

Luiss

School of Government

School of European
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Foreword

Italian politics has always been an arcane subject. A handful of specialists and enthusiasts love to talk of its Machiavellian intricacies for hours on end, but most people, especially north of the Alps, not only do not understand it, but see no reason why they should care to understand it. Today there are at least three reasons why they should. First, in Italy the crisis of the political establishment that is now evident in many advanced democracies has begun a quarter century ago. This means that the country is further down the road of the democratic malaise – it is a laboratory and a bellwether. Second, Italy is the first country from within the historical core of the European community to be governed by anti-establishment parties. Third, its politics represents the greatest threat to the stability, or possibly even the existence, of the common European currency.

Founded in 2010 in a University that has a very strong international vocation, the LUISS School of Government aims at easing the connection between Italy and the world outside it. It aims at preparing the future Italian public elite to the complexities of an ever more integrated planet, and at providing first-class education to non-Italian students in Italy's capital city. SoG professors have often helped non-Italian journalists and newspaper readers understand Italian politics. Thus, it seems only natural to me that, also in preparation of the coming European elections, the LUISS SoG should offer a monthly report on Italy that provides an interpretation of the country's recent political events, and makes an educated guess about what happens next.

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1 Politics and Policy

a) Government

Tension is rising between the two parties in the coalition, the League and the Five Star Movement, on immigration and infrastructure, but the government looks united on the banking system, foreign policy and European issues.

Immigration. Immigration remains a pet subject for Matteo Salvini. This month the Interior Minister and leader of the anti-migrant League, has been harshly criticised by his Five Star coalition partner for refusing to allow any of the 49 asylum seekers on two rescue boats to land at Italian ports. The ships remain at sea after Malta said it would not allow the boats to dock and Salvini insisted that all Italian ports would be closed to any vessels carrying migrants.

On the immigration crisis, the government is playing the blame game with the EU, arguing with Brussels that the redistribution agreed this summer at the European Council meeting has not been implemented by the other member States. The government is arguing that most of the other European nations are not contributing to the migrants' relocation. Prime Minister Giuseppe Conte stated that the European Union risks collapse unless it finds a common position on migrants. "If we continue to stall without a shared way forward, we risk bringing down the European structure," Conte told a news conference when speaking about a meeting in Rome with European Home Affairs Commissioner Dimitris Avramopoulos.

As Interior Minister Salvini has put controlling migration at the centre of his political plan, Luigi Di Maio, leader of the Five Star Movement and the Deputy Prime Minister, has largely left Salvini unchallenged on the issue since the new government came to office in June. And Salvini has seized the opportunity to approve a new security decree and to put himself and his party forward as Italians' protectors. **The strategy has worked and has enabled the League, which had come to office as the junior party, to overtake the Five Star Movement in the polls.**

But now Di Maio is showing himself less inclined to find an agreement on immigration policy with Salvini. Indeed, the Five Star Movement needs to differentiate its political position from that of its government partner in the run-up to the European elections. Di Maio's strategy targets moderate voters and, particularly, the left-leaning electorate disappointed with the Democratic Party. Di Maio is pulled in this direction by the Five Star Movement's radical faction led by Alessandro Di Battista, a former MP and a very influential political figure in the Movement, who is less willing to compromise with Salvini.

While Salvini stated that Italy would accept "zero" migrants, the Five Star leader said the country should allow some of the asylum seekers to disembark as part of a Europe-wide solution to the migration crisis. "We are not retreating on migration policy, which has enabled a considerable reduction in landings, but when it comes to women and children we are ready to provide a lesson to the whole of Europe and to welcome them," said Di Maio.

However, Salvini is standing firm on immigration and the Italian ports stay closed. In the last week, the SeaWatch vessel with 47 migrants on board remained ten days off Sicily without permission to dock and disembark passengers. In the end, seven European countries offered to take in some of the migrants who were aboard. Salvini considered this result a victory for his intransigent political line which has put pressure on other European countries to cooperate in receiving migrants.

Tension with France. In the meantime, the Five Star leader blamed France's President Macron for the immigration crisis and they are at diplomatic loggerheads. Luigi Di Maio has accused France of exploiting the monetary supply of the CFA Franc to its former colonies in order to pursue a neo-colonial strategy which hampers the economic development of these African countries. This, according to Di Maio's allegations, would be the basis for the massive flow of immigrants from Africa to the Mediterranean looking for better living standards. Salvini has aligned himself on the same position as his colleague. A small diplomatic crisis occurred and the Italian ambassador was summoned by the French government. **Fed by reciprocal nationalism, the political tension between the two countries is rising.**

The two parties of the coalition are playing an aggressive game in preparation for the European elections in May and Emmanuel Macron is being targeted by them. **The French President is considered by Italian populist parties as the embodiment of the pro-European establishment and he is perceived as the symbol of everything that must be defeated.** Macron has played hardball on immigration over the past few months, closing the port of Marseille and refusing entry for immigrants at the frontier with Italy. **Moreover, the French government has appealed to the European Competition Authority to prevent the acquisition of the French STX by the Italian State-owned champion Fincantieri.** These moves have been considered hostile action by the Italian government, which has chosen to undertake a political battle with France.

Political-Judicial conflict. Furthermore, the conflict between the judiciary and politics, which characterized the Berlusconi era, is coming back with Salvini. **An Italian court has cleared the way for potential prosecution of the Interior Minister over allegations including kidnapping related to a migrant vessel incident in August.** Initially, the potential charges against Salvini were dropped in November following a statement by the prosecutor of Catania but now another judicial institution, called the Tribunale dei Ministri from Catania, has reopened the case.

The charges originate from the case of the vessel Diciotti, a ship of the Italian Coast Guard, which picked up migrants in the Mediterranean and attempted to bring them to Italy in mid-August. While Salvini allowed the vessel to dock at an Italian port, he refused to allow the migrants onboard to disembark onto Italian soil where they could claim asylum. For these reasons Salvini is being prosecuted by the magistracy for breaching international laws on immigration. **In the next few months Parliament will vote to decide whether to send the Interior Minister to trial or not.** On that occasion, the Five Star Movement will have to choose between voting against the trial and defending Salvini and thus abandon its traditional position in favour of judicial investigations, or voting for the trial but risking the collapse of the government.

Salvini has exploited the charges by the judges in the media to launch an offensive against the judiciary and to reaffirm that he will pursue his immigration policy at any cost.

Italian history shows, particularly when Silvio Berlusconi was prime minister, that, at least at the beginning, **conflict between politicians and magistrates benefits the former.** Indeed, Salvini could

use the media attention generated by the criminal investigation to increase approval for his strict immigration policy. **Polarization of public opinion is helping Salvini to set the agenda and an investigation into his actions on immigration policy might drive a further polarization of his figure as the League's leader and enable him to make the most of the media attention.**

Divisions on infrastructure. The other warm front for the governing coalition is on infrastructure. In early January pro-high speed rail-link associations and parties gathered to press the government to start work on a key project. The League participated in the initiative, but the Five Star Movement still opposes the infrastructure on environmental grounds.

Luigi Di Maio said that the controversial Turin-Lyon TAV high-speed rail-link project should be halted if a new cost-benefit analysis commissioned by the government is negative. **Di Maio's Five Star Movement has long been against the TAV. Matteo Salvini has said he is in favour of the project and has suggested holding a referendum if the new analysis gives it the thumbs down.** However, accepting a referendum on the TAV might be risky for the Five Star Movement because it is likely that most people in the Piedmont Region will vote for the infrastructure. The battle for the TAV is wide open and the balance of power between the two parties in government will be tested by the final decision, which could be taken post-European elections. The Minister for Infrastructure Danilo Toninelli (Five Star Movement) has announced that the cost-benefit analysis commissioned by the government will be made public and discussed in coming weeks.

At the moment the end of the story is still shrouded in uncertainty. However, if the League, through a governmental decision or through a referendum, wins out over the construction of the TAV, **it will be a major political defeat for the Five Star Movement.**

b) Opposition

Salvini's hard line on migration has been contested by **left-leaning mayors of several large Italian cities**, including Naples, Palermo and Florence, who have denounced his recently passed security law to erode the rights of asylum seekers. This "mayors' revolt" against the government might be interpreted also as a "tactical skirmish" within the centre-left. Indeed the Democratic Party is weak in the polls and the party will hold its Congress in March and the rest of the left is divided into splinter groups. **In this scenario the leftist mayors of the most important cities are aiming to occupy the vacant political space on the left and to mount an offensive against the apparatchik in Rome.**

Furthermore, the **Democratic Party is organizing for primary elections to choose its next Secretary.** According to polls among party members Nicola Zingaretti, the governor of the Lazio Region, is ahead of Maurizio Martina, the outgoing secretary of the Democratic Party. Third is Roberto Giachetti, a long-standing member of Parliament and someone close to the former Prime Minister Matteo Renzi.

Meanwhile on the right **Silvio Berlusconi announced he will run for the European elections.** The leader of Forza Italia has criticized the government, particularly on economic policy, and he stated his comeback was in order to defeat the Five Star Movement. However, Berlusconi went easy on deputy prime minister and former ally Matteo Salvini. Indeed, **the leader of Forza Italia did not raise any doubts about the centre-right coalition at regional and local levels. The two parties will remain allied in the next regional elections over coming months.** From February to May several regions are voting (Abruzzo, Basilicata, Piedmont, Sardinia) and it seems likely that the centre-

right will win most of these races. Moreover, Forza Italia has announced that in Parliament it will vote against the authorization to try Matteo Salvini in court for his migration policy - another signal of loyalty toward the League.

c) Public Policies

Carige. Administrators in charge of Banca Carige have announced a restructuring plan after Italy's populist government said it would provide state guarantees to stave off a full bailout for the ailing Italian lender. The Genoa-based lender said that its administrators had begun a process to reduce its bad loans and that it was applying for access to a state-backed guarantee on bonds it planned to sell. The decree, signed off after an urgent cabinet meeting, will allow the bank to benefit from state-backed guarantees for new bond issues and funding from the Bank of Italy. The lender, which last year failed to secure shareholder backing for a capital increase, will also be able to request access to state-backed precautionary recapitalization, if needed.

Italy's government is ready to nationalise struggling Italian bank Carige, leaders of the anti-establishment government said. The comments from the two Deputy Prime Ministers, Di Maio and Salvini, came as the government stepped in to bail out the bank which has teetered on failure since a do or die €400m capital increase failed to find sufficient backers in late December and the ECB stepped in to take control of the lender.

The government acted in continuity with previous ones in providing public guarantees to save the small bank. In political terms this means that populist government is not revolutionary on banks. When they were in opposition, they harshly criticized the bailout of financial institutions, such as Monte dei Paschi, but once in government, both the League and the Five Star Movement agreed to intervene in the bank's capital.

However, a few days later **Matteo Salvini accused the ECB of harming Italian banks.** "The new attack by the ECB supervisor on the Italian banking system and Monte dei Paschi shows once again that the banking union ... not only does not make our financial system more stable, but causes instability," Salvini pointed out. The League's leader accused the ECB of overriding decisions made by the European Commission, adding it raised a "fundamental question" about the **central bank's supposed impartiality.**

Such a statement is significant looking at the upcoming European elections. Indeed, the new European far-right group, which might be led by Salvini's League, could **call into question the independence of the European Central Bank and the rules of the European banking system.** This position on the ECB and banking system might become central in the negotiation for the next EU Commission if the far-right group has the chance to join a coalition to govern the European Union.

Citizens' income. This month the Italian government approved a new poverty relief scheme known as "citizens' income", fulfilling a long-standing election promise of the Five Star Movement.

The citizens' income will cost state coffers 7.1 billion euro this year, 7.8 billion in 2020 and 8.0 billion in 2021. The initial proposal by the Five Star Movement was to give a monthly income of 780 euro to any unemployed person and it would have cost the government 17-18 billion euro per year. However, in the drafts of the Budget Law and the related decree Minister Luigi Di Maio made the process to obtain the citizens' income more cumbersome and stringent, reducing as well the amount of public money allocated for it. Now eligibility depends on income, savings and property ownership. A single person living in rented accommodation with no income and minimal savings

can receive a maximum of 780 euro per month. Of this, 280 euro must be used for rent or 150 for a mortgage. Someone who already has a source of income, but below 780 euro per month, will have it topped up to this threshold, which is considered the poverty line for a single person paying rent. Some benefits are provided for families with two or more children.

The money will be loaded onto a digital card at the start of each month and is removed at the end of the month if it has not been spent. Recipients who are able to work must do eight hours' community service per week, take any training courses proposed, and take one of the first three job offers that match their qualifications.

The citizens' income can be received continuously for 18 months, after which it is suspended for one month and a new application must be submitted. A company that hires someone on the scheme receives the citizens' income that would have gone to the unemployed person for the remainder of the 18-month period. Hence a company that hires a person who has been on the scheme for two months will get the income for 16 months.

The policy implementation process poses some risks for the government. The procedure to obtain the citizens' income card might be perceived as too bureaucratic and cumbersome. Furthermore, the government has to set up some new arrangements for job centres: hiring and training new personnel (10,000 people will be hired by the government to ensure effective policy implementation), establishing procedures and controls, implementing data sets. Shortcomings and organizational delays might occur during this phase. Moreover, risks of fraud, particularly of people being subsidized and moonlighting at the same time, are clear.

Moreover, **voters expected a simpler procedure, fewer restrictions to access the income and a higher amount of money as the Five Star Movement promised during the election campaign.** In political terms too the citizens' income scheme seems risky. Indeed, despite its costs being reduced from the initial proposal, voters who would have preferred to commit those resources for other policies will remain unhappy at the government's decision to carry it out and, on the other side, voters who agree with this policy proposal might be disappointed at its downsizing. **Half-measures hardly ever pay in contemporary politics.** The result could be that the **Five Star Movement will lose support from its voters without scoring points from the other political forces.** However, whether or not in the long run the policy will work for the beneficiaries, we might expect a consolidation of consensus for the Five Star Movement, especially in the south and among younger voters where the unemployment level is higher.

Lower retirement age. The pension reform, championed by the League, rolls back a 2011 law which had overnight raised the retirement age to 67 for many Italians, with further increases scheduled to match rising life expectancy.

Under the new rules, people will be able to retire when the sum of their age (say 62) and the years of their pension contributions (say 38) adds up to 100. The changes, which will take effect from April for private sector workers and August for state employees, will cost 4 billion euro this year and just over 8 billion in 2020.

The **2011 reform (Fornero Law)** passed at the height of a debt crisis with further increases scheduled to match rising life expectancy. However, this reform **has become deeply unpopular**, partly because hundreds of thousands of Italians who had quit work early expecting to retire shortly afterwards were left stranded for years with neither a job nor a pension and partly because the reform was approved and implemented by Mario Monti's technocratic government, which was perceived by most citizens as politically illegitimate and distant from their needs.

For these reasons the former Prime Minister Matteo Renzi (Democratic Party) overhauled the Fornero Law in 2016 by introducing an option for people to retire earlier, but with a lower pension. The measures cost over 2 billion euro.

Demography counts in politics and Italy has an ageing population. The over 65s account for over 35% of the population, five per cent above the European average, and for any political party gaining the consensus of senior citizens means increasing their share of the vote.

The populist government took a step further with its budget law. The main principles of the Fornero Law remained untouched but additional exceptions have been introduced. **The policy is a flagship reform of both the Five Star Movement and the League. The reform is a risk for Italy's public finances, but in political terms it can pay off.** Part of the ageing population, concerned at the rigidity of the 2011 pension reform, might be attracted by the relaxation of the retirement policy.

d) Forecasts

Probability of snap elections:

Elections before or together with European Elections (by the end of May 2019): 10%

Elections between Q3 2019 (autumn) and Q2 2020 (spring): 40%

Election after 2020 or at the end of the legislature (2023): 50%

An early vote by spring 2020 is becoming less likely. **The coalition is not being pressed by the opposition for a snap election and the two parties, particularly the Five Star Movement, have shown no sign of being impatient to return to the polls.** The populist alliance, despite the tensions on some specific issues, still seems solid. Furthermore, when we analyse the strategy adopted by the President of the Republic Sergio Mattarella in the previous legislature, we can see that he supported government stability and succeeded in avoiding a snap election. **The temptation for Salvini to break up the coalition might rise after the European election, but the scenario, with the spectre of a new recession looming, could become more complicated for him.** Indeed, an early vote cannot be taken for granted even if the League were to withdraw its support for the Conte government. Mattarella, according to his constitutional powers, could find another majority in Parliament and, considering the weakness of the opposition, it is not out of the question he might get it. In this case Salvini would lose his place in government and would not get the chance to return to the polls.

For these reasons the duration of the Conte government might be longer than expected. Moreover, the Prime Minister has been playing a more prominent role in recent months. Conte is becoming more independent from the two-party leaders, Di Maio and Salvini, and his stronger position might help him bridge the gap between the two parties, securing a continuation of the government. Indeed, the probability of a cabinet reshuffle after the European and regional elections remains high.

Moreover, in the worst-case scenario the coalition could split in the next two months due to the magistracy's investigation into Salvini. If the Five Star Movement does not vote against putting Salvini on trial, the government could fall because the League, at that point, would leave the

majority. It is the least likely scenario today because the two parties do not have many incentives to break up. However, we cannot consider it completely impossible.

2 Public Opinion Trends

a) Polls

As the 2019 European Parliament election is approaching, Italian political parties are getting ready for the race. **The League is capitalizing on the experience in government and has by now consolidated its leadership within the centre-right coalition. The Five Star Movement is searching for allies in Europe to avoid the risk of being isolated after the elections.** Silvio Berlusconi is trying to relaunch his Forza Italia party (hereafter FI) and has recently made public his decision to run for a seat in the European Parliament. Finally, the Democratic Party will hold primary elections next March to choose the new party Secretary who will bear the burden of revitalising a dispirited party after the collapse at the general elections of March 2018.

If parties are adjusting their strategies, the voting intentions of the Italian electorate have remained substantially stable in the last month (Table 1). **The honeymoon period between voters and those political parties which now support the Conte government has not come to an end yet.** In line with survey data collected at end of December, the League and the 5SM together account for almost 60% of voters' support, although combined they have lost a couple of percentage points. However, if compared with the results of the general elections, these data clearly confirm the impressive electoral growth of the League (moving from 17.3% at the general election of March 2018, to 31.8% now) and clear declining support for the Five Star Movement (moving from 32.7% obtained at the general election to 25.3% in early 2019).

As for the opposition parties, they have not been able to re-mobilize voters after the disruptive results of the general election. The Democratic Party is stuck on a meagre 17.7%, while a straightforward electoral decline can be observed for FI, which has lost more than 5 percentage points compared to the last general election – when the party won just 13.9% of the vote.

Tab. 1 – Vote intentions based on recent surveys, and comparison to March 4

	Polls last week of January	Polls last week of December	March 4 elections
League	31.8%	32.9%	17.3%
Five Star Movement	25.3%	26.3%	32.7%
PD	17.7%	17.6%	18.7%
FI	8.4%	8.7%	13.9%
FDI	4.0%	3.8%	4.4%
+EU	2.8%	2.5%	2.6%
LeU (MDP and SI)	2.7%	2.1%	3.4%
PAP	2.2%	2.0%	1.1%

b) What’s behind the League’s electoral success?

Despite the widespread support for the government led by Prime Minister Giuseppe Conte, so far the experience has not been equally rewarding for the political parties forming the yellow-green majority. Indeed, **the leap forward by the League is coupled with a clear decrease in support for the Five Star Movement.** This situation raises the intriguing question about what underpins the electoral success of the League, and what, instead, is pushing the Five Star Movement back.

One tentative answer looks at the role of specific issues, their relevance for the electorate, and the perceived competence of parties to handle these issues. A CISE survey conducted between 10 and 19 December 2018, asked a representative sample of the Italian electoral population (N=1,113) to indicate the most important problem the country is facing at the moment. This question was immediately followed by a second one, in which respondents were asked to name the party that is best at handling these issues.

Not surprisingly, in a country characterised by one of the highest unemployment rates in Europe, unemployment is considered the most important problem in Italy by a plurality of the respondents (31%). This is followed by the lack of economic growth (11%), taxes (11%), public debt (11%), political corruption (9%), and immigration (8%). To assess which parties are more likely to appeal the electorate on each of these issues, Table 2 reports the proportion of respondents indicating which, among the four major Italian political parties, is deemed best at handling each of these issues by those respondents indicating that as the number one problem of the country. To facilitate the comparison between the League and the 5SM, the table also reports for each issue the difference between the proportion of those considering the League and the 5SM respectively as the most competent party.

Tab. 2 – Best party at handling the most important problems Italy is facing at the moment. Source: CISE survey, December 2018 – 1,113 CAWI interviews)

	Unemployment	Taxes	Public Debt	Economic growth	Corruption	Immigration
Most important problem (whole sample, N=1,113)	31%	11%	11%	11%	9%	8%
Best party at handling problems						
League	17%	33%	13%	24%	23%	68%
FI	12%	11%	8%	2%	1%	3%
5SM	8%	19%	17%	17%	31%	7%
PD	22%	4%	25%	23%	2%	6%
Δ (% League - % 5SM)	9%	14%	-4%	7%	-8%	61%
Total respondents	342	116	112	126	104	105

Out of the six most important issues listed in Table 2, there are only two cases in which the 5SM is deemed to be more competent than its partner in government. In particular, as regards the management of Italian public debt and corruption in politics, respondents are more likely to give

credit to the capacity of the 5SM rather than the League. However, it should be noted that the difference between the two parties, in terms of credibility, is not particularly high, namely 8 percentage points for corruption, and 4 percentage points for Italian public debt.

Contrarily, on all the other issues listed in Table 2, there is a clear competitive advantage for the League compared to the 5SM. Here the gap between the two parties in terms of perceived competence ranges from a minimum of 7 percentage points (for the lack of economic growth) to a peak of 61 percentage points when it comes to immigration. **It is worth noticing, in this respect, that more than two thirds of those who indicate immigration as a crucial problem for Italy are convinced that the League is the most competent party to manage this issue.** In other words, immigration is the only issue on which there is just one party (the League) holding a privileged position and leaving no room for competition.

How to interpret these data? To the extent voters express their preferences based on the party competence to deal with issues and problems that are generally considered relevant for the country, **the electoral success of the League can, at least partially, be explained as a consequence of a broadly diffused perception of competence on a number of issues among public opinion.**

Indeed, with the exclusion of specific issues (i.e. public debt and corruption in politics), in which their partners in government appear to be slightly more appreciated by the electorate, the League holds a robust competitive advantage on a series of significant problems (in particular on immigration). On these issues the party might have been able to mobilize voters more than the 5SM, thus creating and consolidating a reputation of competence and pragmatism.

Finally, these **data provide a clue about what issues might be at the core of the campaign for the European elections.** If it is clear that the League is the most likely candidate to exploit immigration (an issue on which this party has no equals in terms of perceived competence), competition on other issues is more open. In particular, there are issues on which neither the League nor the 5SM are considered the most competent parties. This is true, for example, for unemployment and public debt, issues on which the Democratic Party maintains a stronger reputation compared to other political parties. Looking forward, these issues appear the most likely candidates to be exploited by the centre-left opposition.

3 Economic Scenario

New Recession. After the positive growth in the first two quarters of 2018, signs of weakness in the Italian economy have become unequivocal. During the third quarter of 2018, a reduction in the annual GDP growth rate (from 1.2% to 0.7%) and a negative rate for cyclical GDP growth (-0.1%) was already clearly visible. As analysts anticipated, the further slowdown in the economy was confirmed by the latest data released by ISTAT on January 31. Indeed, in the last quarter of 2018 cyclical GDP growth was negative (-0.2%). Moreover, signs of substantial weakness emerged with the publication of the index of industrial production in December that showed both cyclical and trend negative variations respectively of -1.6% and -2.6%.

The clearest signals of a slowdown came from the manufacturing sector. The PMI index, although slightly increasing since November (48.6%), confirms the difficulties that companies had in acquiring new orders in the month of December. At 49.2%, the index remained below the 50% neutral level at the end of the year. A sign of improvement came instead from the tertiary sector in the month of December (50.5%) compared to the previous month (50.3%). Overall, the Manufacturing Composite Index for December stood at 50%, that is, at an inflection point between recession and expansion. Significantly, in early January, Finance Minister Giovanni Tria confirmed that Italy was at risk of stagnation.

It is very likely that the economic slowdown was aggravated by the political and institutional uncertainty arising in the course of a heated conflict between the government and the European Commission over the draft budget law proposed in mid-October. The tensions between Rome and Brussels led to a severe rise in the spread between ten-year Italian government bonds (BTP) and German bonds (BUND), influencing the cost of financing for the State and for the banks, and, in the end, having repercussions on families and businesses. A severe impact on the real economy was inevitable.

Weak domestic demand... The effects of the uncertainty and of the credit restrictions were also seen in Italian families' consumption. In fact, the data on consumption show a slowdown compared to the positive trend in the first and second quarters of 2018, and thus a reduction in consumption in the third quarter. In addition, family savings rose from 2017 (2.3% in 2017 and 2.4% in 2018, as a percentage of disposable income) and are estimated at 2.9% in 2019. As already mentioned, the behaviour of economic operators is justified because it is a consequence of a period of severe economic and political uncertainty, real as well as perceived. For this reason, it is especially important to analyse the confidence indicators in order to identify Italian economic operators' future choices.

...with interesting data from the confidence indices The five consumer confidence indices produced by ISTAT outline a situation that is consistent with the one described previously. In fact, all the published indicators, except for "Consumer Personal Climate" (Clima personale dei consumatori), fell in November. In addition, new information in the published data for December shows a further deterioration in consumer expectations with all the indicators in decline.

Particularly significant has been the evolution of the Business Confidence indicator, which mirrors the expectations of Italian companies. As for the construction, services and trade sectors, this index shows how in November and December confidence in the construction and services sectors was in steep decline, while expectations improved in the trade sector. With regard to the manufacturing sector, the index shows Italian firms' general discontent in the current economic

situation by recording the continuation of the negative trend from September 2018 until December. A more detailed analysis of confidence in the manufacturing sector shows that the negative sentiment for the month of November was not shared by the whole country, but mainly by Northern Italy, while in Central Italy the decrease in the index was modest and in the South the situation even improved. The December figures show us how expectations in Northern Italy still remain downbeat, albeit with a slowdown in the deterioration of expectations in the Northwest (from 103.1 to 103), while Central Italy and the South recorded a net reversal of the trend compared to the previous month, with the confidence index rising in Central Italy and, instead, decreasing in the South.

...and mixed signals from the labour market. The latest available data (November) show that employment levels were equal to the previous month, while the annual variation saw a slight increase (0.4%). As regards the unemployment rate, November recorded a decrease (cyclical change of -0.9% and trend change of -4.3%).

Trade tensions have negative effect on expectations... In 2018, the general negative trend in the Eurozone had a negative impact on the Italian economy. However, after a decline in Italian net exports at the beginning of the year, the latest available statistics (November) show an improvement in the balance between exports and imports. The American Presidency's commencement of hostile trade policies with China and the threat of extension to commercial disputes with the major economies of the world, including the European Union, have had a severe impact on the expectations of the main economic operators. In November, a relative recovery in the trend in Italy's trade balance gave more encouraging signals about tensions within the EU. In general, signs of less antagonism between Washington and Beijing have been perceived, although the tension has not been fully relieved yet.

...and the financial markets are very influential... The pronounced political-institutional uncertainty at the end of the year resulted in a strong increase in the spread on Italian government bonds. As already pointed out, the effects have been very damaging, resulting in higher financing costs firstly for the State and secondly for the banking sector. A deterioration in the banks' credit supply at a time when Italy expects economic growth to reach pre-crisis levels is likely to have very negative effects on households and firms, as well as negative repercussions on the real economy. A greater degree of credit restriction could not come at a worse time, since at the end of 2018 the European Central Bank terminated its unconventional monetary policy program.

...and the approaching end of QE. The ECB's conclusion of the APP (Asset Purchase Programme) with the termination of new bond purchases is taking place at a time in which Italy, especially the Italian banking sector and public finances, require the continuation of an accommodative monetary policy. In particular, one of the main problems of Italy's banks is linked to the presence in their balance sheets of non-performing loans, which during the second quarter of 2018 amounted to almost 10% of all Italian loans (€159 billion). The credit conditions could thus be detrimental for private investments. In addition, the current government's budget policy is oriented to giving priority not to public investment but to public spending on consumption and transfers. Against this backdrop, we cannot exclude further tensions on the markets with a rise of the BTP-Bund spread in the course of 2019, if the most pessimistic view about growth this year proves to be correct. An increase of the differential would have a negative impact on the balance sheets of Italian banks, which are holders of a large amount of Italian government bonds. Losses on such high volumes of bonds would force the banks to increase their capital in a context in which the monetary policy conditions will be influenced by the end of bond purchase programs that were part of the ECB's unconventional policies, among other reasons. However, we do not expect the

ECB to refuse to give support to Eurozone countries in 2019. The ECB has committed itself to reinvesting the entire capital used in the APP once the bonds expire, to keep liquidity conditions adequate in the markets until it raises interest rates, or at least until it is necessary to do so. In January, the ECB clearly said that it will carefully consider any sign of economic slowdown in the Eurozone. Even against this backdrop, however, bad surprises in Italy's GDP growth, like the new data released on the last day of January by ISTAT, can derail the relative current stability in the German-Italian spread.

Finally, it was possible to avoid the infringement procedure for excessive debt. At least for the moment, EU Commission sanctions have been avoided and this has eased the tension, perhaps allowing households and firms to assume a positive outlook, waiting to form an opinion on the economic policies of the government. Today, in fact, Italy has a budgetary policy that is more or less consistent with the standards of the European Commission (compliance with the deficit rule), even if it will hardly help the Italian economy come out of the "stagnation trap" in which it has been for many years now. Moreover, the forecasts of a recession in Italy for the rest of the year are justified if the effects of the fiscal relaxation produced from the limited application of the flat tax envisaged by the Budget Law are not sufficiently positive, or if there is no increase in private consumption due to the expected transfer of resources to people with a reduced consumption capacity through the Citizens' Income. On the whole, the disappointing quality of fiscal reforms gives reason to think that the recession might continue.

In consideration of the above, the government's overly optimistic growth estimates have recently been cut back. Compared with those of the major international institutions, these economic forecasts, however, remain optimistic. Paradoxically, the possibility that they become reality depends on the margins for violation of European budgetary policies. It is possible, therefore, that the dispute on balancing the budget between Brussels and Rome will resume. Italy seems stuck between a rock - slow growth - and a hard place - a sanction for the infringement of European fiscal rules.

In the last few months, the various tensions in Europe, such as the Yellow Vests in France, Brexit in the United Kingdom and the violations of the rule of law in Hungary, have contributed to the fact that Italy has not been the only subject under the watchful eye of the European Commission in its evaluation of fiscal reforms. So far, all this tension - along with the constructive dialogue between Rome and Brussels - has in some way helped Italy. However, as already mentioned, with the infringement procedure for Italy avoided for the moment, in the course of this year there remain possible tensions at the EU level because of budget overruns. Consequently, Commissioner for European Affairs Pierre Moscovici has been very clear, saying that "safeguard clauses" will be used, thus increasing VAT, should Italy's deficit prove higher than agreed. In this case, the recession will not be a temporary fluctuation, but rather a new trend in GDP.

Finally, in late May, the European elections will play a key role in the future and the stability of the EU, further conditioning the levels of uncertainty and the expectations of economic operators. Should there be surprisingly destabilizing results, Italy might find itself exposed to conditions of greater fragility compared to the other Eurozone countries.

4 Foreign Policy

The last month has been characterized by growing international tensions between Italian and foreign leaders, but also inside the government coalition over European and foreign policy issues.

The controversy with the European Union on the Italian budget law is still alive: formally, the Italian government decided not to give up on the two main social reforms included in the “government contract” (the citizens’ income and the pension reform). Nonetheless, the decision to take into account the position of the EU Commission and the informal agreement to reduce the negative impact on the budget of these reforms has reduced the tension.

The substantial normalization of relations with Brussels has not led, however, to an improvement in the Italian position in the European Union. Notably, relations with both Paris and Berlin have significantly worsened. Deputy PM Luigi di Maio took a critical stance towards France and openly challenged Emmanuel Macron: Di Maio criticised the continuing impact of French colonialism, which is alleged to survive through the monetary ties between France and Western African countries. Di Maio’s statement was harshly condemned by Macron and by the French leadership. The quarrel over the supposed survival of French colonialism was only the latest stage in broader disagreement on a number of strategic issues, ranging from immigration policy to the reform of the EU. Relations with Germany are also at a critical stage: on 22 January the German government announced its withdrawal from the Sophia mission for the naval patrolling of the Mediterranean. This was its way to express the complete disagreement of the German government at the Italian position on the migration crisis (Italy has the formal coordination of the Sophia mission).

The distance between Rome on the one hand and Paris and Berlin on the other has been increased by the signing of the Aachen treaty which reinforces structured cooperation between France and Germany within the European Union. The treaty, which promotes strategic cooperation on policies such as security and defence, has been seen in Italy as confirmation of the Franco-German plan to increase the isolation of Italy.

Another signal of the changing patterns in Italian foreign policy was the **rumour about a potential withdrawal of Italian troops from Afghanistan.** The declaration by the Defence Minister, Elisabetta Trenta, that a withdrawal from Afghanistan is currently under evaluation was not supported by the other members of the government (Foreign Minister Enzo Moavero Milanesi declared that he had not been informed). The debate on Afghanistan (and broadly speaking on military missions abroad) shows a lack of coordination at governmental level and the inability of the main ministries to generate comprehensive and effective international action.

Moreover, the cohesion of the government has been challenged by the recent events affecting **Venezuela**, where Juan Guaidó is challenging the leadership of President Maduro. Italy has abstained from the European decision to recognize Guaidó. The real reason behind the abstention is the need to maintain a cautious approach in order to guarantee the safety of the Italian community in the country. In the controversy, however, strong disagreement has emerged in the coalition: members of the Five Star Movement took a position in favour of Maduro (for instance Di Battista); on the contrary, the League expressed its support for the democratic (and formally anti-communist) leadership of Guaidó.

What is emerging in recent weeks is that the **two parties of the coalition are engaging in a competition, in which European and international policy plays a key role**. The two parties are developing their strategies for the European elections: Salvini is working to create a large front of nationalist and euro-sceptic forces, while the Five Star Movement is engaging in negotiations with the German Greens to overcome their current condition of isolation in the European network of parties and movements.

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