Italian election: assessing the risks

- **One of the key political risks for Europe this year**: Italian voters will head to the polls on 4 March to elect the two chambers of parliament. In this report, we assess the risks of the election for Italy and the eurozone.

- **Grand coalition likely**: The polls suggest that none of the parties of the centre-right/right-wing and the centre-left alliance will achieve a majority (Chart 1). We therefore expect that the next government will be formed of a grand coalition (70% probability), including parties of the centre-left and centre-right/right-wing. This should enable Italy to continue on its current path of modest economic growth and manageable fiscal deficits. Frustratingly, Italy may reverse some of its recent labour market and pension reforms. We see 10% probability of a centre-right/right-wing victory, a 10% chance of new elections and 5% likelihood that M5S will work with centrist parties.

- **Significant risks**: Most of the parties are promising to reverse structural reforms and increase spending significantly. Some are even threatening a referendum on Italy’s membership of the euro – although since Le Pen’s defeat in the French elections, most politicians have toned down their anti-euro rhetoric.

- **Il Cavaliere is back**: Former prime minister (PM) Silvio Berlusconi is likely to be kingmaker after the election, although his centre-right Forza Italia (FI) party received only c16% in opinion polls, and the fact that he is barred from office.

- **Best-case scenario**: In our view, a technocrat-led grand coalition that would introduce a few new reforms while not undoing many previous reforms would be the best outcome for Italy.

- **Worst-case scenario**: We think a coalition consisting of the anti-establishment Five Star Movement (M5S) together with other radical parties would have the most negative impact on Italy, but luckily, this scenario looks unlikely (5% probability).

- **Little systemic risk**: We do not expect a euro exit by Italy (Italexit), or a systemic crisis that could endanger the eurozone economy.

**Note**: Likely distribution of seats in the Chamber of Deputies, parties that entered alliances are shown together, based on average of last seven opinion polls.

<table>
<thead>
<tr>
<th>Alliance</th>
<th>Seats</th>
</tr>
</thead>
<tbody>
<tr>
<td>Radical FI/LN/FdI/Ncl</td>
<td>163</td>
</tr>
<tr>
<td>Left Fi/LN</td>
<td>27</td>
</tr>
<tr>
<td>Centre-left PD/CP/+E/I</td>
<td>280</td>
</tr>
<tr>
<td>SVP/PaP</td>
<td>10</td>
</tr>
<tr>
<td>Centre-right M5S/LeU</td>
<td>150</td>
</tr>
</tbody>
</table>

**Source**: National opinion polls, Berenberg calculations
Parties and alliances

Forza Italia (FI): Berlusconi is the president of the centre-right FI, which he founded in 1993. He was three times Italian PM and owns several private TV stations. Unsurprisingly, the party depends heavily on Berlusconi, who has a good track-record in election campaigning. FI is pro-business and favours cutting bureaucracy and taxes.

Lega Nord/Northern League (LN): The LN was officially founded in 1991 by Umberto Bossi who was convicted of fraud last year. In 2013 Matteo Salvini became the new secretary after defeating Bossi in a leadership election. The far-right party opposes immigration, is highly critical of the EU, and demands more power for Italy's regions and fiscal federalism, which would favour the richer north of the country.

Fratelli d'Italia/Brothers of Italy (FdI): The eurosceptic, far-right FdI was founded in 2012 to oppose ex-PM Mario Monti. In elections, it usually allies itself with FI to increase support among the right. The party is led by Giorgia Meloni.

Noi con l'Italia/Us with Italy (Ncl): The centre-right Ncl party was founded in December 2017. Raffaele Fitto is its president. The party represents the centrist wing in the centre-right/right alliance and favours Berlusconi or another centrist as PM.

Partito Democratico/Democratic Party (PD): The centre-left party was founded in 2007 as a merger of several centre-left parties. Since the 2013 election, the PD has been the largest party in the Chamber of Deputies and the Senate. The party's secretary is ex-PM Matteo Renzi, who stepped down as PM after he lost the election law referendum in 2016. Paolo Gentiloni, his successor as PM, is quite popular, but the party is plagued by internal splits.

Più Europa/More Europe (+E): The liberal and pro-EU party was founded in November 2017. It is led by Emma Bonino, a former minister of International Commerce and Foreign Affairs. The party is pro-migration and strongly pro-Europe, and supports the idea of Italy being part of a “United States of Europe”.

Italia Europa Insieme/Italy Europe Together (I): Known as “Insieme” or “Together”, this progressive party was founded in December 2017 as an alliance of several parties (including the Italian Socialist Party), which support the environmental, social and economic sustainability of Italy. The party’s logo includes an Olive Tree, a reminder of the broad centre-left coalition that was active from 1995 to 2007.

Civica Popolare/Popular Civic List (CP): The party was founded in December 2017 and is a centrist alliance of political parties including Alternativa Popolare/Popular Alternative. The leader is health minister Beatrice Lorenzin; she is calling for increased healthcare spending by the government.

Movimento 5 Stelle/Five Star Movement (M5S): The anti-establishment party was founded in 2009 by comedian Beppe Grillo, who is still president of the party. M5S won more votes than any other single party in 2013 but less than the centre-left and centre-right alliances. The M5S candidate for PM is 31-year-old Luigi Di Maio.

Liberi e Uguali/Free and Equal (LeU): This alliance of left-wing parties, including Movimento Democratico e Progressista/Democratic and Progressive Movement (MDP), Sinistra Italiana/Italian Left (SI) and Possibile/Possible (P), was founded in December 2017 and is headed by former anti-Mafia prosecutor and president of the Senate Pietro Grasso.

Centre-right/right-wing alliance: Berlusconi's centre-right/right-wing alliance consists of his FI, the far-right LN and FdI as well as the centrist Ncl. The coalition has strong support among the voters and is gaining momentum, but is still fragile: it could fracture after the election if it fails to achieve an outright majority.

Centre-left alliance: The centre-left alliance consists of PD, +E, I and CP.

No alliance: The M5S party does not want to participate in an alliance ahead of the election, but it does not rule out joining a coalition after the vote. The LeU also does not want to join an alliance before the election, but might join the centre-left or M5S afterwards.
New electoral system favours parties that form an alliance

The lower and upper house will be elected under a new electoral law, called the “Rosatellum”. 36% of the seats will be allocated via a majoritarian system (“first-past-the-post”) and 64% via a proportional system. The hurdle rate to enter the parliament is 3% for single parties and 10% for alliances. For parties in alliances that achieve less than 3% but more than 1%, the votes will be proportionally allocated to the other alliance members. Importantly, the new law no longer includes the majority bonus clause, which granted a party/alliance with more than 40% of the votes the additional seats required to have a majority in the lower house. Still, according to survey institutes, an alliance or party that reaches 40% in the election and is 12% ahead of the second largest alliance/party is likely to reach the votes required to form a majority of seats in both houses.

The new election law harmonises election rules for the upper and lower house. It intends to produce more stable governments. The seats allocated via the majoritarian system make it easier for alliances such as Berlusconi’s centre-right/right than for standalone parties (e.g. M5S) to win a seat majority.

What the polls say

Chart 2: Opinion polls development since 2017

The chart is based on the average of the seven latest available polls.
Centre-left alliance: Democratic Party (PD), Popular Civic List (CP), More Europe (+E) and Together (I).
Centre-right/right-wing alliance: Forza Italia (Berlusconi), the far-right Lega Nord, Brothers of Italy and centrist Us with Italy (Ncl).

Berlusconi’s centre-right/right-wing alliance (FI + LN +FdI +Ncl) is currently ahead. The FI party gained momentum over the last weeks as Berlusconi stepped up his media campaign. Polls suggest that Berlusconi will win 16-18% of the votes. His alliance partner LN has lost momentum and could score 12-14%. The FdI hovers around 5-6% and the Ncl around 2-3%. Overall, the centre-right/right-wing alliance polls around 36-39%. The largest single party is M5S with 27-28%. The centre-left alliance is around 26-28%, headed by the PD party with 22-24%. PM Gentiloni receives high personal ratings, but his PD party is hampered by the fallout from ex-PM Matteo Renzi’s lost referendum on a new electoral law and internal splits. The three other centre-left parties (+E, I, CP) could receive 3.5-4.0% combined. The LeU hovers at around 6-7%.

Five Star Movement
Democratic Party
Centre-left alliance
Centre-right/right alliance

The drop in support for PD after 25 February 2017 was caused by defectors who founded a new left-wing party, the MDP, which later merged into the Free and Equal party (LeU).
Sources: National opinion polls, Berenberg calculation.

Berlusconi’s FI and Renzi’s PD benefit from the new electoral system

M5S is the strongest party, followed by PD and FI
Who will win the most seats?

Chart 3: Seat projections for Italy’s chamber of deputies (split by parties)

<table>
<thead>
<tr>
<th>Party</th>
<th>Seats</th>
</tr>
</thead>
<tbody>
<tr>
<td>M5S</td>
<td>163</td>
</tr>
<tr>
<td>LeU</td>
<td>142</td>
</tr>
<tr>
<td>CP/+E/I</td>
<td>128</td>
</tr>
<tr>
<td>PD</td>
<td>102</td>
</tr>
<tr>
<td>NcI</td>
<td>8</td>
</tr>
<tr>
<td>FI</td>
<td>42</td>
</tr>
<tr>
<td>Lega</td>
<td>10</td>
</tr>
<tr>
<td>FdI</td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
</tr>
</tbody>
</table>

Likely distribution of seats in the Chamber of Deputies, single party seats shown, based on average of last four opinion polls, includes small seat adjustments to fit with the alliance seat allocation from the last seven opinion polls from Chart 1.

M5S: radical Five Star Movement
LeU: left-leaning Free and Equal
Centre-left alliance: Democratic Party (PD), Popular Civic List (CP), More Europe (+E) and Together (I)
Centre-right/right-wing alliance: Forza Italia (FI), far-right Lega Nord (LN), Brothers of Italy (FdI) and centrist Us with Italy (NcI)
Other: foreign elected seats, regionalist South Tyrolean People's Party (SVP) and the communist Power to the People (PAP).

Source: National opinion polls, Berenberg calculations

316 seats are needed to win a majority in the 630-seat Chamber of Deputies. According to the average of the last four polls, the centre-right/right-wing alliance would win c280 seats (c44%), consisting of 128 seats for FI, 102 for LN, 42 for FdI and 8 for NcI. The centre-right/right-wing alliance has an advantage in that it is likely to win 50-70% of the majoritarian system seats. M5S should be the largest single party with c163 seats (c26%). The centre-left is projected to receive c150 seats (c24%), split into 142 for PD and 8 for CP/+E/I. The LeU is on course for c27 seats (c4%) and others c10.

Therefore, no alliance or party is expected to obtain a majority. However, coalitions could be formed after the elections. FI together with PD, CP/+E/I, LeU and NcI, would reach c313 seats; M5S together with LeU, LN and FdI c334; M5S together with PD and FI c433. A grand coalition consisting of the centre-right/right-wing alliance with PD would command c422 seats, according to the polls. A high uncertainty factor is attached to these forecasts, as the electoral system is new and c38% of voters are still undecided.

Berlusconi’s alliance looks on course to win by far the most seats, but probably not enough to govern alone.
We see four possible scenarios for the election outcome.

1) We estimate a 70% probability of an Italian government supported by a grand coalition of centre-right and centre-left parties. Berlusconi’s FI is likely to be the largest party in the centre-right/right-wing alliance. However, Berlusconi is banned from legislative office until 2019 due to a 2013 tax fraud conviction. He is currently appealing against this sanction at the European Court of Human Rights. Instead of Berlusconi, his long-time ally, the President of the European Parliament, Antonio Tajani, or his longstanding ally and right-hand man, Gianni Letta, could become the new PM.

This 70% probability splits into a 40% probability that this grand coalition will have a majority of the seats and will have a politician as its PM and a 30% chance that the grand coalition would be headed by technocrats, or be a minority government backed by grand coalition parties. A technocratic government would be good news for Italy, in our view, as it would be more likely to introduce new reforms while not undoing many previous ones. If Italy ends up with a minority government, current PM Gentiloni could be the favourite to remain in office.

2) We see a 10% probability that the centre-right/right-wing will continue its recent surge in the polls and win the majority of seats.

3) We see a 10% probability that the M5S will be able to form a coalition, with its leader Di Maio becoming the new PM.

This 10% probability splits into a 5% chance that this coalition would consist of other radical parties that might push for a euro exit (Italexit), and a 5% chance that Di Maio will seek a coalition with centre parties.

4) We see a 10% chance of a repeat election due to failed negotiations to form a coalition.
Three main risks for Italy

1) **Italexit**: Following Le Pen’s defeat in the French elections and an improvement in Italy’s economic performance, the percentage of Italians wanting to keep the euro has increased. According to the Eurobarometer survey of November 2017, 59% of Italians are in favour of European economic and monetary union with one single currency, the euro, only 2% below the EU28 average of 61%. Politicians such as Berlusconi, Salvatelli and Di Maio have significantly toned down their anti-euro rhetoric in the past months. Italexit therefore looks like a low-probability event. In our view, only an unlikely coalition of M5S and the radical right has a small chance of leading to a referendum on the euro. However, it would be complicated to hold such a referendum as Italy’s constitution bans referenda on international treaties and a turnout of at least 50% of all eligible voters would be needed for the vote to be valid. Italy would first need to hold a referendum on whether the euro referendum could go ahead, and the results of the referendum would be non-binding.

2) **Economic slowdown**: Ex-PMs Monti and Renzi implemented important pension and labour market reforms, which boosted employment and reduced the pressure on the fiscal budget from rising retirement costs. It was crucial for investor confidence that Italy would not default on its debt, and should therefore reduce the budget deficit and lower interest payments on government bonds. However, these successes seem to have been mostly forgotten during the election campaign as most parties are promising to reverse some of the labour and pension reforms, while increasing social spending. If this is not just campaign talk, and is actually implemented by a new government, it would be damaging for the Italian economy in the long term.

3) **More pressure on public finances**: A reversal of the pension reform, higher fiscal spending and lower economic growth could put a lot of pressure on the budget deficit and public debt. Italy’s debt-to-GDP ratio is high at 130%, the second highest in the EU after Greece. If, as expected, the ECB ends its government bond-buying programme in September, Italian bond yields could rise by more than those of neighbouring eurozone members.

**Main policy pledges**

The main topics so far are: 1) how to treat immigrants; 2) how to help the less well-off; 3) how to change the tax code; 4) whether to reverse ex-PM Mario Monti’s pension reforms; and 5) whether to reverse ex-PM Renzi’s labour market reforms.

1) Over the last few years, Italy has received a large number of illegal immigrants (over 600k since 2014), mostly arriving via the Mediterranean Sea. The centre-right/right-wing alliance wants to expel all illegal immigrants. The M5S echoes this anti-migrant stance, demanding that Italy should regain control of its borders. The PD wants to find a solution with the EU to reduce immigration.

2) The M5S is demanding a “citizen’s income” of EUR780 per month minimum. Berlusconi minimum is attempting to outflank them by calling for a “dignity income” of EUR1,000 per month minimum for all Italians. The PD wants to introduce a higher minimum wage and to give more support to families with children.

3) Nearly all parties want to cut taxes: the FI suggests a 23% flat income tax; the LN a 15% flat income tax; while the PD wants to cut income tax for families, reduce corporate tax and lower payroll taxes by a total of 20bn pa. Berlusconi’s flat tax could reduce income tax revenues for the government by 30% or 50bn annually (3% of GDP). However, Berlusconi believes that the flat tax will pay for itself via higher GDP growth and lower tax evasion.

4) Ex-PM Monti’s pension reform (the “Fornero Law” 2011) increased the pension age (up to 67 years by 2019) and based the pension level on the amount contributed over a working lifetime, instead of on the final salary. This reduced the pension burden on the government. FI wants to change the Fornero Law, by keeping the part that increases the retirement age, but reducing the number of years that a person needs to work before retirement to 41 from 42 currently. Another of Berlusconi’s aims is to allow people to retire early at 50, but with a pension that reflects only what has been paid in. At the same time, Berlusconi is calling for a minimum pension of EUR1,000 a month (double the current level), which in our view the budget cannot afford. For LN, complete repeal of the Fornero pension reform is its number-one priority: it aims to reduce the retirement age by three years and break the link that causes the retirement age to move up in line with
increases in life expectancy. The PD does not want to change the law, while M5S demands retirement after 41 years of contribution, similar to Berlusconi.

5) Renzi’s Jobs Act, implemented in 2014, increased the flexibility of the labour market, but is disliked by most parties. For Berlusconi, the Jobs Act failed as it incentivised temporary rather than permanent employment. He does not want to abolish the system, but instead provide incentives for companies to hire permanent employees.

How to pay for the election promises

The parties are promising to pay for increased spending through a combination of a higher budget deficit (so far we expect 2.3% for 2017), plus hopes for higher tax income from stronger GDP growth, reduced tax evasion and cancellation of tax rebates. The lack of detail on how to finance such election promises might explain why the voters are sceptical. Based on a recent Index survey, nearly 80% of voters believe that none of the election promises will be implemented; only 7% believe that taxes will be reduced; and 65% believe that planned increases in the retirement age will be reversed. Only 2% believe that the M5S citizen’s income pledge will be implemented. The parties know that their election promises are unrealistic, but they can always blame a coalition partner for preventing them from delivering on a promise.

Key economic challenges

Italy’s economy is the third largest in the eurozone and among the top 10 in the world. It is one of the largest exporters globally and has a leading position in luxury goods. However, it has been hindered by slow growth in the last two decades (0.6% on average versus 1.5% for the eurozone since 1996 – Chart 4). We see three main reasons for the weak performance: 1) Italy concentrated on producing low-tech manufacturing goods, which in the 1990s came under severe pressure from an emergent China, now the global leader in manufacturing production; 2) Italy’s manufacturing sector is dominated by small family businesses, which lack the funds to invest in new technologies; and 3) Italy has been hampered by bureaucracy, high taxes and high wage inflation. In the past, this could be partly offset by devaluing the lira; however, this was no longer possible after Italy locked in its exchange rate to currencies of the other eurozone countries in 1999, to create the euro.

Italy’s economic recovery has been weak since the global financial crisis. Since 2013, its GDP growth has been just half the eurozone average (0.9% pa versus 1.8% pa). Moreover, the employment recovery disappointed: unemployment reached 13% in 2014 and was still around 11% at the end of 2017, while the EU average peaked at 12.1% in 2013 and fell to 8.7% at the end of last year. Italian unemployment is therefore still significantly above the 1999 average of 9.3%, while the eurozone has managed to reduce unemployment to below its 9.6% average (Chart 5).

A much higher budget deficit is the key risk

Italy suffers from high government debt, weak GDP growth, high unemployment and graft

A large portion of the new jobs in Italy are only temporary. Moreover, youth unemployment at 32.7% versus a eurozone average of 18.2% is a particular problem. The country suffers from low investment and low productivity growth. Productivity per
employee is still below pre-crisis levels, while eurozone productivity has gained momentum again and is significantly higher than before the crisis (Chart 6). Since 1996, productivity growth in Italy has been only 0.3% annually, versus 0.7% in the eurozone. Investment growth fell dramatically after the global financial crisis and the euro crisis in 2011/12. Investment has still not fully recovered from that today, while eurozone investment levels are already close to pre-crisis highs (Chart 7). At the end of 2010, Italy accounted for 16.3% of investment in Europe; in Q3 2017 this fell to 13.4%.

Chart 7: Italian productivity growth versus eurozone

Productivity: Output per Employed Person (SA, 2010=100)
Source: Eurostat

Chart 8: Italian investment versus eurozone

Gross Fixed Capital Formation (SWDA, Billions of chained 2010 euros).
Eurozone left hand side, Italy right hand side. Average 1996-2017
Source: Eurostat

Italy’s government is heavily indebted, with a debt-to-GDP ratio of 132% at end-2017 (Chart 8), and the cost of its pension system is the second highest in Europe after Greece (16% of GDP). Another issue is the high non-performing loan exposure of Italian banks, preventing them from increasing lending to consumers and businesses to support economic growth. On a positive note, the 1.5% GDP growth in 2017 was the fastest since 2010 and we expect Italy to grow at the same rate in 2018E due to a booming European economy, but this also depends on who will govern Italy after the general elections in three weeks. Leading indicators are supportive. In January, the PMI Services index jumped to a 10-year high, while the PMI Manufacturing index rose to a seven-year high. Thanks to recent reforms by Monti and Renzi, the country climbed up the World Bank’s Ease of Doing Business index, from 87th in 2011 to 44th in 2014. However, corruption is still a major issue, with the country ranked 60th out of 176 in the 2016 Transparency International corruption index, below Romania and on the same level as Cuba (Chart 9).
Election results: impact on the economy and markets

From the point of view of the economy and financial markets, a grand coalition led by a technocrat would probably be the best outcome of the election. A technocrat-led grand coalition should enable the structural reform process and economic recovery to continue, allowing for stable inflation, a falling budget deficit and a narrowing of the bond spread with Germany from the current 130bp. A grand coalition or minority government led by Gentiloni as PM would be the next best outcome, in our view: it would probably result in fewer new reforms and more reform reversals, but overall should have a similar impact on the economy and the bond market to a technocrat-led grand coalition.

Victory by the centre-right/right-wing alliance would lead to higher spending and lower taxes and a small boost to GDP and inflation. On the downside, such a programme would increase the budget deficit and likely widen the bond spread with Germany. A government coalition consisting of the inexperienced M5S together with the right and/or left would lead to significantly higher social spending combined with doubts about how to finance new expenses. This would have a negative impact on economic growth, inflation and bond spreads. Investors might lose trust in Italy and companies would probably scale back investments, leading to lower supply growth and a drop in productivity. The planned fiscal stimulus (eg citizen’s income) would increase demand and lead to higher inflation and an increased budget deficit.

According to Bloomberg consensus, the market is not prepared for a significant widening of the budget deficit: 19 out of 20 economists expect a budget deficit of less than 2.6% in 2018 or 2019. A coalition of M5S and centrist parties (eg FI and PD) would lead to some higher spending, some reform reversal and investor concerns about the inexperienced M5S being in power. The overall impact on bond markets should be better than if M5S worked together with the radical parties, and not much worse than what we would expect from a centre-right/right-wing coalition.

Table 1: New government impact on the economy

<table>
<thead>
<tr>
<th></th>
<th>Technocratic*</th>
<th>Grand coalition</th>
<th>Centre-right/TP</th>
<th>M5S + RP</th>
<th>M5S + CP</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>2018</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GDP</td>
<td>1.6</td>
<td>1.5</td>
<td>1.6</td>
<td>1.7</td>
<td>1.8</td>
</tr>
<tr>
<td>Budget deficit %</td>
<td>2.2</td>
<td>2.1</td>
<td>2.3</td>
<td>2.4</td>
<td>2.5</td>
</tr>
<tr>
<td>CPI</td>
<td>1.1</td>
<td>1.4</td>
<td>1.2</td>
<td>1.6</td>
<td>1.3</td>
</tr>
<tr>
<td>Bond spread vs.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Germany</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Includes technocratic or minority government supported by grand coalition. 10-year Italian sovereign bond spread versus Germany. RP = radical parties, CP = centre-left and centre-right parties. Source: Berenberg

Berlusconi’s track record

We do not expect miracles. Berlusconi has already been PM three times, for a total of around nine years: the first time from 10 May 1994 until 17 January 1995; the second from 11 June 2001 until 17 May 2006; and the third from 8 May 2008 until 16 November 2011. This gives us the opportunity to check how the economy and financial markets performed under his leadership and whether he kept his election promises. During the election campaign in 1994, Berlusconi promised one million more jobs; however, he had to resign after just 10 months in the office and employment fell by 168k in H2 1994.

During the 2001 election campaign, Berlusconi promised Italians voters that he would: 1) simplify the complex tax system by introducing just two income tax rates of 23% up to EUR100k and 33% above that level, together with an EUR11k income threshold; 2) reduce unemployment by half; 3) finance and develop a large public works programme; 4) increase the minimum monthly pension to EUR516; and 5) reduce crime. Berlusconi promised to not stand for re-election in 2006 if he failed to honour at least four of these five promises. Between 2001 and mid 2006, an impressive 840k jobs were created under Berlusconi’s government, but unemployment fell from 9% to 6.8%, less than he had promised. Berlusconi simplified the tax rates somewhat, but not as much as he wanted. In 2006, there were still four income tax brackets and at higher rates than he had intended (23%, 33%, 39% and 43%). However, Berlusconi kept his promise about increasing the minimum monthly pension level.

In the 2008 election campaign Berlusconi promised to improve the Italian economy and reduce public debt. However, when he was forced to resign in November 2011, the Italian economy...
The economy had not improved and unemployment jumped from 6.8% in mid-2008 to 9.2% at end-2011. Italy’s debt-to-GDP ratio increased further to 115% in 2011 versus 100% in 2008.

Is Berlusconi as PM a win for financial markets? Looking at the past, he does not have the best track record. During his first premiership, Italian 10-year bond spreads over Germany rose from 310bp to 490bp. During his second term, they fell slightly from 39bp to 32bp while during his third term they jumped from 45bp at the end of April 2008 to 475bp at the end of November 2011. The Italian stock market (Dow Jones Italy 30 Index) fell by around 10% in his first term, was unchanged during his second term and fell by 50% during his third. However, one cannot blame Berlusconi alone. Most of the financial and economical damage caused during his third term was due to the great financial crisis of 2008/2009 and the euro crisis of 2011 as a result of fears that Greece might leave the eurozone, triggering rising bond yields and falling stock markets across southern Europe.

During the nine years that he governed the country, average quarterly GDP yoy growth was 0.15%, below the 0.75% average since 1994. On a qoq basis, the numbers are not much different: 0.03% during Berlusconi’s reign versus 0.18% on average since 1994. Inflation averaged 2.27% during Berlusconi’s leadership, while it was only 2.15% since 1994 on average. The budget deficit (measured on a quarterly basis) during the Berlusconi years was also higher than when others were leading the country since 1994 (3.76% versus 3.13%). Over 2m jobs were created in Italy since 1994, but only 166k net during the nine years of Berlusconi’s leadership. On a positive note, Berlusconi might have learned a lesson from his nine years in power. He recently promised that, if he won, he would elect 12 technocrats/experts in the 20 member government to boost economic growth and cut unnecessary fiscal expenses.
Upcoming events

On Sunday 4 March, the polling stations will open from 7am until 11pm. Exit polls will be announced immediately after the ballot closes and the final result could be announced as early as Monday morning.

Election on 4 March
## Italy: forecast summary

|                      | 2016 | 2017 | 2018 | 2019 | 1Q17 | 2Q17 | 3Q17 | 4Q17 | 1Q18 | 2Q18 | 3Q18 | 4Q18 | 1Q19 | 2Q19 | 3Q19 | 4Q19 |
|----------------------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|
| **GDP**              |      |      |      |      |      |      |      |      |      |      |      |      |      |      |      |
| % y/y                | 0.9  | 1.5  | 1.5  | 1.5  |      |      |      |      | 1.3  | 1.5  | 1.7  | 1.6  | 1.4  | 1.5  | 1.5  | 1.6  |
| % q/q                | 0.5  | 0.3  | 0.4  | 0.3  | 0.4  | 0.4  | 0.4  | 0.4  | 0.4  | 0.4  | 0.4  | 0.4  | 0.4  | 0.4  | 0.4  | 0.4  |
| %q/q ann.            | 2.2  | 1.3  | 1.5  | 1.2  | 1.6  | 1.6  | 1.6  | 1.5  | 1.6  | 1.5  | 1.5  | 1.5  | 1.5  | 1.5  | 1.5  | 1.5  |
| **Private Consumption** |      |      |      |      |      |      |      |      |      |      |      |      |      |      |      |      |
| % y/y                | 1.5  | 1.5  | 1.1  | 1.2  |      |      |      |      | 1.5  | 1.5  | 1.5  | 1.5  | 1.1  | 1.2  | 1.1  | 1.2  |
| % q/q                | 0.7  | 0.2  | 0.3  | 0.2  | 0.3  | 0.3  | 0.3  | 0.3  | 0.3  | 0.3  | 0.3  | 0.3  | 0.3  | 0.3  | 0.3  | 0.3  |
| **Government Consumption** |      |      |      |      |      |      |      |      |      |      |      |      |      |      |      |      |
| % y/y                | 0.5  | 0.9  | 0.7  | 0.8  |      |      |      |      | 0.5  | 0.9  | 1.2  | 0.9  | 0.6  | 0.7  | 0.8  | 0.8  |
| % q/q                | 0.4  | 0.2  | 0.1  | 0.2  | 0.2  | 0.2  | 0.2  | 0.2  | 0.2  | 0.2  | 0.2  | 0.2  | 0.2  | 0.2  | 0.2  | 0.2  |
| **Investment**       |      |      |      |      |      |      |      |      | 2.1  | 3.6  | 4.6  | 2.1  | 5.1  | 4.5  | 2.1  | 2.4  |
| % y/y                | 3.0  | 3.1  | 3.5  | 2.4  |      |      |      |      | 0.1  | 0.4  | 0.8  | 0.2  | 0.3  | 0.3  | 0.3  | 0.3  |
| % q/q                | -2.2 | 1.1  | 3.0  | 0.3  | 0.6  | 0.6  | 0.6  | 0.6  | 0.6  | 0.6  | 0.6  | 0.6  | 0.6  | 0.6  | 0.6  | 0.6  |
| **Final Domestic Demand** |      |      |      |      |      |      |      |      | 1.4  | 1.8  | 2.0  | 1.5  | 1.7  | 1.7  | 1.2  | 1.3  |
| % y/y                | 1.5  | 1.6  | 1.5  | 1.3  |      |      |      |      | 0.3  | -0.2 | -0.1 | -0.1 | -0.2 | 0.3  | 0.2  | 0.2  |
| % q/q                | 0.1  | 0.4  | 0.8  | 0.2  | 0.3  | 0.3  | 0.3  | 0.3  | 0.3  | 0.3  | 0.3  | 0.3  | 0.3  | 0.3  | 0.3  | 0.3  |
| **Net Exports**      |      |      |      |      |      |      |      |      | -0.3 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | 0.1  | 0.1  |
| % y/y                | -0.2 | 0.0  | 0.1  | 0.1  |      |      |      |      | 0.3  | -0.4 | 0.1  | 0.0  | 0.0  | 0.0  | 0.0  | 0.0  |
| % q/q                | 0.1  | 0.4  | -0.5 | 0.0  | 0.0  | 0.0  | 0.0  | 0.0  | 0.0  | 0.0  | 0.0  | 0.0  | 0.0  | 0.0  | 0.0  | 0.0  |
| **Stockbuilding**    |      |      |      |      |      |      |      |      | 45.6 | 49.7 | 52.1 | 54.5 | 5.8  | 10.7 | 16.4 | 16.8 |
| % y/y                | -0.3 | -0.1 | -0.1 | -0.1 |      |      |      |      | 2.7  | 2.9  | 3.0  | 3.0  | 5.8  | 10.7 | 16.4 | 16.8 |
| % q/q                | 0.1  | 0.4  | -0.5 | 0.0  | 0.0  | 0.0  | 0.0  | 0.0  | 0.0  | 0.0  | 0.0  | 0.0  | 0.0  | 0.0  | 0.0  | 0.0  |
| **Current Account Balance** |      |      |      |      |      |      |      |      | 1.8  | 3.3  | 3.9  | 3.4  | 4.7  | 3.6  | 2.4  | 1.9  |
| EUR bn               | 1.9  | 3.1  | 3.1  | 1.3  |      |      |      |      | 1.1  | 1.4  | 1.4  | 1.4  | 1.1  | 1.4  | 1.4  | 1.4  |
| % of GDP             | 11.7 | 11.2 | 10.5 | 9.9  |      |      |      |      | 11.6 | 11.2 | 11.2 | 10.9 | 10.7 | 10.6 | 10.4 | 10.3 |
| **Unemployment Rate** |      |      |      |      |      |      |      |      | 1.3  | 1.6  | 1.3  | 1.1  | 1.0  | 1.1  | 1.2  | 1.2  |
| %                   | 0.0  | 1.3  | 1.1  | 1.4  |      |      |      |      | 1.3  | 1.3  | 1.4  | 1.5  | 1.3  | 1.3  | 1.4  | 1.5  |
| **CPI**              |      |      |      |      |      |      |      |      | 132.0| 132.0| 130.8| 129.2|      |      |      |      |
| % y/y                | -2.5 | -2.3 | -2.2 | -2.1 |      |      |      |      | 1.3  | 1.3  | 1.4  | 1.5  | 1.3  | 1.3  | 1.4  | 1.5  |
| % of GDP             | -2.5 | -2.3 | -2.2 | -2.1 |      |      |      |      | 1.3  | 1.3  | 1.4  | 1.5  | 1.3  | 1.3  | 1.4  | 1.5  |

*Contribution to GDP growth  *Period averages

Source: Berenberg, Haver, Istituto Nazionale di Statistica, Eurostat
Disclaimer

This document was compiled by the above mentioned authors of the economics department of Joh. Berenberg, Gossler & Co. KG (hereinafter referred to as “the Bank”). The Bank has made any effort to carefully research and process all information. The information has been obtained from sources which we believe to be reliable such as, for example, Thomson Reuters, Bloomberg and the relevant specialised press. However, we do not assume liability for the correctness and completeness of all information given. The provided information has not been checked by a third party, especially an independent auditing firm. We explicitly point to the stated date of preparation. The information given can become incorrect due to passage of time and/or as a result of legal, political, economic or other changes. We do not assume responsibility to indicate such changes and/or to publish an updated document. The forecasts contained in this document or other statements on rates of return, capital gains or other accession are the personal opinion of the author and we do not assume liability for the realisation of these.

This document is only for information purposes. It does not constitute investment advice or recommendation to buy financial instruments. It does not replace consulting regarding legal, tax or financial matters.

Remarks regarding foreign investors

The preparation of this document is subject to regulation by German law. The distribution of this document in other jurisdictions may be restricted by law, and persons, into whose possession this document comes, should inform themselves about, and observe, any such restrictions.

United Kingdom

This document is meant exclusively for institutional investors and market professionals, but not for private customers. It is not for distribution to or the use of private investors or private customers.

United States of America

This document has been prepared exclusively by Joh. Berenberg, Gossler & Co. KG. Although Berenberg Capital Markets LLC, an affiliate of the Bank and registered US broker-dealer, distributes this document to certain customers, Berenberg Capital Markets LLC does not provide input into its contents, nor does this document constitute research of Berenberg Capital Markets LLC. In addition, this document is meant exclusively for institutional investors and market professionals, but not for private customers. It is not for distribution to or the use of private investors or private customers. This document is classified as objective for the purposes of FINRA rules. Please contact Berenberg Capital Markets LLC (+1 617.292.8200), if you require additional information.

Copyright

The Bank reserves all the rights in this document. No part of the document or its content may be rewritten, copied, photocopied or duplicated in any form by any means or redistributed without the Bank’s prior written consent.

© 2017 Joh. Berenberg, Gossler & Co. KG
BERENBERG CAPITAL MARKETS LLC

Member FINRA & SIPC

EQUITY RESEARCH
Andrew Fung +1 646 949 9023
Donald McLee +1 646 949 9028
Adam Mozehi +1 646 949 9022
Gal Munda +1 646 949 9027
Patrick Trucchio +1 646 949 9027

SALES
Enrico DiMatt +1 646 949 9230
Kelleigh Fald +1 646 949 9230
Ted Franchetto +1 646 949 9027
Sheeva Guost +1 646 949 9236
Rich Harb +1 657 202 9228
Zuber Hulbner +1 646 949 9202
Michael Lasser +1 646 949 9221
Jessica London +1 646 949 9203
Anthony Masucci +1 646 949 9282
Ryan McConnell +1 646 949 9204
Emily Moneck +1 415 802 2525
Peter Nichols +1 646 949 9201
Karan O'Sullivan +1 657 202 9202
Rodrigo Ortigao +1 646 949 9205
Rameeske Siss +1 415 802 2525
Matt Waddell +1 646 949 9220

CRM
LaJeda Goroka +1 646 949 9270
Mireia Kauck +1 646 949 9272

CORPORATE ACCESS
Olivia Lee +1 646 949 9207
Tiffany Smith +1 646 949 9208

EVENTS
Laura Hawkins +1 646 949 9209

SALES TRADING
Ronald Capra +1 646 949 9144
Michael Haughey +1 646 949 9106
Christopher Kannan +1 646 949 9103
Lars Schwartau +1 646 949 9101
Brett Smith +1 646 949 9100
Bob Spillane +1 646 949 9102
Jordan White +1 646 949 9122

ECONOMICS
Mickey Levy +1 646 949 9039
Rosara Reid +1 646 949 9038

Michael Lesser +1 646 949 9221
Tiffany Smith +1 646 949 9208
Jordan White +1 646 949 9222

Mickey Levy +1 646 949 9099
Jessica London +1 646 949 9203

EQUITY SALES TRADING
BERENBERG CAPITAL MARKETS LLC

E-mail: firstname.lastname@berenberg-us.com