

Europe Flash

Italy

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Economic Analysis

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Italian elections: What to expect?

Bottom line

- Italy will hold general elections next Sunday 24th and Monday 25th (until 15.00) of February. The result is uncertain, as the current Italian electoral system gives an automatic majority to the winning coalition in Congress, but not in the Senate, where the majority rule applies at a regional level. Control of the Senate is essential to govern in Italy.
- Our baseline scenario (probability of 55%), which coincides with that of most analysts, is of a Bersani-Monti coalition, although we attach a significant probability to a Bersani outright victory (20%), the same as to a Berlusconi win (20%). A hung parliament, which is increasingly feared by markets and analysts, is unlikely (5%).
- Under the baseline scenario, we would expect several structural reforms (with no meaningful labour market reform) and maintenance of fiscal austerity, but relatively high government instability.
- Under such scenario we do not foresee problems of debt sustainability in Italy, but neither do we expect a significant pick-up of growth potential in the medium term (currently very low at below 1%).

How does the electoral system work?

Voters choose parties, and these may group into coalitions. **In the congress, the winning coalition obtains automatically 55% of seats**, while the rest are distributed among those parties or coalitions that pass a threshold. The threshold is 10% for coalitions and 4% for parties not in a coalition. Within a coalition, seats are distributed with D'Hont method (same as the one applied in Spain for congress). **In the Senate, the same rule applies, but at a regional level**, and with higher thresholds, i.e. 20% for coalitions and 8% for parties not in a coalition. There are 7 Senators for life that have been appointed in the past by the President of the Republic (Monti is one of them). The number of seat in the Congress is 630, while the number of senators is 315 (majority requires 158). Senators for life usually (but not always) vote with the majority.

Which are the main coalitions and what would be their policies?

- **Centre-left:** Led by Democratic Party (PD, Pier Luigi Bersani) with SEL (Nichi Vendola) as the main partner to its left. Mr Bersani was a minister under the Prodi government in 2006, when he promoted reforms to liberalize pharmacies and taxi licenses. He has defended a pro-European stance, and though he has supported less austerity at a European level through more investment in infrastructure he is also committed with fiscal consolidation. Mr Vendola has governing experience as president of the Puglia region and opposes further labour market reforms. Even senior figures in the PD have opposed changes in labour laws at least in the short-term.
- **Centre-right:** Led by the Popolo della Libertà (PdL, Silvio Berlusconi) with the Northern League (NL, Roberto Maroni) as its main partner. Since the campaign started, Berlusconi has been strongly critical with Germany and at times has advocated the exit from the euro. Its main proposal is a reduction of taxes, especially an unpopular real estate tax (IMU), which would be suppressed 2013 and refunded for 2012. It is not clear who would be the Prime Minister under such coalition, though the latest news point to Berlusconi himself. Despite the opposition of the NL.

- **Centre:** Led by Mario Monti, and formed by a coalition of small parties whose most prominent figures are Pier Ferdinando Casini (UDC) and Gianfranco Fini (FL). Mr Monti strongly supports further reforms, including a further labour market reform.
- **Outsider:** Five Star Movement (M5S, Giuseppe Grillo), which opposes austerity and the euro but lacks concrete proposals on economic policy. Grillo is a TV comedian who refuses to appear in traditional media and has based his campaign on the Internet and public gatherings.

Will Bersani win the elections in the congress?

Table 1 shows that the **centre-right has gained in voting intentions over the past two months**, although the lead of the PD coalition was on average still of 5 pp two weeks ahead of elections (the latest to be published). The recovery of Berlusconi is due to a dynamic campaign management, the Monte dei Paschi affair (which has damaged the PD as it is considered to have strong links with the bank) and to the PdL proposal to scrap the IMU tax. **However, the momentum of the PdL is not very likely to have been maintained during the last two weeks of the campaign** due to lack of new shock news and to the rise of Grillo in recent weeks, which could damage more the PdL as it shares its anti-austerity and anti-euro stance. This seems to be confirmed by recent attacks from Mr Berlusconi to M5S. Voters of the NL seem also to be attracted by M5S. Hence, we attach a high probability (75%) to a victory of the PD-led coalition at a national level, which will allow it to control the congress.

Who will control the Senate?

The result for the Senate is very uncertain even under a Bersani win at national level, as the largest regions are traditionally more biased to the right (Sicily) and/or the Northern League (Lombardy, Veneto).

- **If the centre-left coalition wins at national level**, it would have to win all the smaller regions (which would be expected) and at least one of the largest ones. Veneto seems to be secured for the centre-right, but there is high uncertainty in Sicily and especially Lombardy.
- **If the centre-right coalition wins the congress**, it would be easier for them to win the senate, as the majority premium is larger in the regions it tends to control.
- **If neither of the two main coalitions manages to control the senate**, most probably it would be enough for the centre-left to join the senators of Monti's coalition to obtain a majority. Monti's backers have presented a unique list for the senate in order to be subject to the 8% threshold instead of the 20%. If the center left loses the largest 3 regions but wins the rest it, would obtain around 145 senators, while Monti is expected to have between 25 and 30 senators, adding to more than 170, neatly above the majority of 158. Even if Mr Monti obtained an overall result of 10% (around 15 senators), it would be enough for a Bersani-Monti coalition. The probability of a hung parliament (with no majority for Bersani-Monti in the senate) would go through a very close result at a national level (implying that the centre-left loses in smaller regions) together with a very poor result for Monti (below 10% in several regions). The latter is unlikely, given its relatively stable share of 13%-15% during the campaign.

Would a Bersani-Monti coalition be stable?

Even if both coalitions have run with the possibility of such a government in mind, there have been criticisms against each other during the campaign, especially between Monti and Vendola. Monti has very recently declared that he sees it difficult to govern with the center-left, although we see it more as an effort of product-differentiation rather than a refusal to cooperate. It would be very difficult for Bersani to drop its minor partner SEL after the elections (as Monti has suggested at some point). Hence we see a Bersani-Monti coalition as an inevitable outcome if the numbers allow for it.

Such a coalition would not be very stable, since it would involve strong discrepancies over an eventual labour market reform, which seems to be required after the weak effects of the reform approved in early 2012 (a watered-down version of the initial proposal). Both SEL and parts of the PD oppose it, while it is one of the key proposals of Monti. Another source of political instability derives from the fact that Mr Monti's coalition is composed of small parties or political figures which have in the past supported centre-right governments. The grip of Monti on its newly created coalition is unknown.

What policies would follow a Bersani-Monti coalition, or a Bersani government?

A Bersani-Monti coalition would **continue to apply deficit-reduction plans** despite the mild anti-austerity declarations during the campaign (both from Monti and the PD). The main imbalance of the Italian economy is its very high public debt (Chart 1), though its deficit is relatively low (2.8% of GDP in 2012, Chart 2), and the additional fiscal consolidation required to balance the structural deficit is very small (around 0.5% of GDP after 2013) if the current budget is applied. Mr Bersani knows that the main variable markets will be watching is its fiscal stance (even more than structural reforms) and he would make sure that fiscal targets are maintained. Efforts to soften this stance or to compensate it with other stimulus would be channeled through negotiations with the rest of the EU rather than through unilateral measures.

On structural reforms we do not expect rapid progress. Apart from the labour market, reforms are required to liberalize professional services and network industries, improve efficiency of the public sector, including a reform of services provided by local governments, improving tax compliance and speeding up judiciary procedures. Monti has also proposed a shake-up of the education system. However, a reform of the electoral system seems to be higher in the agenda of the centre-left, despite the urgency of action on other areas in order to rise potential growth. The extent and speed of reforms will depend very much on the relative strength of Monti in the coalition. Were Mr Bersani to obtain a majority of its own, the pace and extent of reforms would be lower.

What policies would follow a Berlusconi government?

If the centre-right wins the elections, it would be more likely that they also obtain an outright majority in the senate than for the center-left, thus reducing the need to find a coalition partner. Otherwise, Berlusconi could try to join forces from Monti, under a pro-euro agenda which would imply a *volte-face* for Berlusconi but would be favoured by some members of his party. We do not foresee Berlusconi (or any other party) joining forces with Grillo given its anti-establishment and anti-euro stance, despite recent speculation in this respect.

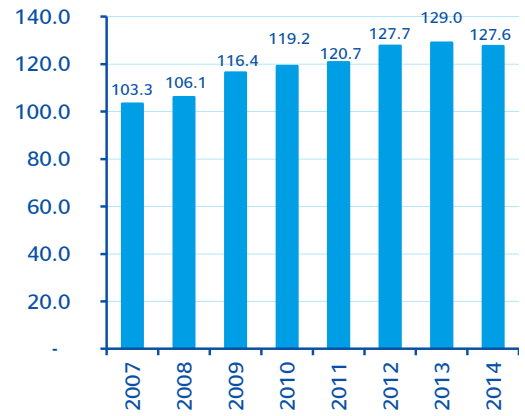
If the center-right won an outright majority **we would expect some adjustment of their program to make the promised tax cuts compatible with fiscal targets**, which would be renegotiated with Europe. Under this scenario we also expect strong pressure from markets on Italian debt until the name of the Prime Minister is decided and a fiscal strategy is clarified, which could take at least several weeks.

Table 1
Polls: Italian Elections 24-25 February

	Latest polls (avg)	A month ago
Bersani (left)	33.5	39.0
Berlusconi (right)	28.5	26.5
Monti (centre)	13.7	14.2
Grillo (out)	14.5	13.4

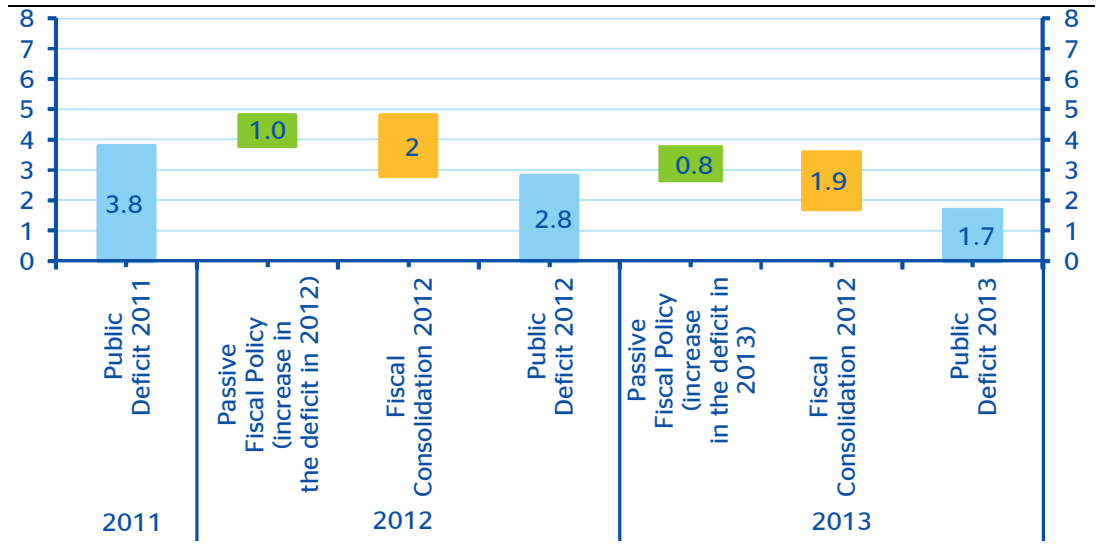
Source: BBVA Research with Central Bank data

Chart 1
Public debt (% of GDP)
under our baseline scenario



Source: BBVA Research

Chart 2
Fiscal Consolidation 2012-2013 (% of GDP)



Source: BBVA Research with Central Bank data

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