

Talking About Italian Politics

Alert: Machiavellian Manoeuvres

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- **Italy's elections are the key Eurozone political signpost for 2013** — Non-Italians may find recent developments in Italian politics amusing, with their Machiavellian overtones. Unfortunately, as the Euro zone's second-largest economy, what happens in Italy's elections on February 24/25 is likely to have significant market implications. Given the high degree of uncertainty and late-breaking shifts taking place in the final weeks, we believe markets may be underpricing the political risks of Italian elections.
- **Italy's Fab Four** — There are four "teams" playing in the games: Bersani's centre-left PD/SEL, the centre-right Pdl/Lega alliance, ex-technocrat PM Mario Monti's centrist list, and Beppe Grillo's upstart 5-Star Movement. Each faces significant challenges. Additionally, the potential for surprises resulting from Italy's Porcellum Law, which guarantees the first coalition or list an overall majority of 55% in the Lower House, increases the difficulty of forecasting. While early polling suggests that the PD/SEL may have sufficient votes to win in the Lower House, it might struggle to win in the Senate—an outcome which would result in a hung parliament. The decisive role of Italy's three "Ohios" : Lombardia, Campania and Sicilia will be key, with Lombardia – Italy's richest and most populous region – a possible swing "state" for the Senate Race. .
- **Poll Position** — According to www.termometropolitico.it, as of January 9, PD/SEL have slightly increased their year-long lead in the polls with 39.1%, PDL/Lega combined are at 22.8%, Beppe Grillo's 5-Star Movement has 14.2%, while Mario Monti's list trails at 12.7%. With just over one month to go and the stakes high, changes in the public mood cannot be ruled out (especially following the recent shift to the Left from PD). Will the Italian vote follow the trend of other eurozone periphery countries, and ultimately elect a mainstream coalition government? Regional and local politics will likely prove decisive.
- **PD/SEL Shifting to the Left** — Following the highly successful "Primarie" which highlighted the support of moderates within PD (Matteo Renzi), PD/SEL held "Parlamentarie" to choose candidates - unusually held on December 28/29th when the turn-out was likely affected by holidays. The c.900 candidates ultimately chosen do not correspond to the Primarie outcome, with its strong representation of the PD's moderates, instead signalling a shift to the left. Meanwhile, the campaign is taking an increasingly populist turn, with SEL's Nicky Vendola recently noting that "he is disgusted by rich people". Such a strategy is unlikely to win votes in Italy's wealthy, and electorally decisive, Northern regions. Back to Lombardia.

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- **The Unlikely Return of Berlusconi** — Once again the PDL/SEL shift to the Left might provide a boon for Silvio Berlusconi who – after having apologized for his past transgressions in a TV interview – revived a longstanding alliance with Lega Nord. His campaign has also taken on a range of hot-button populist issues, ranging from the abolition of EMU, the futility of austerity measures, and the perils of Germany's influence. After 20 years in Italian politics, Berlusconi retains a significant base of support, especially amongst those most affected by the crisis. While it is highly unlikely his party could win, they could prove to be spoilers – especially if the alternative is a perceived overly leftish PD/SEL.
- **Beppe Grillo** — Italians are conservative and – in our view – Beppe Grillo might fail to replicate the success the party achieved in Sicily. His movement recently suffered defections and has struggled to maintain its momentum. 15% might be the party's upper limit, and like other new political parties, it may see its voters switch to a mainstream party in the voting booth, as protest votes in debtor countries may be regarded as more risky than in creditor countries, where NEAPs (New/Extreme/Alternative Parties) have had more success at the ballot box.
- **Mario “Come Lately” Monti** — since March last year (see [Shaping Italy 3.0 Version - The Years of Living Dangerously](#) and [Italy: In the Lions' Den](#)) we warned that Mario Monti might have wasted a unique opportunity to undertake much-needed reforms, focusing too much on bond spreads and international profile. In retrospect, he could have been bolder, challenging political party opposition, and then resigning before September – calling the bluff of a Parliament reluctant to back his reform measures. Unfortunately, the move came too late – even worse when Italians were struggling to pay EMU. Italians eat absolute bread rather than “spread” and might not be willing to support Mario Monti, who joins party politics for the first time in this race, and has a narrower base of support drawn from a mix of long-time status quo politicians
- **Hung Parliament?** — As we said in our report [Italy: In the Lions' Den](#), we think that a technocratic/political government might be the most likely outcome (although we were right on the timing of Christmas crisis - we were wrong in assuming Mario Monti as Presidente della Repubblica) and a centrist/PD coalition might be more likely. Unfortunately, a hung parliament would hardly be the best outcome to spark reforms and re-launch the economy; instead, it may increase the likelihood of Italy transferring more sovereignty abroad
- **Are Markets Rationale?** With spreads under control both Italian equities and bonds have rallied hard. However, over the same period the economy has gotten worse and politics looks to be heading nowhere. We fear that the general elections to be held in Italy on February 24th and 25th might be a reminder of how deep the Italian crisis is. Investors playing with fire might ultimately get burned.

Appendix A-1

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