

Luiss
School of Government

Monthly Report on Italy

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Sommario

1. Politics and Policy	4
1.1 Government	4
1.2 Opposition	6
1.3 Public Policies	7
1.4 Forecasts	8
1.5 Mapping risks	8
2. Public Opinion Trends	10
2.1 Polls	10
3. Economic Scenario	13

Introduzione

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.

Giovanni Orsina
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1. Politics and Policy

1.1 Government

Conte on the brink. Three months ago PM Giuseppe Conte was deemed the new lord of Italian politics. Now he is under siege. Luigi Di Maio and Matteo Renzi are back on the scene and they are contesting the Prime Minister's line and upsetting his balance of power. Both of them have reasons to be concerned. In the polls, Renzi is stuck around 5% and he is not growing as fast as many analysts were forecasting. Moreover, it is becoming increasingly difficult for the former PM to pursue his moderate policies through this government, which is mostly influenced by the Five Star Movement programme and a more socialist approach embodied by the PD and the other left-wing groups. Renzi's Italia Viva is formally part of the majority, but its leader is speaking as if he was in opposition. Renzi is pursuing a difficult strategy: implicitly supporting the government in Parliament, but acting publicly against his PD and Five Star Movement allies. Albeit, at this moment, Renzi seems too weak to pull the plug, he is strong enough to increase tension within the government. Di Maio is moving on the same line. The Five Star Movement suffered a terrible defeat in the last regional elections and the polls of recent months show a slow but continuous decline. This result makes the leadership of the Five Star Movement very nervous. The approach of the anti-political party is becoming more aggressive: on the environment, on industrial policy, on justice and on Europe. Every time Conte attempts to moderate the Five Star's line, Di Maio becomes tougher on the government's programme. For the Prime Minister mediation on strategy and policies is becoming increasingly difficult.

PD without soul. While Renzi and Di Maio are becoming more aggressive, the PD is gradually vanishing. The leadership by Zingaretti is perceived as too weak by many activists and the party is stuck in the status quo. The main policies of the democrats are not clear and the impact of the PD in the political debate is overshadowed by its more flamboyant allies. In the polls, Zingaretti's party is not losing consensus but, at the same time, it is not growing. The main party of the Italian centre-left appears soulless and the secretary is failing to achieve a structured alliance with the Five Star Movement at local level. The next regional elections in January will show us how damaging this lack of strength is.

Is Beppe Grillo coming back on the scene? The Five Star Movement are passing through their worst political moment since their foundation. With a vote on the party's online platform, activists have decided that the movement, albeit weakened, should participate in all the regional elections. The issue was put to the vote because the Five Star's leadership was sceptical about the opportunity to run in the regional elections in Calabria and Emilia-Romagna, because the Movement risks a humiliating decline in consensus. However, party members chose to run in these elections. After the virtual vote, Beppe Grillo released a video with Luigi Di Maio, announcing he will be involved more into the

leadership strategy. The comeback of the comedian is not a positive sign for the Movement. Indeed, in the last five years Grillo has intervened only when there have been divisions within the party. Tension is rising in the Five Star Movement and there are different factions that are contesting Di Maio's leadership, who seems unable to deliver good electoral results. For now, Grillo is on Di Maio's side and has tried to reduce divisions. If the results in regional elections are disappointing, confrontation might explode within the party. Di Maio's leadership might be on the brink. In this case, we might expect a wider intervention by Grillo in order to secure the future of the government.

Pro-European orthodoxy at stake. After a few months of calm the relationship with the EU has resurfaced in the Italian political debate. The Conte 2 Government is considered an orthodox pro-European cabinet because it was created to bring the country back on a pro-European track against the euro-scepticism of the League, but reality is always more complex than theory. In particular, the reform of the European Stability Mechanism has caused confrontation between government and opposition and within the majority itself. A draft of the reform was agreed by eurozone finance ministers in June and is due to be finalised by leaders next month, but senior Italian officials, including its central bank chief Ignazio Visco, have warned some measures are financially dangerous. Concerns over some points of the reform have been expressed also by important economists and former civil servants. In particular, they are against proposals that would make it easier to restructure eurozone sovereign bonds in the event of a financial crisis. This would involve turning the bailout fund, known as the European Stability Mechanism (ESM), into a sort of European Monetary Fund that would make support for countries in financial crisis conditional on them restructuring their debt. The League has attacked Conte, accusing him to have secretly endorsed the draft of the Treaty during his first government. "Approving the ESM changes would mean ruin for millions of Italians and the end of our national sovereignty," said the League leader Matteo Salvini. The Financial Minister Roberto Gualtieri (PD), a strong pro-European, agreed with the ESM reform, considering it convenient for Italy. However, it is not only the opposition on the warpath. The Five Star lawmakers stated they do not agree with the reform. While Conte has defended the new ESM, Di Maio assured that the Five Star Movement would not vote for ratification without some changes. Both Gualtieri and Conte have been summoned by the Parliament for a public hearing. As we anticipated in previous reports, euro-scepticism is back on the table of Italian politics. The ratification of the ESM Treaty, in this scenario, is not guaranteed. In political terms, Salvini and the centre-right seem in a win-win situation. If the ESM reform was not ratified by the Parliament, it would be a victory for the opposition; on the contrary, if the reform was approved, the opposition could accuse the government of betraying national interests. Salvini is still driving the Italian political agenda.

On the ESM reform, Italian politics is divided between the centre-left (PD, Italia Viva, LeU) and the rest of the political forces (the Five Star Movement and the right-wing coalition). Within the Five Star Movement, Conte is on the opposite side to Di Maio and the Five Star's MPs. In political terms, the issue might be risky both for Conte and hazardous for the consensus of the pro-European forces. It is not very popular to defend a technocratic financial institution that has been criticized even by many moderate, non-populists, pundits and economists.

Sardine, what is it? In recent weeks a new movement has appeared on the Italian political stage. The name of the association is *Sardine* (sardines) and they are a group of left-leaning youngsters who gathered, for the first time, in Bologna. The event was attended by more than 10,000 people. The

movement is spontaneous and the left-wing parties did not join the political rally. The young left-wing activists are providing a wake-up call to PD, the Five Star Movement and other left-wing parties which risk being defeated by the League in the regional elections of Emilia-Romagna, traditionally a stronghold for the left-wing coalition. The *Sardine* are campaigning for the incumbent governor of Emilia-Romagna Stefano Bonaccini, a PD member with very strong ties with the civil society of his region. After the success of the Bologna meeting the *Sardine* are replicating the rally in others towns in Emilia-Romagna, but their leaders are looking at launching a national movement. What will be the future of the *Sardine*? It is probably too early to assess. However, we might note two signals: the creation of the movement is mainly based on opposition to the League, the young left-wing participants are representing themselves as anti-far-right activists. A sign that the real polarization in Italian politics is still centred around Salvini and his party; the rally is also a message to the centre-left parties and to the Five Star Movement, indeed *Sardine* are an expression of discontent towards the government parties and their programmes. To conclude, on the left the civil society is attempting to create a more effective political movement to compete with and to defeat Salvini's centre-right. At this stage, we cannot say if the *Sardine* will remain a grass-roots movement, if it will attempt to renew the PD, or if it will become the start of a new left-wing party.

1.2 Opposition

Salvini and Europe. Salvini shows an ambiguous strategy on Europe. After he broke the coalition with the Five Star Movement, the League leader steered his position to a softer approach on the European Union. Indeed, an overly aggressive approach might undermine the future of the party as the main governing force. Moreover, the establishment of the party leaked news of a possible form of cooperation or alliance with the EPP in the future. Now, with the contestation of the ESM reform, the League has come back to its more sceptical position on EU reform. In coming months we will see if Salvini uses the opposition to the ESM reform to simply embarrass the governing majority or if the League will look at a more radical and anti-European platform. The impression is that the League aims to cultivate an ambiguous line on the relationship with the EU on purpose, changing its position as convenient. The party is balancing its two souls, mixing its euro sceptical and anti-establishment soul with the moderate, governmental one. It is very likely that the pragmatic and indecipherable position of the League on the Europe Union will not be resolved until it returns to government.

The rise of Giorgia Meloni. Her party, Brothers of Italy (FdI), tops 10% in every poll and she is consolidating her position as centre-right deputy leader, just below Matteo Salvini. Meloni's party offers a traditional right-wing position on the economy, immigration, Europe, and public security. Brothers of Italy at European level is part of the ECR group. These positions are rewarded by voters, who increasingly appreciate the firm approach of Brothers of Italy, the only party in Parliament that has always been in opposition in the last six years. Meloni is perceived as credible because she opposed (and still opposes) both the centre-left and the Five Star Movement, while Salvini formed a government with the latter. FdI's electorate is mainly located in the centre and in the south, where Meloni could gain more consensus in coming months as a consequence of the Five Star's decline. Indeed, disappointed Five Star voters are a "non-ideological" electorate and many of Meloni's political positions, except for on the environment, are not far removed from the Movement's origins. She is

moderately euro-sceptical, pro-small business, anti-immigration, in favour of a tougher public security policy and not compromised by the flawed governments of recent years. What does her growth imply for the right-wing alliance? For the moment she is not contesting Salvini's leadership and she is adding value with her southern electorate to the League's position (whose voters are mainly located north of Rome). She might have some successful candidates in the regional elections in the South in coming months and she is hoovering up Forza Italia (Berlusconi)'s voters. Should Salvini disappoint his voters in the future, she is ready and now strong enough to take advantage.

1.3 Public Policies

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

- **The victory of continuity.** The policy continuity with the first Conte government is still impressive. The policy on pensions, so-called "quota 100", has been maintained, the same for Citizens' income. Moreover, the immigration policy of the Italian government has not changed. As we reported, the negotiations to reform the Dublin Treaty are not taking off at European level and as a consequence continuity is prevailing. The new Interior minister Lamorgese is applying the same "closed ports" policy enacted by Salvini and the disputed security decrees passed by the first Conte government are still effective. The same is true for anti-corruption policy, a flagship policy of the Five Star Movement, that aims to strengthen the power of magistrates' investigations and to increase the severity of punishments.
- **The war against tax evasion.** The government is pursuing new policies against tax evasion. Tougher criminal rules and incentives for electronic payment are entering into decrees and the budget law. However, it is still not clear the amount of money the executive will get back from this initiative. The fight against tax evasion is a strategy for increasing government's revenues rather than cutting public expenditure. Moreover, the government has rejected the League's policy to reduce taxation for self-employed on income between 65,000 and 100,000 euros. The measure is a risk in political terms, the industrial part of the country might consider the government's rhetoric aggressive and worrying.
- **Plastic tax.** Environmentalism is taking the form of taxation to reduce the impact of some products. One of the most discussed measures of the budget law is the "plastic tax", which aims to punish plastic producers. However, the plastic sector is strong in Italy, particularly in the north, and the tax on this kind of business might not be a great idea in terms of popularity. The tax increase is a sign that due to budget constraints the government is pursuing environmental policy through taxes rather than through public investments. The result might be negative: depressing some sectors, without introducing any other fiscal stimulus to compensate the increased taxation.

1.4 Forecasts

Probability of snap elections:

Elections within 2020: **60%**

Election after 2021 or at the end of the legislature (2023): **40%**

There are two scenarios on the table. **Scenario A is based on a paradox: the government is too weak to fall.** Indeed, all the parties in the majority have no rational incentives to break up the coalition and come back to the polls. Five Star consensus is declining constantly (around 15%), PD is firmly below 20% and Renzi seems unable to exceed 5% and to occupy the centre. With the current numbers and the present electoral law, a right-wing coalition victory is certain. In this situation, probably worsened by possible defeats at regional level next month, a snap election would be suicide for the government coalition. For this reason, we think that, despite the weakness and precariousness of the majority, snap elections in 2020 are unlikely.

Scenario B is founded on a less rational assumption. The confrontation within the majority is becoming increasingly harsh. An accident, at parliamentary level, might occur in coming months. One of the parties might impose an acceleration on the government's programme or policy and the others could stop it. Then, a *casus belli* for breaking up coalition would be available. Part of this possible scenario will depend on the agreement for modifying the electoral law that probably will be discussed in early 2020. Indeed, the current law disadvantages the majority parties because they will not form a coalition at elections and, as a consequence, in the single-name constituency the right-wing coalition would probably win nearly all of these seats (1/3 of the total). The majority parties might change the electoral law transforming it into a pure proportional law with an entry threshold (4 or 5%). In this case the parties of the majority might limit the damage in terms of seats.

Then, **some analysts argue that the President of the Republic Sergio Mattarella would do everything possible to avoid a snap election.** In this case, a new (reshuffled) government with the same majority might be an option. However, Mattarella has already done everything possible to safeguard the legislature with the appointment of the Conte 2 government. In the case of a government crisis, we think it would be very difficult for the Quirinale to explore other solutions than snap elections. There could be a short-term solution, such as an institutional government to take the country towards a vote, but it would be very difficult to form another government that would last for the rest of the legislature.

1.5 Mapping risks

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

- **A weak budget law.** The government is striving to respect Brussels' recommendations and, in contrast with 2018, it is avoiding tensions with the Commission. However, **the budget law is weak because it focusses on micro-policies and unambitious reforms.** The discussion is focused on tax expenditures, fiscal evasion, small variations in the level of taxation and welfare benefits. The government is not discussing pro-growth and pro-productivity measures. It has confirmed the pensions policy and the citizens' income that take up most of the expenditure allowed. Policy

continuity and immobilism are prevailing, despite the change in the majority. This risk is that a pro-European orientation is perceived by voters as a mere status quo, which might further delegitimize EU institutions and the pro-European message.

- **De-industrialisation?** An important case for Italian politics in recent months has been the purchase of the ILVA steel mill in Taranto (Puglia) by Arcelor-Mittal. For environmental and ideological reasons, the government reduced the legal protection for environmental crimes that had been assured to the purchaser Arcelor-Mittal. The Franco-Indian colossus reacted by threatening to close the Taranto plant (24 billion Euro is the value of the factory's production, 11,000 employees). The government has revised its position and now is negotiating with the company on job losses. The uncertainty produced by the government has been perceived by the business community as a more general hostility towards big business. Concerns are growing about the will of the government to keep large foreign producers in Italy. Regulatory instability and the uncertainty of industrial policy are certainly risks associated with Italian politics.
- **Political instability and confrontation with Brussels.** In these conditions there is no safe harbour for the government. The tensions within the majority are increasing, there is a lack of leadership in the government and PM Conte is now weaker than ever. The Five Star Movement could divide and collapse or Matteo Renzi could trigger a harsher confrontation and exasperate tension with the other parties. **Neither the government nor the legislature can be considered completely safe and stable.** Moreover, it is likely that the opposition will win most of the forthcoming regional elections, an event that will put the government in trouble, both in political and administrative terms. Moreover, considering the influence of the European Union in the creation of the government it is not implausible to imagine a resurgence of new friction with Brussels in 2020. **It would be very difficult for the government to face another budget law with such limited fiscal space and avoiding a definitive collapse in consensus for the majority.** As a consequence, we could expect an increasing confrontation on the deficit with the Commission in coming years, even if a pro-European government remains in charge.
- **Constitutional reform as a trigger for instability.** The coalition will need to navigate a number of political risks in 2020, particularly in the first half. First, the parliament passed the Fricano law in October to reduce the number of MPs and senators. If the law takes effect as scheduled on January 12, near-term elections become less likely. This is because constituency boundaries first need to be amended, which is unlikely to occur in 2020H1. Moreover, the risks to our baseline scenario allow a confirmative referendum to be called. In the event the referendum is held, the new law would be delayed, opening a window for elections to be held under the current electoral law.

2. Public Opinion Trends

2.1 Polls

In the first weeks of December the party led by Matteo Salvini (the League) is still firmly above 30% of votes, on average (Table 1). These results confirm the key role of the party not only in the centre-right camp, but in the entire Italian political arena.

	Polls of December	Polls last week of October	Polls of September	Polls last week of June	May 26 European elections	Polls last week of March	Polls last week December	March 4 elections
League	32.4%	32.5%	32.4%	36.2%	34.3%	33.1%	32.9%	17.3%
Five Star	16.2%	18.7%	19.7%	18.0%	17.1%	21.3%	26.3%	32.7%
PD	18.6%	19.6%	20.9%	23.4%	22.7%	21.0%	17.6%	18.7%
FI	6.3%	6.8%	6.7%	7.4%	8.8%	9.6%	8.7%	13.9%
FDI	10.3%	8.0%	7.2%	6.7%	6.5%	4.5%	3.8%	4.4%
+EU	1.7%	1.9%	2.3%	2.8%	3.1%	2.9%	2.5%	2.6%
Italy Alive	4.9%	4.8%	4.6%					
Action	2.2%							

Table 1: Electoral trends in recent surveys

The continuity of the party's electoral performance over the last year shows in particular the consolidation of a broad and generally stable electoral basin. If electoral stability seems to be the distinguishing feature of the League, the decline of the former ally, the Five Star Movement (M5S), is now clear. After the formation of the yellow-red government together with the Democratic Party (PD) in September, the Movement led by Luigi Di Maio lost more than 3 percentage points, reaching a low of 16.2% at the end of the year. This declining trend is paralleled by the one recorded for the Democratic Party (PD). Compared to the European elections of May 2019, in a steadily decreasing trend, the PD has lost around four percentage points (the party now polls at around 18.6%). Nevertheless, the party still remains the second political force in the country in electoral terms, preceded only by the League of Matteo Salvini.

More generally, in the centre-left camp, the electoral performance of the new party founded by Matteo Renzi has remained stable. This is a sign that, a few months after its formation, Italy Alive is not bringing the expected results in terms of electoral consensus. On the contrary - and this is perhaps the most significant novelty that emerges from the data - in the centre-right camp, the electoral success of

the League is increasingly challenged by the slow - but steady- rise of the party led by Giorgia Meloni (Brothers of Italy, FdI). As already noted in previous reports, FdI has steadily increased its votes since the general elections held in March 2018. In those elections, the party got 4.4% of the votes. In the European elections of May 2019, FdI grew by two percentage points. In the regional election in Umbria the party got 10.4% of valid votes (whereas it had obtained just 6.2% in the same region in 2015). Today the party polls around 10%, clearly outstripping Berlusconi's party (which is now in decline) and advancing as right-wing alternative to the League.

This new - somewhat unexpected - scenario, raises two intriguing questions: first, what is the real electoral potential of FdI? Second, how compatible is the electorate of this party with the electorates of other Italian political parties? To answer these questions, we rely on recent survey data collected by Winpoll (November 2019). In this survey we asked voters to express not simply their voting choice in the case of new general elections; but also their *propensity to vote* (i.e. PTVs) for each party in the Italian political system. These propensities are measured on 0-10 scales, with 0 meaning that the respondent expressed a propensity to vote for a certain party that is substantially non-existent; and 10 that the respondent expressed the highest propensity to vote for a party.

The PTVs allow us to study whether and how the electorates of different parties overlap. Graphically, the result of this analysis is synthesized by the Venn diagram (Figure 1). The size of the circles in the diagram corresponds to the number of respondents for which the probability of voting for a given party ranges from 7 upwards. So it includes both voters who already vote for that party and those who may want to vote for it in the future. It is no surprise that the League of Salvini, which polls on average around 30%, is characterized by the largest circle. It is instead a surprise that the Brothers of Italy, which by now polls around 10%, has a circle almost as large as that of the League. This means that, although the party led by Giorgia Meloni is still relatively low in the polls, it has considerable potential for electoral expansion. Most interestingly, however, is the large area of overlap between the circle of the League and that of Brothers of Italy. This means that there are many voters who vote today for Salvini - and will probably continue to do so in the future -, but who also consider it very likely that they may vote for Brothers of Italy in the future.

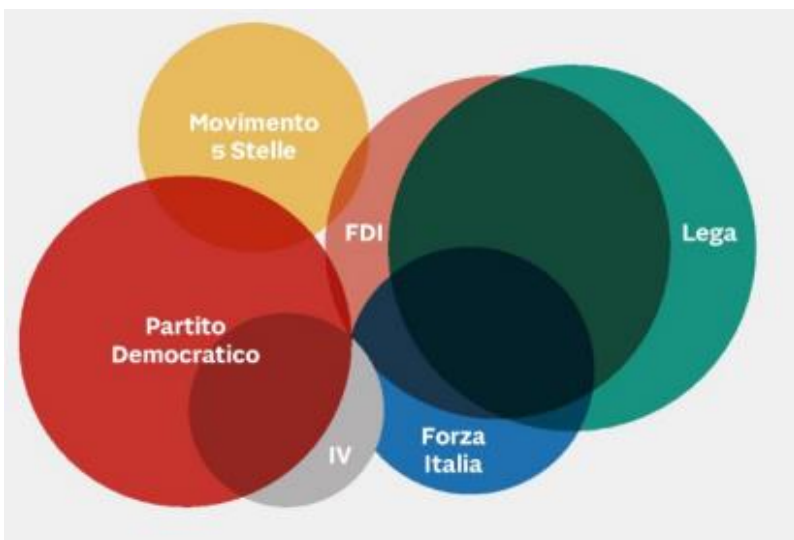


Fig. 1 - Degree of overlap of the voters of the main Italian parties. Source: CISE elaboration of Winpoll data, November 2019

This scenario appears even more plausible if we come back to recent electoral trends concerning FdI. In short, Salvini has found a formidable competitor. Today the voters willing to vote for one or the other of these two parties are practically the same.

On the left the picture is quite different. From the Venn diagram the difference is clear. On the right there is a compact block. Voters of right-wing parties widely overlap. They could potentially move from one party to the other of the bloc. On the left it is not so. Voters are more distant. In particular, the isolation of the M5S is clear. Not only has its electoral basin shrunk dramatically, but it seems that its remaining voters may either vote for the Movement only or simply abstain. Only the PD and Italy Alive have a significant share of overlapping voters. And this confirms that today the realistic target for Renzi's party is more among the voters of the PD, rather than among the electorate of Go Italy (FI), whose voters have a clearly right-wing position. Thus, not only is the potential vote of left-wing parties more limited, with the exception of the Democratic Party, but the overall left-bloc does not have the same homogeneity as the rival, right-wing bloc.

In short, the Italian political system's centre of gravity seems to have clearly shifted to the right. However, Salvini now has to deal with the intra-coalition challenge raised by Giorgia Meloni, who is targeting the same constituency as the League. At the same time, on the left, the M5S appears completely marginalized, unable to mobilize voters of other political parties. As for the PD, although it remains the second largest political party, it is still not able to be pivotal in the formation of a coherent electoral coalition. Indeed, voters of this party overlap only with the electorate of Italy Alive, thus showing the lack of attractiveness of the PD for the voters of other parties (in particular voters of the M5S).

3. Economic Scenario

In recent years the Italian economy has been significantly supported by a very accommodative monetary policy. The problem is that the instruments at hand of the central bank have a strong impact to the financial markets mainly in the short term, with effects that disappear over time, as the markets discount the various monetary programs to date. Meanwhile, **the ECB's "review of strategy" proposed by its new president Christine Lagarde could cast doubt on the fundamentally supportive role played by the bank during Mario's Draghi presidency.** From the geopolitical point of view, the NATO summit in early December, after criticism from the US President, ended with greater uncertainty about the future of NATO's collective defense and the world trading system. In this fragile and complex climate, with the perception of there being an imminent recession, **the Five Star Movement/Democratic Party coalition government's increasing respect for European rules is reassuring, but a strong fiscal impulse for welfare and infrastructure is what the Italian economy, and in general the Eurozone, needs more.**

In this extremely weak economic environment, **Italian growth is not accelerating, confirming itself also for the third quarter of 2019 at 0.1%, compared to the previous period, with a positive contribution from consumption spending and changes in inventories and negative from net exports.** An unchanged growth rate is forecast for the last quarter of the year, compared to the previous one (0.1%). On a trend basis, economic growth appears to be slightly more substantial (0.3%). Overall growth in Italy for 2019 would be 0.2% and unemployment would be in decline. Furthermore, the government's growth estimates for 2020 (0.6%) were shared by the Bank of Italy, which however commented that the 1% expected for 2021 is subject to extended financial conditions and the absence of serious negative developments in tariff conflicts and geopolitical turbulence.

At the economic level, final consumption spending is increasing by 0.3%, gross fixed investments (note: Gross fixed capital formation) and exports are decreasing by 0.2% and 0.1% respectively, while imports are increasing by 1.3%. Comparing the growth rates with the previous quarter, we note that all the main aggregates of domestic demand have decreased, with final spending for consumption at 0.8%, gross fixed investments at 2.5%, imports at 1.6% and finally, exports at 1.2%.

The weakening of the Italian economy's domestic demand is one of the causes of the expected anemic growth (0.2%) for 2019, as an increase in household consumption in real terms (0.6%) is expected to slow down compared to the previous year, which would be accompanied by a marked increase in the Italian families' propensity to save. As for gross fixed investments, while remaining positive, they are slowing down, with growth at 2.2%, from 3.2% in 2018.

For 2020 is forecast a reduction in the growth rate of gross fixed capital formation (1.7%) with the same growth rate of 2019 for household consumption (0.6%), supported by improvements in the labor

market. In fact, Istat is satisfied with the dynamics of the unemployment rate, down to 10% for 2019, from 10.6% in 2018, and expected to be 9.9% in 2020.

In November, the ISTAT index summarizing consumer confidence recorded a substantial decrease of -2.7% (from 111.5 in October to 108.5 in November). In detail, the indices underlying the composite index almost all follow the same dynamics. The economic climate decreasing from 127.2 to 116.3, the current climate falling from 107.9 to 106.8 and the future climate dropping from 116.1 to 110.2, with the exception of the consumer confidence index for the personal component in which the index rises slightly from 105.4 to 105.8. These numbers are confirmed by the increase in the families' propensity to save.

Moving on to the economy's productive sectors, signs of uncertainty are coming from industry, with more reassuring data for services. In detail, the index declined marginally in the manufacturing sector, from 99.5 to 98.9, and dropped from 141.3 to 137.1 in construction. On the contrary, in market services the index is stabilizing at the previous month's value (99.6), while in retail trade it remains substantially stable (from 108.3 to 108.2).

The industrial production index confirms the persistence of an extremely weak economic environment. Industrial production is estimated to have decreased by 0.3% in November compared to the previous month, while for the last quarter of 2019 a zero change is recorded, after the -0.5% of the previous Istat's survey. The decline in activity is consistent with a reduction in support from domestic and foreign demand, and in line with the negative trend in the confidence climate of manufacturing entrepreneurs. No improvement is expected in the short term.

The scenario outlined by the PMI indices (Purchasing Managers Index) tends to reflect Italy's very fragile (and not only) economic context. The manufacturing sector continues to record a sharp contraction in production and new orders, with a greater drop in exports in almost eight years. The PMI index reached 47.6 in November, reflecting the greatest contraction in operating conditions since March, recording the fourteenth consecutive month of deterioration in the condition of the Italian manufacturing sector. According to the PMI index, the Italian construction sector is again contracting, with activity declining for the third time during the last five months, together with the first contraction of new orders since May; the data shows how the sector is closing the year with a rather disappointing performance. Nevertheless, companies have increased their staff at the fastest rate in five months while, concerning prices, higher costs for raw materials result in higher inflation in business purchase costs. Finally, the tertiary sector PMI index stands at 50.4 in November, down from 52.2 in October, representing the slightest expansion of the sector's production since May. The weakest growth is mainly due to the lower flow of new orders, with a negative contribution from the foreign market and a positive one from the domestic market.

With the interruption of the drop in consumer prices at the end of 2018 there was an increase of the annual growth, reaching 0.4% in November, or 0.9%, if calculated net of the most volatile components (energy and food). There were favorable energy dynamics for families and businesses, with an annual decrease of 4.6%. Worrying data concern industry, which strongly feels the instability in international trade (US tariffs, difficulties in the car sector), with a slight growth in industrial goods prices of 0.3% from the negative performance of October (-0.2%). Moreover, the weak Italian domestic demand reflects the sluggish dynamics of the prices of goods, with companies being forced not to transfer to the consumers the increase of labor costs and, in general, the increase of the costs involved. Consistently

with the analysis of the PMI index for the tertiary sector, the economic activity of services is decidedly more resilient with respect to manufacturing and construction, with prices increasing by 1.1%. Consequently, the risk of deflation that could affect the Italian families' propensity to consume will shift consumption spending in the household with the expectation of a fall in prices and a greater weight of private and public debt, with the GDP deflator, crucial for reducing the debt-to-GDO ratio, estimated at insignificant growth (1%) in 2019.

All this poses substantial problems for the ECB, which, with former president Mario Draghi's last move, had continued to influence the market by introducing very expansive monetary policy measures which, however, have failed to increase inflation for the moment. The ECB's new president, Christine Lagarde, has often said that she would continue the previous president's monetary policies but at the same time, however, has prepared a "review of the ECB's strategy" in order to face the continuous changes and the challenges of recent years. A key point of the review is to define a better way for achieving the ECB's medium-term monetary policy objective.

On 20 November **the European Commission, in its judgment of the budgetary plans of Eurozone members, expressed greater concern for France, Italy and Spain, given the tendential increase in public debt for these countries.** The Commission highlighted that in their draft budgets there are neither fiscal adjustments, nor fiscal expansions. The increase in public debt is worrying mainly because of the reduced ability to react to economic shocks and market pressure on the increase in country risk, which is reflected in a higher rate of yields on government securities. In particular, the Commission has made it clear that these countries have missed the opportunity for recent decreases in refinancing rates to reduce the level of public debt; therefore, they are expected not to meet the European debt reduction targets for next year. Finally, in addition to the recent pressure from the outgoing ECB president, also **the European Commission is pressuring those countries that have public debt levels in line with European treaties (mainly, Holland and Germany) to undertake expansive fiscal measures to support the economy with the aim of obtaining positive effects for the entire Eurozone.**

The coalition government's budget is appreciable for its effort to stay in line with the directives of the European Commission, maintaining the deficit at 2.04% of GDP and thus avoiding further tensions. **However, it should be noted that government debt is growing well above 130% of GDP, severely restricting flexibility on fiscal policy decisions for Italy, which is wasting precious resources that could be allocated to welfare, infrastructure and justice, and to repaying high refinancing rates.** Expectations, and especially those of private investors, will play a major role during the year in determining Italy's economic growth. Unfortunately, the fiscal maneuver received much criticism, starting with the previous commission led by Jean-Claude Juncker, who noted that the measures aimed at supporting economic growth could be less suitable for doing so than expected. Giovanni Sabatini, general manager of the Italian Banking Association (ABI) intervened to defend the banking sector, negatively judging the large contribution of the banking world to the 2020 Budget Law, which will lead to a liquidity drainage in the sector, with clear repercussions on supporting families and businesses. **Overall, this Budget Law is considered important for some points but insufficient with respect to the needs of the country. It will therefore risk not to effectively influence substantial stagnation of the Italian economy.**

After accusations from various opposition parties (League and Brothers of Italy) and government forces (5 Star Movement) concerning the agreements made by the previous majority (5 Star Movement, the League and Brothers of Italy) on **the reform of the European Stability Mechanism Treaty (ESM), the issue is now dominating Italy's political debate. The two main criticisms regard automation in debt restructuring and the rescue of German banks.** It is therefore necessary, before delineating the key points of the aforementioned reform, to explain why these criticisms are groundless. After carefully reading the ESM treaty reform, it is clear that an automatic link between the request for financial assistance and debt restructuring is not present. What would happen is that, after the reform, if debt restructuring is needed, it would be managed more orderly and effectively by calling on bondholders to lower the debt itself before resorting to aid from the ESM. This aid would be subordinated to a careful analysis of the ESM and subsequently voted on by the Board of Governors (it comprises government representatives of each of the 19 ESM shareholders with the responsibility for finance) in which Italy, due to the share of the underwritten capital, has the power of veto. With regard to the rescue of German banks, there is very little to say, as the ESM will be able to intervene as a support to the common interbank resolution fund, which in turn intervenes in favor of the ailing bank after, due to the application of the Bail-in, the shareholders bear the costs of the bankruptcy. Therefore, the reform of the ESM represents a greater risk sharing mechanism in the Eurozone, as its role serves precisely to assist EU members if ever in difficulty, with assistance from the entire community through the ESM.

Given the complexity of the issue, it is necessary to describe the reform point by point. First of all, it is clear that this new treaty is part of a broader reform package approved by member state governments to complete the banking union and to strengthen the Economic and Monetary Union and therefore the ESM. The first point is that the ESM will participate in the common support mechanism (common backstop) previously agreed in 2013. It will play a more important role in financial aid programs. Together with the European Commission, it will monitor macroeconomic and financial risks and the sustainability of public debt for the 19 member countries of the ESM. It goes from the "double-limb CACs" to the "single-limb CACs", which will facilitate the conditions for reaching the debt restructuring agreement, where necessary. Finally, if requested by the state in question, the ESM could take on the role of facilitator in the dialogue between country and investors. Concerning the details of the key points, one of the main innovations of the reform is that there is a possibility that the ESM will be able to support the single resolution fund for banks. Indeed, this role will be extremely useful if the country, a member of the ESM, is not able to cope alone with a crisis in its institutions. This point should be considered as a common backstop if the Single Resolution Mechanism Fund (SRM), which is entirely financed by the banking sector, runs out of resources. This point is crucial as it is the first step in risk sharing in the Eurozone. Furthermore, it should be noted that when the common backstop is introduced, the Direct Recapitalization Instrument (indirect financing to the banking system for financial stability purposes, currently used only by Spain) will be suppressed. Proceeding by order, the most important role in financial aid programs concerns the conditions for granting "precautionary" credit lines, already provided for in the current treaty, for countries with a particularly solid economic and financial situation but which have to face shocks due to adverse circumstances. In detail, priority will be given to rapid intervention and greater control. This credit line will function as an insurance policy, calming the markets only by providing the availability of credit from the ESM, without actually

proceeding to disbursement. Concerning the next point, the ESM will have a more important role in the preparation and monitoring of future financial assistance programs: it will be more involved in the design of policy conditionality and any future Memorandum of Understanding (MoU) will be signed jointly by the Commission and the ESM's managing director. The Commission will be responsible for providing clarification if the Debt Sustainability Analysis (DSA) diverges between the ESM and the Commission, pronouncing the overall judgment of the DSA. With regard to the Collective Action Clauses (CACs), it is to be clarified that the "double-limb CACs" has been active since January 1, 2013, requiring two separate majorities to approve a change in the terms (with different maturities, interest amounts, etc.) of government securities: one at the level of each series of securities (series by maturity, different interest rates, etc.) and another at the level of all the series. The reform seeks to simplify the achievement of an agreement, since the right timing plays a key factor in the case of risks to financial stability. Therefore, the introduction of a "single-limb CACs" will allow only a majority to be requested at the level of all the combined series in order to avoid having a minority of security holders block the formation of a majority, leading to a delay in the resolution of the debt crisis. Finally, the role of facilitator, appropriately activated by the member state, is to be considered marginal since the participation of the ESM in the dialogue between member country and investors will be voluntary, informal, non-binding, temporary and on a confidential basis.

The ESM is therefore an essential institution in today's European reality and the criticisms raised by various opposition political forces to the reform of the Mechanism actually point to the very existence of the ESM. **Worthy of attention is the criticism coming from economists; they refer to the peculiarities of Italy where most of the, already high, public debt is held by Italians themselves and a restructuring could result in a tax on assets and/or that the market's expectations on the securities of a country with high debt can accelerate its entry into crisis.**

At the Euro Summit of 13 December 2019, leaders will take stock of the progress made on the ESM reform, but, **due to negotiations with Italy, the adoption of the new ESM mandate would be postponed to next year.** The next step will be to create a European deposit insurance scheme (EDIS), which will be the third pillar of the banking union. All this should lead, in the coming years, to the creation of the Capital Markets Union, and consequently we might move towards greater European integration.

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