

Italy: What's Next?

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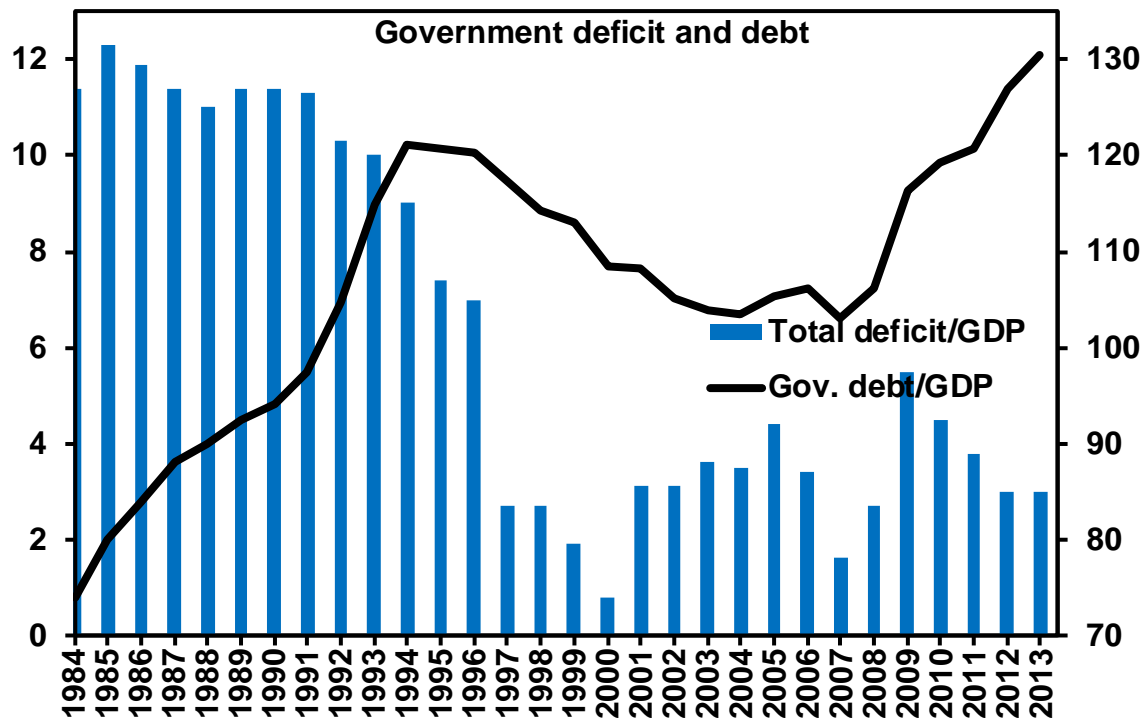
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Goldman Sachs International

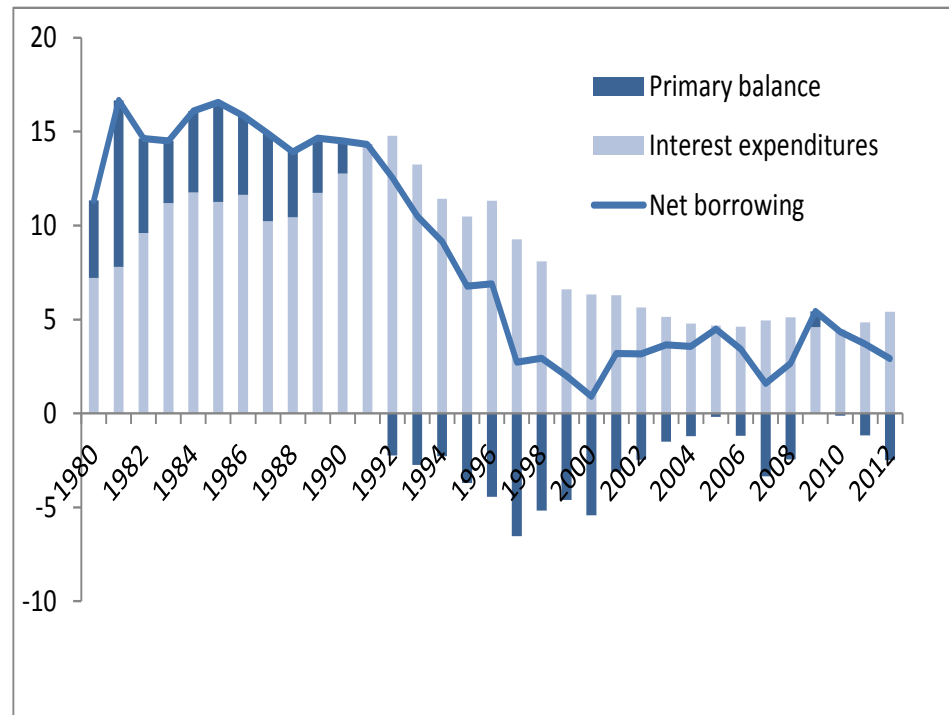
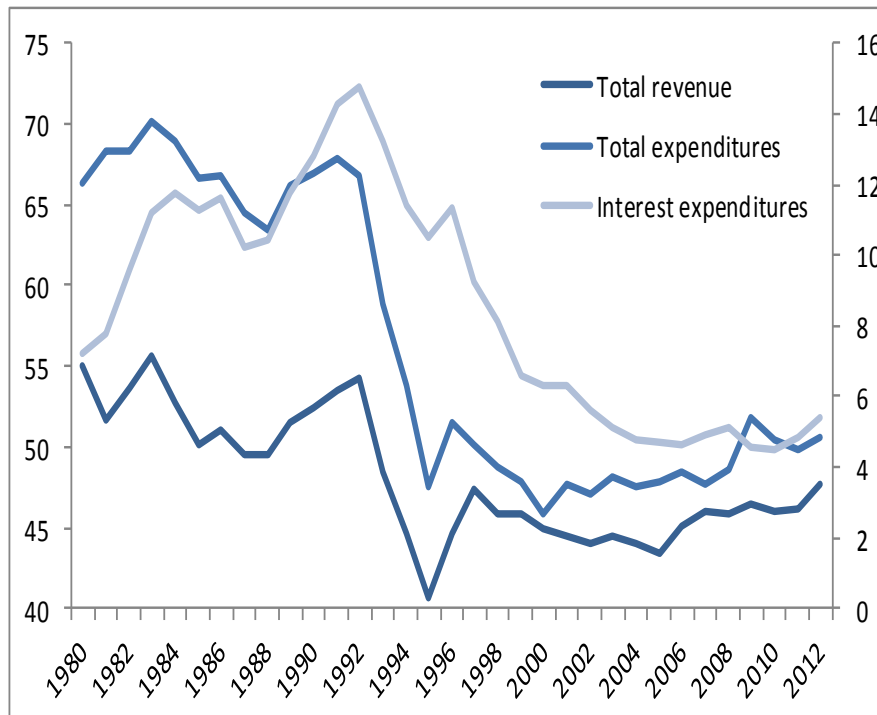
September 2013

High Public Debt – An old friend

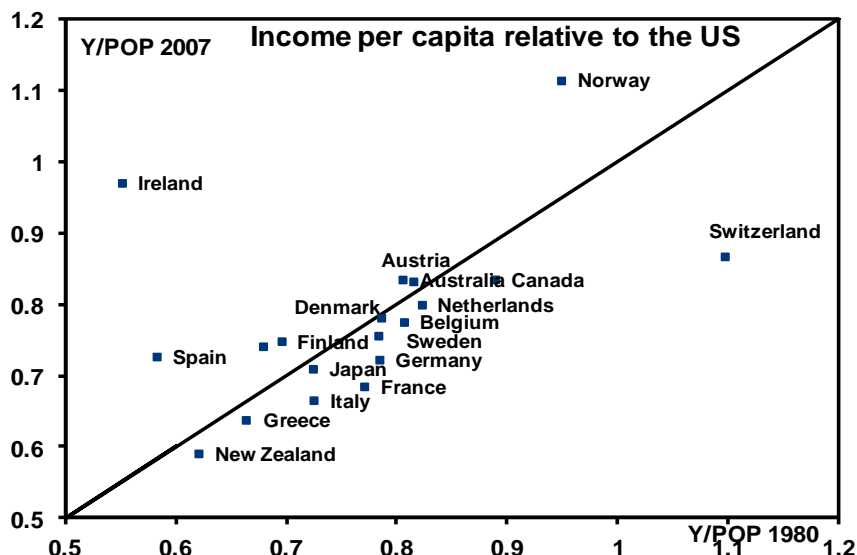


Source: Eurostat

The Maastricht Effect



Convergence and Divergence



Source: Penn World Tables, GS Global ECS Research



Source: OECD

Average GDP growth in Italy

1990-1999 = 1.4%

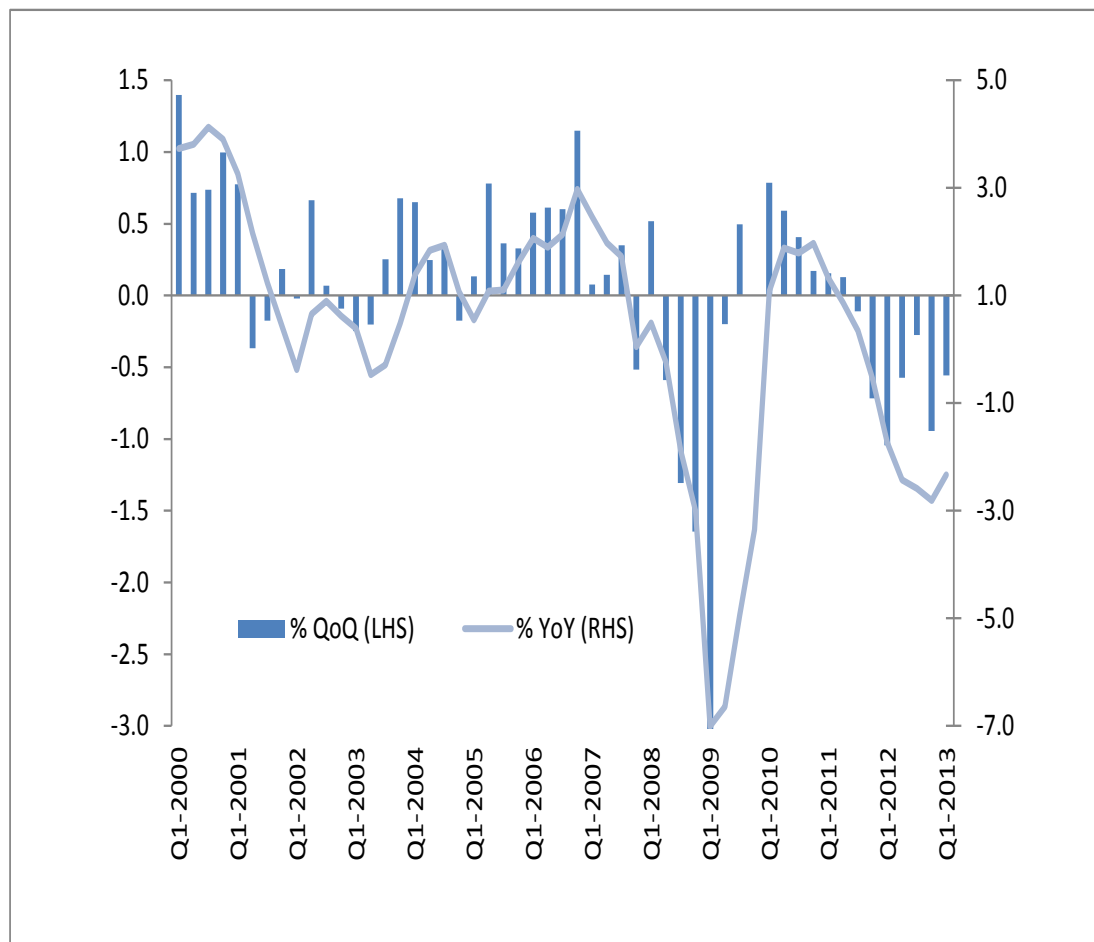
2000-2007 = 1.6%

2008-2010 = -1.6%

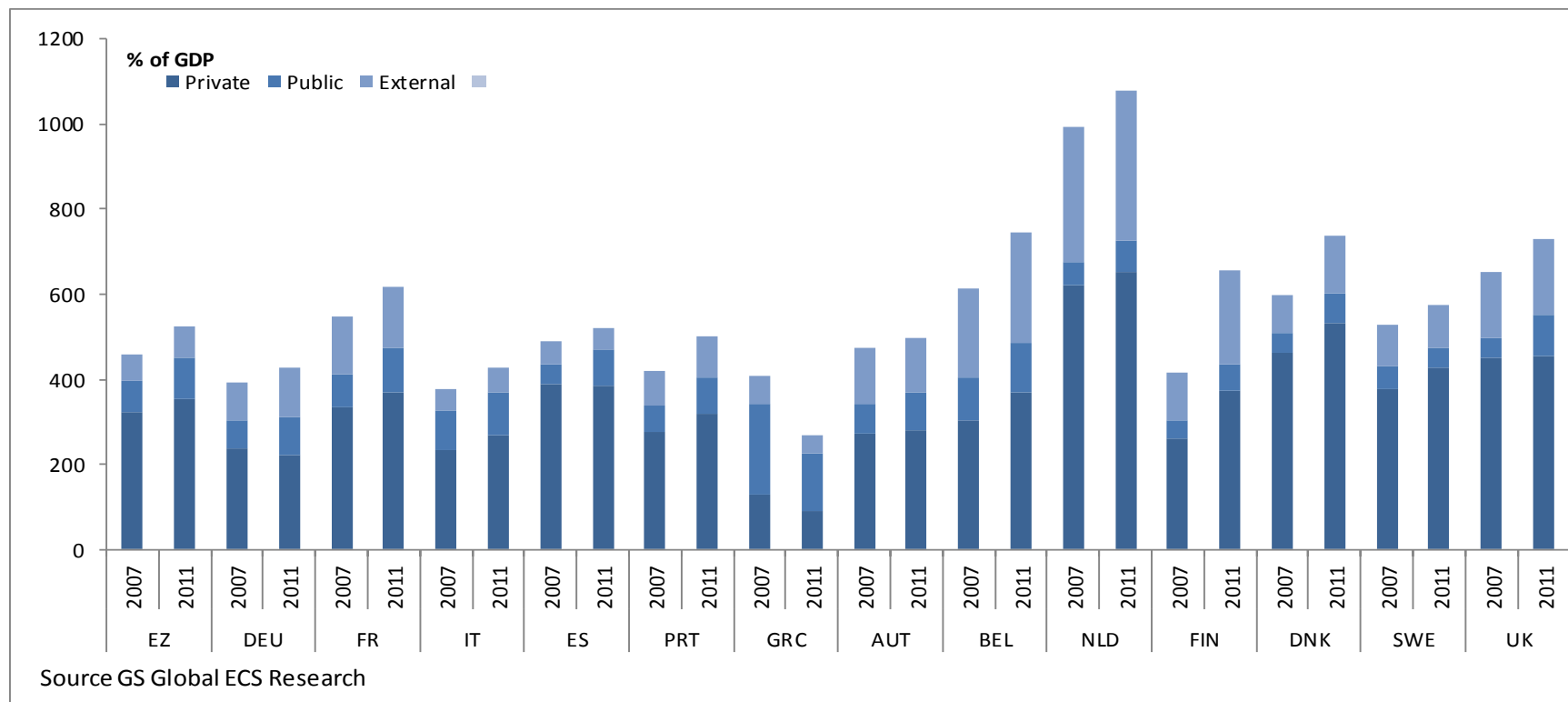
Quarterly GDP growth in 2011

Q1= 0.1%, Q2=0.28%, Q3=-0.15%

Recession During Financial Crisis



The “triplets” crisis



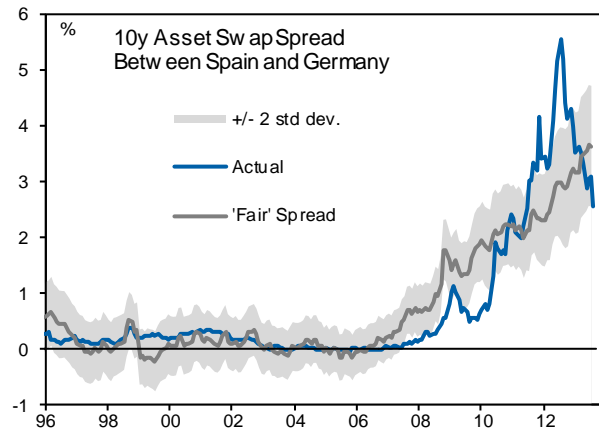
Key public finance figures

| <i>% of GDP</i> | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|--------------|--------------|--------------|--------------|--------------|--------------|
| Net Borrowing Requirement | -4.6 | -3.9 | -3.0 | -2.9 | -1.8 | -1.5 |
| <i>Cyclically-adjusted NBR</i> | -3.6 | -3.6 | -1.2 | 0.0 | 0.4 | 0 |
| <i>Change in Cyclically-adjusted NBR</i> | -0.4 | 0.0 | -2.3 | -1.1 | -0.4 | 0.4 |
| Primary Balance | 0.0 | 1.0 | 2.5 | 2.4 | 3.8 | 4.3 |
| Public Debt | 119.2 | 120.7 | 127 | 130.4 | 129 | 125.5 |
| Public Debt (net support to Euro Zone) | 118.9 | 119.9 | 124.3 | 126.9 | 125.2 | 121.8 |

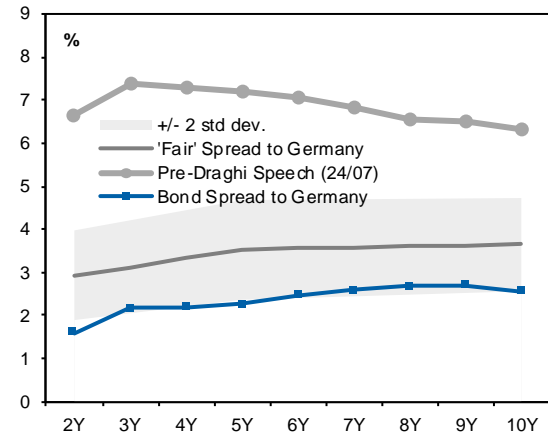
Source: Ministero dell'Economia.

"Believe Me, It Will Be Enough"

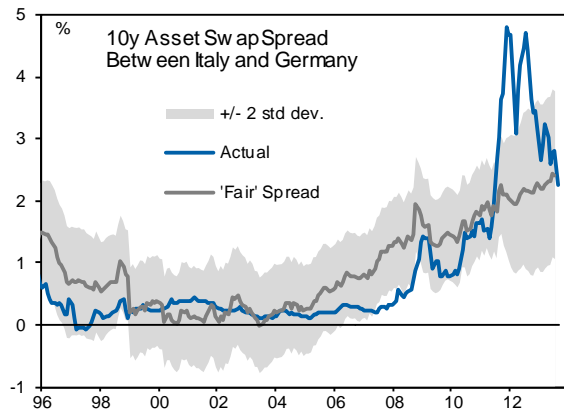
Spain: 10-yr Bond Spread to Germany



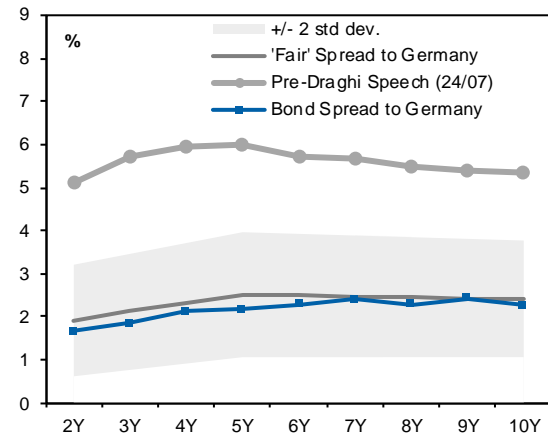
Spain: Fundamental Spread to Germany



Italy: 10-yr Bond Spread to Germany



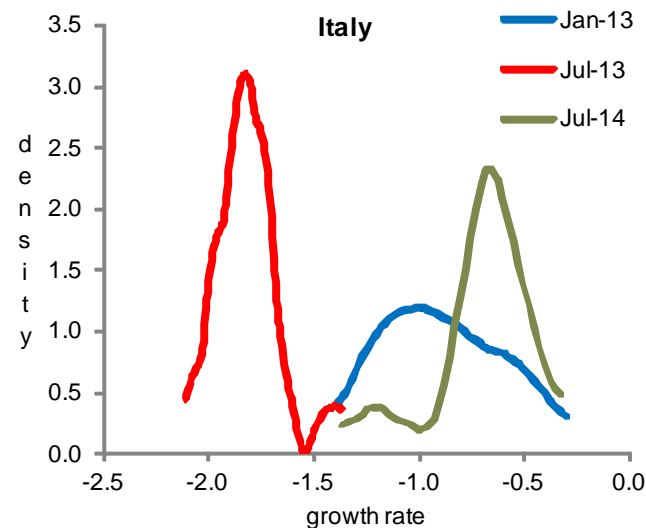
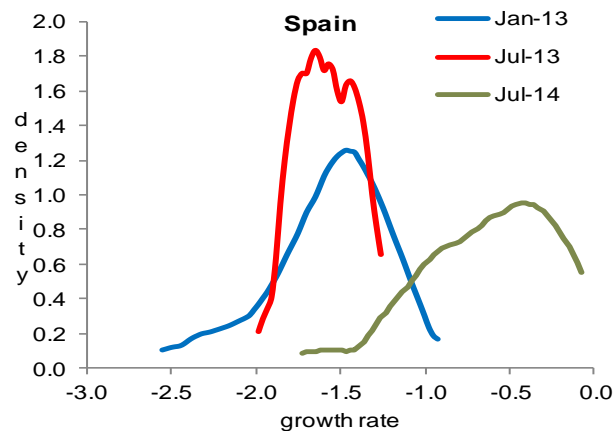
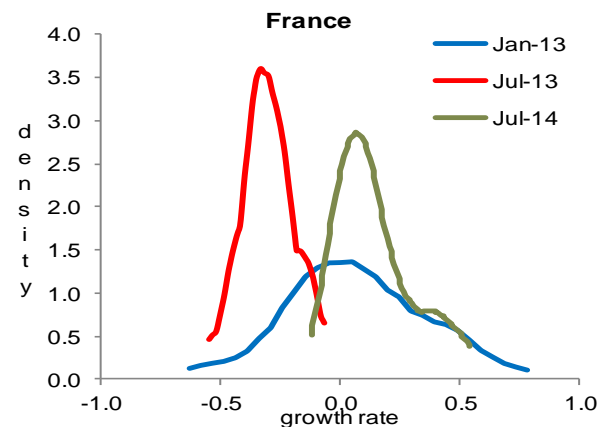
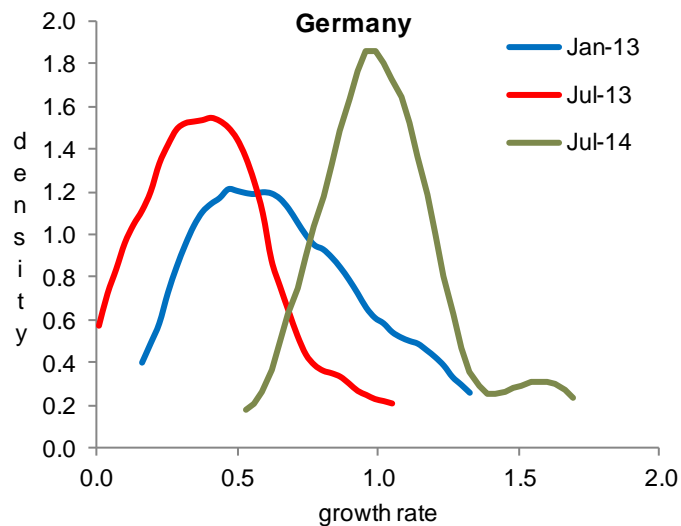
Italy: Fundamental Spread to Germany



Source: GS Global ECS Research

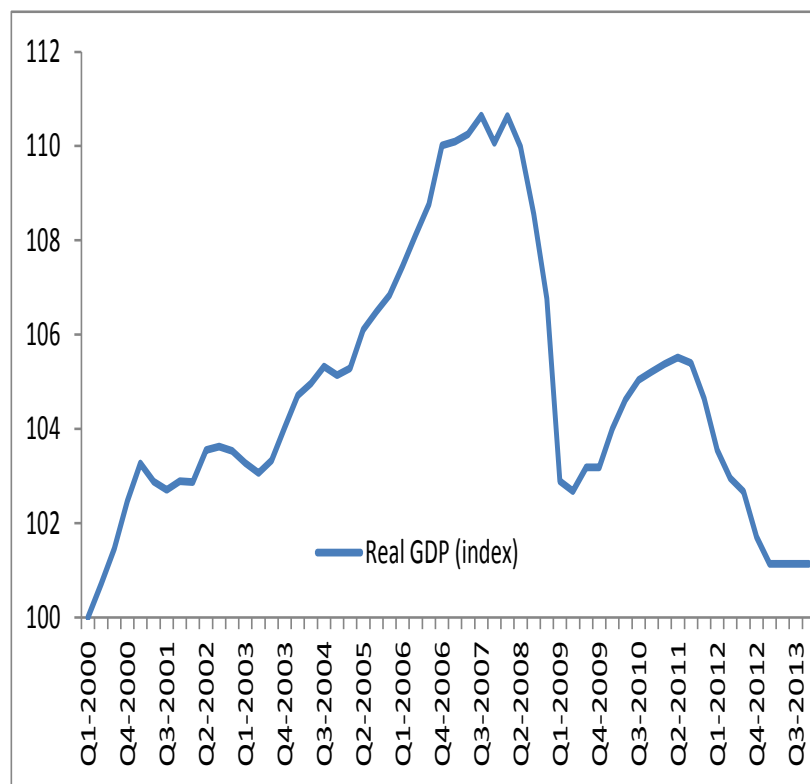
Shifts in the Consensus

Distribution of 2013-14 Growth Consensus Forecasts

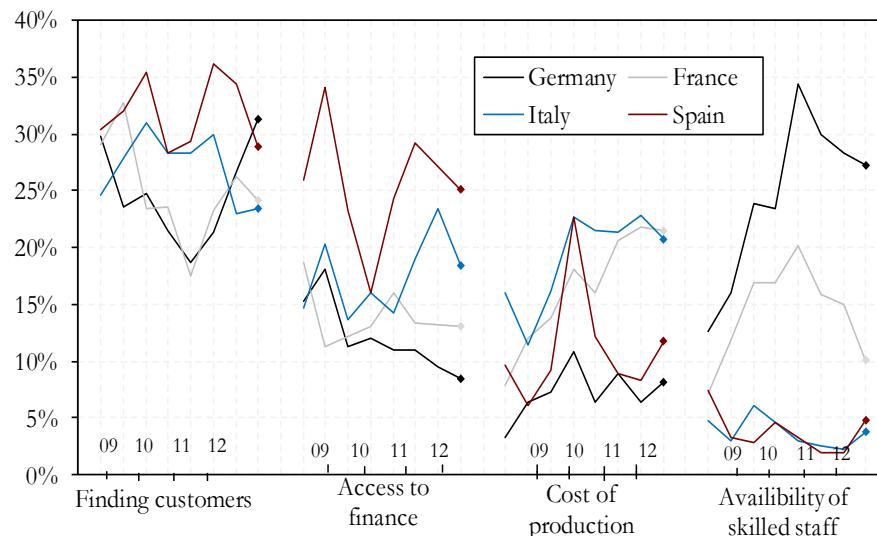
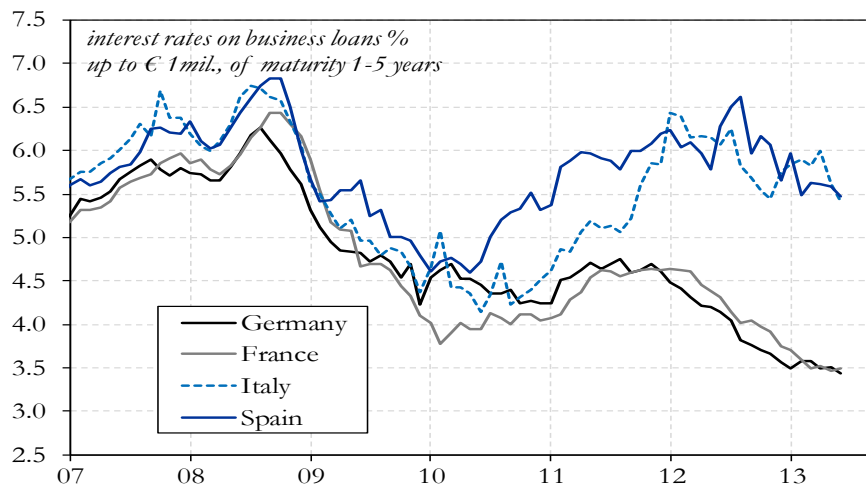
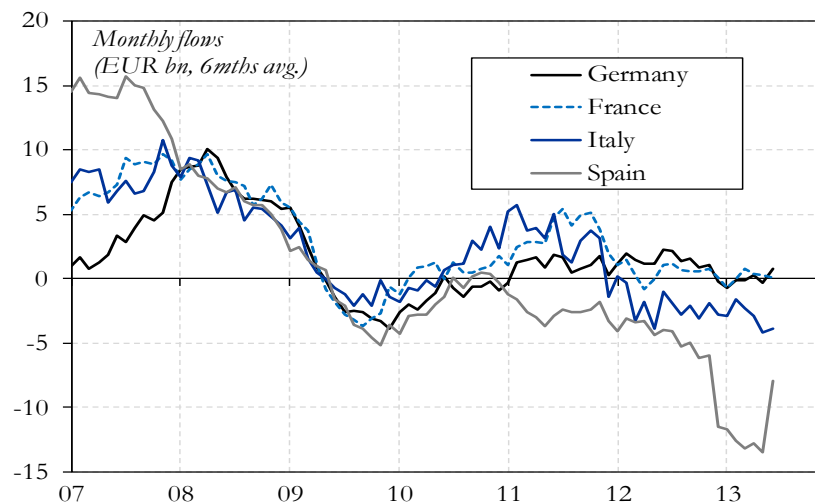
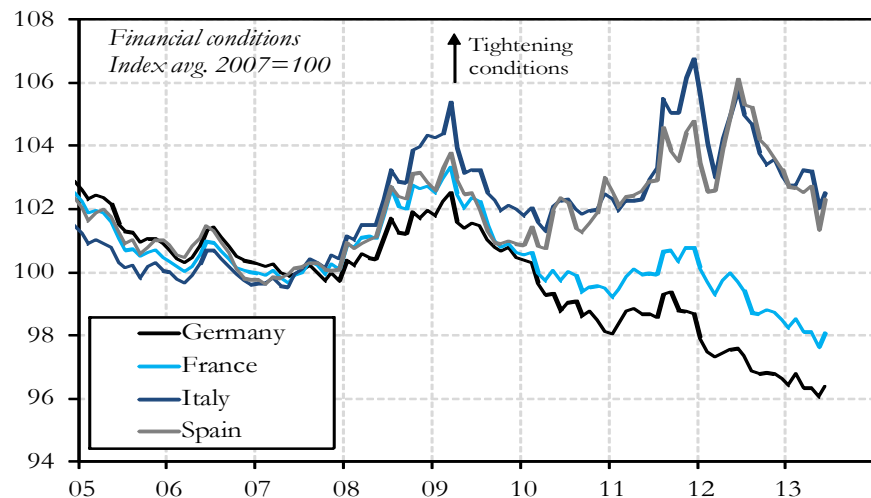


Source: Consensus Economics, GS Global ECS Research

Output 10% Below Pre Recession Peak

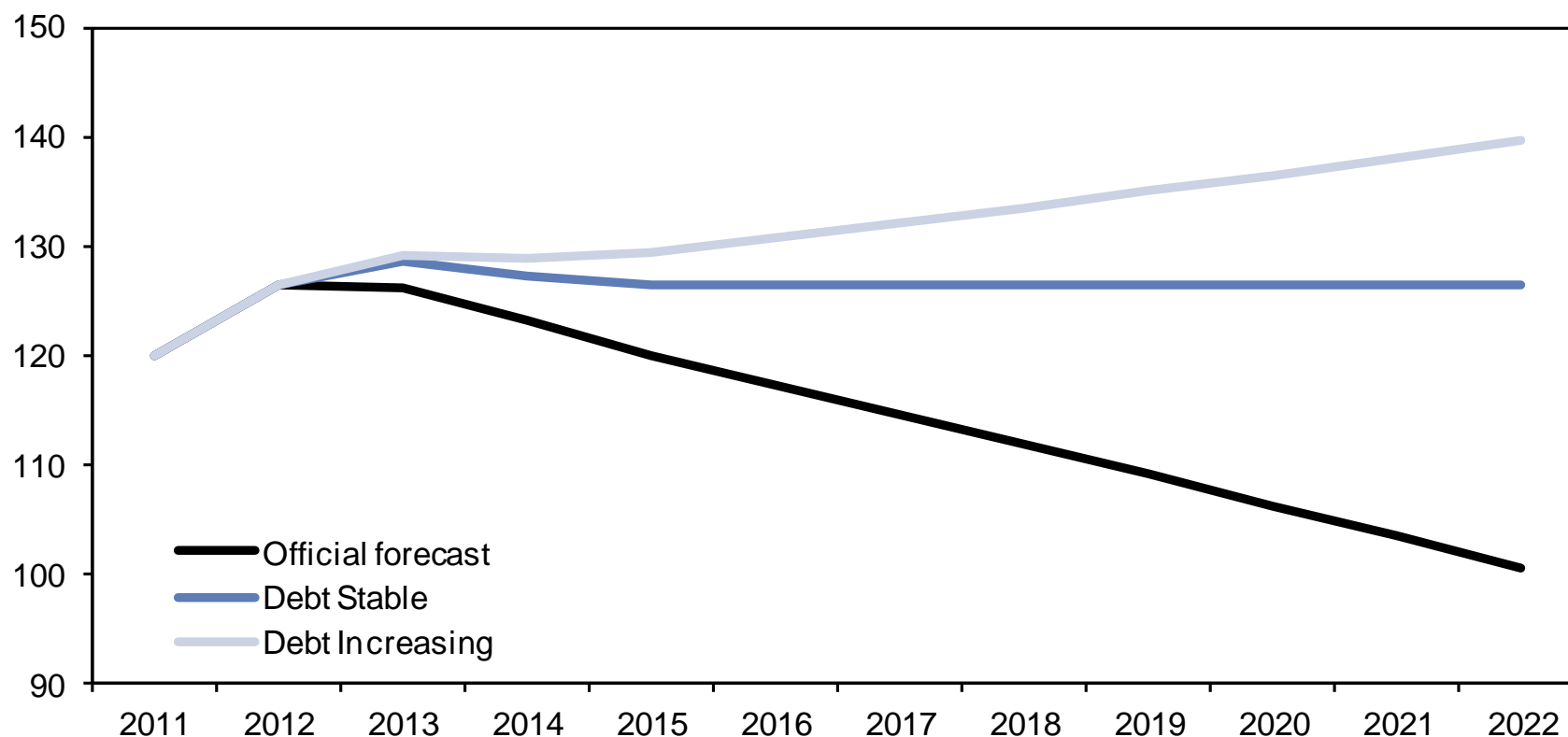


Financial Conditions Still Tight



Source: ECB, National Central Banks, Goldman Sachs Global ECS Research

Is Public Debt Sustainable?



Source: GS Global ECS Research

| | Primary balance | Growth-Interest Differential | Primary balance | Growth-Interest Differential | Primary balance | Growth-Interest Differential |
|------|-------------------|------------------------------|-----------------|------------------------------|-----------------|------------------------------|
| | Official forecast | | Debt Stable | | Debt Increasing | |
| 2012 | 2.9 | -5.6 | 2.9 | -5.6 | 2.9 | -5.6 |
| 2013 | 3.8 | -3.4 | 2.9 | -4.4 | 2.0 | -4.4 |
| 2015 | 4.8 | -1.9 | 2.9 | -2.3 | 1.5 | -2.3 |

Possible Non Mutual Exclusive Solutions

❑ **Grow Out of Your Debt**

- Rebalancing composition of budget, structural reforms
- Room exists but is there the political will?

❑ **Following Japan**

- Rebalancing composition of budget, structural reforms
- Room exists but is there the political will?

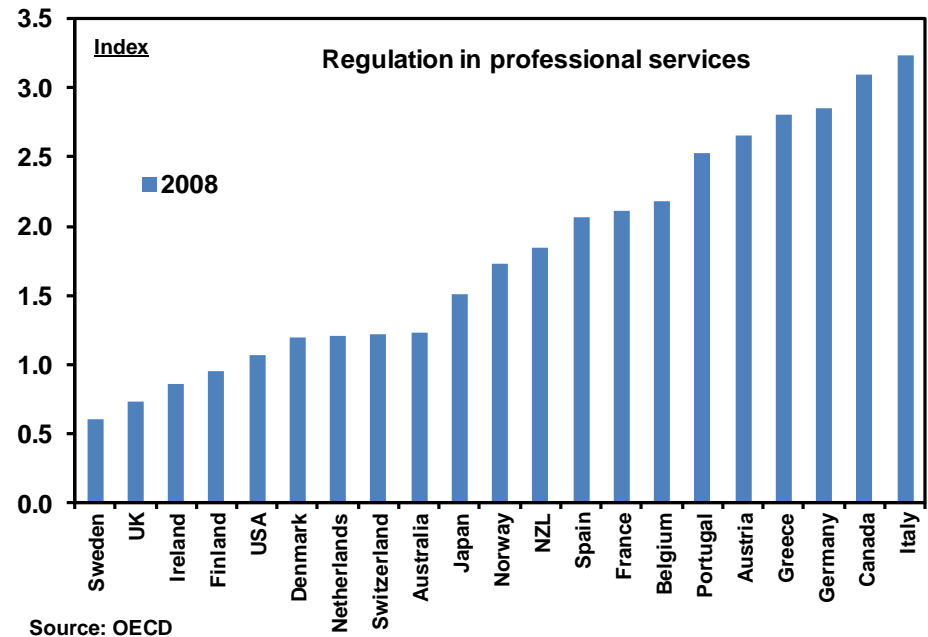
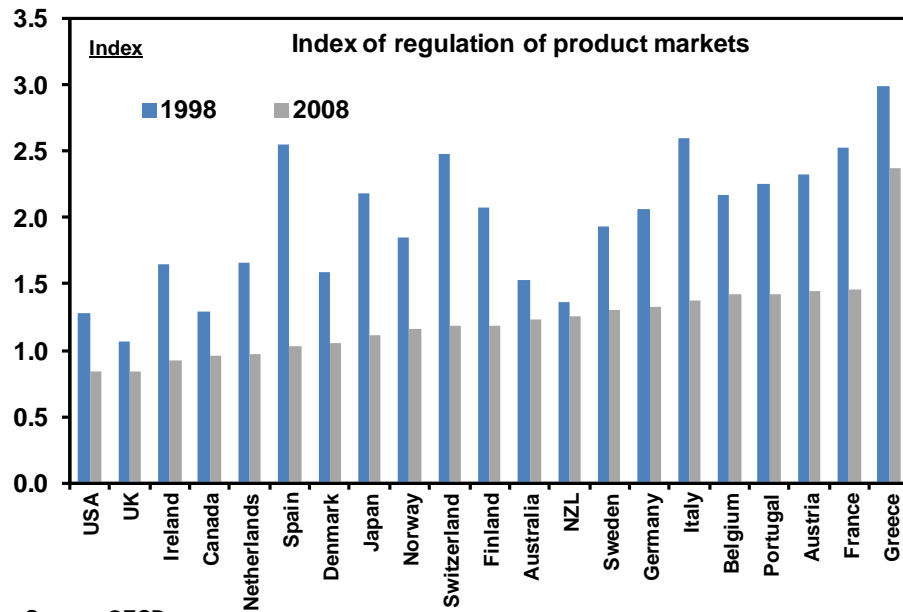
❑ **PSI within the EMU**

- Distributional costs
- Political support
- Contagion

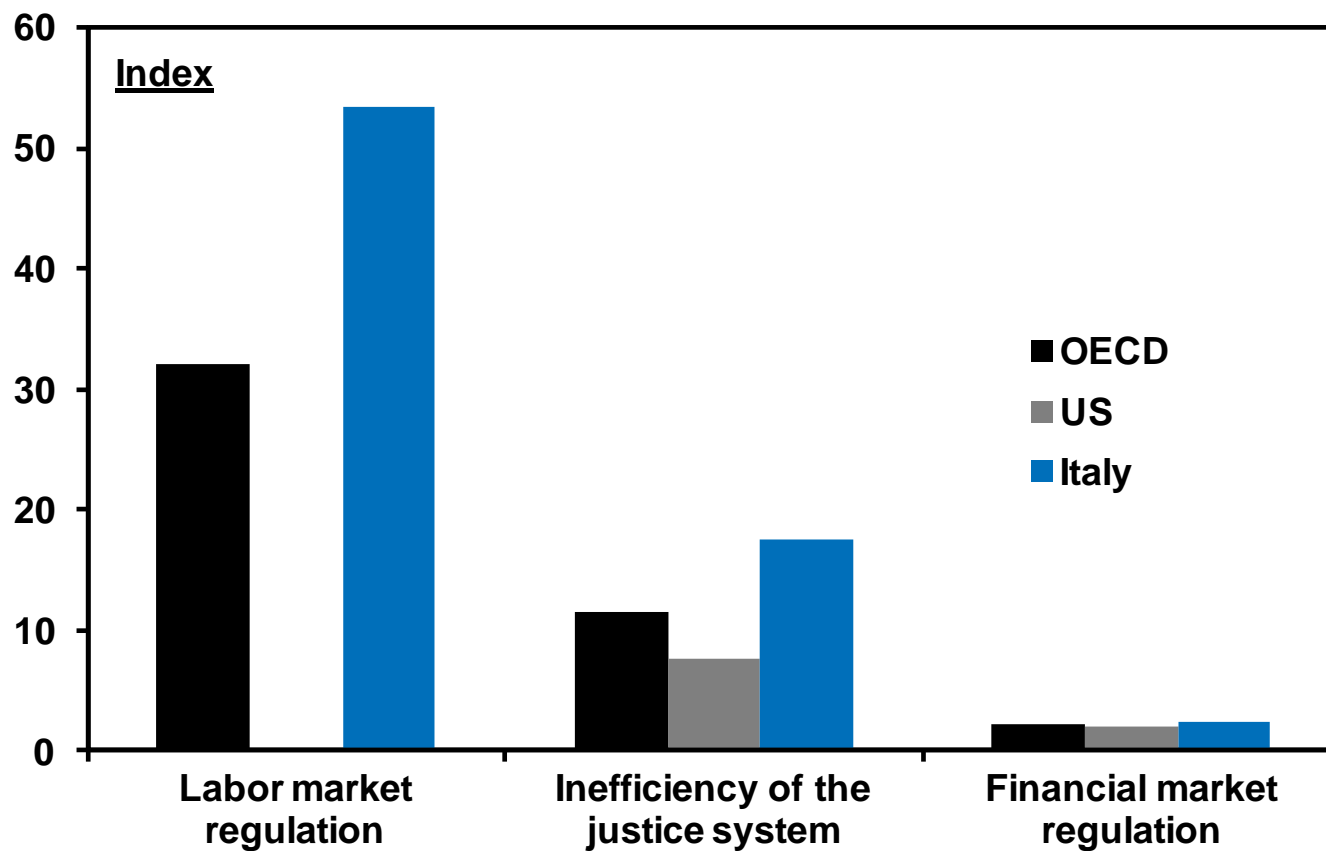
❑ **A More Feasible Outcome?**

- ERF with improved incentive scheme and possible private sector participation
- PSI and Eurobonds

Product market regulation

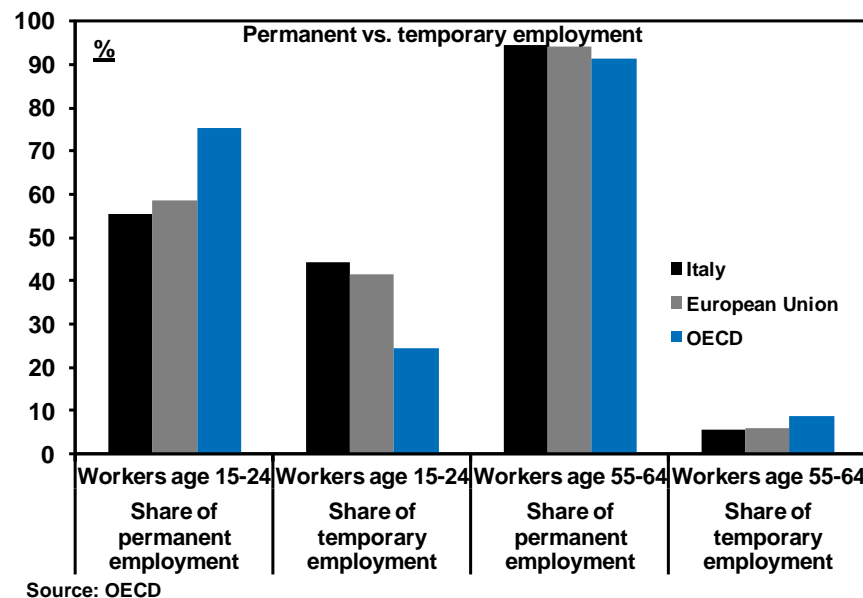
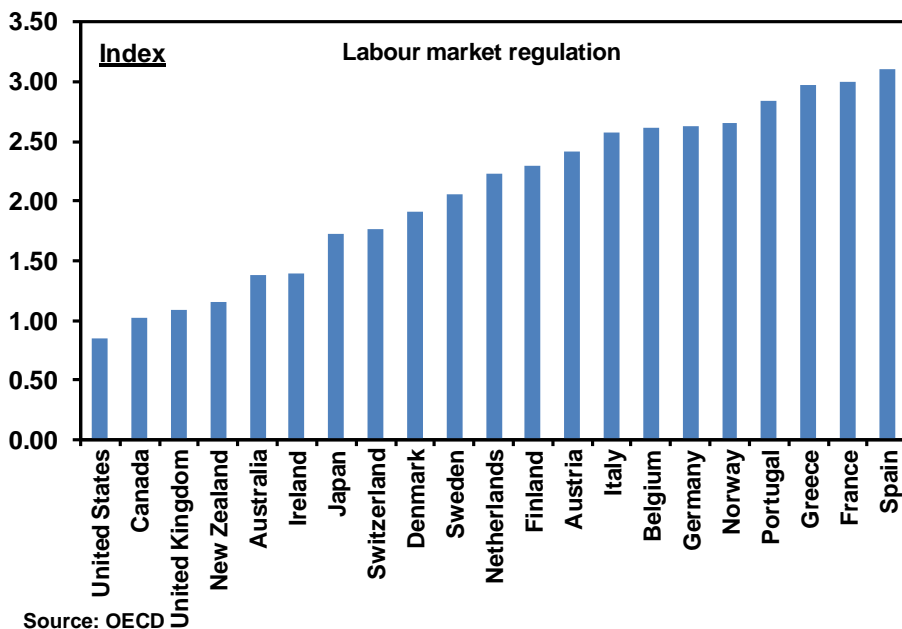


Regulation in other areas

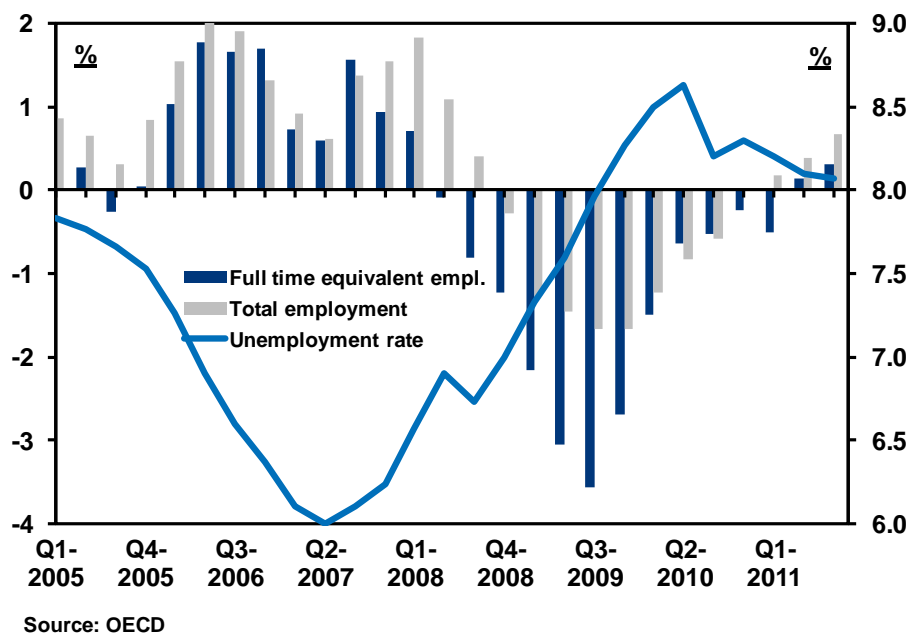
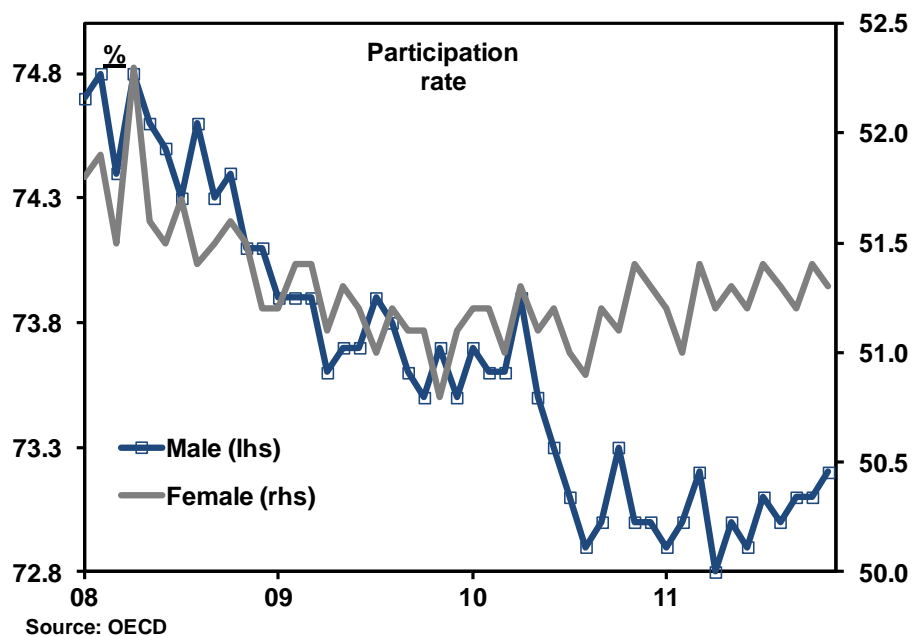


Source: OECD, Economic Freedom of the World. GS Global ECS Research

Labour market regulation

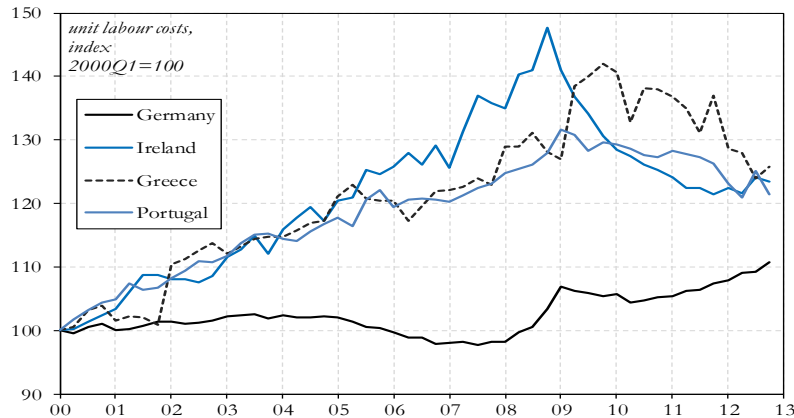


Labour market outcomes

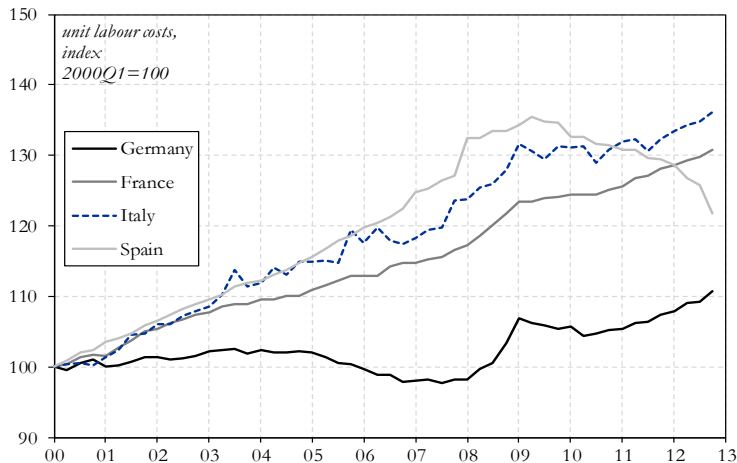


External Imbalances in the Euro area

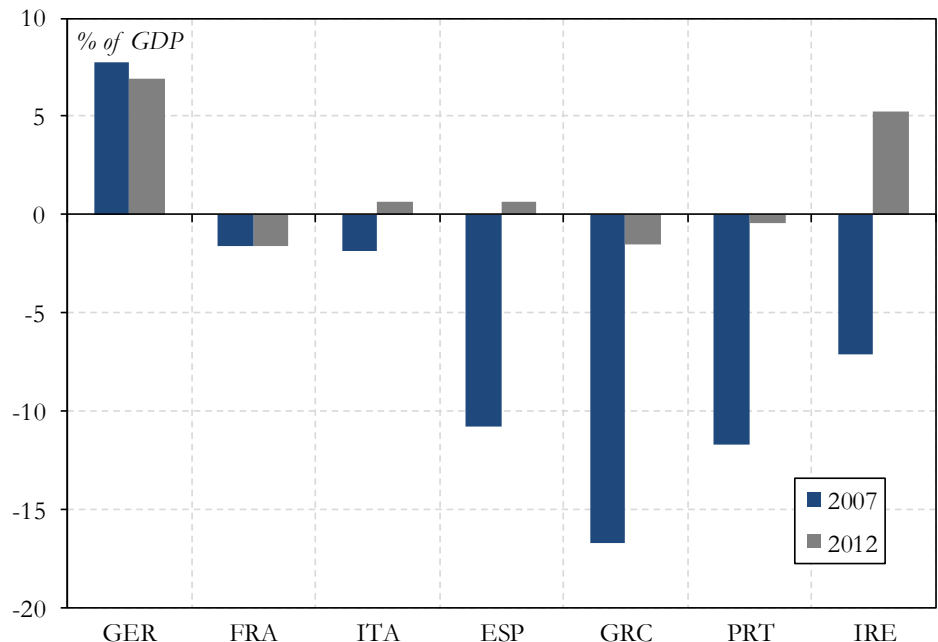
Peripheral economies are adjusting unit labour costs...



...contrasting with France and Italy

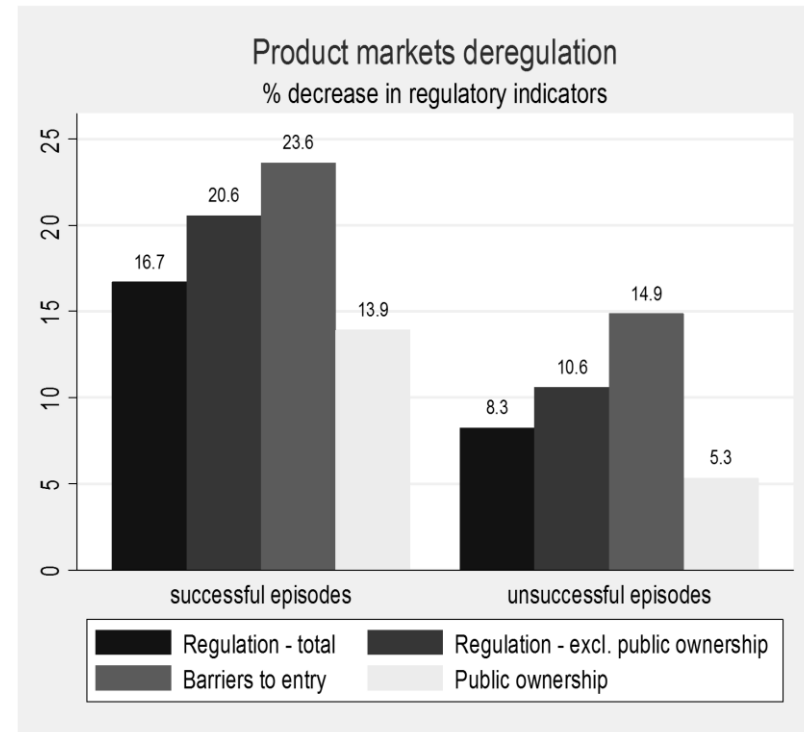
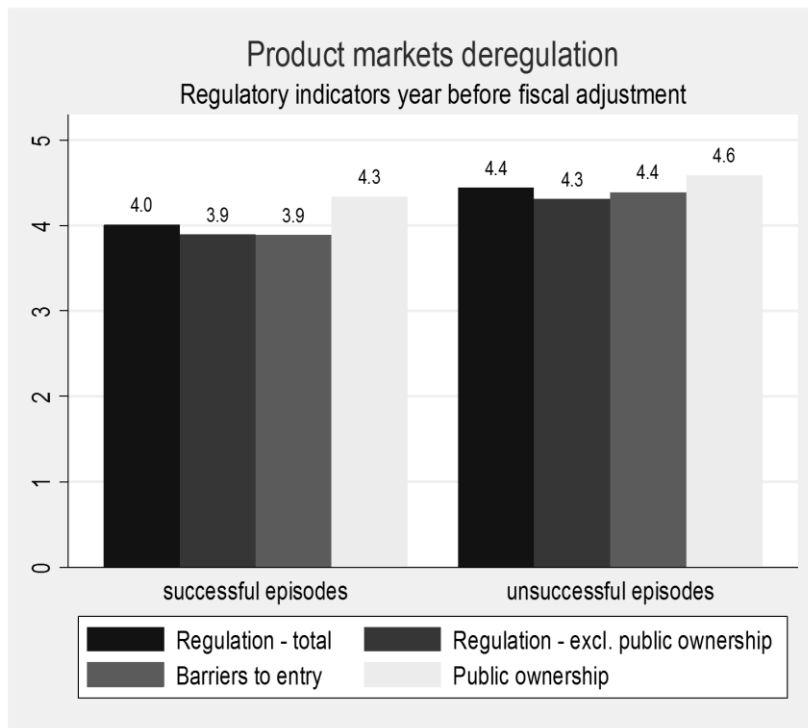


Current account balance is improving in the periphery



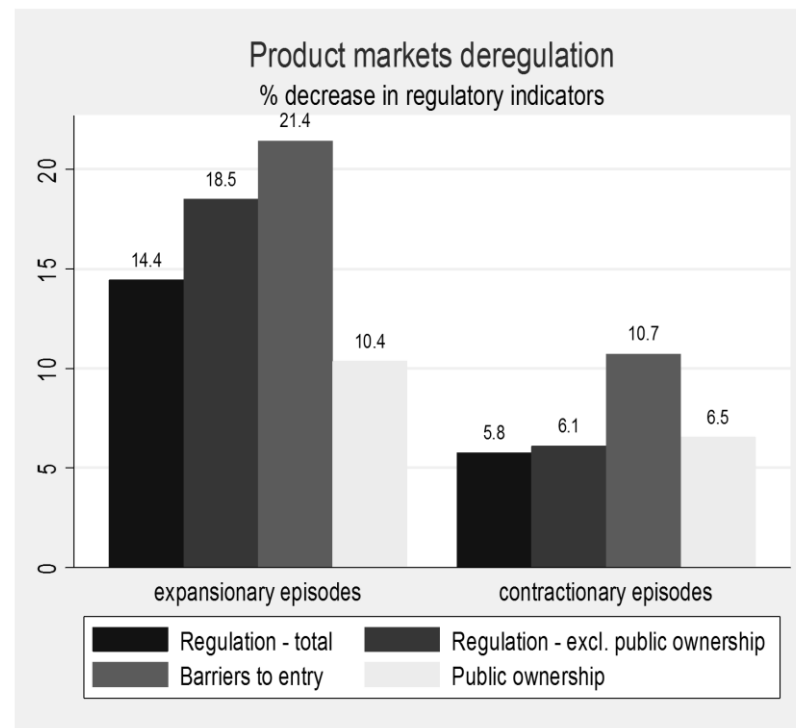
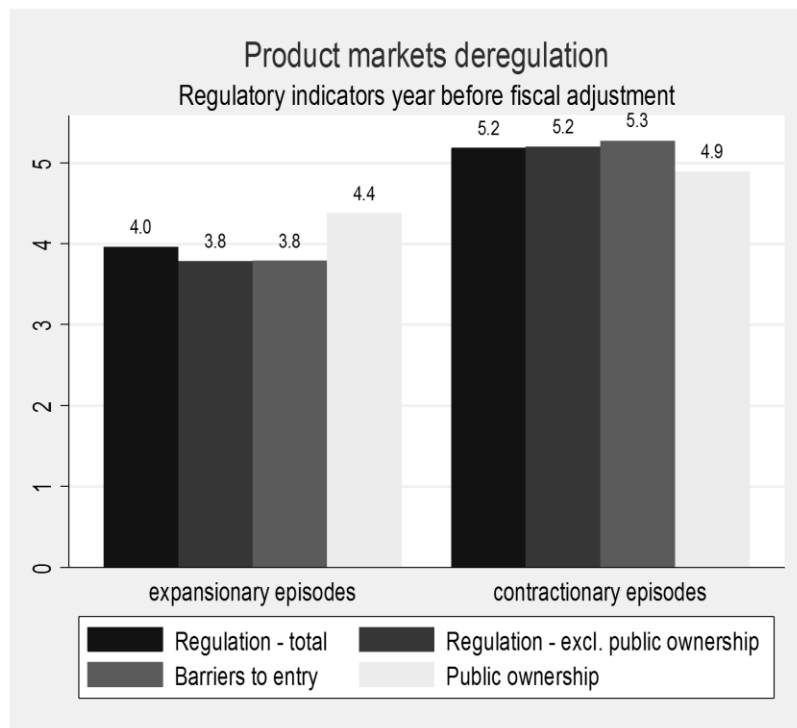
Source: Eurostat, National Statistical offices, Goldman Sachs Global ECS Research

Product markets reforms and gov. debt during episodes of large fiscal adjustments



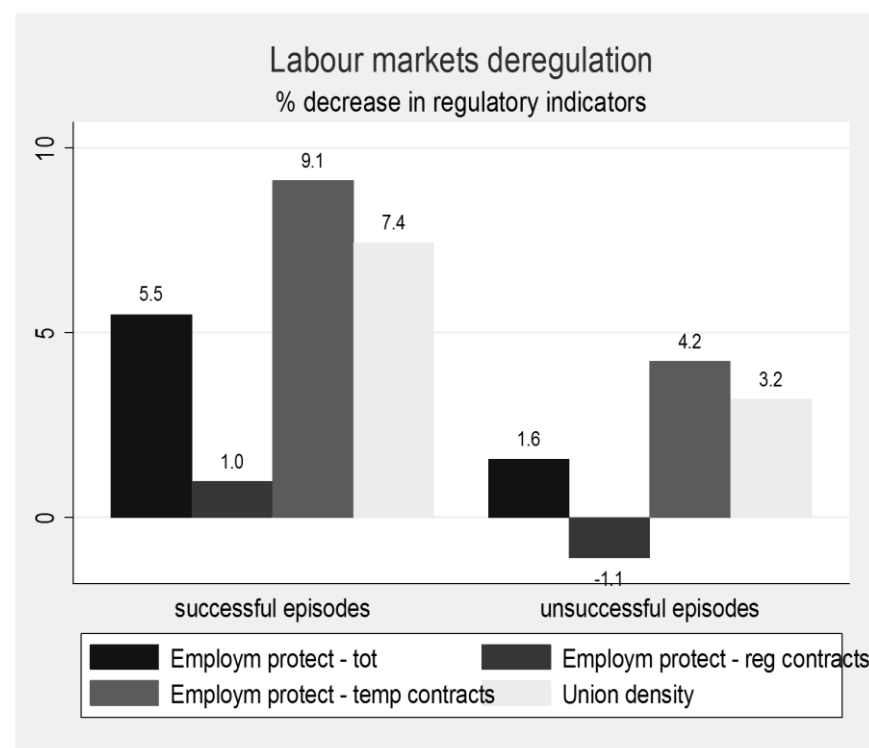
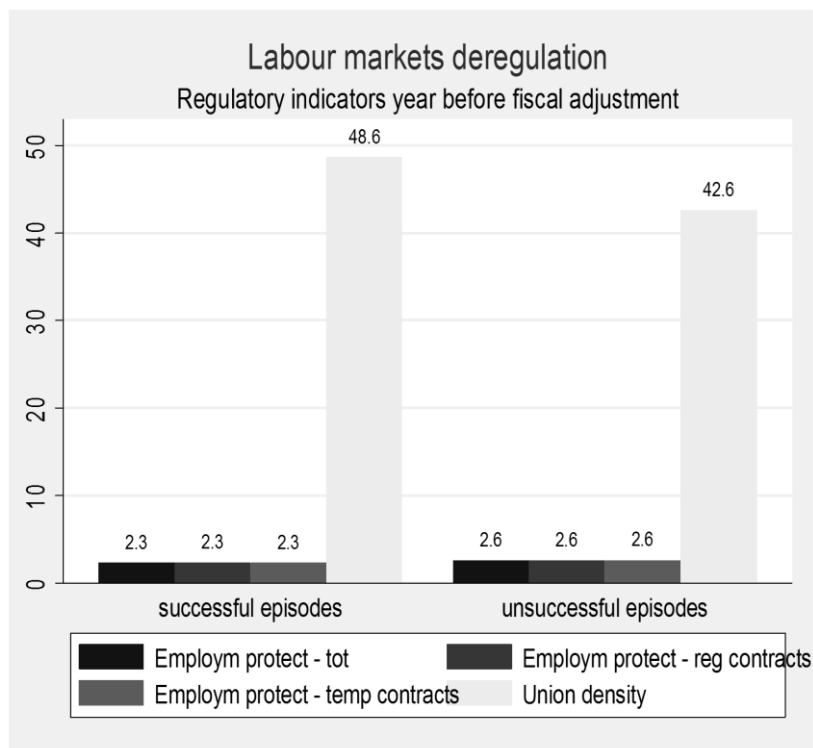
Source: Alesina and Ardagna (AEA meetings 2012)

Product markets reforms and growth during episodes of large fiscal adjustments



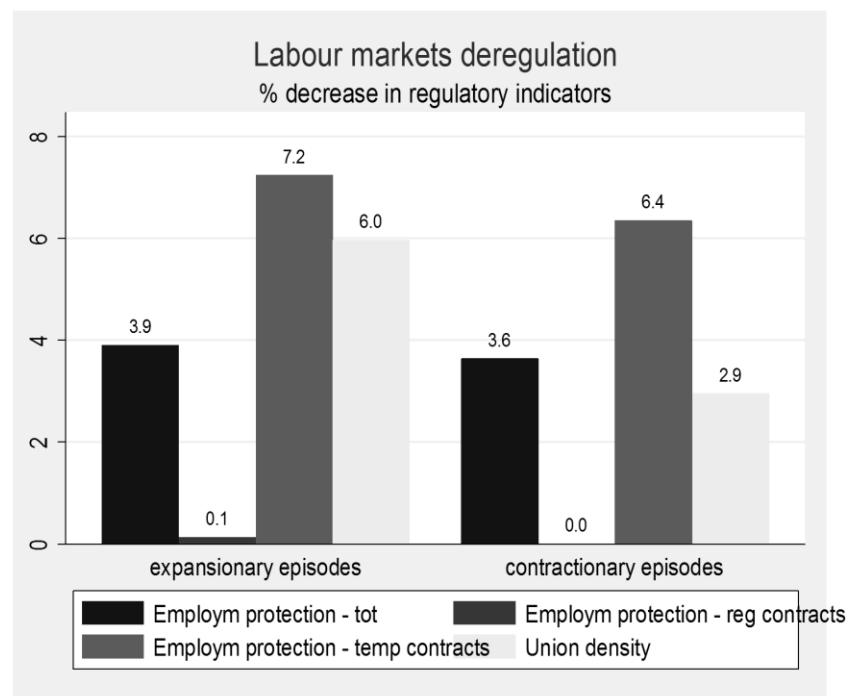
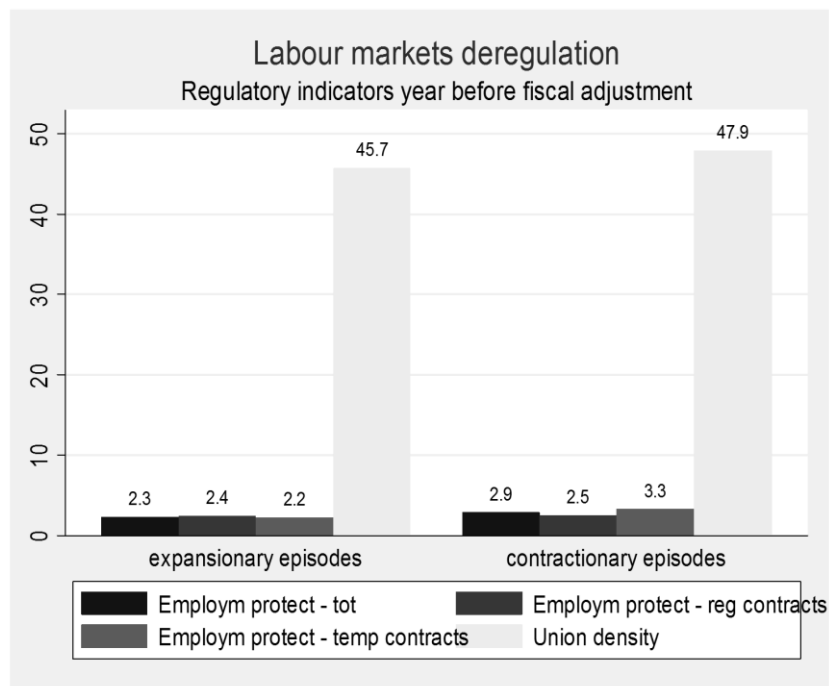
Source: Alesina and Ardagna (AEA meetings 2012)

Labour markets reforms and gov. during fiscal adjustments



Source: Alesina and Ardagna (AEA meetings 2012)

Labour market reforms and GDP growth during fiscal adjustment

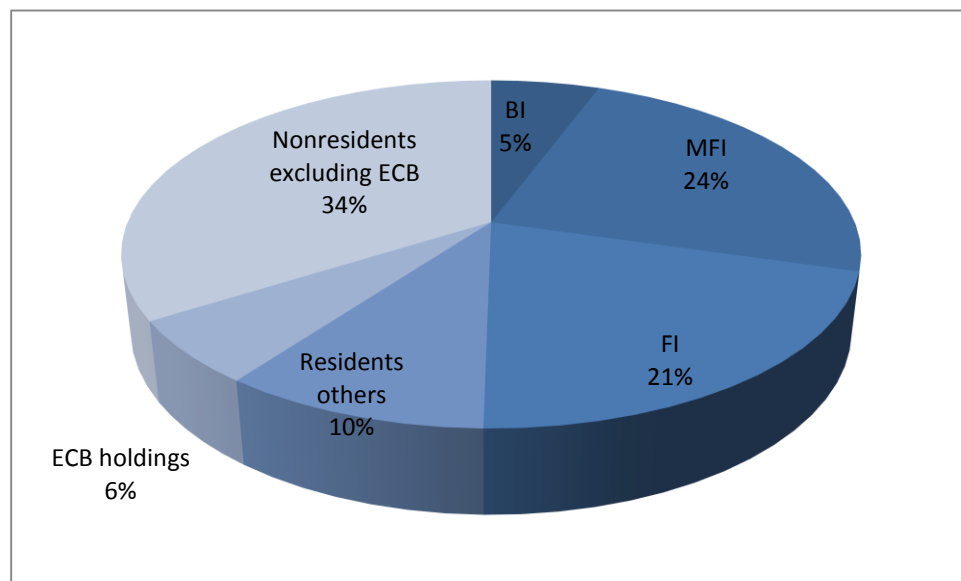


Source: Alesina and Ardagna (AEA meetings 2012)

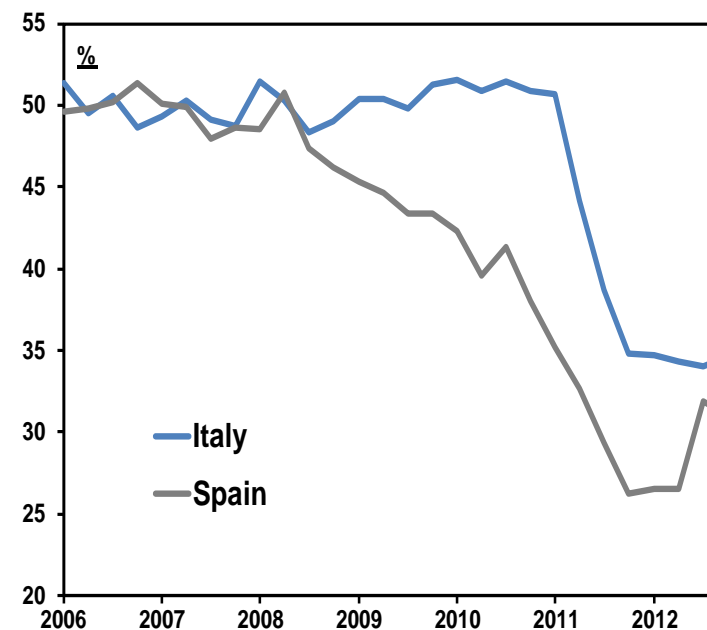
Composition of Fiscal Policy

- ☐ Spending Review
- ☐ Tax Wedge
- ☐ Indirect and Wealth Taxes
- ☐ Privatizations

Owners of Italian Debt



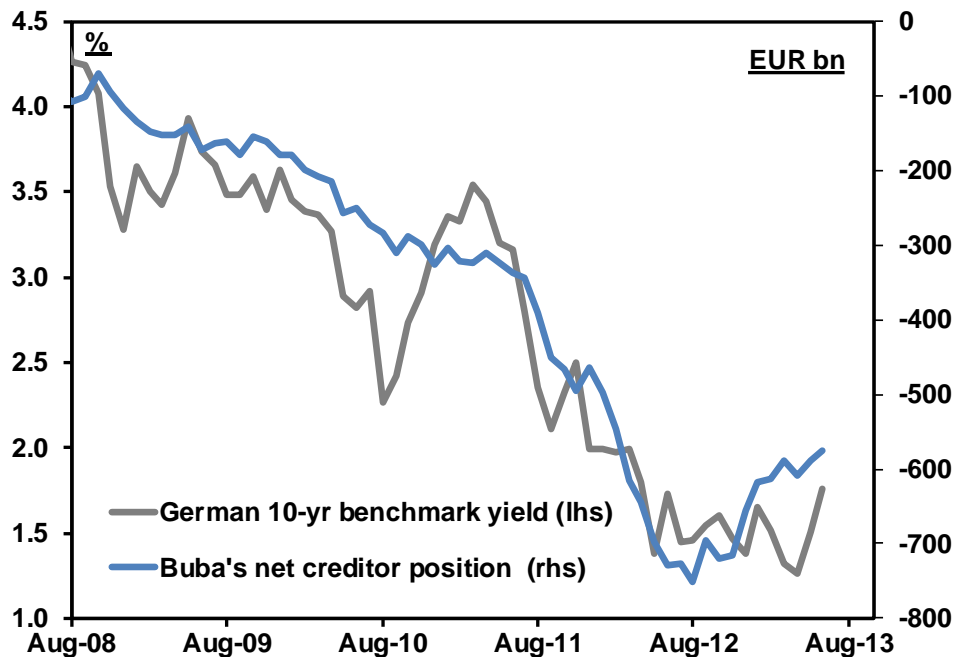
Foreign Holdings of Government Bonds



Source: Bundesbank, GS Global ECS Research

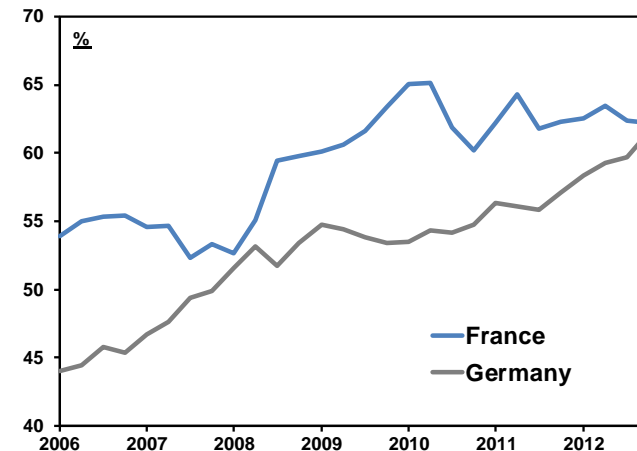
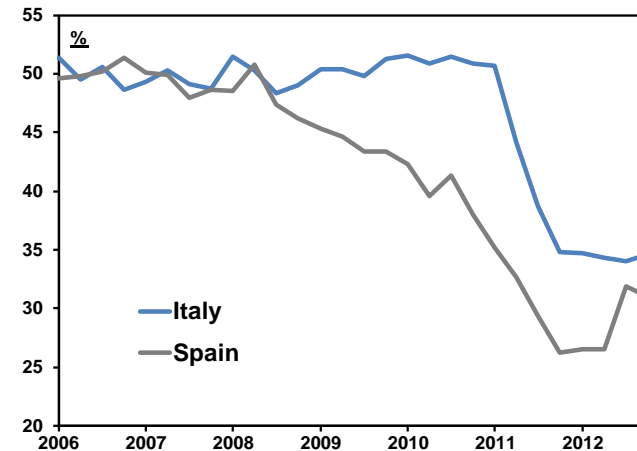
TARGET 2 Imbalances Key

**TARGET 2 Net Claims
vs. German 10-year German Bund Yield**

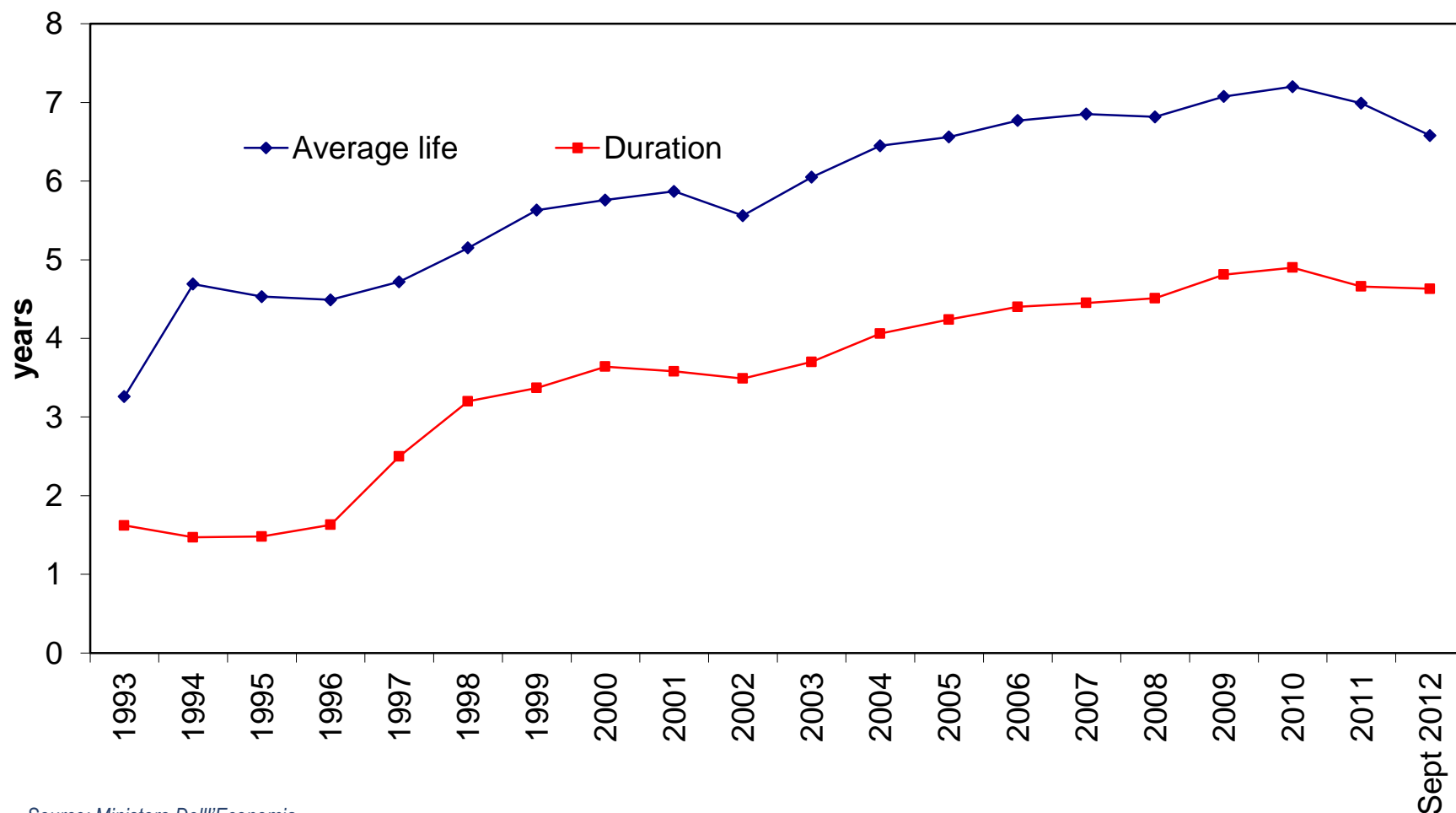


Source: Bundesbank, GS Global ECS Research

Foreign Holdings of Government Bonds

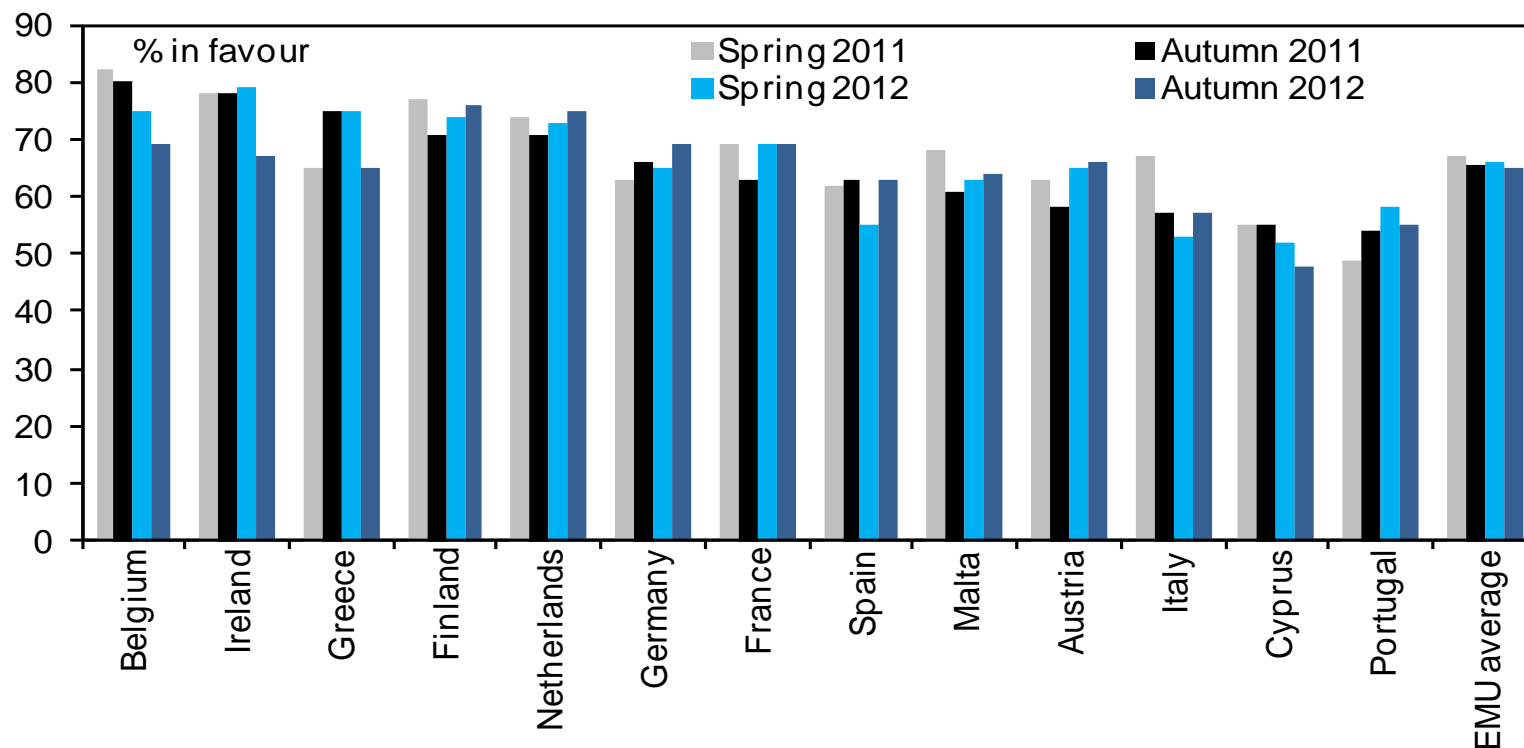


Maturity of Government Debt



Source: Ministero Dell'Economia

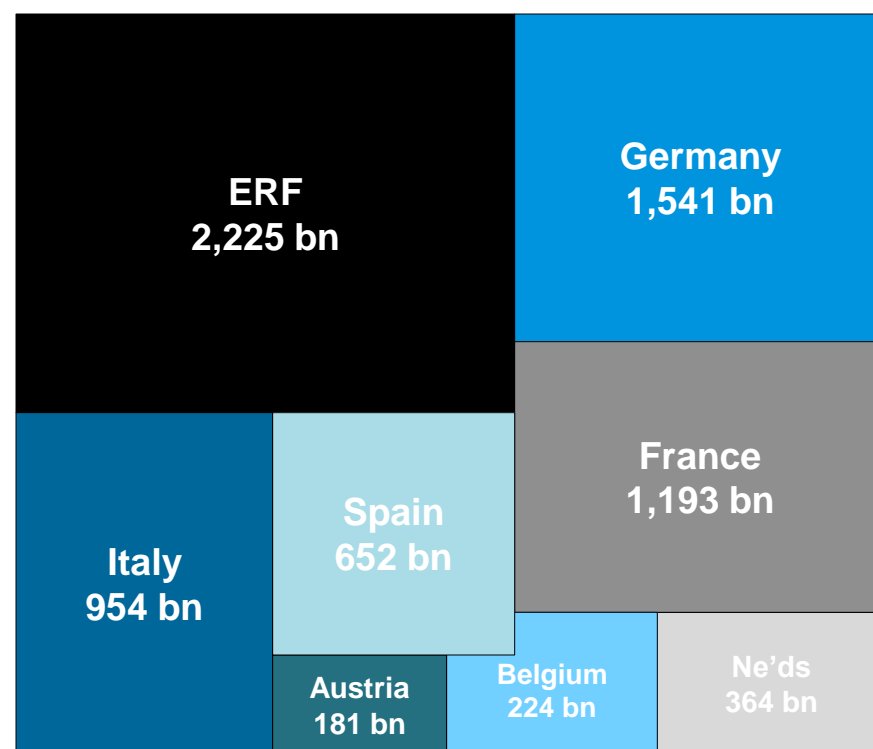
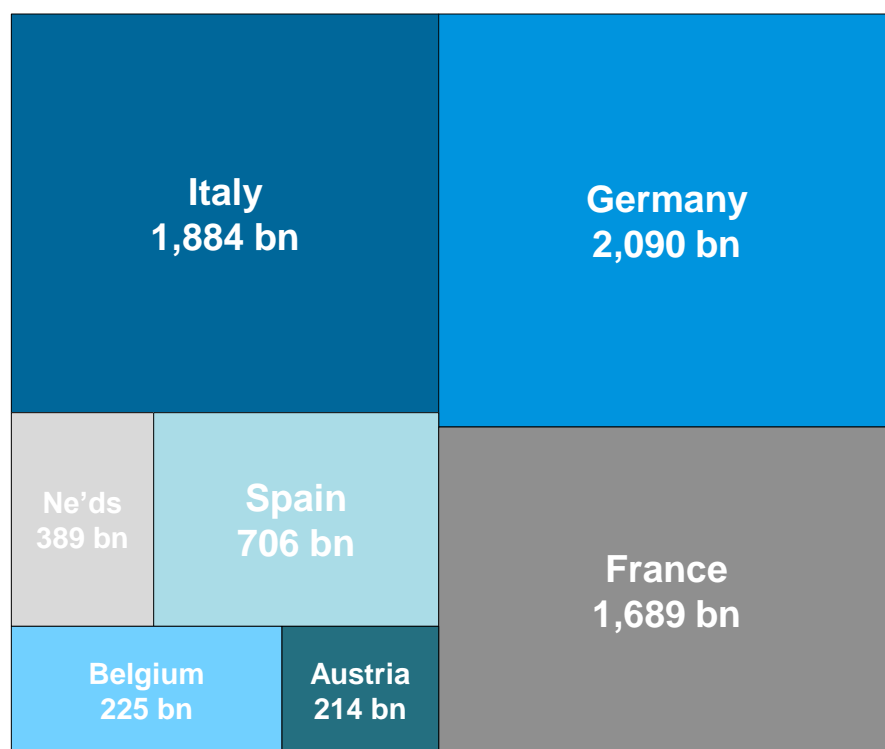
Opinion of Euro Area Citizens on EMU and Euro



Source: Eurobarometer

ERF: The Path To Redemption

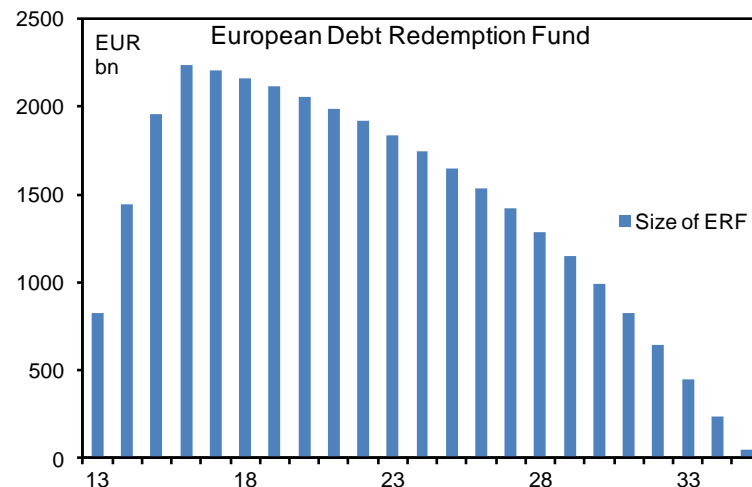
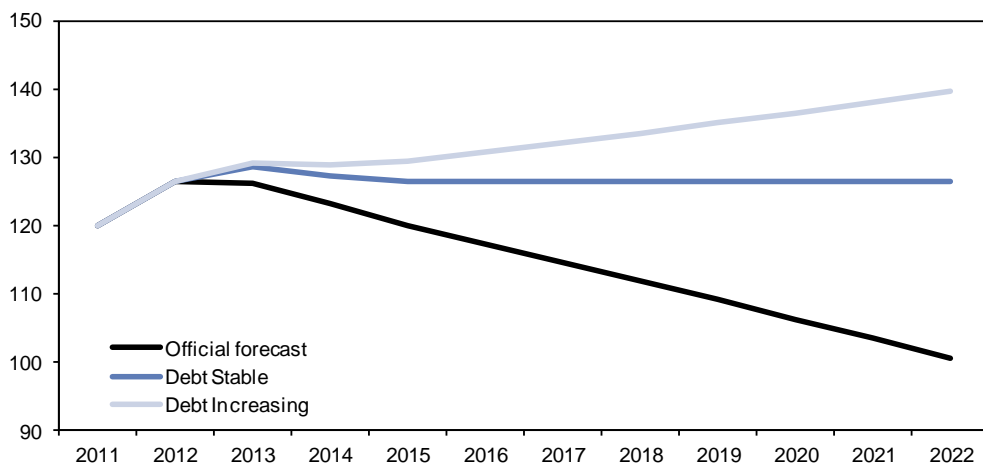
Euro area Redemption Fund (ERF) Takes Over Debt in Excess of 60% GDP



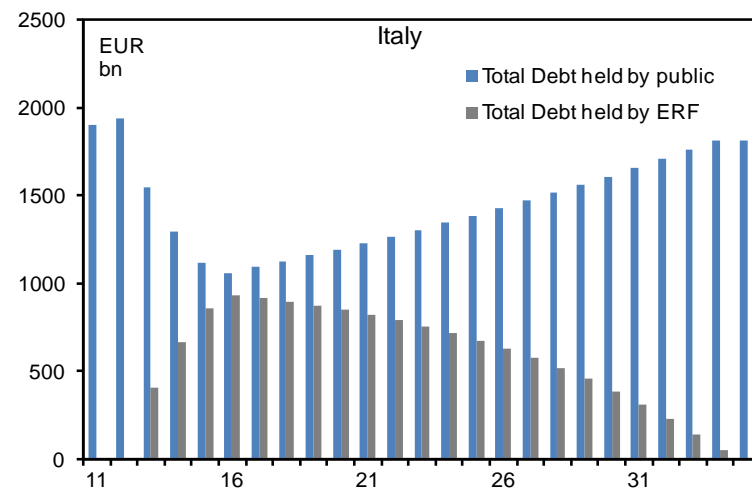
Source: GS Global ECS Research

The Italian Case

As % GDP



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|------|-------------------|------------------------------|-----------------|------------------------------|-----------------|------------------------------|
| | Official forecast | | Debt Stable | | Debt Increasing | |
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Source: GS Global ECS Research

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