Press Release

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Euler Hermes study: Economic consequences of Italy's "No" vote

HAMBURG - 21 DECEMBER 2016 – Italy's "No" in the constitutional referendum is expected to have economic consequences for the country. The impact has been analyzed in detail by Euler Hermes, the worldwide leader in trade credit insurance, in a recent study: "Italy: The show must go on." The most likely scenario is that the "No" vote will initially have no adverse effects on banks or the bond market. But even in the absence of any fallout, the rejection will cost the Italians around 0.3 percentage points (pp) in terms of GDP growth.

Political uncertainty impacts on economic growth and triggers crisis of confidence
"The 'No' on Italy's referendum is not yet a cause for serious panic," said Ludovic Subran, chief economist at Euler Hermes. "The economic consequences are expected to be far less serious than those caused by Brexit. But a knee-jerk reaction is inevitable. A 0.3 pp slower growth means that the Italian economy should post only 0.6% in 2017. That is low, especially when compared with other European and even southern European countries."

Companies pay the price – the economy has been going nowhere fast for years
"The news is not good for Italian companies, their German trading partners or the Italian economy as a whole," said Ron van het Hof, CEO of Euler Hermes in Germany, Austria and Switzerland. "In addition to the banking crisis, the economy has already been gripped for years by persistent weak growth, excessive debt, low productivity and competitiveness, high employee costs and high unemployment. Now political instability has been added to the mix. Financially, Italian companies are bound to suffer a crisis of confidence, although this is expected to be fairly minor."

Low capital flows from abroad and slightly more difficult financing conditions are expected to result, according to the study. Consequently, investments will stagnate overall – instead of increasing by 2% as previously expected. Above all however, Italian businesses are contending with persistent problems.

"Low profitability and high wage costs are making Italian firms less competitive, especially from an international perspective," continued Van het Hof. "They have fallen far behind Spain and Ireland, not to mention Germany. Reforms are needed as a matter of urgency, along with investment in R & D. However, as everywhere else, investment hinges on confidence, in both politics and the banking sector."

Political uncertainty – what happens after Brexit and the Italian referendum?
After 59% of Italians voted against constitutional changes, Prime Minister Matteo Renzi resigned, leaving behind political uncertainty, at least temporarily.

"This situation signals further political uncertainly in Europe," said Subran. "Brexit followed by Italy – and who knows how the elections in France, Germany and the Netherlands will turn out? There are doubtless more surprises in store in 2017. However, it is also clear that political instability in Italy in 2017 will lead to a minor crisis of confidence."

Risk of contagion from the Italian patient will probably be limited
However, this should be far less damaging than the 2011-2012 financial crisis, when Italy nearly returned to zero growth.

"If banks and the bond market suffer fallout however – which we are not currently anticipating – we could see near zero growth again," remarked Subran. "At the moment we don't think this is on the cards. The ECB's quantitative easing (QE) monetary policy is helping Italy. European institutions also have much clearer regulations on rescuing banks without government intervention, for example through a banking union and bail-in rules."

Additionally, despite all its structural weaknesses, Italy still also has a trade surplus, which will leave some room for maneuver even if interest payments increase. Debt ring-fencing should limit the risk of contagion for Europe: 65% of Italian debt is held by Italian residents.

Banking sector still vulnerable
"Italian banks are suffering the effects of years of low economic growth," explained Subran. "Non-performing and bad debt in particular are giving local institutions a tough time."

Non-performing loans are estimated at around 360 billion euros, more than the annual federal budget of Germany. "Sofferenze", or bad loans, which have already been written off, account for nearly 200 billion euros -- a figure representing nearly 12% of Italy's GDP.. Banks therefore consider these loans to be definitively lost. These problems are exacerbated by low profitability and too-low capitalization levels at banks, especially small and medium banks.

To read the full study "Italy: the show must go on" go to:
http://www.eulerhermes.com/economic-research/blog/EconomicPublications/italian-constitutional-reforms-referendum-economic-insight-nov16.pdf

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