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Italian Elections

A crisis event for the Eurozone?

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Italian Elections March 2018: Are the Italian elections a crisis event for the Eurozone?

Amidst recent political violence, harassment and clashes, Italy is marching towards elections on Sunday. Mr. Renzi, former Prime Minister, characterized the election campaign as divided and divisive, hence describing the tone.

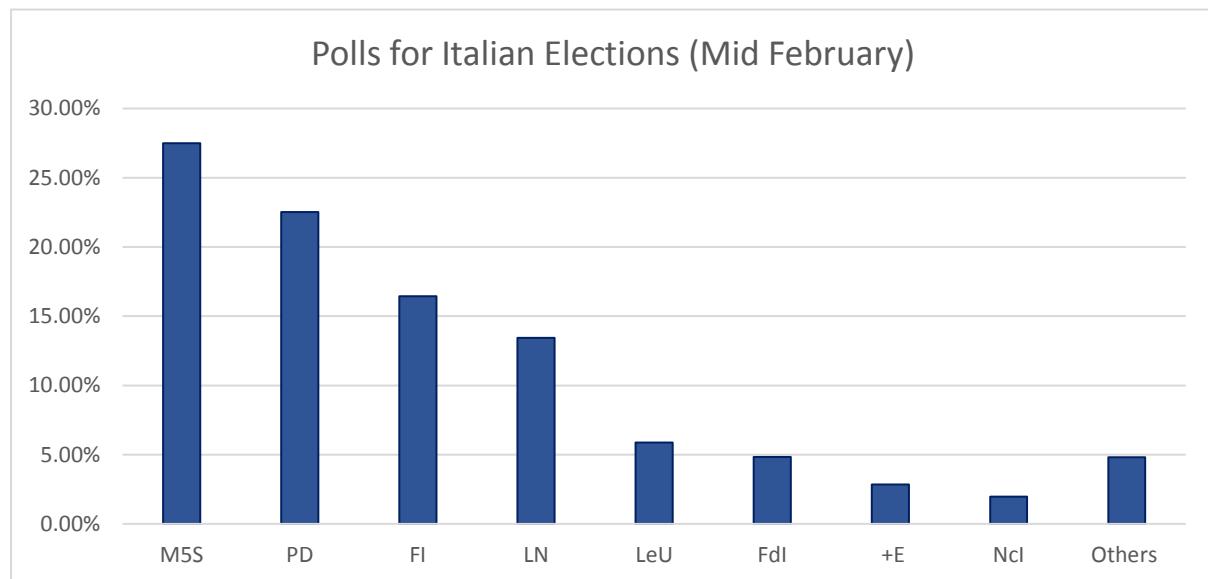
What will the new government have to face once elected?

Italy as an economy, is considered as the third-biggest in the euro zone and has expanded this year at its quickest rate since 2010. However, it remains amid the slowest in Europe. The most important issue within Italy is the unemployment rate that persists beyond 11 percent. In particular, youth unemployment reaches 35 percent which shows that a lot has to be done to improve the situation. Furthermore, Italy has the biggest public debt in the euro zone right after Greece's and all the main political movements are guaranteeing to raise the budget deficit if they win the election. Moreover, Italy's Gross Domestic Product growth rates has been increasing in very slow pace also signifying that changes must take place and a new economy plan must be implemented.

On the other hand, voters seem to weigh in heavily on the immigration issue which worsened especially in the past few years, giving rise to even xenophobic proclamations by a number of parties.

What are the scenarios?

Recent polls (mid-February) seem to reflect that opinion, as they render roughly the following fragmented results:



5 Star Movement (M5S) 27%, Democratic party (PD) 23%, Forza Italia (FI) 16%, Northern League (LN) 14%, Free and Equal (LeU) 6%, Brothers of Italy (Fdl) 5%, More Europe (+E) 3%, Us with Italy (Ncl) 2% and various other political parties sum up at about 4%.

At a first glance, it seems to be the case that no political party on its own can form a government. So let's look at the various possible governing scenarios and their possible threats.

Scenario 1: 5 Star Movement

The 5 Star Movement is projected to be the winner of the elections, with 27%. The issue here, is that it has widely proclaimed that the Movement would not enter any negotiations to form a coalition government with any other party, as such a move may cost a significant number of votes. Even should there be a possible forming of a coalition and thus gaining of power, the movement's anti Eurozone tones have lowered considerably, even have started to sound a bit pro-European lately. Hence the possibility of Italy exiting the euro seems remote in this scenario. The movement though strongly arguments for an increase of the deficit in the governmental fiscal budget for social purposes and proclaims that it intends to renegotiate EU terms.

Scenario 2: Alliance of Forza Italia, Northern League and Brothers of Italy

An alliance among the right wing parties could generate up to a 35% which should not be enough for the 40% threshold. However, political analysts point out the "shy voter" effect, which usually favors the right wing parties gaining higher results than the polls indicate. In such a scenario a number of issues arises. The first issue, would be the extreme anti-euro political thesis of the Northern league for either leaving the common currency or introducing back the lira domestically, while in parallel maintaining the euro for foreigners and international transactions. In this issue however, we see the case for Berlusconi's Forza Italia to prevail and keep Italy within the euro. Recent rhetoric of Forza Italia seems to strengthen arguments for the above. Another issue, which could arise in this coalition, would be who would be the Prime Minister. Media suggest, that Forza Italia and the Northern League have agreed that whoever has the best results, could pick the Prime Minister. Should Forza Italia, as projected by the polls, have the best results it will not be able to appoint its leader, 81 year old Silvio Berlusconi as Prime Minister. Silvio Berlusconi is currently banned from taking the office until 2019 after a tax fraud case conviction. President of the European Parliament Antonio Tajani is cited as a possible replacement to be picked by Berlusconi. Such a selection could also strengthen the pro euro arguments.

Scenario 3: Grand Coalition of Democratic Party, Forza Italia

The favorite scenario according to media for all three main issues: EU relations, Business/ Investment and Italy's recovery. Should the two parties also get the support of the smaller Europe Plus party, we could see them surpassing the 40% hurdle and provide a stable government. In such a case, the prime minister issue should be solved as Renzi would be expected to take office, and a stronger than other scenarios pro-EU outlook of the government could be expected. Three issues may arise in this scenario. First, the three parties may not agree on how to govern, as their programs may be too diverse to compromise, however the will to gain power rather than risk another election may overcome that obstacle. Second, Berlusconi could prove to be unpredictable and as the Democratic Party may take the Prime Minister's office, it could be the case that Forza Italia may try to form alternative alliances. However, such an issue could also be overcome as Mr. Berlusconi himself cannot be Prime minister under any scenario. Third, there could be reactions to such a scenario from the Democratic Party base members as Berlusconi is seen as the "enemy" traditionally. However, as Mr. Renzi excluded a possible coalition with any extremist and the 5 Star Movement recently in Italian media, he did not exclude Forza Italia which is considered as in the center right position of the Italian political stage.

Scenario 4: Hung Parliament

Most analysts, consider the possibility of hung Parliament as the most probable scenario. In such a case, no viable coalition can be formed between the parties and the country will have to hold new elections. In such a scenario the outcome could be even more uncertain, as instability factors may rise. However, such a scenario would imply practically that solutions for pressing issues such as unemployment and economic recovery will be further postponed.

Please note that a scenario were the 5 Star Movement and the Democratic Party form a coalition, was not examined as both parties have recently excluded such a scenario.

Evaluation:

At the present, no scenario from the above could pose an immediate threat to the Euro, in the sense that Italy may leave the Eurozone. However, the major four parties seem to include in their political programs the need for the budget deficit to increase, in order for the next government to proceed to more spending, either for social programs or otherwise. Hence, the main threat for the Eurozone may arise from a possible Italian request for further easing on the fiscal regulations which are currently at work. In the long run that may under certain circumstances (say for example if Greece and Portugal join Italy), affect the Euro.

On the other hand, should there be an election result on Sunday that favors a rather stable government (as in scenario three), the Euro could strengthen as the market may react positively in relief, to a major risk factor being overcome for the Eurozone.

The possibility of a hung parliament on the other hand, may not affect the Euro as much, as the situation will have effectively not changed.

Whatever the result of the Italian elections maybe, we would also like to point out that on Sunday, 4th of March, the results of the German party SPD voting, regarding the coalition to form a German government, will be announced. Despite prognoses being in favor of a positive result and the coalition coming into form, a possible negative surprise could overshadow the result of the Italian elections.

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