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Holger Schmieding, Chief economist | holger.schmieding@berenberg.com | +44 20 3207 7889

POLITICAL CRISIS IN ITALY: A CAUSE FOR CONCERN?

Berenberg Macro View

Italian prime minister Giuseppe Conte has lost a small coalition partner which had – so far – granted him a majority in parliament. The political crisis in the midst of the second wave of the pandemic shines a spotlight on Europe‘s long-standing top political risk: if new elections were to sweep anti-EU populists to power in Rome (or in Paris in 2022), the Eurozone could be in for some turbulence.

Does the departure of Matteo Renzi's centre-left splinter party from the government in Rome add to this risk? Not very much, in our view. Conte may still cling to power. He may hold a confidence vote next week, possibly after trying to pass a "recovery programme" needed to receive EU support first. More importantly, Italy's solidly pro-European President Sergio Mattarella will try hard to avoid new elections. Instead, he will explore options to reshuffle the government or bring some other centrist (splinter) parties on board to replace the Renzi group. He may also push for a broad government of "national unity". Even in the still highly unlikely case that the right-wing populists of Matteo Salvini's Lega and/or Georgia Meloni's ultra-right Fratelli d'Italia were to gain power after early elections, the risk that Rome would seriously consider leaving the EU and/or the euro would still look very remote.

Britain's bruising Brexit experience has further diminished the appeal of anti-EU ideas on the continent. Although populists are trying to blame Brussels and Berlin for slow inoculation progress in Italy, that argument looks unlikely to win an election while Italy is actually ahead of Germany in inoculating its people with a vaccine invented in Germany. The government has broken up in a dispute about how to spend €209bn from the EU‘s mutual fiscal support package (€81.4bn in grants, €127.4bn in cheap loans for Italy). The option to simply forego the money and be frozen out of debt markets in a financial crisis should not cut too much ice with voters either. Within the confines of the euro, reality has a way of taming the radicals. Just ask the erstwhile Greek prime minister Alexis Tsipras, who had to ditch his worst ideas after six months in office 2015, unfortunately only after inflicting great pain on his country. Or look at the 5Star movement in Italy, which has become much less radical since becoming the senior party of the Italian government in 2018. After first damaging the Italian economy by reversing some earlier pro-growth reforms, the 5Stars have been forced to get real on many counts since then.

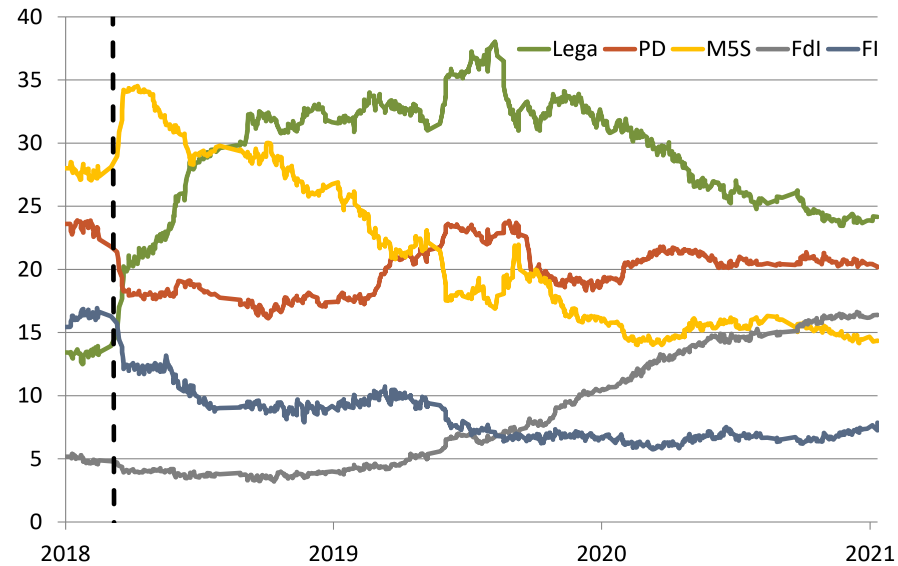
THE RENZI FACTOR

Renzi served Italy well as a pro-reform prime minister in 2014-2016. He also helped to put together the current coalition between the 5Stars and the centre-left Democrats in 2019, allowing Conte to stay in office after Salvini's Lega had left the first Conte coalition. Upon leaving the Democrats to form his own splinter party, Italia Viva, shortly afterwards, Renzi kept his new group in government - until yesterday. On substance, Renzi may have a point or two. He says that he wants to spend the EU money wisely, tie it to much-needed public sector reforms, and apply for more cheap loans from Europe (€36bn from the European Stability Mechanism to beef up the health system). The 5Stars are dragging their feet on some key pro-growth reforms and object to ESM money because they (wrongly) fear that it would come with onerous conditions and/or a stigma effect. But politics is not just about substance. Many Italians reportedly see Renzi's manoeuvres as an attempt by a now fairly unpopular politician (Renzi) to unseat the quite popular prime minister Conte.

KEY PLAYERS HAVE LITTLE TO GAIN FROM SNAP ELECTIONS

Renzi's Italia Viva holds 30 of 630 seats in the Lower House and 18 of 315 seats in the Italian Senate (source: Wikipedia). His small party was – so far – needed to grant Conte a majority in the Senate. The decision to call new elections is largely up to President Mattarella. Expect him to first try to put together a slightly different or new government by bringing in some small current opposition groups or even Silvio Berlusconi's Forza Italia (54 seats in the Senate). He may also explore the option of a "national unity" government of major parties including Salvini's Lega, possibly to be headed by a non-partisan technocrat until the next regular election in 2023. Former ECB president Mario Draghi is mentioned as a possible candidate in Italian media. Outcome unclear. But opinion polls suggest that the major players either have a lot to lose from new elections (5Stars), little to gain (Democrats) or would advance only modestly (Lega) relative to the March 2018 election result. The major winner could the far-right Fratelli d'Italia rather than Salvini's Lega – see chart. Renzi's group languishes at a mere 2.8% in the polls. That points to a reasonable chance of settling the crisis without snap elections. In the end, it should be attractive to be part of a government that, if it gets its act together, can spend much more money than previous governments thanks to the help from the EU. In the meantime, ongoing ECB bond purchases should serve to contain swings in Italian yield spreads.

Chart 1: Support for major Italian parties in opinion polls, in %



M5S: 5 Stars, LN: Lega; PD: centre-left Democratic Party, FI: centre-right Forza Italia ; FdI: right-wing Fratelli d'Italia, average of 7 latest available polls, vertical line: national election result March 2018. Sources: National opinion polls, Berenberg calculation.

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