

# Italian Election Monitor

## Eurosceptic shift

The result of the Italian parliamentary election appears to be a hung parliament, as earlier polls pointed to already. Anti-establishment parties such as the Five Star Movement and Northern League nevertheless registered strong gains, but none of the three major political blocs seem to be able to secure an outright majority (see chart). At the time of writing, the Five Star Movement was projected to get around 31% of the votes and the Northern League around 19%, whereas the PD party's result disappointed with 20% (see chart).

At this stage it is difficult to say which party will get the mandate by the president to form a new government, but overall a grand coalition or centre-right coalition together with some smaller parties still seems most likely, in our view. Even in the case of a euro-sceptic coalition of Five Star and Northern League emerging, we still think that the actual euro exit risk is low. However, such an outcome would still be the most adverse one for markets, given the combination of reform roll-back and significant fiscal easing, which could bring Italy's debt woes quickly back into focus (see also *Italian Election Monitor - The good, the bad and the ugly scenarios for Italy*, 25 February 2018).

### New elections cannot be ruled out

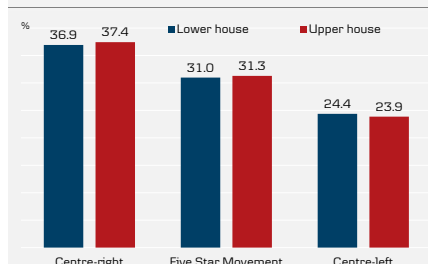
First coalition debates are likely to be starting behind the scenes already, despite the inconclusive result. The next important date on the election agenda is 23 March, when both houses of parliament will come together for the first time and speakers of the houses are elected, which is a necessary precondition for President Sergio Mattarella to start the formal consultation process aimed at forming a new government. After a deal is found, the new government has to secure a confidence vote in parliament, leaving us to conclude that it is unlikely that we will have a new Italian government in place before May or June this year. Should renewed coalition building efforts fail, new elections held in H2 18 cannot be ruled out either, in our view.

### Markets await more clarity

The reaction in FX markets to the eurosceptic shift in Italy so far has been muted, as investors await more clarity on the composition of the next government. **EUR/USD trades still around the 1.23 level at the time of writing and the muddy outcome should keep the cross in the recent range, in our view.**

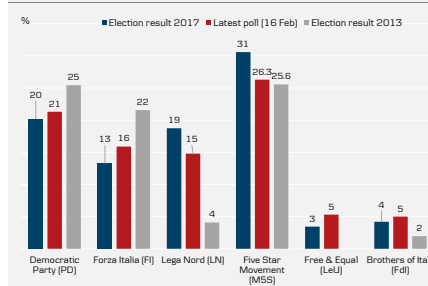
In the fixed income market, the Italian election is not a positive for the peripheral spreads this morning, but it is mainly an Italian 'problem'. Hence, we expect Italy to lose relative to Spain and Portugal as well as the core EU markets. **We expect the 10Y spread between BTPS and Germany to open up some 5bp wider on the back of the election result**, and given the big gains for populist parties, it is difficult to see this as a positive factor for Italian government bonds going forward. That said, **other factors are also at play such as the SPD joining Angela Merkel in a grand coalition in Germany, which will be positive for the EU. Hence, together with the centre-right coalition in Italy winning the most votes but without having a majority, this should limit the potential spread widening between Italy and Germany.**

### No clear majority in sight



Source: Italian Interior Ministry, Danske Bank

### Five Star and Northern League are the winners



Source: Italian Interior Ministry, Danske Bank

#### Analyst

Aila Mihr  
+45 45 12 85 35  
amih@danskebank.dk

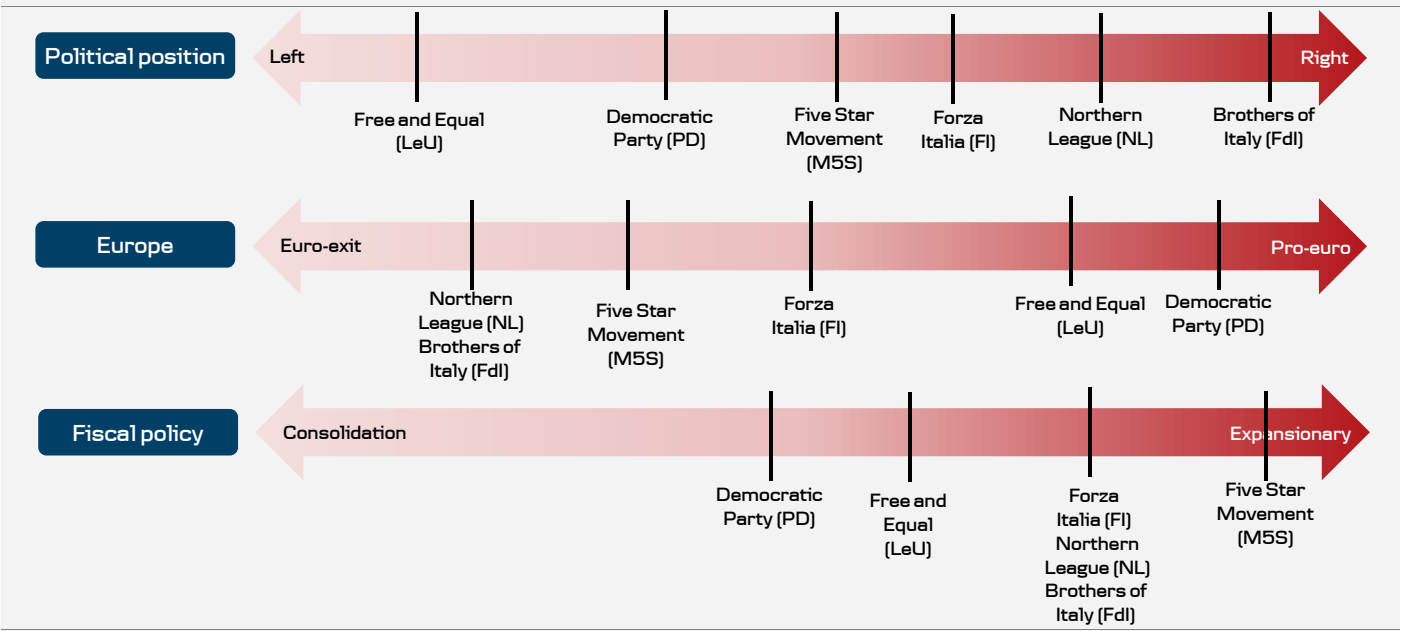
#### Chief Analyst

Christin Kyrme Tuxen  
+45 45 13 78 67  
tux@danskebank.dk

#### Chief Analyst

Jens Peter Sørensen  
+45 45 12 85 17  
jenssr@danskebank.dk

Wide political spectrum...



Source: Danske Bank

...but most parties are calling for higher fiscal spending

	Democratic Party (PD)	Five Star Movement (M5S)	Forza Italia (FI)	Northern League (NL)
Economic and fiscal policy	<ul style="list-style-type: none"> <li>New benefits for families with children</li> <li>Minimum wage 9-10 € per hour</li> <li>Lower business taxes to 22% (from 24%)</li> <li>Reduction of labor costs by 1pp per year and lower contribution rates</li> <li>Investment in transport, schools, digitalization of the public administration</li> <li>10-year plan for debt reduction to 100% of GDP</li> <li>Abide by rules of Fiscal Compact</li> </ul>	<ul style="list-style-type: none"> <li>Productive investments of EUR 50bn (innovation, broadband, electric mobility etc.)</li> <li>Commitment to cut public debt by 40pp of GDP in 10 years</li> <li>Abolish Fornero pension reform.</li> <li>Minimum pension of EUR780/month.</li> <li>Create an Italian Public Bank for investment</li> <li>Raise revenues through tighter rules on tax evasion and corruption</li> </ul>	<ul style="list-style-type: none"> <li>Flat tax of 23% for households and businesses (exempt low incomes)</li> <li>Abolish Fornero pension reform</li> <li>Increase minimum pensions</li> <li>End austerity policies</li> <li>Investment in transport, schools, digitalization of the public administration</li> </ul>	<ul style="list-style-type: none"> <li>Flat tax of 15% for households and businesses (exempt low incomes)</li> <li>Abolish Fornero pension reform</li> <li>Increase minimum pensions</li> <li>End austerity policies</li> <li>Investment in transport, schools, digitalization of the public administration</li> </ul>
Europe	<ul style="list-style-type: none"> <li>Pro-EU stance ("United States of Europe")</li> <li>European unemployment insurance</li> <li>Euro area finance minister</li> </ul>	<ul style="list-style-type: none"> <li>No euro exit (referendum only as a last resort).</li> </ul>	<ul style="list-style-type: none"> <li>No euro exit</li> <li>Revise EU treaties</li> <li>Reduce payments to EU budget</li> </ul>	<ul style="list-style-type: none"> <li>Pro euro exit - renegotiate EU treaties</li> <li>Reduce payments to EU budget</li> </ul>

Source: Italian Interior Ministry, Danske Bank

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This research report has been prepared by Danske Bank A/S ('Danske Bank'). The authors of this research report are Aila Mihr (Analyst), Christin Kyrme Tuxen (Chief Analyst) and Jens Peter Sørensen (Chief Analyst).

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