

Renzi's 'huge gamble' on Italian referendum

- December poll aims to prevent political gridlock in Italy
- PM has threatened to resign if he loses, triggering new crisis
- Italian economic growth remains weak, with lower forecasts

Italian Prime Minister Matteo Renzi is taking a "huge gamble" on a referendum to reform the country's political system, says Chief Economist Léon Cornelissen.

Losing the national vote called for 4 December could bring down Renzi's government and potentially destabilize the EU if it is replaced with a Eurosceptic-led party, Cornelissen warns. Italian bond spreads have already widened, while investors are also wary of weak growth prospects for Europe's third-largest economy.

"It seems like an arcane issue in seeking constitutional reform, and not a lot of Italian voters know the nuts and bolts of it, but it is meant to curb the power of the Senate and shift more power towards the lower house of Parliament, the Chamber of Deputies," says Cornelissen.

"This aims to prevent political gridlock. So this is a once in a lifetime chance for Italy to get a strong and stable executive, which isn't a bad thing when you bear in mind that they've had 63 governments in the last 70 years."

"However, Renzi has personalized the referendum by threatening to resign if he loses it, and the problem is he's not that popular because he's seen as being responsible for EU-imposed



Léon Cornelissen Chief Economist

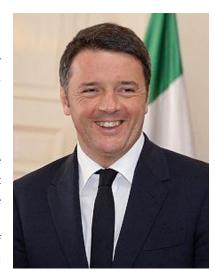
'They've had 63 governments in the last 70 years'



austerity, the refugee crisis and the Italian banking problem. He isn't seen as being sufficiently assertive, so it's a huge gamble by Renzi, particularly since the polls are too close to call at 50-50."

The young reformer

Renzi has been Prime Minister of Italy since February 2014 as the leader of the center-left Democratic Party. Elected at the age of 39, he was the youngest national leader in the EU and the G7. He has been the chief architect of the constitutional referendum and has staked his political career on it.



Matteo Renzi

"If he loses, people will basically say that Italy is a hopeless case that cannot reform itself, and it could increase the risk of an alternative government – and possibly one run by the Five Star Movement, headed by former comedian Beppe Grillo," says Cornelissen. "So fears of Italy getting a non-mainstream government which is populist and anti-EU will increase."

"This doesn't have to happen, because it's unclear if Renzi actually will resign, and even if he does, the Italian President has a lot of leeway to make sure there is a caretaker or technocratic government. With new elections scheduled for 2018, the president can play for time."

"It does though make the fall of the Italian cabinet likely, and that's why we've seen the risk premium on Italian government bonds increase to 135 basis points over Germany. By way of comparison, Spain's spread is lower at 100 basis points."

"But then as long as Italy has a government which nominally expresses the will to follow EU policies, the ECB will do nothing less than support the Italian bond market if the need arises. And with the ECB's quantitative easing program firmly in place, there is limited downside on Italian bond spreads."

Growth is weak

Cornelissen says the bigger problem for Renzi is economic rather than political, because the Italian government has lowered its growth projections for 2016 to 0.8% and for 2017 to 1.0%. "This means more trouble ahead; the government would like to present an October budget with some giveaways, but this is now becoming especially difficult due the still-



disappointing growth projections," Cornelissen says. "The lack of growth and lowered estimates is depressing, and isn't of course very positive for EU-friendly sentiment in Italy."

In an attempt to boost growth, Renzi has advocated new infrastructure projects, including a long-cherished dream to build a 3 km suspension bridge between Sicily and the Italian mainland across the Strait of Messina, costing upwards of EUR 6 billion.

"This is an old wish of Italian politicians but has never materialized because of fears of corruption along with the technological challenge of building such a bridge," says Cornelissen. "But I don't think the electorate will be all that impressed."

Brexit contagion

He says another potential worry is any rise in Euroscepticism following the UK's shock June decision to leave the EU. British Prime Minister Theresa May said in early October she will invoke Article 50 of the Lisbon Treaty, which would start the formal process for the Brexit, by the end of March 2017.

"The impact of the Brexit has so far been limited in an economic sense, mainly thanks to the fall in the British pound," Cornelissen says. "The main worry is that this could strengthen Eurosceptic sentiment in Italy, bearing in mind that the Five Star Movement wants a referendum on EU membership."

"Any Italian exit from the EU would have far wider repercussions than the Brexit. Unlike the UK, Italy is a member of the Eurozone and a founder member of the EU itself. Italy has a huge national debt which is 130% of GDP, and a big banking problem, so they are basically heavily dependent on support from the ECB and the Eurozone.

"Therefore, if things escalate with Renzi losing a referendum and possibly an associated new EU crisis, then that would be devastating for the whole Eurozone. But so long as Italy has a government that is prepared to play to EU rules, then the ECB is basically a guardian of the Italian bond market."

Spanish inquisition

The Italian issue comes on top of Spain's continued inability to form a workable government after inconclusive elections last December, though the country has brighter economic prospects, Cornelissen says.

"Spanish economic growth is much stronger than Italy's, and Spanish debt is much smaller," he says. "New Spanish elections are likely in December. There are some political parallels

'The ECB is basically a guardian of the Italian bond market'

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between Italy and Spain, along with a general rise in Euroscepticism and fringe parties, but generally in Spain, politicians get things done, whereas in Italy it's mostly stalemate."

Other upcoming issues include French presidential elections in April 2017 in which there is a risk of far-right candidate Marine Le Pen getting elected, and the lesser-risk German general elections the following September in which the current SPD/CDU government is expected to win through again.

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