Monthly Report

Mapping Italy: scenario and political risks

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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 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. Scenario and risks

1.1 Politics

The red wall of Emilia. Stefano Bonaccini, the PD's incumbent governor, has won the regional election in Emilia-Romagna, an important industrial region in northern Italy. **This victory is significant: Salvini failed to storm a traditionally left-wing stronghold; the Five Star Movement got a very poor result (4.5%); Conte's government has some breathing space**. A defeat in Emilia-Romagna could have been fatal for the executive.

PD declines and Sardines rise? Despite the centre-left victory, the PD lost 10% compared with the regional election of 2014. **Bonaccini's leadership and good administration played a major role in the centre-left winning. Moreover, the new leftist movement, the Sardines, helped Bonaccini by mobilizing many potential voters, indeed the turnout was surprisingly high for a local election (67%).** The Sardines' contribution was valuable in terms of reviving enthusiasm, and civic mobilization, but it is too early to assess their political future within the left-wing coalition.

Salvini, not invincible. The League's leader attempted to polarize and nationalize the regional vote as much as possible, campaigning hard for the centre-right's candidate, Lucia Borgonzoni. It was not enough. On the contrary, the left benefited from polarization against Salvini and the League, obtaining a wider mobilization of its electorate. **This election proves that Salvini is not invincible, albeit his party is still very high in the polls. The right-wing coalition fails to convince former Five-Star and moderate voters. For the League, Emilia-Romagna was a setback.** Moreover, in the next few months confrontation might increase within the centre-right. In particular, Giorgia Meloni's Brothers of Italy, the strongest ally of Salvini, could obtain a stronger specific gravity due to the League's defeat and to the growth of her party both at local and national level.

Five-Star's collapse. The collapse of the Five Star Movement is striking. From 33% in 2018, now they are polling under 15% everywhere. **The latest regional elections in Umbria, Emilia-Romagna and Calabria were a disaster.** In the north, they have nearly disappeared, in the south they are in severe decline. Is a recovery possible? In this currant state, it seems implausible. The **Five Star Movement has the relative majority in Parliament, but it is evaporating in the country.** After the resignation of Di Maio as political leader (see below), in a couple of months they should find new leadership. In the long term, this disintegration is the main element of uncertainty for the future of the government.

Clues from Calabria. The other regional election was in Calabria, a region in the South. The centre-right coalition led by Jole Santelli won a landslide victory. Santelli is from Forza Italia, Berlusconi's party. **There are three lessons from Calabria: in some regions, particularly in the south, Salvini still needs Forza Italia to win at local level; the Five Star Movement, which obtained great results in the**

southern regions in the 2018 general election, is collapsing; outside of its strongholds and the larger cities, the PD has numerous problems in gaining consensus.

1.2   Scenario

Analysts and markets are wondering how long this government will last. Nobody knows: predictions are even more difficult than they normally are in Italy. Two months ago, it seemed on the brink of collapse, today it looks more solid, but the situation remains precarious.

Salvini is keeping the majority alive by playing the part of a scarecrow. The vote in Emilia-Romagna demonstrated this axiom. However, even more than Salvini, the key factor is the desire of parliamentarians to remain in parliament as long as possible. **Moreover, the President of the Republic and the European Union establishment support the continuation of the Conte 2 Government. Another factor is the wave of public appointments in State-owned companies and public entities that must be done in the early Spring.**

Five Star Movement leaderless. This month Luigi Di Maio resigned as political leader of the party. A Congress will be held in March to choose new leadership. **In the short-term, the weakness of the Five Star Movement may strengthen the cooperation and the alliance with the PD, in order to avoid a government collapse.** In broader terms, Salvini's success has re-established the left-right divide as the most relevant cleavage in the Italian political system, whereas the Five Star Movement was meant to transcend that division. Moreover, the Movement was designed for opposition, not for government. Five Star parliamentarians have a very strong survival instinct, but it is not impossible that they may fragment up to the point where a working majority with them becomes unviable. The next few months will be decisive both for the Movement and for the Government.

Another factor causing uncertainty is Renzi, who is in a strategic blind alley. He is the real father of this government, that he backed in order to buy time, create his own party, and re-establish himself as a major political player. **In the electoral polls, however, his party is stuck below 5%. In this situation, it could be in Renzi's interests to pull the plug, have new elections, put Salvini in charge, and propose himself as his main opponent, exploiting the dissolution of the Five Star Movement and the ineffectiveness of the Democratic Party (PD).** Albeit in coming weeks, this is not the most likely scenario.

The PD is a party of the establishment and of responsibility and has an interest in the survival of the Conte government and the legislature. The party, however, is divided and quarrelsome; it has problems of identity, consensus, and political initiative; and the Government's agenda is being largely imposed by the Five Star Movement – in spite of the latter's crisis. The PD will not start the avalanche but, if the avalanche starts, it may not have the will or the strength to stop it. In Emilia-Romagna, the winning left-wing candidate decided to obscure the PD symbol during the electoral campaign. **Without the civic lists built by Bonaccini, the coalition would have not defeated the right. In Calabria, the centre-left coalition suffered a very heavy defeat. All signs that the PD is resisting in its strongholds, but consensus is still declining when compared to the past.**

The referendums. This month the Constitutional Court denied a referendum proposed by the League to reform the electoral law. The right-wing party proposed a popular vote for the introduction of the first-past-the-post system, but for technical reasons the Court denied it. Then, **there is a referendum on the constitutional reform reducing the number of parliamentarians which has already been set for 29 March. This enhances the odds that the legislature will survive.** The constitutional law has reduced the number of seats and consequently the incentive for the governing majority parties to dissolve the legislature. It is very likely this referendum will be approved by Italian voters and it is possible that the next electoral law will be proportional. In this case, **the Italian political system will probably return to "*bipolarismo imperfetto*": centre-right vs centre-left, but with a fragmented and fluid political scene. Instability will continue to characterize the Italian political scene.**

What will the government do in the next few months? In realistic terms, nothing significant. **This means: nothing dangerous in the short term, but also nothing potentially beneficial to the sustainability of Italy's public debt in the long term. The government will continue with micro-policies; it won't break European rules but, at the same time, it won't be able to deliver the structural reforms asked for by Brussels and Frankfurt.** Indeed, the majority is divided and fragmented, and each of the governing partners has an interest in imposing its own agenda. Permanent conflict and eventual paralysis is the most likely outcome of these premises. The PD is now discussing future reforms. Gualtieri, the economy minister, is proposing a small cut on taxes on labour and the Five Star Movement is trying to reform justice. However, factions and vetoes are making it more difficult for each party to achieve the reform it has promised. There is not much reform on the table. **The *status quo* and survival are the two imperatives of Conte 2 now. Today, this is the most likely scenario: the government will survive in the next few months, without achieving great reforms.**

1.3   Forecasts

Probability of snap elections:

Elections within 2020: **20%**

Election after 2021 or at the end of the legislature (2023): **80%**

With the centre-left coalition winning in Emilia-Romagna, the legislature appears safer. A defeat could have been more destabilizing. However, in the mid term, the condition of the Five Star Movement is worrying. The Movement is the largest party in Parliament and is behind Prime Minister Giuseppe Conte. A crisis might occur due to the fragmentation of the Five Star Movement, due to the rapid decline in the party's consensus. There are two countervailing forces: on one side, the party's weakness does not encourage a return to the polls; on the other, the Five Star Movement might completely disappear in the next few months at electoral level and might consider a long permanency in government to be against its interests. **For these reasons, we do not expect an immediate government crisis in the next few weeks, but we cannot exclude a progressive weakening of the majority within a year.** Much will depend on how the Five Star Movement manages its internal crisis.

Moreover, other regions are voting in May and a further major defeat of the Movement might be fatal. **We cannot even exclude a cabinet reshuffle in the next few months, with a strengthening of the left-wing coalition members.**

1.4   Mapping risks

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

- **A fragile government and a weak programme.** The government is stuck with the status quo. **The majority is fragile and Conte cannot embrace an ambitious reform programme.** In the next few months the government will be careful, and it will muddle through, trying to avoid breakdowns. **From a market and Brussels perspectives, the government will not go against EU rules and constraints, but, at the same time, we do not expect the accomplishment of structural reforms.** Conte 2's philosophy will be survival in the next few months and, if possible, years in a difficult political environment.

- **Political instability and fragmentation.** The victory of the centre-left coalition in Emilia Romagna regional election reduced near-term risks but the level of uncertainty over Italy's political future remains high. However, **Italy will hold further regional and local elections in May, if the right-wing alliance prevails in most of them, the government might become weaker, while the Five-Star Movement's political reshuffle could also be perceived as a source of uncertainty.**

2. Public Opinion trends

2.1   Polls

In the last week of January and at the regional elections in Emilia-Romagna and Calabria, the League still polled above 30% (31.4%) (Table 1). However, a slight negative trend (-1 percentage point) is apparent compared to the December surveys. Although this is just a slight drop, it is noteworthy that this occurred in the context of an electoral competition (in particular, the one in Emilia-Romagna) in which the leader of the League, Matteo Salvini, invested a massive effort in a clear attempt to politicize and nationalize the regional vote. It is still too early to establish whether this is the beginning of a more structural decline and whether (and to what extent) the outcome of the regional elections in Emilia-Romagna is affecting the electoral support for the League at national level, but after four months (September – December, 2019) of substantial electoral stability, the party has suffered electoral losses for the first time.

	Polls January	Polls December	Polls October	Polls September	Polls June	May 26 European elections	Polls March	Polls December	March 4 elections
League	31.4%	32.4%	32.5%	32.4%	36.2%	34.3%	33.1%	32.9%	17.3%
Five Star	15.5%	16.2%	18.7%	19.7%	18.0%	17.1%	21.3%	26.3%	32.7%
PD	18.9%	18.6%	19.6%	20.9%	23.4%	22.7%	21.0%	17.6%	18.7%
FI	6.7%	6.3%	6.8%	6.7%	7.4%	8.8%	9.6%	8.7%	13.9%
FDI	11.1%	10.3%	8.0%	7.2%	6.7%	6.5%	4.5%	3.8%	4.4%
+EU	2.1%	1.7%	1.9%	2.3%	2.8%	3.1%	2.9%	2.5%	2.6%
Italy Alive	4.0%	4.9%	4.8%	4.6%					
Action	2.2%	2.2%							

Table 1: Electoral trends in recent surveys

However, if the League goes down in the polls, its coalition ally, Brothers of Italy (FdI,) goes up in parallel. In fact, Giorgia Meloni's (no longer) small party has grown by almost one percentage point compared to December, stabilizing above 10%. Silvio Berlusconi's party also recovered slightly (+0.4 percentage points compared to December), although Go Italy (FI) has been steadily under 10% share months and is reduced to being the smallest party in the centre-right coalition.

These data clearly signal that the League's electoral losses have been reabsorbed by the partners of the centre-right coalition. This dynamic clearly leaves the electoral competitiveness of the coalition unchanged (and in fact it remains the strongest one in terms of votes, even compared to a possible enlarged centre-left coalition), but it could have major consequences on the dynamics *within* the coalition: in the centre-right, the electoral success of the League is now increasingly challenged by the rise of Brothers of Italy (FdI), whose potential for electoral expansion is high and extends to those voters who, for now, vote for the League. As we already signalled in previous reports, there are voters who are voting for Salvini today, but who consider FdI a plausible option in future elections.

Moving to the centre-left camp, the data show greater stability than observed in the centre-right (a clue that the electoral trends observed among the parties of the centre-right are to be attributed to flows *within* the centre-right coalition rather than to *outflows*). The PD remains substantially stable at around 18.9%, just over 0.3 percentage points up compared to the performance of December. Electoral prospects for Matteo Renzi's party (Italy Alive) have instead worsened: the party has lost almost 1 percentage point compared to December. The experiment started by the former secretary of the PD does not therefore seem to be getting the desired results and remains stuck on a meagre 4%.

But the grass is no greener elsewhere. The Five Star Movement, currently in government with the PD and with Italy Alive, continues its electoral decline. Compared to the last month of 2019, the party has lost 0.7 percentage points and more than three percentage points compared to October 2019. The party is clearly suffering critical losses and, on the top of this, its organizational structure is seriously undermined after the resignation of its political leader, Luigi Di Maio. The party congress (the so-called 'Stati Generali') will be held in March: on that occasion the Movement will have to set up a new organizational structure and redefine its policy platform. The date will be therefore crucial to understand the future of the Movement.

The regional election in Emilia-Romagna and its national consequences

The victory of the centre-left candidate, Stefano Bonaccini, in the elections in Emilia-Romagna went beyond expectations. The 7.8% gap between the newly re-elected regional President (who got 51.4% of the votes) and the Northern League candidate, Lucia Borgonzoni (who got 43.6% of the votes), was greater than the pre-election polls predicted (Table 2).

	General election 2018		European election 2019		Regional election 2019	
	V.A.	%	V.A.	%	V.A.	%
Voters	3,326,885		3,436,541		3,508,179	
Turnout	2,604,664	78.3	2,313,084	67.3	2,373,974	67.7

Parties

Leftist parties	165,536	6.5	67,301	3.0	107,584	5.0
PD	668,837	26.4	703,131	31.2	749,976	34.7
Minor allies PD			1,319	0.1		
Other centre-left parties	97,568	3.8	146,155	6.5	75,243	3.5
Centrist parties	38,126	1.5	14,191	0.6	6,341	0.3
FI (or PDL)	265,927	10.5	131,992	5.9	55,317	2.6
Minor allies of FI (or PDL)						
FDI						
Lega (Nord)						
Right-wing parties						
M5S						
Other						
Minor allies of FI (or PDL)						
FDI	84,785	3.3	104,861	4.7	185,796	8.6
Lega (Nord)	486,997	19.2	759,948	33.8	690,864	32.0
Right-wing parties	29,204	1.2	9,012	0.4		
M5S	698,204	27.5	290,019	12.9	102,595	4.7
Other			22,460	1.0	188,500	8.7
Total valid	2,535,184	100	2,250,389	100	2,162,216	100

Poles

Left (alternative to PD)	165,536	6.5			23,281	1.0
Centre-left coalition (PD)	780,600	30.8			1,195,742	51.4
Centre	23,591	0.9				
Centre-right coalition (FI/PDL)	838,049	33.1			1,014,672	43.6
Right	29,204	1.2				
M5S	698,204	27.5			80,823	3.5
Other					10,979	0.5
Total valid	2,535,184	100			2,325,497	100

Table 2: Electoral results of single parties and coalitions in Emilia-Romagna in the last national, European, and regional elections[1]

The victory of the centre-left was mainly a personal and local success for Bonaccini, a success that certainly rewarded the good governance of the region. However, the result in Emilia-Romagna goes far beyond the region. In fact, there is no doubt that this result helps stabilize the Conte government.

For the Five Star Movement this election (as well as that in Calabria) confirms a by now consolidated negative trend. It is true that at the local level the performance of the Movement has rarely been brilliant, but now we are witnessing a real landslide among its electorate: from 27.5% in the general elections, to 12.9% in the European elections, down to 4.7% in the regional elections. Where did the voters of the Movement go? And why did they move away from their party?

The analysis of the electoral flows in some cities in Emilia-Romagna (Figure 1) clearly shows that many of those who voted for the Movement in the European elections, decided to vote for Bonaccini in the regional elections. The Movement had previously lost a good chunk of its right-oriented voters, who were mobilized by Salvini; now the party is losing those voters who came from the left and are now returning there. And this is a phenomenon that should make the Movement's leadership think carefully about its national strategy and in particular about its relations with the current government ally (the PD). Especially since this result highlights a clear return to a bipolar structure in politics with two competing groupings and two leading parties within them (the PD and the League). In fact, the two major groupings together collected a total of 93.7% of the votes, with the Democratic Party and the League together getting 66.7% of the votes.

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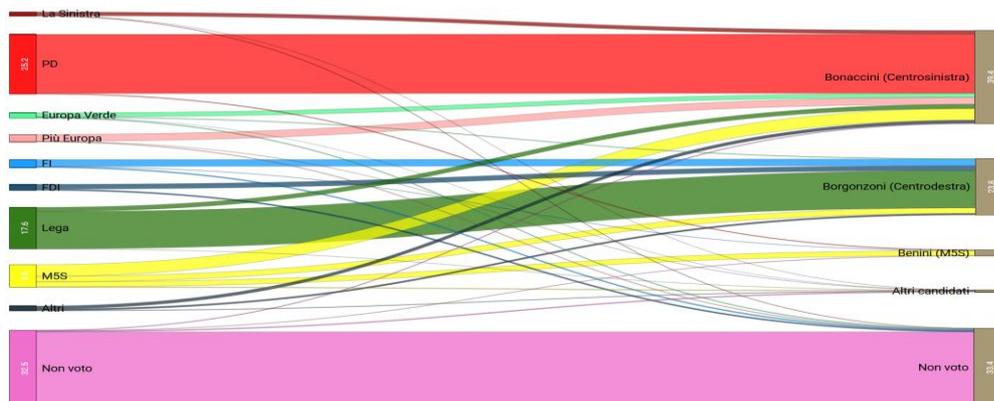
[1] In the upper part of the table the proportional results are shown (for the general elections of March 2018, the votes expressly assigned to the parties are reported, before the assignment of the votes to the only supported candidate in the district); in the lower part majoritarian results are used. In the upper part of the table, each row adds the results of the related parties, regardless of the coalition of which they were part. The 'Left parties' category includes: PRC, PC, PCI, PAP, SEL, SI, MDP, LeU, RC, PCL. The category 'Other centre-left parties' includes: Insieme, PSI, IDV, Radicali, +EU, Verdi, CD, DemA. The 'Centre parties' category includes: NCI, UDC, NCD, FLI, SC, CP, NCD, AP, DC, PDF, PLI, PRI, UDEUR, Idea. In the 'Right parties' category are included: La Destra, MNS, FN, FT, CPI, DivB, ITagliIT. In the lower part the results of the candidates (single-member district) are added, classified according to the criteria indicated below. For the general election in 2018 and the regional elections in 2020, we considered as the votes of candidates the votes received by the coalitions (supporting a candidate, premier or governor). 'Left alternative to PD' brings together all the candidates supported by at least one among PAP, RC, PRC, PCI, PC, MDP, Leu, SI, SEL, PCL, Insieme, PSI, + EU, CD, DemA, Verdi, IDV, Radicali - but not by the PD. The 'Centre-left' is made up of candidates whose supporting coalitions include the PD; the 'Centre' brings together all the candidates supported by at least one among NCI, UDC, CP, NCD, FLI, SC, PDF, DC, PRI, PLI (but neither by the PD nor FI / PDL). The 'Centre-Right' is made up of candidates whose supporting coalitions include FI (or the PDL). The 'Right' brings together all the candidates supported by the League, FDI, La Destra, MNS, FN, FT, CasaPound, DivBell, ITagliIT – but not by FI (or the PDL)

Figure 1: Electoral flows in Reggio Emilia between the European elections in 2019 (left-side of the figure) and the regional elections in 2020 (right-side of the figure)

In conclusion, for the Democratic Party this election was a positive one, also due to the strong mobilization of the youth and the Sardines Movement. Young people were precisely those who voted massively for the Democratic Party (and its allies). For the League and most importantly for its leader Matteo Salvini, it was a clear political defeat. True, the League is still around 32% in the region; however, the nationalization and politicization strategy adopted by the party, which tried to weaken the national government by means of these regional elections, was not rewarded. As for the Five Star Movement, the defeat in Emilia-Romagna, is a clear sign of the crisis that the party is going through. Meanwhile, the 'battle' slowly moves to other regions where regional elections will be held in the spring, including Tuscany - another 'red' stronghold at risk - where the League has obtained positive electoral performances in recent times.

3. Economic Scenario

With temporary positive signals from the trade battle between the United States and China, 2020 started with a delicate geopolitical environment due to political instability in Libya, tensions between the United States and Iran, the beginning of the Brexit transition and the new US presidential elections scheduled for early November. Overall, global growth is projected to rise but moderately. Italy, faced with the weakness of the manufacturing sector, should close the last quarter of 2019 in substantial stagnation.

In 2019, ISTAT forecast weak economic growth in real terms of 0.2%, which would slightly accelerate during 2020 (0.6%) with positive effects from the labour market and negative effects due to low investment, a modest expansion in consumption and uncertain export performance in view of geopolitical risks. The increase in growth prospects during the new year is due to higher domestic demand and a recovery in industrial production. The employment rate, which has been improving since the beginning of 2014, recorded a monthly increase of 0.2% in November, and the unemployment rate, which has tended to decline since the beginning of 2017, remained unchanged for November at 9.7% compared to the previous month. Exports, with their third consecutive increase (3.2%), with a greater contribution from extra-EU sales, could slow down due to renewed global risks. Consumption, albeit slightly increasing, would be the driving force of growth, supported by favourable conditions in the labour market, while investments should maintain a negative trend in the last quarter of 2019 with an uncertain trend (gross fixed investments estimated at 2.2% in 2019 and 1.7% in 2020), but downwards, in 2020.

In December, the ISTAT index summarizing consumer confidence, down by -2.7% in November, showed a clear improvement of 2% (from 108.6 to 110.8). In detail, the indices underlying the composite index all follow the same trend, with the economic climate going from 116.5 to 120.7, the personal climate growing from 105.8 to 106.8, the current climate increasing from 106.8 to 108.8 and, finally, the future climate passing from 110.2 to 112.2.

Turning to the economy's productive sectors, the composite climate improved for all sectors, up by 1.5% in December. In detail, confidence in the construction sector clearly increased, with the index going from 137.1 to 140.1, in services from 99.7 to 102.2, in retail trade from 108.3 to 110.9 and, finally, with a marginal increase in the manufacturing sector, from 99.0 to 99.1 .

The scenario outlined by the PMI (Purchasing Managers Index) partially reflects that suggested by the ISTAT confidence indicators, which summarize the confidence in various sectors of Italian companies. In fact, only the service sector is expanding, with business increasing for the seventh consecutive month due to the faster growth of new orders. In detail, the index went from 50.4 in November to 51.1 in December. The construction sector index reflects a weakness at the end of 2019, recording a contraction in activity for the second consecutive month and settling well below the no-change threshold of 50, decreasing to 47.7 from 48.2 in November. Finally, the weakness of the manufacturing sector is reflected in the PMI index, with a reduction in production and new orders for the seventeenth consecutive month, which stood at 46.2 in December, down from 47.6 in November.

ISTAT's preliminary estimates on price dynamics confirm a stable inflation rate, mainly due to weak domestic demand, with a slight monthly increase in consumer prices of 0.2% and 0.5% on an annual basis. For 2019, consumer prices rose by 0.6%. Overall, Italy is in penultimate place (after Portugal, 0.4%) in terms of the inflation rate recorded in December 2019, with an average of 1.3% in the euro area. These are values that are well below the primary objective of the European Central Bank (ECB). The issue prompted an immediate reaction from the new president of the ECB, Christine Lagarde, who decided to launch a review of the strategy of the monetary institution in Frankfurt. In detail, the quantitative formulation of price stability, the set of monetary policy tools, the economic and monetary analyses and finally the so-called forward guidance will be remodelled. In the meantime, the debate on the direction to be taken in the "reform" of the ECB's modus operandi has highlighted that the reformulation of the primary objective could benefit from a wider range of values, between 1 and 3 percent, instead of a specific number. This approach could give the institution more time and flexibility to act, avoiding extreme measures in an attempt to pursue the much desired annual inflation rate that is lower but close to 2 percent.

With the Italian budget plan, that became law in December, the coalition government set itself the goal of tackling some of the country's structural problems, and avoiding the increase in VAT, provided for in the safeguarding clauses. The crucial points are the reduction of the tax wedge, direct investments in the Italian Green New Deal, the introduction of taxes with direct social/environmental impact (sugar tax and plastic tax), cuts to government administration expenditure, greater expenditure on infrastructure and health and, finally, the fight against tax evasion, which will be carried out by encouraging the use of electronic money.

In the face of this very progressive budget law, at least in its intentions, there is an inevitable negative dynamic in the public debt/GDP ratio, forecast at 136% for 2019 and then slightly increasing in 2020 to 137%, due also to the low nominal growth rate of the Italian economy. Furthermore, the 2019 trend deficit (2.2%) was lower than planned (2.4%), although higher than that communicated to the European Commission on July 1. This year, with moderate growth, the trend deficit is expected to increase slightly, around 2.4%, not in line with the goal of the coalition government expressed in the 2020 draft budgetary plan (2.1% in 2022). Much will depend on the impact of the current budget law, and the future one, together with the country's economic growth prospects.