

# Italian Election

## Risks of Political Instability Have Increased

- **The outcome of the upcoming Italian general election (24-25 February) remains highly uncertain**, now more over the past two months. According to the latest polls, released last week before the black-out period started, the gap between the two main coalitions — Bersani's centre-left Italia Bene Comune (IBC) and Berlusconi's centre-right (CDX) — had been quickly narrowing in the past month to slightly below 5%, down from 12-13% in early January (see Figure 1). This trend has been driven both by IBC losing ground — down 4pp, to 34.3% on average in last week's polls — and Berlusconi gaining support (to 29.5%). Polls also suggest the centrist-coalition led by Mario Monti has remained roughly stable at around 13-14%, while the anti-establishment Movimento 5 Stelle (M5S) has increased its share to around 15.5-16% of the votes.
- Assuming that the ballot outcome matches the polling figures, the **centre-left IBC is still likely to win an absolute majority of seats in the Lower House**. The result for the Senate, however, is far less clear, as it depends on the relative performance of each coalition in each of the 20 Italian regions. The coalition gaining the most votes in each region gets 55% of the Senate seats assigned to that region. Regional polls indicate that the IBC-CDX race is close in the biggest regions of Lombardy (16% of the Italian Senate seats), Campania (9%), Sicily (8%) and possibly also Piemonte (7%) and Puglia (6%) (see Figure 2). The centre-right seems to lead with a good margin in Veneto. Given the tightness of the contest between IBC and CDX, small moves in the votes can lead to large swings in the Senate seat allocation.
- On balance pollsters agree that IBC is unlikely to win a clear Senate majority, making a **post-election alliance between IBC and Monti's centrists the most likely scenario**. This would happen in our view even if IBC wins a slim majority of seats in order to improve governability. Both leaders have hinted at such a possible coalition, which would probably support a Bersani-led government with Monti's role still unclear (Finance Minister, Senate President, or possibly even President of the Republic when that vacancy opens up in May). While this alliance would ensure some governability in the election aftermath, its very broad political spectrum (from Monti's right-wing ally, Fini, to the left-wing ally of Bersani, Vendola) makes its survival for the entire 5-year legislature highly uncertain, in our view.
- **Two alternative, and in our view less market-friendly, outcomes have become increasingly likely**: i) a hung parliament, where even a Bersani-Monti coalition does not muster a majority in the Senate and where lack of governability may lead to a fresh election in a matter of months, probably after a temporary care-taker government is appointed to change the electoral system; and ii) an outright victory for Berlusconi, where market disappointment, similar to what happened in 2011, could re-emerge on renewed fears of a poor reform drive and lack of international credibility.

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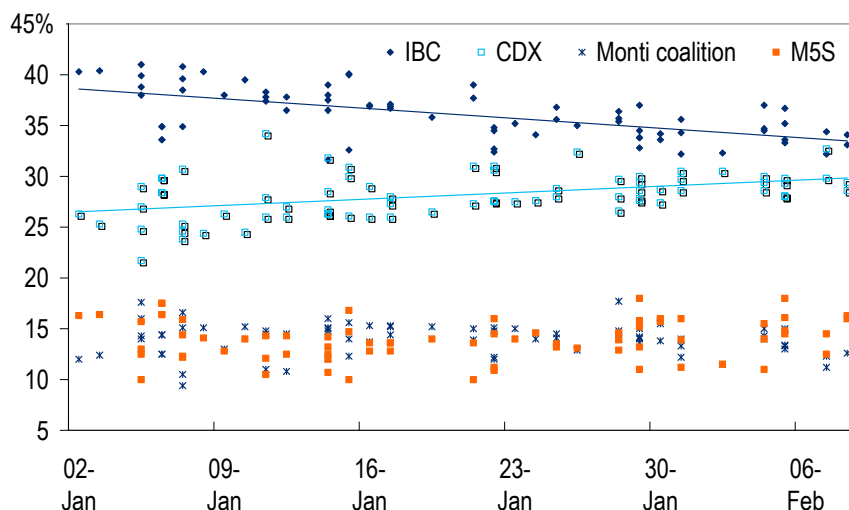
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We analysed the recent polls and judged that there are four possible outcomes from the general election on Sunday-Monday 24-25 February 2013. Three of these four outcomes assume that the centre-left IBC coalition will win the Lower House. The other outcomes are crucially dependent on the seat allocation in the Senate based on the fairly complex electoral system (see box below). These outcomes are based on the latest poll data available from several pollsters up to 8 February. However, with the gap between the two major coalitions at around 5 percentage points, the final result in the national vote — which decides the seat distribution of the Lower House — may also still hang in the balance. As a reference, ahead of the 2008 general election, opinion polls underestimated the performance of the centre-right coalition led by Silvio Berlusconi relative to the centre-left coalition by about 4%. Moreover, with still around 30% of voters either undecided or declaring to abstain, the results remain highly uncertain. A leading pollster this week said in the 2008 election, about 20% of voters made up their minds in the final week before the election, with 10% on the last day.

Figure 1. Italy – Voting Intentions (%), 01-Jan-2013 – 08-Feb-2013



Sources: termometropolitico.it, sondaggipoliticoelettorali.it and Citi Research

Here are the possible alternatives:

1. **An outright victory for the centre-left in both Houses of Parliament:** although still possible, pollsters seem to agree that the centre-left will not be able to win a comfortable majority in the Senate, especially considering the recent weakening trend in the polls. Unless a major turnaround of voting intentions in favour of IBC happens in the final week, we think an alliance with Monti's coalition will be likely in the case of an IBC *slim* majority in the Senate.
2. **A Bersani-Monti post-election alliance remains the most likely scenario** in our view, although its probability has likely decreased significantly over the past month. Polls suggest IBC would get around 150 seats in the Senate (out of 315) and with some 25-35 seats for Monti's coalition, which would guarantee a fairly large majority in the Senate (see Figure 2). We think this would probably be the most market-friendly outcome as it should ensure decent governability thanks to a fairly broad coalition supporting the government and some degree of continuity with the reform agenda of the previous technocrat Monti government. However, we also think this outcome is not free of risks in the

medium term. Monti has already expressed concerns about Bersani's left-wing party ally (SEL, led by Nichi Vendola) and his anti-reform stance and he recently said he would not want SEL (which appears to gather about 3.5-4% of votes) in a possible future coalition. We think the ability of a Bersani-Monti coalition to stick together will be put under severe strain as soon as the next round of structural reforms and most-needed public spending cuts require to be agreed. We suspect such a coalition may succeed in staying together only in the presence of an external enforcement mechanism, such as increased market pressure and/or an ESM Memorandum.

3. **No coalition winning a majority of seats in the Senate** as a result of the centre-right coalition winning the race in the still-large number of contested regions, such as Lombardia, Sicilia, Campania and possibly Piemonte and Puglia. Note that all these regions were won by the centre-right coalition led by Berlusconi in the 2008 election. If this happens, and perhaps Monti performs at the lower end of the range of expectations, then a Bersani+Monti alliance may fall short of an absolute majority in the Senate. With the anti-establishment M5S party unlikely to form a coalition with any other political force, this would leave a "hung parliament". In this event, we think a care-taker government supported by a grand coalition (similarly to what happened with the Monti government in November 2011) may be appointed in order to approve a new electoral law and to elect the new Italian President whose mandate ends in early May, before fresh elections would probably be called. This would likely leave a political vacuum in Italy for a few weeks (or months), implying further delays in the pace of reforms and severely heightened uncertainty around future reform progress.

Figure 2. Italy – Senate Seats by Region, IBC-CDX Gap in Voting Intention By Region and Estimated Distribution of Senate Seats

	Senate Seats	No of Seats for the Winning Party/Coalition	IBC-CDX Gap in Voting Intentions*	IBC-CDX Gap in Voting Intentions*	Senate Seats for IBC	Senate Seats for CDX	Senate Seats for Monti list
			Source: Termometro Politico		Source: Scenari Politici		
Lombardia	49	27	-2.3%	-1.5%	14	27	3
Campania	29	16	3.5%	3.0%	16	6	2
Lazio	28	16	10.5%	9.5%	16	6	3
Sicilia	25	14	-8.7%	-1.0%	6	14	2
Veneto	24	14	-7.1%	-4.0%	5	14	2
Piemonte	22	13	7.0%	5.5%	13	5	1
Emilia-Romagna	22	13	20.4%	20.0%	13	4	2
Puglia	20	11	3.6%	3.5%	11	5	2
Toscana	18	10	26.6%	25.0%	10	4	0
Calabria	10	6	8.4%	2.0%	6	2	1
Liguria	8	5	11.9%	10.0%	5	2	0
Marche	8	5	17.6%	12.0%	5	1	1
Sardegna	8	5	11.3%	10.0%	5	1	1
Trentino-Alto Adige	7	4	Others	Others	5	1	1
Friuli-Venezia Giulia	7	4	3.4%	4.0%	4	2	0
Umbria	7	4	17.7%	18.0%	4	2	0
Abruzzo	7	4	9.5%	6.0%	4	1	1
Basilicata	7	4	17.0%	18.5%	4	1	0
Molise	2	1	4.8%	4.0%	1	1	0
Valle d'Aosta	1	1	Others	Others	0	0	0
Votes from Italians Abroad	6	-			4	1	1
<b>TOTAL SEATS</b>	<b>315</b>	<b>177</b>			<b>151</b>	<b>100</b>	<b>23</b>

\*Red = IBC leads by more than 5%; orange = IBC leads by less than 5%; yellow = IBC-CDX gap less than 3%; blue = CDX leads by more than 5%; light blue = CDX leads by less than 5%.

Sources: Termometro Politico, Scenari Politici, based on polls released until 8 February 2013, and Citi Research

4. **Outright victory for the centre-right coalition led by Berlusconi.** Although this scenario remains in our view the least likely of all, its probability has increased on the back of the improving support in the polls for Berlusconi's centre-right. The polls say the gap with the centre-left is around 5%, which is still fairly large assuming a small margin of error. However, as we said, the reliability of the Italian electoral opinion polls is somewhat weak and the 2008 election, if taken as a guide, suggests they may be underestimating the support for the centre-right. The centre-right coalition has not yet officially nominated their PM candidate; the electoral agreement between the two main coalition parties (PdL and Northern League) requires that Berlusconi will not be appointed again as Prime Minister, possibly replaced by PdL Angelino Alfano. Under this scenario Berlusconi has said he would become Finance Minister. Under the scenario of a CDX win in the Lower House, but not a clear outcome in the Senate, we suspect there is still a possibility that Monti could decide to team up with the centre-right coalition — possibly under the condition of Berlusconi not being involved in the government — in order to ensure governability to a centre+centre-right government.

The probability of outcomes 3 and 4 has risen in the past weeks, judging from polling results, which means in our view that from a market standpoint the risk of a disappointing result has increased. The uncertainty until the election results is likely to remain elevated because no official polls are available (albeit some newspaper articles may still report some unofficial figures). We reckon Italy may be facing a prolonged period of political instability, hence a severe delay in much-needed reforms and budget adjustments, as a result of the next general election.

The Italian electoral system is a “modified” proportional system that awards a majority premium to the party, or coalition of parties, that wins the majority of votes. Voters cast ballots for the chosen party, rather than for individual candidates. Political parties who intend to form coalitions, have to do so ahead of the ballot, present a coalition programme and choose a coalition leader. As for the election in the Lower House (Camera dei Deputati), 617 out of 630 seats are allocated with a proportional system in 26 constituencies (1 MP is elected with the majority rule in one autonomous region and 12 are elected by overseas residents). Thresholds apply to enter the distribution of seats: that is, 4% for single political parties, 10% for coalitions, and 2% for parties within a coalition. Votes for the coalitions or single-running parties are counted at the national level. If none of the coalitions, or single-running parties, gain 340 seats in the Camera, then a majority premium is awarded so that the most voted coalition (or party) obtains 340 seats (54% of the seats), independently of the share of votes they won. The electoral rules for the 315 MPs in the Upper House (Senato) follow the same “modified proportional” system, but seats and the majority award are allocated on a regional rather than national basis. The Senate has identical powers to the Camera. This leaves a possibility of a different political majority in the two branches of the Parliament, depending on how regionalised voting preferences turn out. In the most recent general election in 2008, the centre-right coalition led by Silvio Berlusconi won 47% of the votes for a total of 344 seats in the Lower House and 174 seats in the Senate. The centre-left coalition led by Walter Veltroni won 38% of the votes, 247 seats in the Camera and 134 in the Senate.

## Appendix A-1

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