

# Macro Note

## Italy's Looming Election

Thursday, 01 March 2018

**Suan Teck Kin, CFA**  
Head of Research  
[Suan.TeckKin@uobgroup.com](mailto:Suan.TeckKin@uobgroup.com)

**Lee Sue Ann**  
Economist  
[Lee.SueAnn@uobgroup.com](mailto:Lee.SueAnn@uobgroup.com)

Italians will head to the polls this **Sunday, 4 March 2018** to elect both houses of parliament, the Italian Chamber of Deputies and the Senate. Polls are open from 8am to 11pm local time on Sunday (1pm SGT on Sunday to 6am SGT on Monday). Exit polls will be published immediately after, and these have been fairly reliable in the past. Official results will be published throughout the night, as votes get counted, and the full picture should be clear during Asian trading hours and/or before European markets open on Monday.

The Major Parties And Politicians		
 <p><b>Matteo Renzi</b> <b>Democratic Party (PD)</b></p> <p>The Democratic Party took a hit when former PM Matteo Renzi lost credibility and resigned after his referendum defeat on senate reform in 2016. Since then, the pro-European centre-left party has stayed in power with Paolo Gentiloni holding the fort as PM and steering Italy through a banking crisis. Renzi was re-elected as leader of the Democratic Party in April 2017 but his hopes of a comeback have been thwarted by internal feuding.</p>	 <p><b>Luigi Di Maio</b> <b>Five Star Movement (M5S)</b></p> <p>The insurgent Five Star Movement started out on the political fringe and now offers a mix of vague right-wing and left-wing policies. The bombastic comedian Beppe Grillo founded the Eurosceptic movement in 2009, but it is now led by the smooth-talking Neapolitan Luigi Di Maio, 31, who used to run a website.</p>	 <p><b>Silvio Berlusconi</b> <b>Forza Italia (FI)</b></p> <p>Forza Italia has been the main conservative force in Italian politics since 1994 and has weathered its leader's sex scandals and corruption allegations. Berlusconi has taken a pro-EU stance and suggested that the president of the European parliament and Forza Italia MEP Antonio Tajani would be a strong candidate for PM. He has also stepped up his anti-immigrant rhetoric, claiming that illegal migrants in Italy are a "social bomb ready to go off" with thousands living "hand to mouth or from crime".</p>
 <p><b>Matteo Salvini</b> <b>Northern League (NL)</b></p> <p>The Northern League is run by Matteo Salvini, 44, who has called for the mass deportation of illegal migrants from Italy and the closure of 800 unlicensed mosques. Salvini has said introducing the euro was a "mistake" for the Italian economy and his party wants to force the EU to renegotiate its key treaties with Italy.</p>	 <p><b>Giorgia Meloni</b> <b>Brothers of Italy (Fdi)</b></p> <p>The Brothers of Italy emerged from the disbanded National Alliance, which can be traced back to the Italian Social Movement formed by ex-fascists after the Second World War. The party's female leader Giorgia Meloni, 41, has campaigned on a far-right, nationalist platform with a clear "Italians First" message.</p>	 <p><b>Pietro Grasso</b> <b>Free and Equal (LeU)</b></p> <p>The new Free and Equal Party is a left-wing splinter group created by defectors from the Democratic Party in the wake of Renzi's referendum defeat. Free and Equal is led by Pietro Grasso, 73, the president of the Italian senate and a former mafia-busting magistrate.</p>

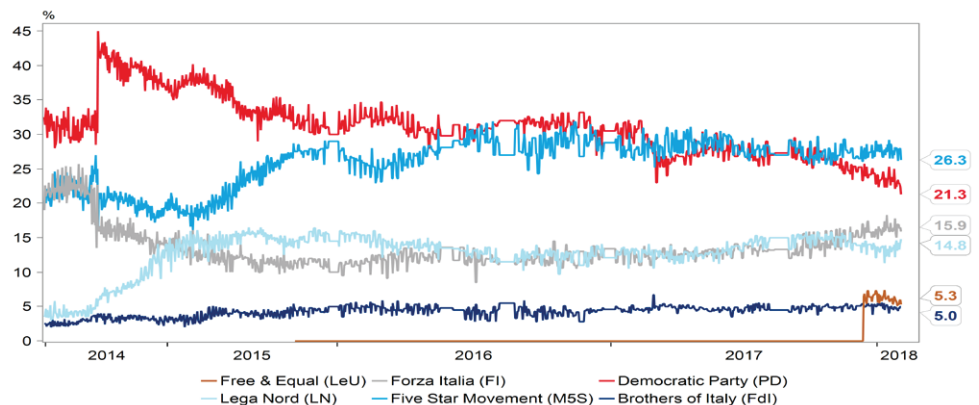
Source: AFP, Getty Images, UOB Global Economics & Markets Research

### What Are Polls Showing?

- According to Italian law, no electoral poll can be published in the two weeks preceding the vote – no official polls are allowed after 17 February.
- Whilst the three main political heads to look out for are Silvio Berlusconi, Matteo Renzi, and Luigi Di Maio; as has been widely reported, the election is highly unlikely to see any party or grouping win enough seats to form a government.
- As such, a hung parliament is the most probable scenario, which is why parties have formed coalition alliances ahead of the vote.

### Opinion Polls Consistently Suggest Inconclusive Electoral Outcome

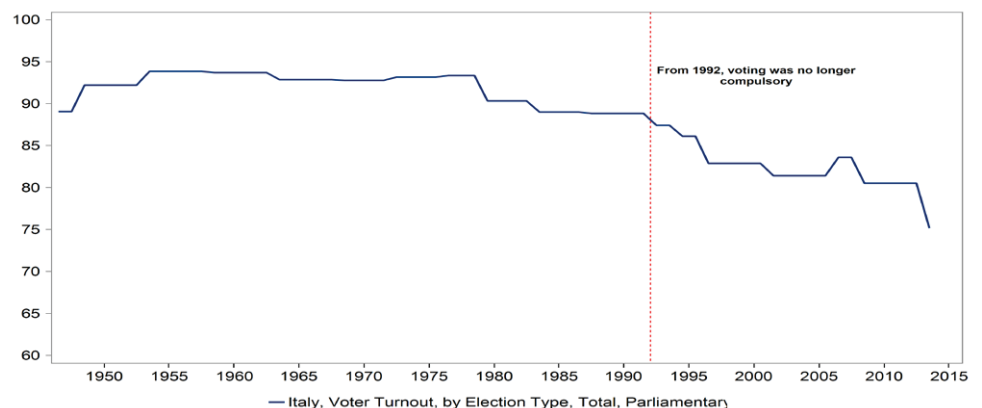
Source: Macrobond, UOB Global Economics & Markets Research



- The election's uncertainty is exacerbated by a new voting system and a clearly disenchanted electorate, which could result in record-low voter turnout.
- Polls suggest that up to 40% of the electorate will either not vote or have not decided yet. Therefore, this election's voter turnout could be even below the record-low 75% showing in 2013.

### Voter Turnout Since 1946

Source: Macrobond, UOB Global Economics & Markets Research

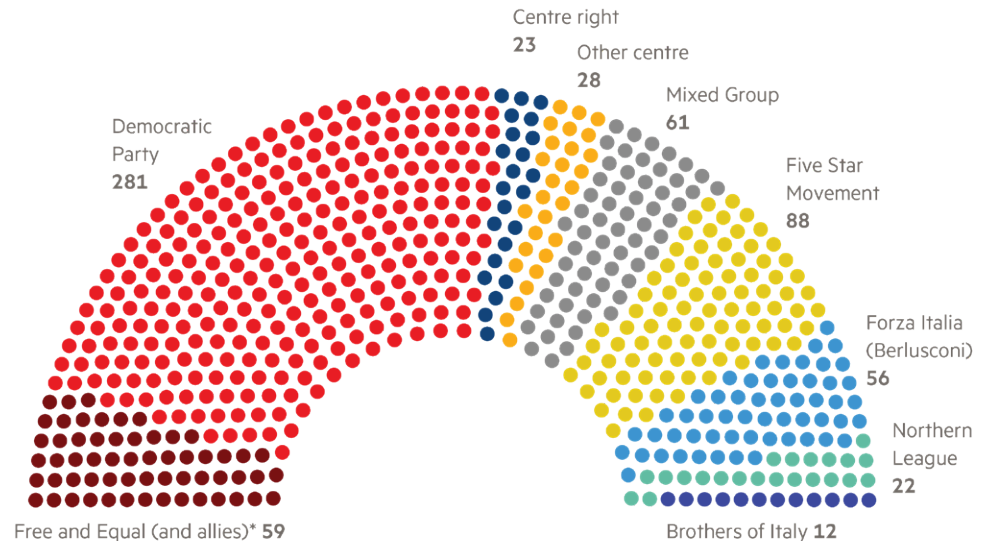


## The New Electoral System

Elections will take place under a new electoral law, which has not been tested since it was brought in under the “[Rosatellum](#)” law in October 2017. Voters will elect 630 members of the Camera dei Deputati (lower chamber) and 315 of the Camera del Senato (the Senate/upper house).

### The outgoing Italian parliament

Seats in the Chamber of Deputies



\*Includes Articolo 1 - Movimento Democratico e Progressista, Sinistra Italiana - Sinistra Ecologia Libertà - Possibile

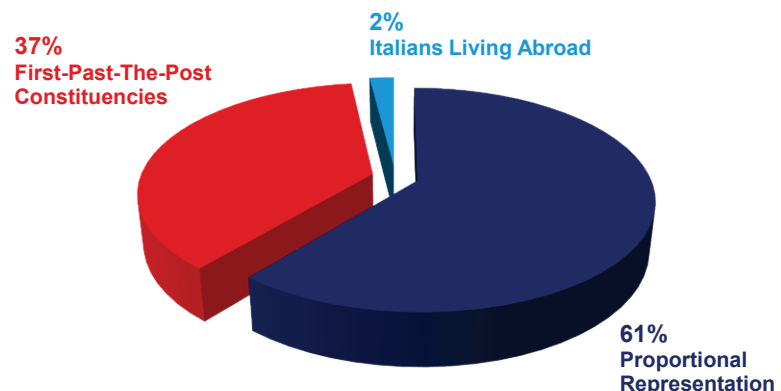
Source: The Financial Times, Open Parlamento

About two thirds of the seats in the lower and upper houses will be elected through proportional representation via party lists. Just over a third will be allocated through single-member districts under the first-past-the-post system. Italians living abroad will elect 2% of seats. This means 61% of the seats — 386 in the lower house and 193 in the upper house — will be awarded by national proportional representation. Some 37% — 232 in the lower house and 116 in the upper house — will be elected in single-member constituencies under a first-past-the-post system. Italians living abroad will elect 2% — 12 seats in the lower house and 6 in the upper house.

Parties must win 3% of the national vote to gain a share of the proportional seats, a measure designed to reduce fragmentation. If they are allied to a larger coalition partner, votes for parties that earn between 1% and 3% are transferred to the stronger party.

### Voting Splits Under New Electoral System

Source: Italian Government, UOB Global Economics & Markets Research



### Potential Outcomes

The new electoral system was meant to encourage coalition building (as well as maintain the status quo) but this could also complicate and delay forming a government which, in turn, could make financial markets nervous in the short term. Any party or coalition will likely need more than 40% support to win enough seats to govern and no party is currently polling above that mark.

### The Centre-Right Coalition Winning Most Votes

Berlusconi's centre-right party Forza Italia is currently in a pre-election coalition with the Northern League and the post-Facist Brothers of Italy (Fdi). This coalition has the best chance of forming a government with polls suggesting the group should get about 36% of the votes. The centre-right coalition, however, would still fall short of an absolute majority of seats in both houses of parliament.

### A Hung-Parliament

A possible grand-coalition – including PD, FI and all other centrist parties in the centre-right and centre-left coalition – would also fall short of a majority. As a result, a hung parliament, at least initially, is a likely outcome given the fragmented political landscape in Italy. Months of talks will probably follow, before some sort of agreement can be found between Forza Italia and the Democratic Party (with support from smaller centrist parties). In the event of complex negotiations between parties, the outgoing PM, Paolo Gentiloni, would help guarantee political continuity between legislatures.

### New Elections

On the whole, we believe that new elections will have to be called. This will likely be preceded by a transitional government with duration of between three to nine months, depending on the transitional leader's duties. This could add a lot more uncertainty, especially because the formation of a government in Germany is simultaneously delayed.

### Our Thoughts

It is worth pointing out that, the Italian election will be on the same day when Germany finds out the results of a ballot of Social Democrat party members on a coalition deal with Chancellor Angela Merkel's conservatives. The outcome could seal or end Merkel's hopes for a fourth term in office. The German result is important for southern European countries including Italy, since a new coalition is expected to take a more pro-European stance and a conciliatory approach to fiscal policies in the bloc.

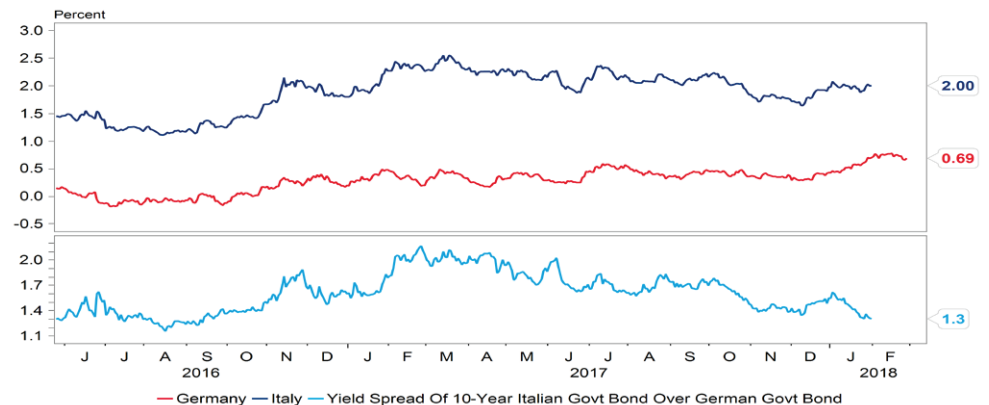
As far as Italy is concerned, according to the European Commission's [Eurobarometer survey](#), most Italians are still in favour of Italy's euro membership (although the popularity of the euro remains one of the lowest in the monetary union – a mere 59% of the population supports the single currency). Their most pressing concerns are unemployment, terrorism and immigration, with pronounced disagreement among parties on how to deal with these three issues.

In fact, the risks of a euro referendum/outright euro-exit have fallen significantly since 9–12 months ago. Most "anti-euro" leaders have softened their tone on the subject. Luigi di Maio for instance, has said that a referendum on leaving the euro would be a "last resort", but that Italy's membership of the euro area could be used as a "bargaining chip" to force the EU to weaken its fiscal rules.

Italy's volatile political environment had little negative impact on growth last year, and we see no reason for this trend to change. A number of near-term vulnerabilities have also faded. In particular, bank non-performing loans are declining and Italy is running a current account surplus.

### Italy-Germany 10-Year Yield Spread

Source: Macrobond, UOB Global Economics & Markets Research



### EUR/USD Recently Touched A 3-Year High

Source: Macrobond, UOB Global Economics & Markets Research



The shorter-term impact would be on financial markets. In this regard, Italian 10-year yield spreads over equivalent German paper have widened by just 20bps since their 18-month low of 120bps, which was reached on the back of a 40bp sell-off in bunds between mid-Dec and early Feb. The resilience of Italian bonds to rising political uncertainty is due to Italy's improving macro fundamentals; expectations that ongoing European Central Bank (ECB) bond purchases will contain spread volatility and the attractive yield pick-up still offered by Italian bonds. Italian banks have also recently reduced their holdings of Italian government bonds, creating room in their portfolios to re-enter the market at more attractive levels. We continue to expect these factors to support Italian bonds in the near-term.

Whilst it is not to say the EUR currency would be immune to all outcomes, political drivers have had little traction in the EUR since last year's French Presidential election. Some near-term EUR weakness may be expected, but the ramifications of any given result for the EUR are less than feared previously. If Italy's election passes without major hiccups, this will remove a layer of political risk and reinforce the case for ceasing ECB support as we expect the ECB to terminate its Asset Purchase Program (APP) at the end of Sep. However, any negative surprise outcome could encourage the ECB to keep asset purchases in place beyond September, in turn prompting financial markets to re-think the timing of rate rises.

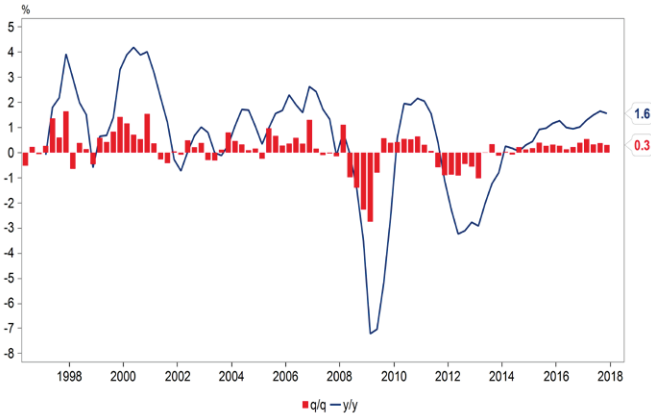


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## ITALY AT A GLANCE

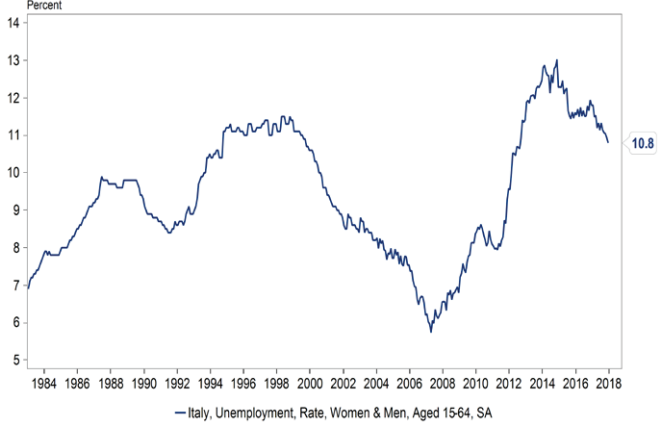
### Italy's Real GDP Growth Has Been Positive For 13 Consecutive Quarters

Source: Macrobond, UOB Global Economics & Markets Research



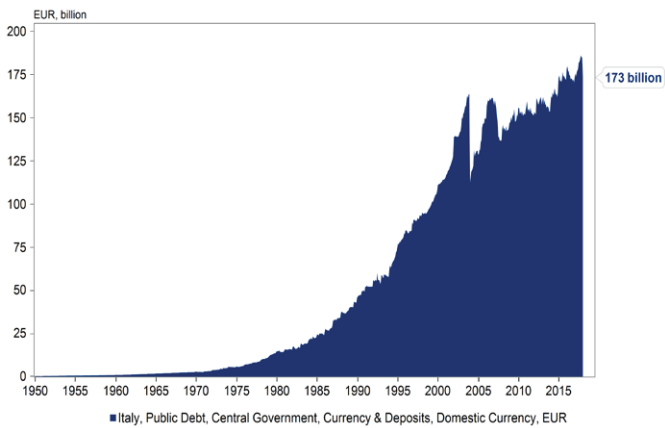
### High Unemployment Is One Factor Fueling Some Of The Frustration Among Voters

Source: Macrobond, UOB Global Economics & Markets Research



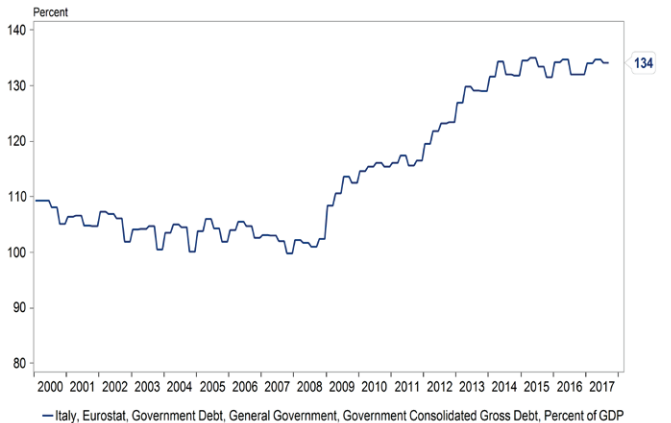
### Debt Levels In Italy Continues To Rise

Source: Macrobond, UOB Global Economics & Markets Research



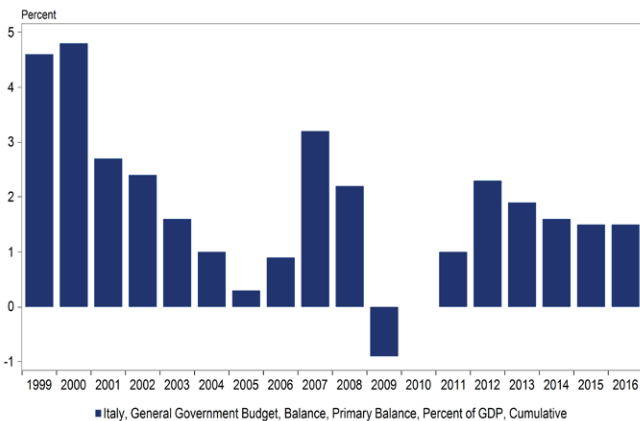
### Italy's Has One Of The Highest Government Debt-To-GDP Ratio Among The 19 Countries In The Eurozone

Source: Macrobond, UOB Global Economics & Markets Research



### The Italian Government Has Done A Good Job Balancing Its Books In Recent Years

Source: Macrobond, UOB Global Economics & Markets Research



### Italian Bank Lending Is Growing Again, Albeit Slowly

Source: Macrobond, UOB Global Economics & Markets Research

