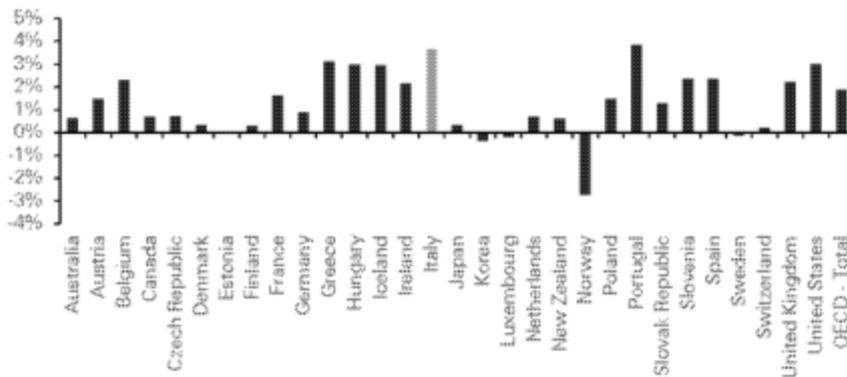




is also spending around 4% of GDP on paying interest on its debt load. This is double the OECD average and also the second highest in the eurozone. They top the list if you take the average of the last 6 years.

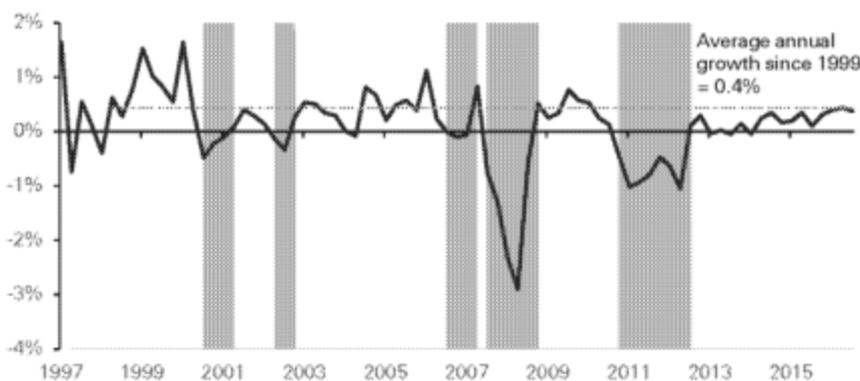
Figure 46: Net government interest costs



Source: Deutsche Bank, BIS

In reality most of these numbers have stayed relatively constant in recent years which is by and large a by-product of aggressive BTP buying by the ECB and historically low bond yields. However a consistently prudent approach towards fiscal deficits by Italy has also been a positive contributory factor. The question we find ourselves asking however is what happens when the ECB slows down the rate of purchases, bond markets start to reverse, and the cost of financing this debt load rises? Growing out of this debt burden would in theory be the most logical explanation, but evidence of Italy's post Euro adoption experience (see Figure 47) suggests this will be extremely hard. The other alternative is some form of debt restructuring and aggressive debt haircutting. We see this as obviously leading to a financial crisis.

Figure 47: Italy – real GDP Growth (QoQ) and recessions



Source: Deutsche Bank, Bloomberg Finance LP

However years of misallocating resources means that Italy's economic underperformance is structural in nature. Low labour force participation, high youth unemployment, poor levels of productivity and low investment are all common features. The end result of this is that Italy has suffered through 5 recessions since the implementation of the single currency back in the late 90s. While some of the soft data indicators suggest growth might be returning, which perhaps helps to keep things in check in the short term, structural reforms are needed for any medium to long term sustainability and it's hardly