

Italy: Last minute showdown

The attempt to form a government backed by the Five Star Movement (5SM) and the Northern League failed on Sunday, when a final clash with President Sergio Mattarella as to the potential finance minister caused PM-designate Giuseppe Conte to hand back his mandate. A “neutral” government driving Italy to new elections looms



The choice of finance minister confirmed as pivotal

As had become clearer over the last few days, the choice of finance minister for the forthcoming 5SM/League government was a potential deal breaker. When PM-designate Conte submitted his proposed list of ministers on Sunday, all were accepted, with the sole exception of the candidate for finance minister, Paolo Savona, a distinguished economist vocally critical on the euro and its governance. He was seen as incompatible with the need to send an unambiguous message on the determination to keep Italy in the current European framework. In a speech that followed the showdown, President Mattarella said he would have accepted for the role a political representative of the majority committed not to encourage or, worse, induce, the exit of Italy from the euro. As the leaders of the Northern League and the 5SM refused to change their choice for finance minister, PM candidate Conte handed back his mandate.

The failed 5SM/League attempt is likely to leave institutional scars. Both Luigi Di Maio, the leader of the 5SM, and Matteo Salvini, the leader of the Northern League, place the blame for the showdown on President Mattarella, with Di Maio even evoking impeachment. We do not believe that the procedure will actually start, but the institutional truce which has characterised the last two weeks

now seems to be over.

Back to square one, in a deteriorated political environment

The failed Conte attempt forced President Mattarella to take the initiative, resurrecting the idea of setting up a “neutral” government aimed at leading Italy to another election, possibly after having approved the next budget. He has mandated Carlo Cottarelli for the job. Cottarelli is a distinguished economist, with a long career at the IMF and commissioner for the spending review under the Letta/Renzi government. Cottarelli accepted with reservation Mattarella’s offer, sketching very clearly what his government would do when in office under two alternative hypotheses. Should he manage to obtain parliament's confidence, he would try to have the 2019 budget approved, and resign before the end of 2018, taking the country to new elections in 1Q19. Should he fail to get parliament's confidence, he would resign and remain in office as a caretaker for ordinary business, taking the country to new elections after August. We believe the chances of the government passing the confidence vote are extremely slim, and hold an autumn vote (in September or October) as our new base case.

New government formation to be quick

In his brief speech after being mandated, Cottarelli made it clear that he and all the members of his future government would not run for office in the following elections. He is now expected to quickly assemble the list of ministers, and submit it to President Mattarella. After getting presidential approval, the Cottarelli government will be sworn in and within 10 days it will have to undergo a confidence vote in both branches of the Italian parliament.

Another harsh campaign looms

It is still too early to understand where the party leaders will position themselves in view of the forthcoming election. Chances are that the perceived institutional wound might induce both the Northern League and the 5SM to radicalise their electoral message, but different political outcomes remain possible. We cannot rule out that European themes (notably absent from the previous campaign) might be more of a focus this time round, together with constitutional issues such as the role of the president. In this light, the constitution of a pro-euro moderate front would likely need more time to organise than that allowed by a September/October vote. Against this potentially inflammable backdrop, the presence of Cottarelli as a fiscally prudent caretaker could act as a short-term guarantee to the markets. With current opinion polls (run before Sunday's showdown) still pointing to a populist lead (with the League gaining ground over the 4 March result) the risk is that this could only be partially effective.

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