

Flash Note

Europe chart of the week – Italian productivity

Stagnant productivity, a major challenge for Italy

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Italy is going into elections with an economy that is performing relatively strongly relative to recent history.

Activity surveys (composite PMI, Istat business confidence index) are at their strongest levels since before the financial crisis.

However, cyclical strength is masking structural weaknesses. Among the main challenges facing Italy, lifting productivity is an important one. Since 1999, productivity has been stagnant in Italy, a key factor behind the country's poor performance over recent years.

However, improving potential output growth is key in managing the public debt burden.

While near-term risks seem contained, investors are likely to become less sanguine about the medium term outlook as monetary and external tailwinds are likely to wane gradually.

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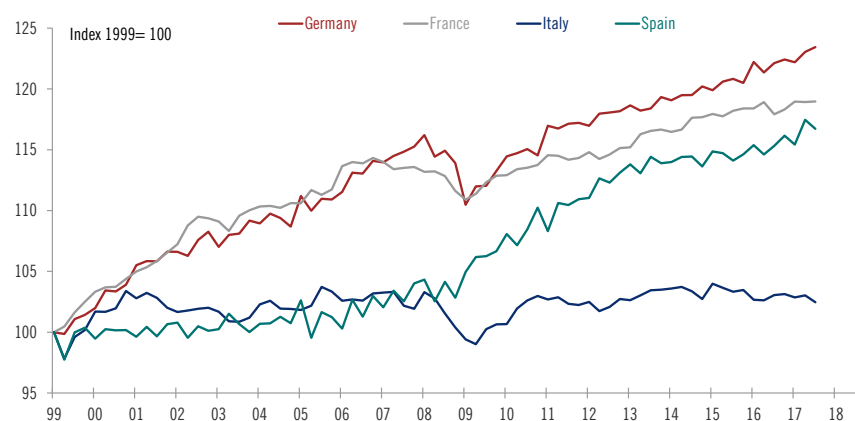
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With less than 30 days to go, the [Italian general election](#) remains highly unpredictable. The new electoral system and the fact that 37% of seats are to be allocated on a 'first-past-the-post' system make projecting seats from voting intentions particularly hard.

Importantly, Italy is going into this election with an economy that is performing relatively strongly relative to recent history. However, **cyclical strength is masking structural weaknesses**. Over the past few years, Italy has endeavoured to address certain these weaknesses, but some reforms have not gone as far as necessary. **Labour productivity remains a problem**: while the other big euro area economies have seen 1% annual average productivity growth since 1999, in Italy productivity has been stagnant (*see Chart*), a key factor behind the poor performance of potential output over recent years. **And a fragmented government will reduce the prospects of reforms to improve things on this front**. Among election candidates, there has been not much discussion about labour productivity so far. Increasing pension benefits and unfunded tax cuts are the most popular pledge.

Nevertheless, **improving long-run potential growth in Italy is key to managing the public debt burden, which is at 134% of GDP (Q3 2017)**. With interest rates still very low, public debt sustainability risks are likely to be limited in the near term. However, investors are likely to be much less sanguine on the medium-term outlook as monetary and external tailwinds are likely to gradually wane.

Chart: euro area real labour productivity per hour worked



Source: Pictet WM - AA&MR, Eurostat

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