Numbed by years of wage freezes and broken promises of reform, Italy is stuck in a rut of diminishing expectations

Italy stalls

BY GAVIN JONES
Three for the price of two” used to be the most common special offer in Giorgio Santambrogio’s supermarket chains. It has barely been used this year. The reason explains why efforts to resuscitate Italy’s moribund economy are failing.

“People aren’t stocking up because they know prices will be lower in a month’s time,” says Santambrogio, chief executive of Vege, a Milan-based association covering 1,500 supermarkets and specialist stores. “Shoppers are demanding steeper and steeper discounts.”

Italy is stuck in a rut of diminishing expectations. Numbed by years of wage freezes, and sceptical the government can improve their economic fortunes, Italians are hoarding what money they have and cutting back on basic purchases, from detergent to windows.

Weak demand has led companies to lower prices in the hope of luring people back into shops. This summer, consumer prices in Italy fell on a year-on-year basis for the first time in a half-century, and they have barely picked up since. Falling prices eat into company profits and lead to pay cuts and job losses, further depressing demand. The result: Italy is being sucked into a deflationary spiral similar to the one that has afflicted Japan’s economy for much of the past two decades.

That is the nightmare scenario that policymakers, led by European Central Bank chief Mario Draghi, are desperate to avoid. The euro zone’s third-biggest economy is not alone. Deflation – or continuously falling consumer prices - is considered a risk for the whole currency bloc, and particularly countries on its southern rim. Prices have fallen for 20 months in Greece and five in Spain, for example. Both countries are suffering through deep cuts in salaries and state welfare. Yet Italy, a large economy with a huge public debt, is the country causing most worry.

Part of the reason deflation is seen differently across southern Europe is cultural. Greeks and Spaniards are historically big spenders. The Spanish economy surged for a decade thanks to a property and consumption bubble that crashed in 2008. Greece grew strongly in the same period, before being brought to its knees in 2009 by its government’s clandestine finances. This year, falling prices are helping these economies sell more of their products at home and abroad, fuelling a nascent recovery. (see p. 4)

Italians, however, are historically big savers. One reason, says Chiara Saraceno,
Falling behind

Italy has one of the world’s most sluggish economies, with high unemployment and a huge national debt.

sociology professor at Turin University, is that Italian parents traditionally save for decades in order to buy their children homes when they marry.

Another factor is Italy’s famously cash-based economy. Italy has fewer credit cards per person than any other country in the euro zone except Slovakia, according to ECB data. That dampens consumption because people who use credit cards buy more freely, economists say. Even the houses parents buy their children are often paid in one lump-sum rather than with mortgages.

Like Japan, Italy has one of the world’s oldest and most rapidly ageing populations – the kind of people who don’t spend. “It is young people who spend more and take risks,” says Sergio De Nardis, chief economist of the Bologna-based Nomisma thinktank. In recent years, young people have been the hardest hit by layoffs, he says. Many have left the country to seek work elsewhere.

People tend to spend more when they see a bright future. Italian confidence has steadily eroded over the past two decades, hurt by a revolving door of ineffectual governments. In Italy, as in Japan, the lack of economic growth has become chronic.

Source: Reuters

*GDP through October, national debt through September

DEBT TRAP

Underpinning economists’ worries is Italy’s biggest handicap: a huge national debt equal to 132 percent of national output and still growing.

Rising prices make it easier for high-debt countries like Italy to pay the fixed interest rates on their bonds. And debt is usually measured as a proportion of national output, so when output grows, debt shrinks. Because output is measured in money, rising prices – inflation – boost output even if economic activity is stagnant, as in Italy. But if activity is stagnant and prices don’t
SPECIAL REPORT

ITALY DEFLATION

In Greece, finally, a few rays of sunshine

At Greek home appliance retail chain Electroniki, a washing machine cost 497 euros six years ago. Today, it sells for 356 euros.

Like most Greek companies, Electroniki has slashed prices to hold on to consumers hit by recession. “Small appliances, big discounts” read flyers it recently stuffed under doors.

“We couldn’t avoid cutting prices,” says Chief Executive Yannis Stroutsis. “People were holding back ... because they didn’t know whether they would have a job in six months’ time.”

Greece has muddled through 20 consecutive months of deflation, or continuously falling consumer prices – a phenomenon that economists say could soon infect the whole euro zone. In October, prices fell 1.7 percent from a year earlier.

Yet alarm over low inflation in other parts of southern Europe does not echo in Greece. “The deflationary period has not been a concern for the Greek economy, but rather is a relief for distressed households,” say Nikos Magginas, an economist at National Bank, the country’s biggest lender.

Economists say prices in Greece were unreasonably high for a long time. Between 1995 and 2010, consumer prices rose 17 percent more in Greece than in the euro area overall.

Lower prices have since made Greek products more attractive.

Of course, continuing deflation would make it harder for Greece to pay down its debt - the largest in the euro zone as a percentage of Gross Domestic Product.

Still, now the price adjustment has largely been made, economists expect prices to start rising again next year as the economy grows. And Greeks are traditionally big spenders.

Central bank data shows that between 2000 and 2010, Greeks spent more than 71 percent of GDP on private consumption like food and entertainment, against a euro zone average of 57 percent. Banks traditionally even offered loans for Greeks to go on vacation.

Stroutsis says business is looking up. One example: two weeks ago, he offered a 28-inch Samsung TV plus free mobile phone for 199 euros. 1,000 units flew off its shelves.

Reporting by Angeliki Koutantou; Edited by Alessandra Galloni

CAN’T SAVE, WON’T SPEND

Through the mid-1990s Italians saved a large proportion of their income by international standards. Savings became a buffer against the unpredictable economic effects of the political instability that has given Italy nearly one government a year since rise, then the debt-to-output ratio will increase. That could potentially reignite the sort of investor panic that set off the euro zone debt and economic crisis four years ago.

Marcello Messori, economics professor at Rome’s LUISS university, estimates that without economic growth, prices in Italy would have to rise at least 3.2 percent a year for its debt to fall at the rate the European Union requires.

“I see an enormous danger that we will still be in this situation in six months’ time, and the longer it lasts the harder it is to get out,” says Gustavo Piga, an economics professor at Rome’s Tor Vergata University.

Sebastiano Salzone, a diminutive 33-year-old from the poor southern region of Calabria, left with his wife five years ago to run the historic Cafe Fiume on Via Salaria, a traditionally busy shopping street near the centre of Rome.

Salzone was excited by the challenge. But after four years of grinding recession, his business is struggling to survive. “When I took over they warned me demand was weak and advised me not to raise prices. But now, I’m being forced to cut them,” he says.

A lunch at Cafe Fiume with a pasta course, mineral water, fruit and coffee costs 7 euros and 30 cents. That’s the same as it was eight years ago. In September, Salzone cut the price of his paninos by 40 cents to 2 euros 80, and cut the price he charges for soft drinks by 30 cents, to 2 euros. Despite the lower prices, sales have dropped 40 percent, or 500 euros a day, in the last three years. Salzone has reduced staff to 12 from 15 to break even.

Through the mid-1990s Italians saved a large proportion of their income by international standards. Savings became a buffer against the unpredictable economic effects of the political instability that has given Italy nearly one government a year since
World War Two. Saving was also encouraged by the high interest rates on government bonds.

As growth has slowed and disposable income has fallen, however, people have set aside a smaller and smaller proportion of their salaries. The savings rate now stands at 8 percent, one third of its level in 1991. The average Italian had less spending power in 2013 at the end of each month than they did at the start of the century, according to Italian statistics institute Istat.

For hard-pressed individuals, low and falling prices can seem a godsend; but low prices lead to business closures, lower wages and job cuts – a lethal spiral. Since Italy entered recession in 2008 it has lost 15 percent of its manufacturing capacity and more than 80,000 shops and businesses. Those that remain are slashing prices in a battle to survive.

Home fixtures maker Iaquone is the kind of small, family-run company that is the backbone of Italy’s economy. The nine-person firm has been making doors, windows and blinds for the last 25 years in Frosinone, 90 km (56 miles) south of Rome.

But owner Benedetto Iaquone says people are now only changing their windows when they fall apart. To hold onto his 500,000 euros-a-year business, Iaquone says he is cutting prices. He has also changed suppliers, shaving the cost of buying glass and iron by 15 percent and 10 percent, respectively. By doing so, he is helping fuel the chain of deflation from consumers to other companies.

“Everyone’s profits are lower but at least we manage to keep working,” says the 45-year-old businessman. “I always tell myself that if we can get through this period we will come out very strong, but I’m honestly not optimistic about the future.”

In Italy’s largest supermarket chains, up to 40 percent of products are now sold below their recommended retail price, according to sector officials. “There is a constant erosion of our margins,” says Vege chief Santambrogio.

Opinions differ over how to head off the risk. Some economists say the European Central Bank should follow the example of the U.S. Federal Reserve and inject thousands of billions of euros into the euro zone economy by printing money to buy government bonds. ECB boss Draghi last week threw the door open to printing money, saying “excessively low” euro zone inflation had to be raised quickly by whatever means necessary.

Many in southern Europe say the EU should abandon its strict fiscal rules and invest heavily to create jobs. They also say Germany, the region’s strongest economy, should do more to push up its own wages and prices. Mediterranean countries need to price their products lower than Germany to make up for the fact that their goods – particularly engineered products such as cars – are less attractive. But with German inflation at a mere 0.5 percent, maintaining a decent price difference with Germany is forcing southern European countries into outright deflation.

Italy’s policymakers are trying to stop the longer it lasts the harder it is to get out.

Gustavo Piga
Economics professor, Tor Vergata University
the drop. Prime Minister Matteo Renzi cut income tax in May by up to 80 euros a month for the country’s low earners. He is also offering workers the chance to dip early into a special fund that stores part of their wages until they leave their job.

But so far the emergency measures have had little effect – partly because Italians don’t really believe in them. A survey by the Euromedia agency showed that, despite the 80-euro cut, 63 percent of Italians actually think taxes will rise in the medium-term. Early evidence suggests most Italians are saving the extra money in their paycheques. If so, it will be reminiscent of similar attempts to boost demand in Japan in the late 1990s. The Japanese hoarded the windfalls offered by the government rather than spending them.

Renato Gu, an energetic 31-year-old who came to Italy from China at the age of six, is closing down the small, mid-range women’s shoe and accessory shop he has run for the last four years in the heart of Rome because he can no longer cover his costs.

Gu says shops like his, catering to middle-class Italians, have been the ones most hit by the crisis, as once-faithful customers look elsewhere for cheaper and cheaper products. He says he has seen “no effect” on spending from the 80 euro tax cut. “I’ll consider any line of work,” says Gu, who is about to join the country’s 3.3 million unemployed. “But I’ve had enough of trying to run my own business.”

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