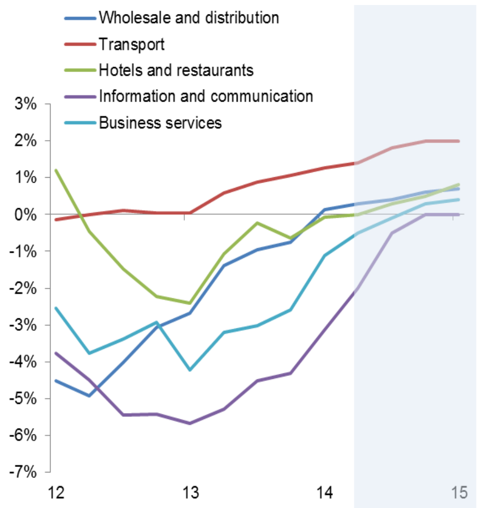
However, the Expo will not deliver the missing piece for a full-fledged recovery: investment growth. Only time will help. We expect investment to stabilize this year, after seven consecutive years of contraction. The investment gap in Italy is estimated at EUR60bn. Turnover growth is a first step in the right direction, as will a halt in the ongoing credit crunch (-3% y/y in lending in February) and better payment practices (DSO at expected at 108 days on average).

Mind *the* post-expo risk: An increase in business insolvencies

Legacy effects of mega events are often linked to sustained efforts before and after the event to harness the benefits and limit the risks. A stylized fact is that post-event, activity is expected to fall especially in those sectors which appeared to be the main winners in 2015. The Government initiatives to make the region 'live' post Expo will be key for the newly created companies since 2013 (~10,000). This initiatives are even more important now that we entered a period of economic recovery and business insolvencies will finally enter a declining trend in Italy, after 7 consecutive years of increases: -2% in 2015 and -5% in 2016 (Chart 3).

In our baseline scenario, we expect business insolvencies to remain on a downward trend

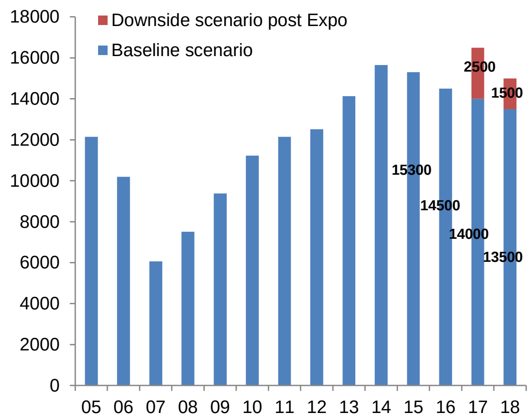
Chart 2: Turnovers in the services sector



Sources: Istat, Euler Hermes

***Expo Milano* 2015: Feeding the Planet, Energy for Life** *is aimed at bringing attention to the challenges, culture, and traditions that surround modern day nutrition and food, as well as sharing more sustainable models of production and consumption. The energy issue will be dealt under the aspect of efficiency and ecological sustainability.*

Chart 3: Insolvencies, number



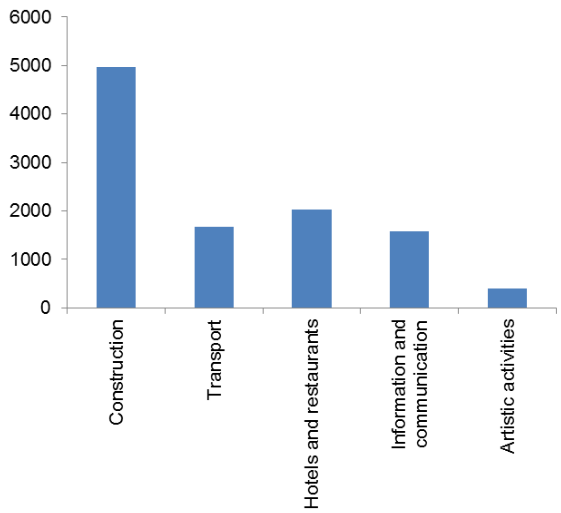
Sources: National sources, Euler Hermes in 2017 and 2018 (see Chart 3). However, there is an increasing risk that the fall in activity would not be compensated after the end of the Expo. In this case, we fear that several newly created companies will default. One third of the newly created companies in the construction sector (1,500 - see Chart 4) could default in 2017 given the drop in activity. The sector is already in a tough situation with insolvencies at record high levels (3,500 per year: +12% in 2014). The hotel and restaurant sector would be less impacted as we expect the flow of tourists to increase post Expo as Italy strengthened its attractiveness. Only 1 out of 10 companies would default in this sector in 2017. In total, in our worst case scenario, 2,500 companies could default in 2017 (+14% rise from 2016), and 1,500 in 2018 (+7%).

Strengthening the 'Made in Italy' brand through imported innovation, extra revenue from tourism and new export routes

Relying on the Expo to open the gates to innovation will be pivotal. 'Made in Italy' has been a major success over the past year and certainly Italy's best safety net as the domestic economy took time to pick up. The Expo should foster synergies between foreign companies and Italian ones. We see agri-food, textile, energy and machinery as the main winners. However, restoring cost competitiveness will continue to be vital for extended benefits as a weaker euro will not suffice. Increasing R&D spending (at a low level compared to peers, see Chart 5) will be essential in order to give a second wind to the benefits of the Expo.

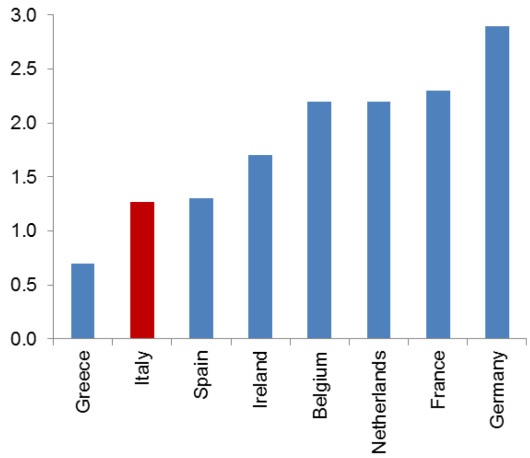
The Italian products will also benefit from greater visibility and additional demand thanks to tourists. Italy's attractiveness will also be reinforced with 30% of Expo participants from abroad mainly from China, USA, Argentina, Brazil, Turkey and UAE. This will also go the other way around: offering new markets for Italian products abroad as some Expo participants could become importers of Italian goods and promoters of Italian services in their home countries. Diversification and increasing market shares outside of captive European markets are welcome.

Chart 4: Additional companies created for the Expo, number



Sources: Istat, Italian government, Euler Hermes

Chart 5: R&D spending, % of GDP



Sources: World Bank, Euler Hermes

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