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Eurozone (debt) crisis: Country Profile Italy

Economic Comment
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To the Eurzone (debt) crisis overview page

- **Public sector debt was already very high and economic growth very weak in the years prior to the crisis. Both are to blame for the country's long-lasting crisis**
- **Private sector indebtedness, especially that of households, was and still is relatively low**
- **Under PM Renzi, the country is finally embarking on meaningful structural reforms of both its economy and political system**
- **But, the economic outlook is still rather weak, unemployment high and public debt is unlikely to decrease rapidly in the coming years**

Diagnosis

In Italy, public sector debt was already very high and economic growth very weak in the years prior to the crisis. Both are to blame for the country's long-lasting crisis. Private sector indebtedness, especially that of households, was and still is relatively low.

In Italy growth has been sluggish in the past decade (less than 0.5% on average). The main reason is that Italy has been losing competitiveness owing to extremely weak productivity growth in combination with relatively high nominal wage growth. Large primary fiscal deficits between the mid-sixties and early nineties, in combination with political instability and the apparent inability to improve Italy's growth potential, have resulted in a high public debt burden. Large primary surpluses during the last two decades have been insufficient to compensate for the already high burden of outstanding debt. When Greece ran into trouble in 2010, Italy was hit by contagion, as investors also started to worry about Italy's capacity to service its public debt. Financial market unrest was fuelled even more by the proposal of Merkel and Sarkozy late 2010 to accompany future financial assistance from the European Stability Mechanism with debt restructurings. And also by talks about partial Greek debt relief by private parties in July 2011 and the agreement thereof in October 2011. Financial market turbulence was also fuelled by Merkel and Sarkozy, who openly discredited Berlusconi, Italy's Prime Minister at the time. Accusations back and forth led the market to believe that a bailout package for Italy was certainly not a given as long as Berlusconi would be PM.

Crisis response

End 2011, Berlusconi resigned and the technocrat government of Mario Monti took over. As a result, market concerns calmed; also because Monti announced severe austerity measures to get public finances back in order. Evenly important, though, was Mario Draghi's July 2012 "whatever it takes" promise and the subsequent announcement of Outright Monetary Transactions. Due to the harsh austerity package, Italy entered a three-year recession in 2012. Under current PM Renzi, the country is finally embarking on meaningful structural reforms of both its economy and political system. Yet, it is too soon to see their impact on economic growth and more needs to be done in order to restore competitiveness and improve productivity and the business climate. That said, since the start of 2015, the economic recovery has slowly gained some traction. As far as its fiscal position is concerned, Italy is one of the very few member states that has run primary budget surpluses in most of the recent years. Its public debt ratio has kept on rising, however, due to years of either weak or negative economic growth and large interest payments. Given the still rather weak economic outlook and low inflation environment the country's public debt is unlikely to decrease rapidly in the coming years.

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