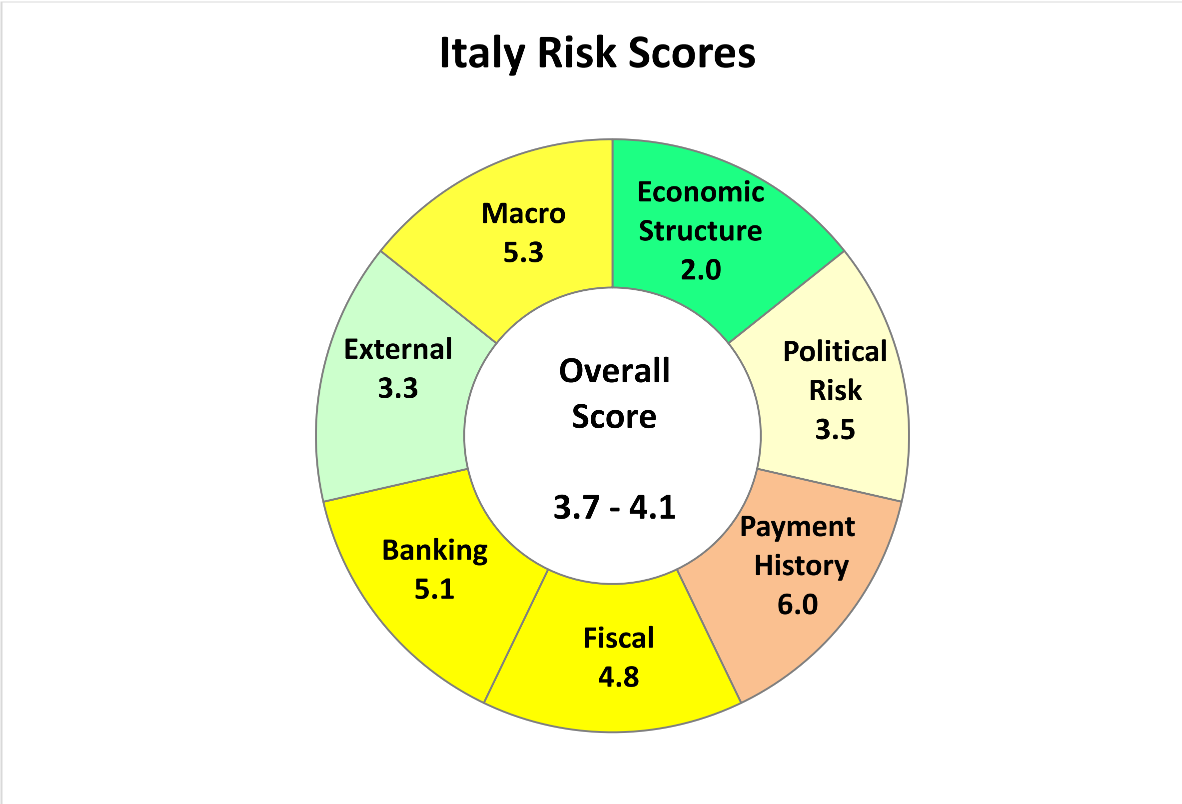

Italy Trend Risk

Despite historically low interest rates, low oil prices, and expansionary fiscal policy, Italy has struggled to generate economic growth for years. Real GDP is likely to rise only 1% in 2017. Low productivity and weak investment imped new job growth, with unemployment stalled at 11%. Major reforms in wage bargaining are needed to boost Italian competitiveness.

The President will appoint a new coalition government following the defeat of a constitutional referendum in December. The new team faces daunting problems in banking and public finances. The banking system is undergoing fundamental restructuring and consolidation as it works through high non-performing loans, inadequate capital and a tight squeeze on profits. Banking reforms must pass EU limits on fiscal subsidies, severely limiting Italy's options. Italy is also making slow headway in capping its huge public debt (133% of GDP) and limiting deficits, while maintaining the social safety net. Public debt will continue to rise for years.