

Italy complicates the European panorama

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We already knew that the Italian elections would prolong the difficult 2017 European electoral cycle well into 2018. Last year's results, for better or worse, meant a certain return to the political centre ground for all the countries involved, despite the fact that the most extreme political options have gained force and will certainly not be disappearing any time soon from the European political landscape.

In Italy, although the results did not diverge much from the predictions, the surprises favoured the two most populist options: the Five Star Movement (M5S, 32% of the votes), and the League, which with 17% ousted Berlusconi's party as the most-voted party in the centre-right coalition. These two parties, as well as embodying the anti-establishment mood that we saw in the Brexit vote and in the US elections, have similar positions on some economic issues: both M5S and the League have at some point called for a referendum on exiting the euro, although they abandoned the idea during the campaign. Also, both propose measures that would greatly increase the public deficit, and reverse some of the (very few) structural reforms that have been approved by recent Italian governments, especially in the area of the labour market and pensions.

The formation of a government remains wide open, and there are many options, but in almost all of them it seems that the M5S will play an important if not preponderant role. Beyond a transversal coalition that would include most of the parties, which for now seems unlikely, the option that seems to best support the Italian business world at this moment would be an alliance between the M5S and the Democratic Party (PD), although the latter is divided on this possibility and most of its parliamentarians want to go into opposition. This option is perceived as the most favourable for economic stability, probably because it has been noted that the M5S seems sufficiently pragmatic to discard the most radical proposals, and it is a party that defines itself as transversal (although admittedly both its leaders and its voters are more skewed to the left). For its part, the PD has been the only consistently pro-European party in Italy. The more vocal populism of the League seems to scare the markets more, and the "grand coalition" between the PD and Berlusconi's party would not have nearly enough seats to be truly grand.

Whatever form the new government takes, the two main problems of the Italian economy - low growth due to anaemic productivity, and very high public debt - are not going to just disappear, and there is no indication that the new government is going to be any more combative in fighting them than was the outgoing government of Paolo Gentiloni. All the Italian parties have made very aggressive spending or tax reduction proposals during the campaign, with increases in the deficit estimated by Carlo Cottarelli and Roberto Perotti, two prestigious Italian economists, of between 3 and 10 percentage points of GDP, depending on the parties. Although we all know that many of these promises are not going to be fulfilled, they accurately reflect the lackadaisical attitude of Italian politicians to fiscal matters, in the country that can least afford it.

The outcome of the elections may have negative consequences for the European negotiations to reform the governance of the euro zone. Right now, the scarcest asset in European politics is trust between the northern states and those of the periphery. The small-country "New Hanseatic League", led by the Netherlands, which aims to introduce mechanisms to restructure sovereign debt - before giving assistance through aid programmes - never ceases to remind us of this, and places Germany almost at the centre of

the debate over the future of the euro, rather than among the hawks.

Even if France and Germany manage to design some reform to move towards greater integration, the agreements will require a balance between the reduction of risks demanded by the north and the mutualisation of risks called for by France and the periphery. And with the third-largest European economy lacking a reliable fiscal anchor and with the risk of reversing the reforms approved in recent years, the chances of reaching a substantive agreement in the coming months are diminishing.

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