

# Monthly Report on Italy

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*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 bother 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 began 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 represent 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 to facilitate the connection between Italy and the world outside of it. It aims to prepare the future Italian public elite for the complexities of an ever more integrated planet, and to provide 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, in light of the recent 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

**Technocrats vs political leaders?** A new standoff seems to be on the rise within the Italian government. On one side, the two party leaders Salvini and Di Maio and on the other the technocratic soul of the Cabinet in the persons of the Prime Minister Giuseppe Conte and the Minister for Economy and Finance Giovanni Tria. The League's leader this month launched his plan of 10-15 billion in tax cuts to boost the Italian economy. Salvini is acting as a hardliner toward the EU rules on the deficit/GDP ratio and he has promised there will be no more spending cuts to reduce the 2020 deficit.

Salvini turned up the volume of the confrontation with the European Commission in early June in order to find a better deal on the level of deficit for the 2020 budget law. The Deputy Prime Minister, to meet his voters' expectations, needs to show some concrete improvements at economic level. For this reason, the League's leader is putting pressure on the rest of the government to implement his tax cuts. Conte and Tria are trying to mitigate Salvini's outburst in order to facilitate a compromise with the EU in the autumn.

**The role of Giuseppe Conte. Does the PM really count more?** The Prime Minister is attempting to exercise more influence over the parties. He is defending his prerogatives in the EU's top job appointments and he is playing out his game mainly at international level. Conte is aiming to control the relationship and the arguments with the other European countries. How strong are the Prime Minister and his fellow technocrats really? At international level Conte is entitled to lead the relationship with his peers and, consequently, he and his policy advisers can influence Italian strategy in the European Council more than Salvini and Di Maio can. However, every European and international strategy has a domestic impact and the two deputy prime ministers are closely monitoring Conte's moves. The Prime Minister might open up new channels to develop a better relationship with the other European countries or he might adopt a more moderate approach in dealing with EU Commission on the budget, but Salvini and Di Maio have the final say. Conte's position might be strengthened by his good relationship with the President of the Republic Sergio Mattarella and by the alliance with Giovanni Tria, the Minister for Economy and Finance. They are positioning themselves as the guardians of Italian fiscal responsibility. Together they are probably influential enough to smooth the populists' hard-line on the economy. However, Mattarella is weakened by the investigation into the magistracy and this month he has been busy managing problems in the judiciary. The President of the Republic has not so far intervened in the debate over the budget law as he has done in the past. Tria meanwhile is under pressure from the League, the party which is close to designing a new fiscal reform (the flat tax). It is very likely the Italian government will reach a dual compromise: one internal and one external. The internal compromise will be between the populist and the technocratic factions of the government. Salvini will get a scaled-down flat tax, but the

government will not force a new standoff with the European Commission on the budget. The external compromise will be between the government, formally managed by Conte, and the European Commission and the European Council. If it is successful, the dual compromise will stabilize the government and will avoid turbulence on public debt.

**No disciplinary procedure and the EU appointments. A normalization for populists?** A disciplinary procedure for excessive public debt was discussed by European Commission. However, Italy responded to the EU by offering new explanations on the deficit and public debt trends. Finally, the Italian government adjusted the 2019 figures with some cuts and savings on major policies such as pension reform and citizens' income (7.6 billion euro) and it avoided the disciplinary procedure. The mediation with the European Commission was successful. Italy exploited its bargaining power on new senior job appointments at European Union level to defuse the disciplinary procedure. The country did not obtain any top jobs for this legislature, but it gained a softer approach on public finance by the Union, at least for the moment, and it could get the appointment of a commissioner with an economic portfolio in the new Commission. These developments might be interpreted as a sign of a normalization and institutionalization process undertaken by populist government. After a difficult start with the budget law 2019, the government has avoided the disciplinary procedure and, with a lower pressure on bond yields, now it might mitigate its relationship with the European Commission in view of budget law 2020. Many analysts were concerned for a possible hard standoff between the government and the European Union on budget's adjustment, but it did not happen because the populist parties have preferred to follow the policy directives by the ECB and the Commission. For now the worst-case scenarios, as Italexit or a new sovereign debt crisis, can be set aside.

**Immigration.** In late June the vessel Sea Watch 3, supplied by an NGO to rescue migrants in the Mediterranean, breached Italian borders to dock on the island of Lampedusa (Sicily), after the crew spent two weeks off the Italian coast. Salvini, as Minister of the Interior, opposed the docking and disembarkation procedure, pursuing his policy of "closed ports". The immigration crisis returned to the political agenda. However, as recent Italian history has demonstrated, "immigration crisis" means increasing political support for Salvini. The League's leader is still taking advantage of the "permanent emergency" on immigration. Indeed, the "closed ports" policy is an effective strategy to control the political agenda. In the second half of June Salvini dominated media debates in Trump-like style. The Five Star Movement has supported the League's strategy on immigration, including Prime Minister Giuseppe Conte. Moreover, with his anti-immigrant rhetoric Salvini has also covered over the weaknesses and embarrassment of Di Maio and the Five Star Movement on industrial policy. Indeed, tensions with ArcelorMittal, Atlantia and Alitalia, which jeopardise thousands of jobs, are potentially riskier for the government than the closed ports policy.

**Has Mario Draghi been the best ally for the populist government?** In early June Mario Draghi released a very clear statement on monetary policy. Interest rates will remain at the same level and the ECB will revive a programme of bond buying, known as quantitative easing, if economic conditions worsen. Those discussions also mentioned the possibility of the ECB lowering its deposit rate. Draghi's decision helped the position of the Italian government. The cost of financing the enormous Italian public debt will be lower and the spread between Italian and German bond yields reached the lowest level in the last year. Salvini and Di Maio will now have less pressure, at public finance level, in drafting the new

budget law. The need to maintain a relaxed monetary policy to face new geopolitical and trade conditions is helping Italy and it might be a stimulus to undertake pro-growth reforms.

**Mattarella, carrot and stick?** In the first year of the populist government the President of the Republic intervened to keep Di Maio and Salvini within the bounds of European politics. He set some conditions to form the Cabinet and he influenced the process of ministers' appointments. Moreover, the Head of the State, particularly at diplomatic level, has often reassessed Salvini and Di Maio's statements on the economy and European politics. He has used the stick, but in recent weeks he has been offering carrots. Indeed, he said the Italian economy is robust and that several of the country's economic indicators are positive. He defended the efforts of Italian governments, included the current one, to reduce the budget deficit and he underlined that there were no grounds to open a disciplinary procedure against Italy at European level. The government might be helped to get confidence on financial markets not only by the ECB's monetary policy but also by the cautious optimism expressed by the President of the Republic.

**League as a pro-business party.** Since the birth of the Conte government the League has been playing a subtle game to be considered as a pro-business party by national and international investors. The League has always been in favour of large public infrastructure and in recent years it has opposed the Five Star's NIMBY and environmentalist policies. In the last few weeks some industrial crises, such as Alitalia, ArcelorMittal and Atlantia, have blown up. While Di Maio has assumed an anti-establishment and environmentalist approach, disappointing the Italian and international community, Salvini has reassessed the government's policy by defending large corporations' interests. The League's leader is presenting himself as the defender of entrepreneurship and jobs against the radical line of Five Star Movement. In the last year the League has become increasingly interested in economic policies, after having spent the first months of the legislature on immigration and security. Now Salvini is depicting himself as the leader of the most trustworthy political party for business in Italy. In this process he has been helped not only by Di Maio but also by the opposition, because under the leadership of Zingaretti the Democratic Party has been repositioned on a more left-wing and environmentalist agenda, sharing some proposals (such as the minimum wage) with the Five Star Movement. In this context, as the results of the European elections showed, the League is considered the best guarantor for business and investment.

## **b. Opposition**

The Democratic Party (PD) is playing the same game as ever on immigration. Some democratic MPs, in the company of other centre-left leaders, boarded the Sea Watch to lend their solidarity to the crew and the migrants.

The strategy of openness on immigration has not paid in electoral terms in recent years and is unlikely to pay now. Since 2014, when it was in government, the Democratic Party has underestimated the impact of immigration on Italian public opinion. Salvini's propaganda, which has been focused mainly on this issue, has worked very well and the League has moved from 4% to 34% in a few years, while the Democratic Party's support has collapsed. The party tried to make a U-turn on immigration in 2017, but it was too late. Italian public opinion was convinced that the centre-left could not be

effective on tightening immigration policy and managing integration. Moreover, the closeness of the Democratic Party to NGOs has become a matter of successful propaganda for the centre-right parties. The Democratic Party has been accused of defending what their opponents called the “business of immigration” and disregarding the interests of Italians in favour of immigrants. The strategy of the PD is more of the same on immigration, which is a crucial issue in the current Italian political agenda. Despite the party having regained some support in the European elections, mostly bringing its traditional voters back to the polls, it is still far from challenging Salvini for control of the political agenda. It is unlikely the Democratic Party can gain more popular support without changing its strategy and messaging on immigration.

Some tensions are rising within Forza Italia. Berlusconi’s party is under pressure as it has been surpassed in the polls by the League and, in particular, by the Brothers of Italy (FdI). Giovanni Toti, the governor of Liguria, is attempting to organize a new faction of the party to challenge Berlusconi’s strategy. The Cavaliere aims to remain within the centre-right but with his own brand and moderate position, while the new faction led by Toti would create a new grouping with the League and the Brothers of Italy. Forza Italia has increasingly lost support in recent elections and a faction of the party would like to come closer to Matteo Salvini and Giorgia Meloni, overcoming the old structure of the party and embracing a more right-wing set of ideas. If we look at history, we can see that Berlusconi does not tolerate challengers within his own party. Politicians who have contested his strategy have been expelled or have left Forza Italia. With Toti’s faction we are in a similar situation. It would not be implausible to imagine a divorce between MPs, local councillors and party members whose aim is to join Salvini and Meloni in a right-wing grouping for the next elections and those who remain loyal to Berlusconi. It would be a further split for Forza Italia, which would make it even weaker. In the meantime, Salvini and Meloni would gain a new faction for their right-wing alliance.

### c. Public Policies

The government is preparing to correct the 2019 budget and to draft the 2020 budget law. Moreover, it must take some decisions on infrastructure. Here are the main policies under discussion:

- **Tax cuts priority.** Soon after his great electoral result Salvini announced tax cuts as the main priority for the League. Hence, on the economic side the implementation and extension of the flat tax has come to the top of the list for Conte’s government. Salvini has promised to apply a 15% flat rate income tax both to entrepreneurs (15% up to 65,000 euro gross income and 20% up to 100,000 euro) and employees (15% up to 55,000 euro). This ambitious programme is practically impossible to achieve in one shot, however fiscal relief will become the priority for the Italian government. The implementation will be gradual, it will probably affect only some taxpayer classes and some income thresholds. Moreover, there will be some cuts and rationalization of tax expenditure. Salvini will try to reward his voters with tax cuts, i.e. mostly the self-employed and private sector workers.

- **TAV.** The European Commission committed to increase the financing for the high-speed rail link known as the TAV up to 55% of costs. The EU has created a new incentive to complete the infrastructure. Now it will be more difficult for the Five Star Movement to reaffirm its opposition to TAV. Moreover, the League, which supports the completion of the project, has also been helped by victories in local and regional elections in Piedmont, whose governments are involved in the decision-making process on infrastructure.
- **Regional autonomy.** The project to expand regional autonomy is part of the League's programme and Salvini aims to approve a new law to move some functions from the central government to the regions which have requested differentiated autonomy. Some criticisms have been raised by ministers from the Five Star Movement, which achieved its best electoral results in Southern Italy. Critics say the request by the northern regions could sound the death knell for national solidarity as well as creating second-class citizens. The two parties are looking for a compromise: the legislative proposal by the government will be discussed by parliamentary committees and by the State-regions conference rather than by being approved as an urgent legislative decree. This process implies a longer timeframe to achieve regional autonomy. Moreover, the risk is that the proposal might be at peril in Parliament because the Five Star Movement has far more MPs than the League and the opposition will probably not help Salvini get it through. This likely impasse could become a problem for the League, which got more than 40% in most of the northern regions in the last European and regional elections. The party's traditional voters have been looking for further devolution for years and they might be disappointed by legislative delay or downsizing.

#### d. Forecasts

##### Probability of snap elections:

Elections within Q3 2019: **10%**

Elections within Q2 2020 (spring): **60%**

Elections after 2020 or at the end of the legislature (2023): **30%**

As we pointed out in our last report, for Salvini there were too many risks to go for snap elections. Indeed, he chose not to break up the government coalition. The Five Star Movement has proved to be loyal to the League and they are supporting tax reform and the immigration policy promoted by Salvini. Now it is unlikely a snap election will be called before the end of the year. The two parties are working together on the new budget law for 2020. However, it is possible that tensions will rise again very soon. **The latest date on which Salvini can trigger an early vote is 20 July.** For this reason, since the end of May Di Maio, who wants to avoid a snap election when his party has an all-time low consensus, has had a submissive approach towards the League. Once the snap election has been



averted, the Five Star Movement will come back to claim their policy proposals, such as the minimum wage, or to exercise their veto, particularly on large infrastructure projects. The probability of a standoff between the two parties will increase in August, when the discussion on the budget law will come to a head. Meanwhile, a small reshuffle is possible. The government has to appoint a new Minister for European Affairs, the League should get the job, and if the new European Commissioner is a member of government a new vacancy in the Cabinet will occur.

Whether or not the relationship between the two parties is eroded by the budgetary process, the most likely scenario seems to us a break-up of the coalition soon after approving the budget. In this case a vote would be possible next spring. This might be a good option for Salvini, now very high in the polls, in order to capitalize on his consensus and set up a centre-right government with Giorgia Meloni. The League's leader could exploit the coming months to capture floating voters from the Five Star Movement and then go for a snap election. Moreover, many criticisms are being aired in the Five Star Movement against Di Maio's leadership. For the radical faction of the party, very upset with the leader for his soft line with Salvini, a snap election is seen as a chance to settle scores within the Movement. However, in the Italian political scene threatening an early vote is easier than enforcing it. For this reason, we continue to assign a high percentage to the option of the government's continuity. Now everything is in the hands of Salvini, but he has proved to rely more than many analysts expected on the alliance with the Five Star Movement. It is not implausible to imagine a longer duration, perhaps with a reshuffle, for the government.

#### e. Mapping risks

There are two major risks at this moment concerning the Italian political system:

- **Uncertainty over the new budget law.** Today we do not have a clear view on the content of the 2020 budget law. Salvini has called for a fiscal shock and he stated he is ready to negotiate a new pact with Brussels on budget rules. The new lord of Italian politics wants to call into question European constraints on the deficit/GDP ratio. The Italian government did not reveal any detail on how it intended to finance the fiscal shock. Moreover, Rome must find around €23bn in additional revenues next year to avoid breaching deficit limits that it previously agreed with Brussels. Salvini has excluded automatic increases in VAT to fund this. The government has announced its intention to announce the measures of the budget law ahead of schedule (for the EU procedure the first draft is expected in October). If the financial markets receive the budget's draft positively, we could consider the risk mitigated.
- **The return of the struggle between politics and the judiciary.** The power of the judiciary is back on the Italian political agenda. Last month a broad investigation involved the Consiglio Superiore della Magistratura (CSM), the governing body of magistrates formally chaired by the President of the Republic, and in recent weeks Salvini has denounced magistrates for being too soft on illegal immigration. In particular, the Interior Minister quarrelled with a judge who freed the German captain of the Sea Watch, a charity rescue ship accused of forcing an Italian naval blockade, and he suggested the ruling was politically motivated. It is not the first time that Salvini has accused magistrates of being politicized for their decisions over his immigration

policy. Now the judiciary's power is weaker and delegitimized owing to the CSM scandal and the League's leader has seized the opportunity to attack it. Institutional struggle is frequent in Italy but, at the same time, it is one of the main weakness of the Italian State. Increasing attrition among public powers is never good news for the government and the stability of policies.

- **Public procurement uncertainty.** Italy has been trying to reform its code of public procurement since 2016, but the result has been an ordeal full of legal uncertainty. The present government has suspended the main articles of the code, which is considered too cumbersome and bureaucratic and was never fully implemented by the previous government, and restored the old legislation. The code is suspended until the end of 2020. For three years the country has not had clear legislation on public procurement. The rules have been changed and amended too many times and too often. This “legislative volatility” is a risk for foreign and domestic investors in public infrastructure.
- **A controversial industrial policy.** Di Maio and Salvini are taking opposing sides on industrial policy. While the League is defending large multinational companies and their Italian business, the Minister for Economic Development Di Maio is causing some tensions concerning environment and social responsibility, as in the case of ArcelorMittal's steelworks (formerly ILVA) in Taranto. Moreover, ministers of the Five Star Movement are threatening Autostrade Spa, a corporation of the Benetton group (Atlantia), and wish to withdraw the concession to manage Italian highways due to the collapse of the Morandi bridge in Genova last summer. Then, the Five Star Movement wishes to stop Atlantia being involved in Alitalia's bail out. The disagreement between the two coalition partners is considered a risk by big industrial players and foreign investors.

## 2. Public Opinion Trends

### a. Polls

One month after the European elections of May 26th, the polls on voting intentions of Italian voters in general elections show substantial stability in the political scenario. Indeed, in the case of imminent elections for the renewal of the Italian Parliament, the electoral results of the European elections would be broadly confirmed (Table 1).

	Polls last week of June	May 26 European elections	Polls last week of March	Polls last week December	March 4 elections
<b>League</b>	36.23%	34.30%	33.10%	32.90%	17.30%
<b>Five Star</b>	18.03%	17.10%	21.30%	26.30%	32.70%
<b>PD</b>	23.35%	22.70%	21.00%	17.60%	18.70%
<b>FI</b>	7.40%	8.80%	9.60%	8.70%	13.90%
<b>FDI</b>	6.65%	6.50%	4.50%	3.80%	4.40%
<b>+EU</b>	2.80%	3.10%	2.90%	2.50%	2.60%
<b>Other Left</b>	3.63%	2.50%	2.30%	2.10%	2.20%

Table 1 – Electoral results in European elections and electoral trends in recent surveys

The League of Matteo Salvini remains firmly the first party in Italy, with electoral support that in the last month increased by 2 percentage points. In the right-wing camp, the party of Giorgia Meloni (Brothers of Italy, FdI) also confirms the positive result of the EP elections: the party now gets more than 6.5%, with a growing trend both with respect to last year's general elections and with respect to the polls prior to the EP elections (the party then polled around 4%). The League and FdI's positive results are counterbalanced by the clear drop of Forza Italia (FI). Berlusconi's party received an electoral result that was well below expectations in the European elections (8.8%), in line however with a negative trend that seems to be unstoppable. One month after the EP vote, the party in fact polled around 7.4%, the worst result recorded over the last year.

As for the centre-left, the **Democratic Party (PD)**, under the new leadership of Zingaretti, confirmed the good electoral performance of the European elections and has gained almost 1 percentage point in the last month. This is clearly an important result: the party is trying to re-consolidate its electorate and,

although in a phase of relative weakness and strategic disadvantage with respect to the major right-wing parties, it sends a clear message: **the party is alive and it is a key actor not only for the centre-left but, more generally, for the Italian political system as whole, a system that seems to be moving more and more towards a bipolar structure.**

In fact, if the League and - to a lesser extent - the PD can be satisfied with the electoral results of the EP elections, the same cannot be said for the Five Star Movement. In the last month the party managed to recover 1 percentage point, but it is still well below the performance of its own governing partner (the League, -18 percentage points), and the Democratic Party as well (-5 percentage points).

In this context, **the only political players that seem truly capable of competing to govern the country are those within the classic centre-right and centre-left blocs.** The League could achieve a majority of seats in the Parliament even in a coalition with FdI alone, and excluding Silvio Berlusconi's party. If FI was also included, the centre-right coalition could get around 50% of valid votes. **The centre-left does not seem competitive yet.** However, if the PD manages to form a coalition with all the other left-wing parties, it could exceed 30% of valid votes. This is still too low to make the coalition really competitive. **However, this seems to be the only credible solution to build up a numerically solid alternative to the centre-right coalition led by Salvini.**

#### **b. Local elections**

Together with the EP elections, administrative elections were also held in most of the larger Italian municipalities. **The result of this round of local elections was in line with the EP elections and in fact redesigned the geographical map of local power.** This is the picture that emerges in Figure 1. Each province is coloured according to the political majority of the provincial capital. Looking at the map, we note first of all how Forza Italia (FI) and its allies now rule 11 more provincial capitals than the coalitions including the PD (48 to 37). **This means that the two coalitions govern practically 80% of the provincial capitals, a percentage that increases if we also consider the 4 municipalities administered by right-wing coalitions (including the League and / or FdI) without FI.**

### Ruling municipal coalition in provincial capitals

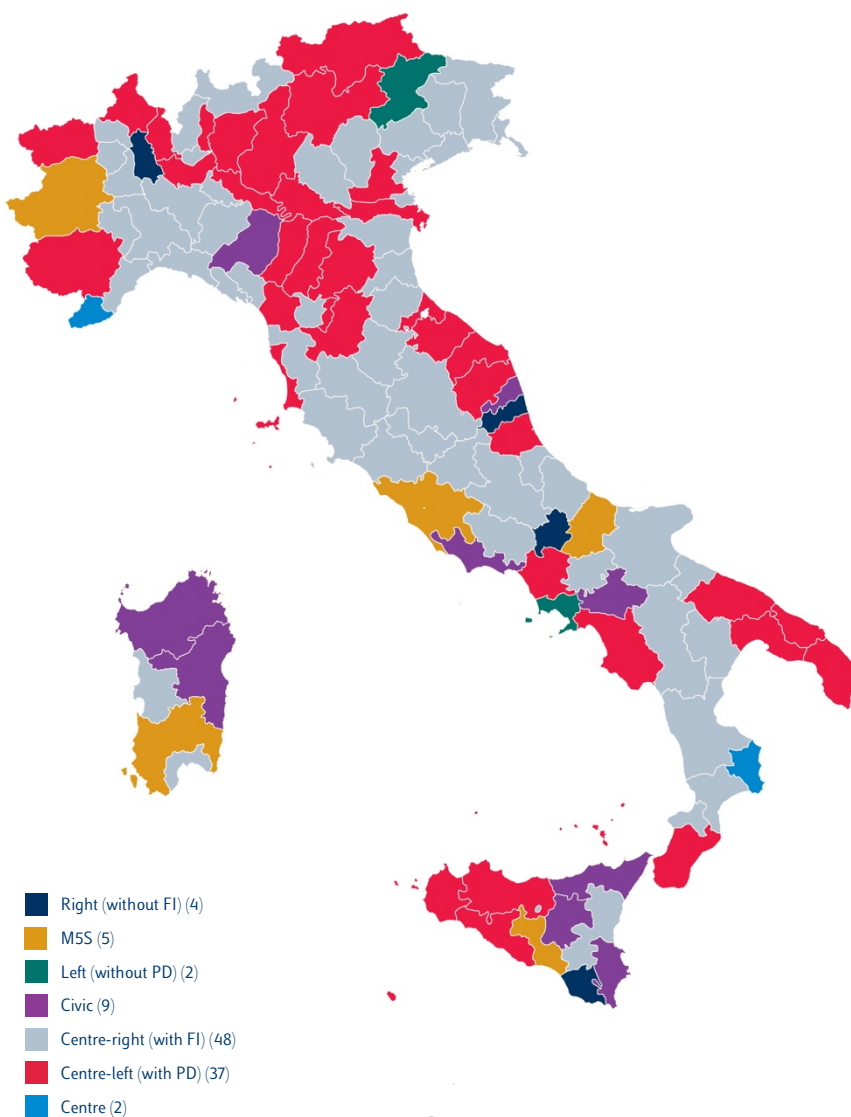


Figure 1: Local governing coalitions

This local bipolarism is coupled with the weakness of the Five Star Movement at the local level (something that is not new at local elections for this party, see Paparo 2018<sup>1</sup>). There are only 5 out of 107 provinces in which the mayor of the provincial capital belongs to the Five Star Movement. Also, 4 of these are in the South, with Turin being the only exception. This broadly confirms the marginalization of the Five Star Movement, now electorally confined to the South.

Another interesting finding emerges from the map: **the distribution of local power does not seem to be in line with the electoral tradition of Italy. In the Red Belt (a traditional stronghold of leftist parties), municipalities in Umbria, most of those in Tuscany and even some in Emilia-Romagna are now administered by centre-right coalitions.** On the contrary, the centre-left governs in most municipalities in Puglia, western Sicily and good portions of the North-East (not only in Alto Adige).

At least partially, this new scenario can be explained by the electoral cycle. **We can observe that in fact the year of the municipal elections (and the popularity of the current government at that time) is a very important factor to understand the conformation of the local power,** even more than the electoral tradition of the different territories (which also continues to play a role in determining the relative competitiveness of the two coalitions in the different territories). **This is clear if we take a look at the electoral results in the last few years. In the two previous years the centre-right won more provincial capitals than the rival coalition in all regional areas** (Emanuele and Paparo 2017<sup>2</sup>; Emanuele and Paparo 2018<sup>3</sup>), thanks to the lack of popularity of the centre-left governments. On the contrary, between 2014 and 2016, when the success of Matteo Renzi, former secretary of the PD, began to go down but had not yet hit bottom, it was the centre-left that conquered most of the local administrations in provincial capitals in different parts of the country. Finally, in 2019, the upsurge of the League and the popularity of Matteo Salvini have mainly favoured centre-right coalitions.

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<sup>1</sup> Paparo, A. (2018), 'Le fatiche del M5S nei comuni: l'avanzata che non arriva e i sindaci che se ne vanno', in Paparo A. (a cura di), Goodbye Zona Rossa. Le elezioni comunali 2018, Dossier CISE (12), Roma, Luiss University Press, pp. 227-234.

<sup>2</sup> Emanuele, V. e Paparo, A. (2017), 'Il centrodestra avanza, il Pd arretra: è pareggio. I numeri finali delle comunali', in Paparo A. (a cura di), La rinascita del centrodestra? Le elezioni comunali 2017, Dossier CISE (9), Roma, Centro Italiano Studi Elettorali, pp. 191-199.

<sup>3</sup> Emanuele, V. e Paparo, A. (2018), 'I numeri finali del voto: il centrodestra vince le comunali conquistando le roccaforti rosse', in Paparo A. (a cura di), Goodbye Zona Rossa. Le elezioni comunali 2018, Dossier CISE (12), Roma, Luiss University Press, pp. 217-226.

### 3. Economic Scenario

**With stubbornly high public debt and gross domestic product (GDP) that is clearly in stagnation, in 2019 Italy will again face financing cost for its public debt that is higher than its nominal growth.** Considering also the less than rigorous fiscal policy of the yellow-green government coalition, it will be very difficult for Minister of Economy and Finance Giovanni Tria to contain the growth of public debt in coming months.

**During the first quarter of 2019, GDP increased by 0.1% compared to the previous quarter and its tendential variation (compared to the previous year) is 0.1%.** Last spring, the European Commission reduced the growth estimate in Italy from 0.2% to 0.1% on an annual basis, placing it last in Europe for economic growth in 2019.

**Italy's GDP is also negatively affected by an expected decline of 0.7% in industrial production during the current quarter. Weak domestic demand, especially for investments, but also weak foreign demand due to the tensions in international trade are the main determining factors of the current economic downturn.** Expectations of an increase in the households saving rate and the stagnation in consumption will undoubtedly be elements that will negatively impact growth in the upcoming months. According to the data, domestic orders for producers of consumer goods decreased by 0.3% in May compared to April and remain unchanged compared to May 2018. The indicator reflects a deterioration in both the demand for goods (-0.2%) and the demand for services (-0.4%). One of the positive factors of Italy's growth has been the acceleration, even if momentary, of exports, mainly during the first quarter of the year. This is primarily due to the strong trade relations outside the EU (USA, Switzerland and Japan), and to the devaluation of the euro against the dollar.

**In general, the conditions of the Italian economy will remain weak and, as confirmed by the confidence indicators, expectations of the operators are still geared to a widespread pessimism as the country emerges from the climate of deterioration in the last nine months.** In detail, in increasing order of intensity, there was a decrease in the personal climate by 1.8 points, from 107.4 in April to 105.6 in May. The current climate, with a drop of 2 points, fell from 109.6 to 107.6. Finally, the future climate, down by 3.3 points, and the economic climate, down by 4.6 points, were the indices where the decrease was more marked in May, respectively from 115.6 to 112.3 and from 125.5 to 120.9.

With regard to the utilization of the economy's production factors, we report the second consecutive drop in new orders in the last four months for the tertiary sector, which has caused a decline of 0.4 points in the purchasing index (PMI) compared to April, and in May arriving at the threshold of a neutral 50. In May the Italian manufacturing sector, in addition to the decline in new orders, also saw

a decrease in production. The trend of declining orders was confirmed by data issued in June, where the lower PMI value was the result of lower demand in manufacturing, with the purchasing index falling from 49.7 in May to 48.4 in June. There was an inversion of the positive tendency for Italian construction activity with a first reduction of new orders occurring since February 2018. The latest available data indicate that the purchasing index for the construction sector declined from 52.5 in April to 49.8 in May, although this could be a temporary decline as companies in the sector have increased their labour force at a high rate. **The negative performance reported by the three PMIs is confirmed by the data published at the end of May on the confidence climate among companies, which shows widespread pessimism in Italian production with values decreasing since the beginning of 2018 and stabilizing at the lowest levels since the end of 2014.** There has also been a decline in the services sector, from 99.3 to 98.9, in the manufacturing sector, from 101.9 to 100.8, and the most substantial fall has been in the construction sector, from 144.3 to 140.9.

Given the Italian government's fiscal efforts, on July 3, European Commissioner for Economic and Monetary Affairs Pierre Moscovici declared that the infringement procedure for excessive debt would not be necessary. However, the Commission will remain vigilant in monitoring the implementation of Italy's promised budget corrections. Commissioner Moscovici's decision should serve as a warning for the coalition government in the preparation of the next Economic and Financial Document. In fact, three crucial points between Commissioner Moscovici on the one side and Italian Prime Minister Giuseppe Conte and Minister of Economy and Finance Giovanni Tria on the other were agreed to avoid the infringement procedure. Firstly, the deterioration in the structural budget for 2018 had to be compensated as much as possible, and this was done by the Italian government's budgetary adjustment of 1 July. Moreover, this decree was also adopted to reduce the 2019 deficit by 0.42%, freezing 2 billion euro in expenditure. **Finally, concrete commitments are required to comply with EU fiscal rules for the 2020 budget, as the Commission estimated a 3.6% deficit and public debt rising to 135.2% of GDP. In addition to the commitments required for the 2020 budget, and with funds lacking for the current government's two main programs (Citizen's Income and the Quota 100 pension program), safeguards, including a VAT increase, worth 9.4 billion euro next year if the programs cannot be financed in an alternative manner have been put in place.**

**Positive signals are coming from a decreasing spread that on July 3 dropped below 200 basis points, returning to the values of May 2018.** It is a very positive message for Italy since a high spread has extremely negative effects on economic growth and on the financial stability of a country. It is, however, necessary to contextualize this decrease in the differential between the BTP and the BUND, as the spread has dropped considerably, also in other European countries. Therefore, we cannot attribute this decline to the European Commission renouncing the infringement procedure. On the contrary, the decision of the main central banks (ECB and FED) to provide additional monetary stimulus has meant that the markets' inclination towards risk could rise, leaving the public debt situation in some European countries unresolved. That is precisely why Rome's coalition government should not exaggerate with endless electoral promises when drawing up the 2020 budget, because the EU Commission's reaction, along with that of the markets, will certainly not be favourable for Italy.

If the European Parliament confirms her, **Christine Lagarde will take over the presidency of the European Central Bank (ECB) as early as next November.** The Managing Director of the International Monetary Fund has already officially supported the statements expressed by the current President of



the ECB during the 20th anniversary of the Economic and Monetary Union in Sintra. **In particular, Mario Draghi stated that the need for further monetary stimulus will not be excluded if the ECB's objective is jeopardised.** He also pointed out that a further cut in the ECB's main reference rates (even in the current condition of zero rates) remains one of the tools of the monetary institute in Frankfurt, and that **it will use all the necessary flexibility, in line with its mandate, to respond to any future threats to price stability.**

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