

Ambrosetti Club Economic Indicator

Italian economic prospects are feeling the impact of the international slow-down and market turbulence

April 8, 2016

The first quarter of this year closed better than it began, but low-key compared with the expectations at the end of 2015.

In mid-February, from Japan to Europe and passing through China and the Middle East, we entered a bear market with a drop in international stock market indices of over 20%, the only exception being the United States.

Between January and February, on an international scale, the publication of economic statistics for 4th quarter 2015 that were lower than expected, the collapse in oil prices, renewed fears of a Chinese slow-down and expectations of a credit squeeze in the US, triggered a financial storm on the markets that involved financial centers worldwide.

The collapse was swift, unexpected and profound. As everyone knows, on the stock market, the bull climbs the stairs but the bear jumps out the window. What surprised just about everyone was the volatility of the market and the extremely high correlation between cyclical and anti-cyclical or a-cyclical sectors, between markets in the various countries, and between stocks, commodities and bonds.

Following the intervention of central banks, the FED, ECB and BOJ, which continued to favor exceptionally expansive monetary conditions, the markets regained some of the terrain lost, but confidence has not yet been fully recovered.

In Europe, despite the increase in Quantitative Easing to 80 billion euros per month, the 0% refinancing interest rate in the Eurosystem, the reduction to -0.4% of the interest rate on deposits with the ECB and the launching of 4 loan operations to banks, including at negative interest rates (with this latest operation, the Central Bank will pay banks to borrow money in an attempt to provide incentive for them to make loans to businesses), among economic operators perhaps, and for the first time, confidence in the ECB's curative powers is vacillating.

In fact, growth remains disappointing and inflation obstinately low. The world economy entered 2016 with less impetus than expected and further signs of weakening have emerged. For 2016, estimates for growth worldwide are around 3%, down from the previous ones last November which forecast a growth rate of 3.3%-3.5% for 2016.

Given these conditions, up until a month ago, many economic operators were talking openly about a global recession and the collapse of major financial indicators seemed to confirm this forecast. As often occurs with a major stock exchange collapse, there follows a worsening in expectations which impacts on investment and consumption, in other words, on the real economy, causing a vicious cycle within the system itself.

Based on our regular survey of sentiment, the picture that emerges remains positive, from the standpoint that a concrete risk of recession is not seen.

Last September we already highlighted this situation Our article was "we are sitting on a motorbike or on a scooter?". After 6 months we can confirm that the results of our survey makes us assume that we are on a scooter.

More specifically, the Ambrosetti Club Economic Indicator shows a continuation of the gradual expansion seen recently, although with some added concern caused by the recent upheavals in financial markets.

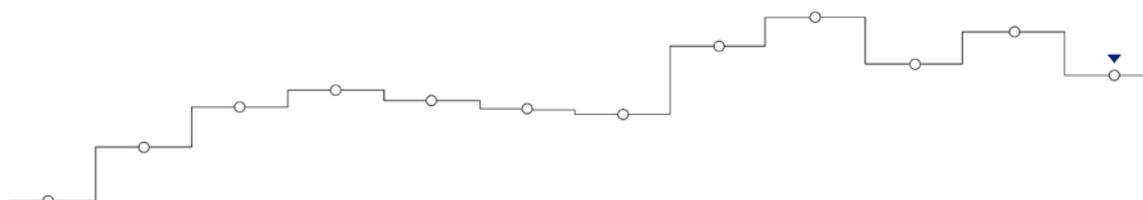
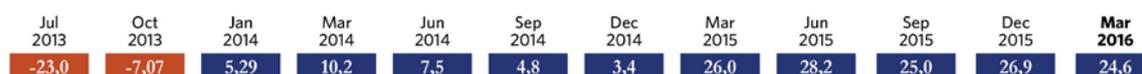
The other factor causing worry is that growth remains slow and is not spreading evenly through all economic sectors from the north to the south of Italy, but is rather remaining “confined” to some sectors and specific geographical areas. As a result, as we have fully noted in previous surveys, we remain far from a path to growth which, in a reasonable time frame, would return us to pre-crisis levels.

Our sentiment indicators are calculated on the basis of results obtained by a survey carried out specifically for the business community of our Club which is comprised of over 350 businesspeople, CEOs and representatives of top management of leading Italian companies and multinationals operating in Italy.

Thanks to regular discussions with them and specially-developed surveys, we obtain a 360° perspective on information about the outlook our business community has on economic trends, planned investment, on sales and stock trends, new orders and the evolution in the markets for its goods and services.

Please note that the indicators should be read as follows: values above zero indicate that sentiment is positive with the forecast of an expansion in economic activity, whereas values below zero indicate that sentiment is negative and with the forecast of a contraction in economic activity.

The sentiment indicator regarding the current situation of the Italian economy is at 24.6 points, a level that has remained more or less constant since September 2015. What emerges is a consolidation of the economic situation we have inherited from the midpoint of last year. The basic points remain essentially unchanged and slightly on the positive side, although somewhat lackluster.



NB: values above zero indicate expansion/positive sentiment, values below zero indicate contraction/negative sentiment

In terms of coming months, the economic outlook indicator is slightly negative at -3.5. Therefore, we see an increase in concern about the future caused by less-positive economic figures, a weaker growth trend than forecast, and probably by the recent tension in financial markets which, if it were to re-emerge in the short-term, could impact on corporate confidence which is currently in a very difficult phase.

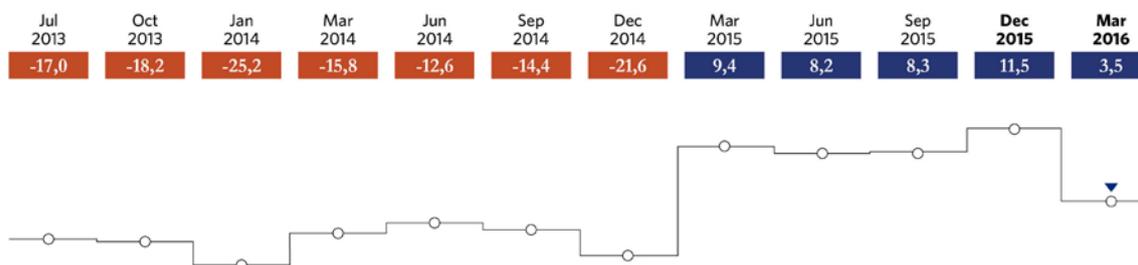
The data on expectations that turns into negative and marks the second worst since the birth, worries but should not be alarmed. In fact, representing future expectations with respect to the current situation, a small negative contraction brings out a future sentiment slightly lower than the current, which in any case is positioned at levels much higher than 2014 and in line with 2015.



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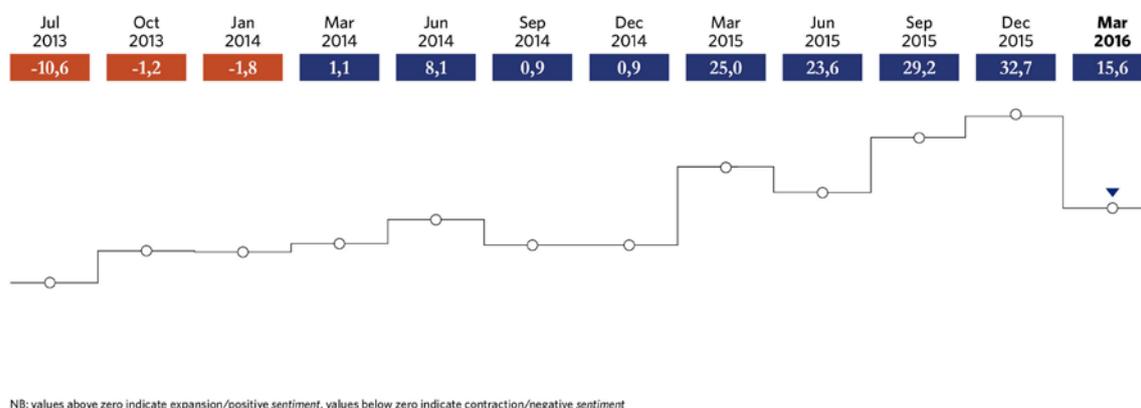
On the employment front, the indicator remains positive and – at 3.5 – is the lowest it has been in a year. However, the observation of the first quarter 2016 is the fifth consecutive in positive territory.

The improved conditions of the labor market, if confirmed in the coming months, could be a first sign of structural positivity. After the historic record set by the indicator in December, as a matter of fact, the reduction of fiscal contributions on new employees decided by the government decreased, but the indicator remained positive.



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Finally, with regard to investments, which are always highly sensitive with respect to the economic expectations and signals arriving from the market, we observe that the positivity reported in 2015 has been maintained, though on lower levels: The indicator goes no higher than 15.6, about half what it was last December.



Paolo Pozzi, Chief Executive Officer of Agrati Group, leader in systems of innovative fastenings with a strong focus on the automotive sector, points out how the movements on the markets may make companies uneasy but that, with solid development plans and a successful strategy, it is possible to keep growing and achieve significant results from both the economic and the occupational standpoint. Agrati Group, for example, grew in 2015 and has been growing for years at higher rates than the market. It has more than doubled its sales with respect to the values prior to the crisis of 2008, with sales for 420 million euro, on record levels of revenues and profits. In 2015, in Italy alone, Agrati Group hired 110 employees out of a total of 1,000. About half of these were stabilizations of contracts prompted by the incentives, but the other half represents more jobs due to increased business.

For the future, Paolo Pozzi expects further improvement, as a result of both the strengthening of the market, and some of the recently approved reforms. Automobile registrations in Europe increased by 10% and in Italy by 20%, and a further push should come with the launch of the new Alfa Romeo Giulia. Concerning reforms, for a company like Agrati, which invests heavily in systems and innovation, the measures relative to “superamortization” at 140%, detaxation of production bonuses, the reform of the labor market and the reduction of Irap had a significant effect.

At Alessi, a leader in housewares design, the Vice Chairman, Michele Alessi, also stresses the importance of a strategy of success and investments in research and development, to maintain a highly competitive position on the market. Though the sector has been in crisis for years and is subject to a strong reorientation of demand with particular pressure on prices, Alessi has been able to confirm the distinctive position and high quality of its brand.

For Alessi, it is important to stay in Italy. The decision to keep production in Italy is a strategic one that depends on the company’s ability to maintain the high quality of its production, but also on the fact that Italy is a country in which the production of beautiful objects with good positioning is viewed very favorably and is easy to achieve. Improvement of the image of Italy abroad through promotion on an international scale of that country as the home of beautiful things would further enhance the positioning of companies like Alessi.

Paolo Pozzi's own priority is the reform of the public administration, so as to speed up and simplify bureaucratic complications and thereby reduce the excessive time lags that penalize Italian companies with respect to their European partners. Michele Alessi agrees that the bureaucracy and complexity of the system are the most critical problems requiring action, along with tax evasion.

In terms of labor and employment, Paolo Pozzi hopes for further corrections to the Jobs Act which, though positive as a whole, has effectively introduced some inequality of treatment among the employees in companies that is an error and is complicated to manage. Michele Alessi, also feels that the difference between the cost of labor for the enterprise and the net salary that the worker finds in his pay envelope is excessive, and that it penalizes labor and the Italian workers.

Finally, Paolo Zambonardi, CEO of Ferring Italia, the Italian branch of the multinational pharmaceutical group Ferring Pharmaceuticals, which focuses on the customized treatment of patients, makes an appeal for greater legislative stability, which he considers a necessary condition in order to be able to plan and program investments, actions and strategies. In Italy the sector is gaining more and more importance and growing at a rapid rate. Production as a whole is now very close to Germany's, and with the growth rates predicted, we could reach or even pass them in a short time. In 2015 alone, the pharmaceutical sector hired about 5,000 people, 80% of whom were college or high school graduates.

The sector is particularly tumultuous at the moment, as innovative, high cost products are arriving on the market. Under these conditions, a stable regulatory framework is essential. Paolo Zambonardi is very clear on this point: we need to set the rules and then we should keep them for at least 3-5 years. This would enable us to program, invest, increase employment and thereby increase the wealth generated. In the coming months, Paolo Zambonardi thinks that, alongside regulatory stability, it will be more important than ever to enact a change in the governance of the system, that appears less and less sustainable today. For example in 2015, it has been forecast that we will exceed by 1.8 billion euro the limits set for hospital expenditure, 50% of which will have to be covered by the nation's businesses. Greater transparency is needed to prevent blockage of the system by companies appealing to the Regional Administrative Courts. Lastly, access to the market should be standardized and simplified. At the present time, every Region has its own healthcare system with consequent differences in the treatment of the patients; drugs should be available for everyone at the same time. It is also necessary to speed the approval of drugs and simplify the procedure, aligning Italy with the other European countries. Once a drug is approved at the European level, it takes an average of two more years for it to become available in Italy because additional authorizations, especially at the regional level, are necessary. This delay means two years in which the patent is unused, with significant economic costs, but what is more important is that this translates into a lack of access to innovative products for the patients.

Concluding, the indicators of the Ambrosetti Club Economic Indicator and our contacts with the business community point to the fact that the confidence of the enterprises, which had been improving for months, has recently begun to erode due to the shocks experienced on the stock markets. The fundamentals of the economy appear to be generally unchanged, however, though not exceptional.