

Flash Note

Italy: politics

Political fragmentation leads to a hung parliament

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Italian voters have shifted significantly to the right and towards populist parties, with a huge split between the North and the South. More than 50% of the votes went to Eurosceptic parties (Five Star Movement and the Northern League).

As no single party or coalition won an absolute majority, negotiations to form a new government will start after parliament reconvenes on 23 March and could extend until the summer.

The risk of an anti-system coalition (LN + 5SM) has increased but remains low, in our view. More likely, we will end up with a fragile centre-right coalition with some ad hoc support from other parties. The risk is that the negotiations last for several months.

Although the election outlook leaves Italy facing a protracted period of political uncertainty and large economic vulnerabilities, the negative consequences for the rest of the euro area should remain limited, in our view.

AUTHOR

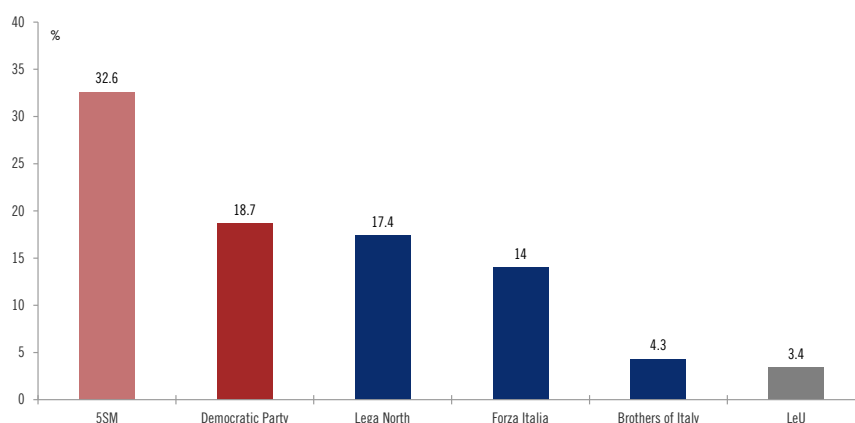
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Italy went to the polls on Sunday, voting in the country's first parliamentary election in five years. The participation rate was 72.9%, **the lowest in Italian post-war history**. The main takeaways are the following:

- **No single party or coalition bloc won an absolute majority**, paving the way for negotiations under the auspices of the President of the Republic, Sergio Mattarella.
- The Five Star Movement (5SM) was the single largest party (~33%). It won massively in the south of the country.
- The centre-right coalition formed by Forza Italia (FI, ~14%), Northern League (LN, ~18%) and Brothers of Italy (FdI, ~4%) fell short of obtaining an outright majority.
- Perhaps, the most important news was that **the Eurosceptic LN came ahead of its right-wing ally, Forza Italia**. This could make negotiations more difficult and could make LN leader Matteo Salvini a serious candidate for the post of Prime Minister (PM).
- The Democratic Party performed badly, ~19%
- In aggregate, **Italian voters shifted significantly to the right and towards populist parties**, with a huge split between the North and the South. More than 50% of the votes went to Eurosceptic parties (5SM + LN).

Chart 1: Italian election preliminary results*



Source: Pictet WM - AA&MR, *Il sole24 Ore* (*based on 96 of votes; seats not available yet)

What's next?

Negotiations will have to take place to form a government as no single party or coalition won an absolute majority, although **5SM has emerged with a significant bargaining power**.

Official government negotiations will start after the parliament reconvenes on 23 March and could extend until the summer (*see Table*). The current Prime Minister, Paolo Gentiloni, will remain in office until the president hands the mandate to somebody else.

The President of the Republic, Sergio Mattarella, will play a crucial role in the consultation phase, as he grants the PM a mandate. Together with the PM, he will appoint the new government. There is no legal requirement regarding who should receive the PM mandate, although there is the stipulation that the President should identify the candidate best placed to win a majority. The PMI needs support from both chambers of the parliament to be elected.

Table 1: numbers of days to form a government

Prime Minister	Gap (# of days)	Election versus resignation
Amato I	90	Election
Ciampi	20	Previous Gov resigns
Berlusconi I	53	Election
Dini	41	Previous Gov resigns
Prodi I	40	Election
D'Alema I	18	Previous Gov resigns
D'Alema II	5	Previous Gov resigns
Amato II	14	Previous Gov resigns
Berlusconi II	39	Election
Berlusconi III	8	Previous Gov resigns
Prodi II	43	Election
Berlusconi IV	31	Election
Monti	6	Previous Gov resigns
Letta	64	Election
Renzi	11	Previous Gov resigns
Gentiloni	7	Previous Gov resigns
Average	31	
Average post election	51	

Source: Bloomberg

Although the outcome of the Italian election leaves the country facing, a protracted period of political uncertainty and large economic vulnerabilities, the negative consequences for the rest of the euro area should remain limited, in our view.

Playing with numbers

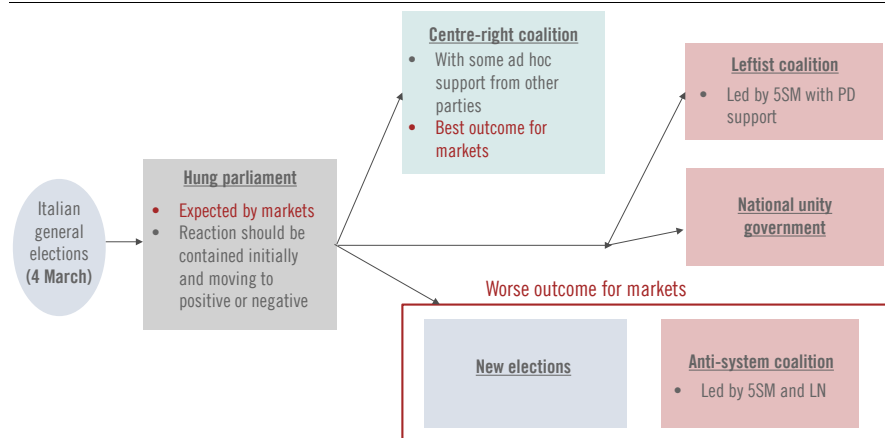
At this stage, it is very difficult to determine who will be the next Italian PM. Arithmetically, there are several options:

- 1) A centre-right coalition centered around FI, LN and BoI, with some ad hoc support from other parties;

- 2) A minority 5SM government with some support from the Democratic Party and other progressive parties; and
- 3) An anti-system coalition composed of 5SM and the LN.

The risk of an anti-system coalition (LN + 5SM) has increased, but remains low, in our view. The PD might decide to participate in a Five Star-led government to block an anti-establishment coalition from achieving power. We think it is more likely we will end up with a fragile centre-right coalition with some ad hoc support from other parties. That being said, **if none of these options materialized, the President may have to accept that there is no working political majority**. One solution would be to ask all political parties to agree on a national unity government, for a limited time. **New elections cannot be ruled out as well.**

Post-election political scenario



Source: Pictet WM - AA&MR

Less Europe, more spending

Whatever Italy's next government looks like, the chances that it will push through long-term structural reforms to improve economic performance or to tackle the country's huge public debt appear low. Based on election promises, the situation could even worsen. All parties are pledging significant expansionary policies. Such policies would likely put Italy on course for a confrontation with the European Commission over fiscal consolidation and deficit reduction targets at some point. Already, Italy is not in compliance with EU fiscal rules. Unless there are compromises (which are likely), the Commission could be forced to open a procedure against Italy in the coming months (Italy is to present an update on its fiscal situation in April-May). If there is no government in place, the European Commission is likely to wait until the situation stabilizes. Nevertheless, rising tension with the EU and fiscal slippage could further heighten market concerns about Italy's debt sustainability.

Significantly, Italian parties have dropped proposals to hold a referendum on the euro, but whoever manages to form a government is unlikely to show any eagerness to tackle the root problems that Italy faces. Thus, 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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