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## EARLY ELECTIONS IN ITALY?

### Berenberg Macro Flash

Italian politics poses the biggest single tail risk to the stability of the Eurozone in 2017, as it did in the second half of last year. The tail risk has probably become a little fatter today with a decision by Italy's Constitutional Court that might pave the way for early elections in Italy, possibly in June. As one of his major reforms while he was prime minister, Matteo Renzi had introduced an election law that automatically awards a majority of seats to the strongest single party in a two-round voting process for the lower house of parliament. The Constitutional Court today struck down one provision, namely that of a potential second round if no party reaches 40% in the first round. However, the Court left the remainder of the "Italicum" law standing, adding that the election law could be applied immediately.

A perceived need to change the election law had been one of the major arguments against holding early elections in Italy. Courtesy of the court decision, Italy now has a valid election law: the strongest party gets a majority in the lower house if it receives at least 40% of the vote. Otherwise, it's a normal distribution of seats without a bonus, requiring parties to form a coalition in order to govern. Of course, the major political parties could still decide to change the law anyway – and take as much time for that as they want. A desire to bring the election law for the lower house of parliament more in line with the different rules for the upper house of parliament could well be an argument to adjust the law even after today's court decision.

Italy does not need new elections ahead of the scheduled end of the current parliamentary term in May 2018. With the support of a few small centrist groups, the ruling centre-left Democrats have a – somewhat shaky – majority in both houses of parliament. That major parts of the opposition such as the radical Five Stars want early elections is par for the course. The real issue is whether parts of the government would want that, too. This is where the tail risk comes in: having lost his referendum on a constitutional reform, the leader of the Democrats, Matteo Renzi, stepped down as prime minister last December. Apart from the different face at the top, his government continued with hardly any change. However, the youthful and energetic Renzi may want to return from his current back seat to the front seat, gaining a mandate to do so through early elections. Like Britain's ex-prime minister David Cameron with his failed Brexit referendum, Renzi may be tempted to take the risk and go for new elections even in the absence of a compelling reason to do so, possibly as early as June.

Current opinion polls suggest that neither Renzi's Democrats nor the Five Stars would get the 40% of the popular vote needed for an outright majority of seats (see chart). The most likely outcome of early elections would probably be a coalition between Renzi's Democrats and Silvio Berlusconi's centre-right Forza Italia, possibly with some smaller centrist groups included. Nonetheless, the risk that the Five Stars may team up with the ultra-right Lega Nord and the even worse "Brothers of Italy" and win a majority of seats jointly with these partners is not negligible. Together, these parties are currently at roughly 43% in opinion polls. These parties agree that they either want a referendum on Italy's membership in the euro (Five Stars) or want to leave the euro outright (the other two). In the past, the Five Stars had ruled out any alliance with any other parties. But recently, they seem to have become a little vaguer on the issue.

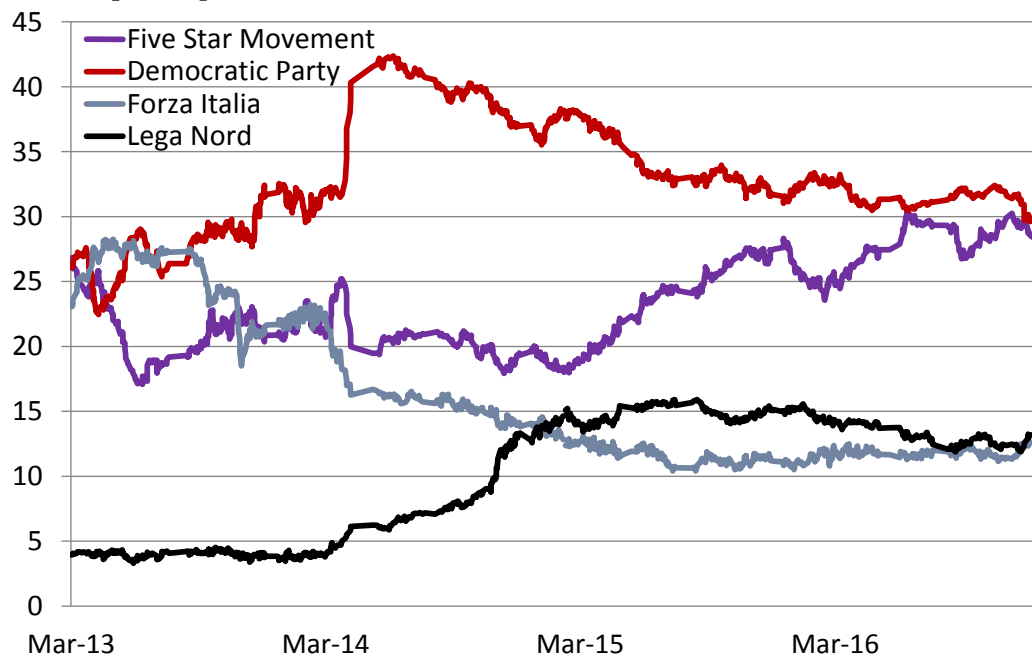
As we argued in our [Global outlook 2017: more growth, more risks](#), we put the tail risk that Italy may vote itself out of the euro at around 5%. Even after today's court decision, the risk continues to look pretty small: a majority of Italians seems to be in favour of the euro, the constitution does not allow for a referendum on an international treaty such as the one establishing the euro and changing the constitution would



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be extremely difficult as Renzi found out last December. In addition, quite a few of the deeply divided Five Stars would likely not vote to leave the euro anyway. Nonetheless, the risk is not zero either. Political uncertainty seems to be hanging like a sword over Italy, discouraging investment and making it difficult to attract capital to recapitalise the banks.

### Italian opinion polls



Centre-left Democratic Party, centre-right Forza Italia, radical Five Star Movement, ultra-right Lega Nord; average of last 5 opinion polls. Source: various national opinion polls

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