Italy: Mario Monti’s challenge

By Céline Antonin

From his arrival in power on 12 November 2011, Mario Monti has explicitly set out his aims, which are structured around three points: fiscal discipline, growth and equity. Will he meet the challenge?

Mario Monti succeeded Silvio Berlusconi at a time when investors’ lack of confidence in Italy was growing continuously, as was seen in the widening gap with German bond rates and the sharp increase in CDS prices.

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To meet his first objective of fiscal discipline, in December 2011 one of the government’s first measures was to adopt an austerity plan, which came to 63 billion euros over three years. This plan, the third in a single year, has the evocative name of *Salva Italia* (Save Italy) and aims to achieve a near balance of the public books by 2013 (see Italy: Mario Monti’s wager in French).

The second objective, to restore growth and enhance the country’s competitiveness, is addressed in the *Cresci Italia* plan (“Grow Italy”) adopted in stormy conditions by the Council of Ministers on 20 January 2012. This plan calls for further reforms, including to simplify administrative procedures (tendering procedures, business creation, digital switchover, etc.) and to liberalize the regulated professions, energy, transportation, and insurance, and in particular to enhance labor market flexibility. The ease with which the austerity measures contained in this second plan were adopted was matched by their poor reception, in particular with regard to discussion of the amendments to Article 18 of the Labour

Code, which provides protection against dismissal for employees and workers in firms with more than fifteen employees.

Finally, with respect to equity, progress is still slow, especially in the fight against tax evasion and against the underground economy.

Italians knows that these measures will be painful: the financial daily *Il Sole 24 Ore* announced that the annual increase in taxes for an average family living in Lombardy will come to 1,500 euros per year, and almost 2,000 euros for a family from Lazio. Yet up to now the people of Italy have displayed great awareness of the national interest, accepting the cure of fiscal consolidation in a spirit of resignation. As for the financial markets, they initially relaxed the pressure on the country, with the gap in long-term government rates with Germany falling from 530 to 280 basis points from early January to mid-March 2012. Mario Monti's actions are not the only explanation: the ECB's purchase of bonds in late 2011 and its two 3-year refinancing operations (LTRO) of the banking system for a total of 1,000 billion euros, which greatly benefited Italy's banks, definitely helped to ease the pressure on rates. Moreover, the success of the plan for the exchange of Greek debt with private creditors also contributed to easing rates.

The situation is still fragile and volatile: the weakness Spain showed regarding fiscal discipline was enough to trigger a renewed loss of confidence in Italy, as the interest rate differential with Germany on long-term bonds began to rise again, reaching 400 basis points in early May 2012, as did CDS premiums (graph).

So what are the prospects for the next two years? After a recession that began in 2011, with two quarters of negative growth, Italy is expected to experience a difficult year in 2012, with GDP falling sharply by 1.7% as a result of the three austerity plans approved in 2011. Their impact will continue to be felt in 2013, with a further contraction in GDP of -0.9% [1]. In the absence of additional austerity measures, this will reduce the country's deficit, but less than expected, due to the multiplier effect: the deficit will fall to 2.8% of GDP in 2012, and to 1.7% in 2013, i.e. a pace of deficit reduction that falls short of its commitment to balance the public finances by 2013.

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[1] The IMF forecast is more pessimistic for 2012, with growth of -1.9%, and more optimistic for 2013, at -0.3 %.