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The Draghi Government: The Europe factor in investor choices

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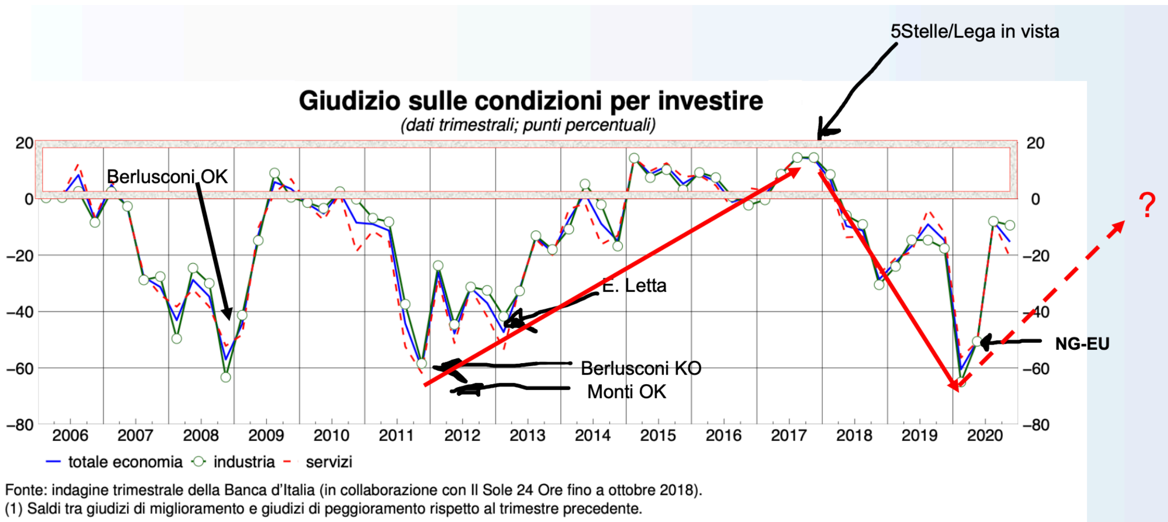
The start of the Draghi government is surrounded by a high level of uncertainty. The climate in which the economic policy of the Italian government will manifest itself is strongly conditioned by external circumstances. However, it is possible to draw some useful considerations from the analysis of the climate in which non-financial investors operate.

Graph 1 (below) shows the assessments of non-financial investment conditions in Italy registered by the Bank of Italy every three months. It is a qualitative indicator that does not have a rigorous statistical correlation with the amount of investments actually made. However, this indicator is particularly useful for identifying the climate in which investors believe they operate and in which both the need to create new activities and the need to destroy old activities that are less capable of surviving should converge. While the amount of investments depends on estimates of the expected income and the capital discount rate, the assessment of the investing conditions appears, in a general observation, much more influenced by domestic politics.

Graph 1 Firms' assessment of the conditions for investing



Source: Bank of Italy, Survey on Inflation and Growth Expectations (in collaboration with Il Sole 24 Ore up to October 2018).
(1) Balance of positive and negative responses compared with the previous chapter

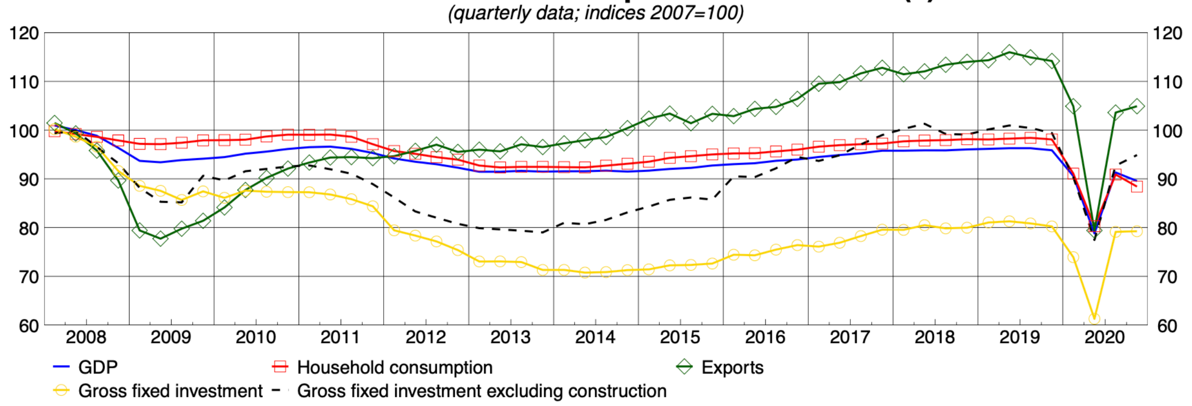
Starting from May 2008, a complex period with high variability of assessments characterizes the fourth Berlusconi government. In the government's first months, investor sentiments worsened radically and then rebounded vigorously, despite the great recession of 2009. In 2011 they plummeted to historic lows that culminated around November 16, 2011 when Berlusconi was forced to resign. From that moment on, with the government led by Mario Monti, a clear change of direction began that increased positive investor assessment for an unusually long period. The leadership of the Italian government subsequently passed to Enrico Letta, then to Matteo Renzi and finally to Paolo Gentiloni. In the last few years of this unusual "long cycle" investor assessment becomes steadily positive, so much so that the improvement in the climate is recognized for several quarters in a row.

This cycle is interrupted at the end of 2017 when, approaching the elections of spring 2018, completely new parliamentary majorities emerge that are decidedly conditioned by the Five Star Movement, which is clearly the first parliamentary force in the country and which will appoint Giuseppe Conte as the leader of two successive executive governments. The new prime minister presents himself to Parliament as a "populist" leader, taking on explicitly antagonistic tones with the European Union. Despite a change of tone in the second Conte government, formed in alliance with the Democratic Party, until 2020 the prime minister maintains a sizeable distance from the pro-European line of the four heads of government who preceded him. Over the 2018-2020 period, the assessment of investment conditions sharply worsens to the point of configuring a real cycle of investor pessimism.

Even this "negative" cycle, however, comes to an end coinciding, paradoxically, with the outbreak of the recession resulting from the Covid-19 health crisis. The inversion factor in investor expectations is probably the launch of the European aid plan for the economy which was formalized at the European Council of July 21, 2020 with the name of NextGeneration-EU. From the spring of 2020, the assessments of the conditions for investments in Italy have in fact become much better than they were before the pandemic. A disposition to resilience also emerges from the actual data on gross fixed investments reported in Graph 2 (below).

Graph 2

2 – GDP and the main components of demand (1)
(quarterly data; indices 2007=100)



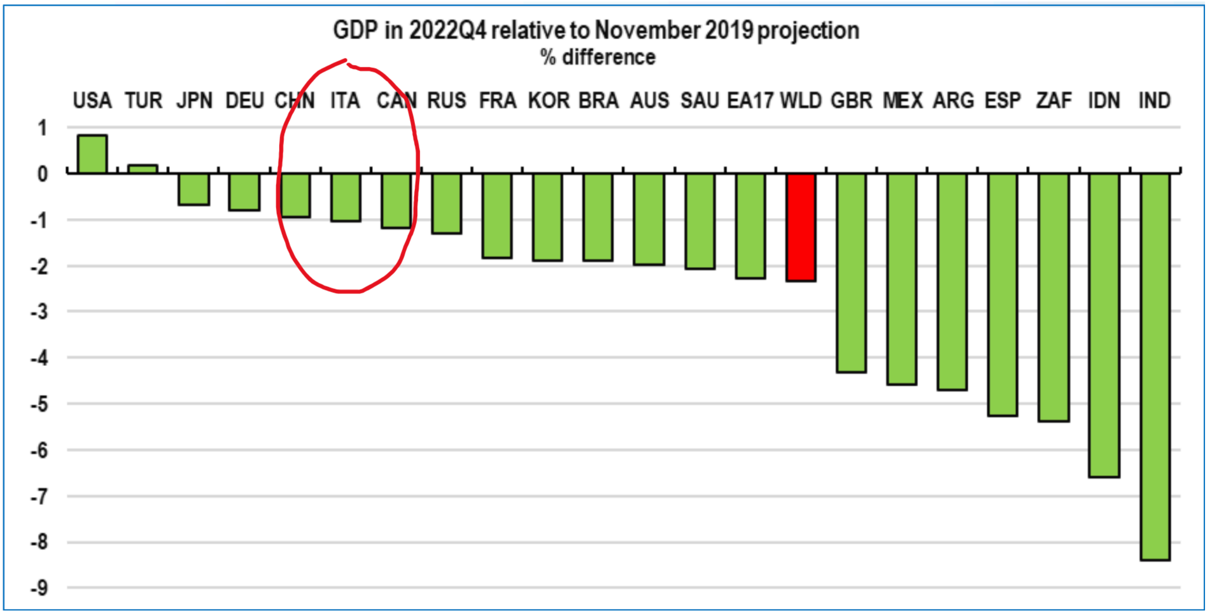
Source: Based on Istat data.
(1) Chain-linked volumes adjusted for seasonal and calendar effects.

If we attempt to interpret this graph, it could be induced that the three reversals of the assessments of investing conditions - November 2011; December 2017; March 2020 - coincide with the turning points in the relationship between Italy and Europe.

If this were the case, it could be concluded that the Draghi government is able to start a new cycle that is favorable to investment conditions, a cycle whose duration, more than by the current executive government, would be determined by the multi-year duration of the NextGeneration-EU program.

This optimistic reading could be strengthened by the positive interpretation of the Italian position expressed by the OECD - "Economic Outlook 2021" - on exiting the recession caused by the pandemic. According to the OECD, in fact, the permanent damage caused by the current crisis to the Italian economy will be visibly lower than the global or euro-area average.

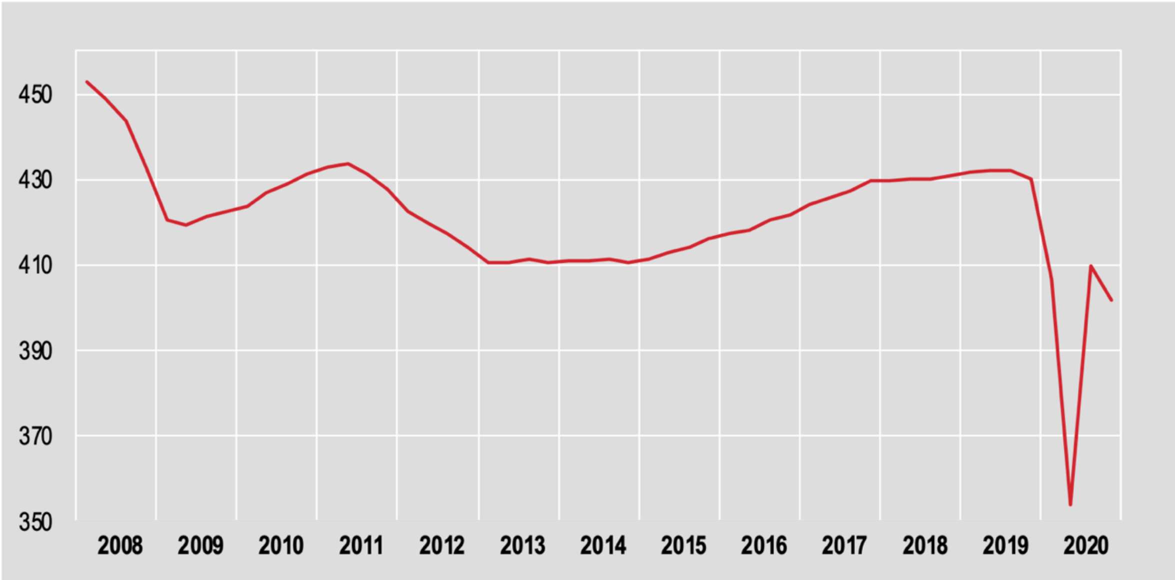
Graph 3



However, as Graph 4 shows, the change in Italian aggregate income is commensurate with its disappointing trend in recent decades. The graph indicates the monetary values at chain-linked prices over the past twelve years. It is clear that a slight decrease in GDP following the pandemic does not make the situation of the Italian economy any less problematic than it was. A ten-year comparison with Spain, which according to the OECD will come out with heavier damage from the current phase, would not make the prospects for the Italian situation better than those of the Iberian economy: while from 2008 to 2019 the Italian economy lost 8.4% of its GDP, the Spanish one grew slightly, although much less than France's and Germany's.

Graph 4

I trimestre 2008 – IV trimestre 2020, dati concatenati, destagionalizzati e corretti per gli effetti di calendario (anno di riferimento 2015), valori in miliardi di euro



The conditions of the framework in which the Draghi government is operating are therefore more encouraging than in the past, but only if the alignment with the European framework - that is, Italian reform and investment policies being in accordance with the multi-year plans for the European relaunch of the economy - is realized in fact. The Recovery and Resilience Facility (a predominant part of the NG-EU) has a limited duration and it will therefore be crucial to justify a longer if not permanent duration and to strengthen this institution with the Commission's autonomous financing capacity through European securities and new forms of own resources. Such a configuration would offer non-financial investors interested in Italy what they have never had: a stable framework for planning their investment.