Election Risk to Reforms Clouds Italian Sovereign Outlook

Italy heads into next month's elections facing multiple challenges. Amid populist electoral programmes, Scope believes Italy risks missing an opportunity to enact key structural reforms during Europe's broader economic upswing.

In Scope's view, the Five Star Movement (M5S) may earn the most votes of any single political party in the 4 March election, but the coalition with the most seats will be the centre-right bloc. However, recent polls indicate that no grouping is presently on course for an absolute parliamentary majority.

With a hung parliament likely, the possibility of post-election uncertainty and the probable emergence of a weak, multi-party alliance, the prospect of a new government capable of addressing the country's competitiveness challenges and adopting far-reaching structural reforms appears unlikely.

Instead, Italy's political parties have resorted to populist platforms to win over a divided electorate: from Silvio Berlusconi's 23% flat tax to M5S's citizenship income. These measures are expensive – a repeal of a controversial pension reform alone could cost a cumulative 20% of GDP by 2060 – with many commitments largely unmatched by fiscal tightening elsewhere. However, Scope notes that many proposals are unlikely to be enacted in their prevailing forms, and would likely be materially watered down.

With 30%-40% of voters still undecided, the possibility of surprises on election day remains. The following are the five possible outcomes, according to Scope:

1) Formation of a grand coalition, particularly if results for the Democratic Party (PD) and/or Forza Italia come in stronger than anticipated;
2) A centre-right government;
3) Fragmented results lead to inability to form a governing majority, forcing a repeat election, ensuring months of uncertainty;
4) A better-than-expected win for the populists, giving M5S scope to negotiate an agreement with Lega and Fratelli d'Italia (FdI);
5) A leftist coalition, involving M5S, PD and smaller left-wing parties, with a compromise candidate for the premiership.

Regardless of the outcome, Scope believes that concerns about an Italian exit from the euro area are overdone. In Scope's view, the ultimate influence of euro-sceptic parties advocating for a referendum on the monetary union will fade in the legislative process once the difficulties and consequences of an exit become apparent, advanced in the case of Italy by constitutional barriers.

Scope Ratings sees a grand coalition as possibly the most supportive outcome for Italy's 'A-/Stable Outlook' credit ratings. However, even this configuration will need to overcome innate instability and policy incoherence. A centre-right government would raise concerns of fiscal backsliding. An administration that includes M5S could raise questions about the sustainability of Italy's debt. Scope notes, however, that Italy retains multiple credit strengths, including a track record of primary surpluses and a long public debt maturity.

Volatility in Italian asset markets may increase in the period ahead. However, ultimately, the impact of the elections on Italy's rating outlook will depend on factors including the election result, the economic, fiscal and financial reform agenda of the next Italian government, combined with its capacity to implement reform.

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March election overview

The outcome of the Italian election is highly uncertain

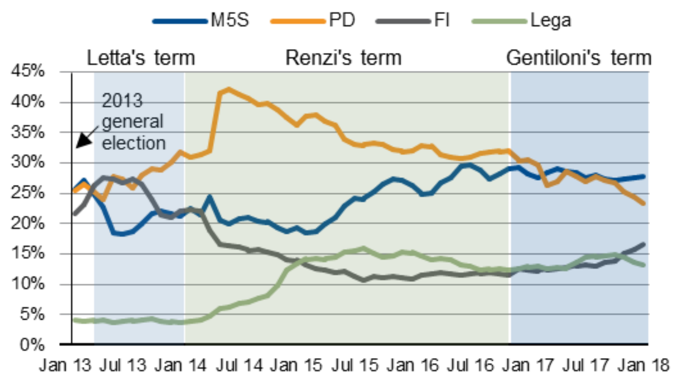
We are now about one month from general elections in Italy[1], to be held on 4 March. Voters will elect the 630 members of the Chamber of Deputies and 315 members of the Senate[2]. Following French and German elections in 2017, and with significant fragmentation across the Italian political spectrum, these elections will be a first major test in 2018 of how far anti-establishment parties can succeed in the heart of Europe, and will prove critical to the assessment of Italian risk.

No party or coalition currently has an overwhelming poll lead

Based on the latest polling figures, the ruling Democratic Party retains about 24% of voting intentions – having seen a steep decline since the party's triumphant surge to around 42% of voters just after May 2014's European elections (**Figure 1**). On a single party basis, anti-establishment M5S comes out ahead, holding around 28% of votes. Former Prime Minister Silvio Berlusconi's Forza Italia has picked up to about 16%, from 11% as of January 2016, while right-wing Lega stands at 13%.

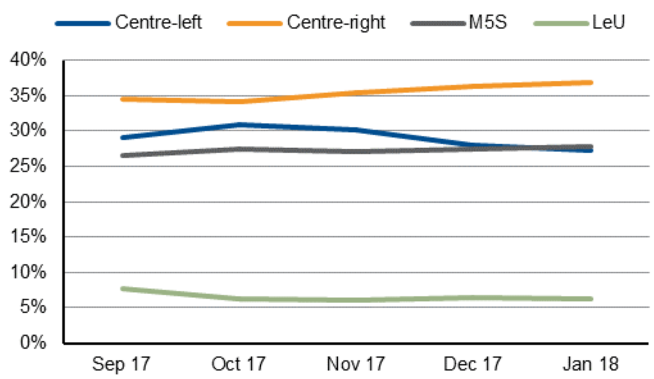
But, Italy's new electoral law, passed in October 2017, alters the voting system decisively in favour of broad pre-election coalitions, penalising single parties like M5S. Owing to this, **Figure 2** shows voting intentions on a coalition basis. As exhibited, opinion surveys are split between three blocs: the centre-right (Forza Italia, Lega, Fratelli d'Italia and Us with Italy), which leads with around 37%, the centre-left (the ruling PD and its junior coalition partners), and M5S.

Figure 1: Percentage of voting intentions, poll of polls, by party, last general election to present



Source: Various polling companies, Scope Ratings calculations

Figure 2: Percentage of voting intentions, poll of polls, by coalition, September 2017 to present



Source: Various polling companies, Scope Ratings calculations

PD has been weakened due to high unemployment, unpopular reforms, its handling of banking sector rescues and the immigration crisis. The party, led by former prime minister Matteo Renzi, has been engaged in a divisive rift with dissidents on the left-wing, some of whom created a rival party (Free and Equal, LeU) last year.

The party that can raise turnout and convince undecided voters may surprise

Critically, surveys note 30% to 40% of voters are still undecided, with about 70% of young people currently expecting to abstain. Historically, around a third of voters change parties at each election. The issue of abstention and undecided voters remains the wildcard that could ultimately swing the election.

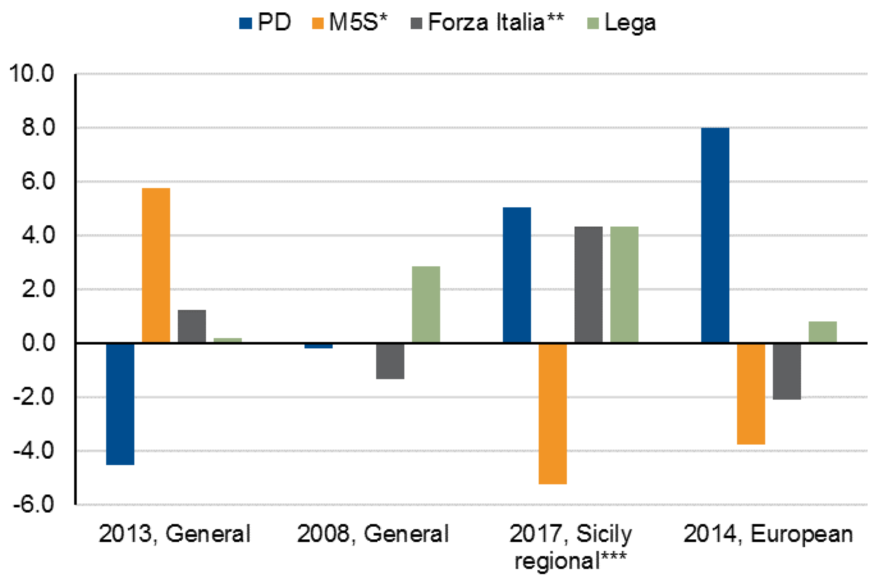
However, a significant share of undecided voters this close to an election in Italy is not necessarily new. With less than a week to go prior to the 2013 general election, polls showed near 30% of Italian voters to be undecided or abstaining, though this was down

[1] Alongside regional elections in Lazio and Lombardia on the same day
[2] 315 Senate seats are elected via popular vote on a regional basis, combined with a certain number of Senators for Life, currently numbering six

from over 50% weeks earlier. Likewise, just before the 2008 general election, up to 30% of voters remained undecided in the last published polls.

In 2013, the surprise on election-day in view of this was the better than anticipated outcome for M5S (and worse than anticipated outcome for PD). In 2008, the disparity was the better than anticipated result for the Northern League. Taken from a big picture viewpoint, surprises have varied by election (as shown in **Figure 3**), and have linked to enthusiasm sparked by new political movements (like in M5S's 2013 outcome, or after Renzi's reinvigoration of PD in the party's 2014 European election result). With this campaign more identifiable for a return to the old and familiar in the comeback of Berlusconi (and Renzi), it remains unclear what group(s) may rally apathetic voters, and deliver an unexpected result on 4 March.

Figure 3: Disparity between last published polls and actual election results, % of overall votes, by election



*M5S was not involved in the 2008 general election, having been founded in 2009
**Shows the results of Forza Italia's predecessor, The People of Freedom, for elections before November 2013
***Forza Italia and Lega ran in coalition in the 2017 Sicilian regional election

Source: Various polling companies, Scope Ratings calculations

A hung parliament?

Centre-right bloc to capture the most seats

In Scope's view, while M5S may earn the most *votes* on 4 March of any single political party, the winning coalition with the most seats will be the centre-right bloc – a consecutive victory for the group after its triumph in November's Sicilian regional elections.

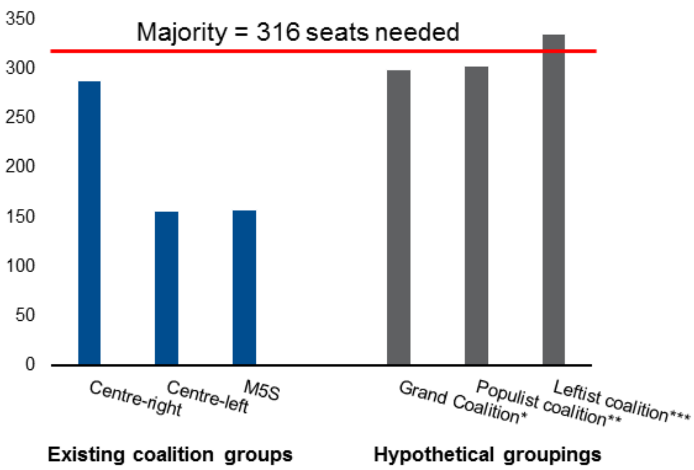
However, no outright majority to emerge in both houses

However, current polls do *not* imply an absolute parliamentary majority for any pre-election coalition, including the centre-right – despite its polling gains. As such, the formation of a new Italian government could easily prove onerous, and Scope expects a hung parliament to be the immediate election result, as pre-election coalition blocs may need to splinter in search of a minimum governing majority.

Even a grand coalition may not reach a majority in both houses…

According to Scope's estimates, based on existing polling, even several plausible post-election reconfigurations of parties/coalitions – like a theoretical 'Grand Coalition' of the centre-left, centre and centre-right or, alternatively, a radicalist coalition (of M5S, Lega and FdI) may not secure a stable governing majority in both houses of parliament (**Figures 4 and 5**). The risk that even a grand coalition may not achieve a majority differentiates from the events of 2013 when a unity government formed out of the crisis, and is a risk that may not be fully acknowledged by markets and commentators, who anticipate a grand coalition.

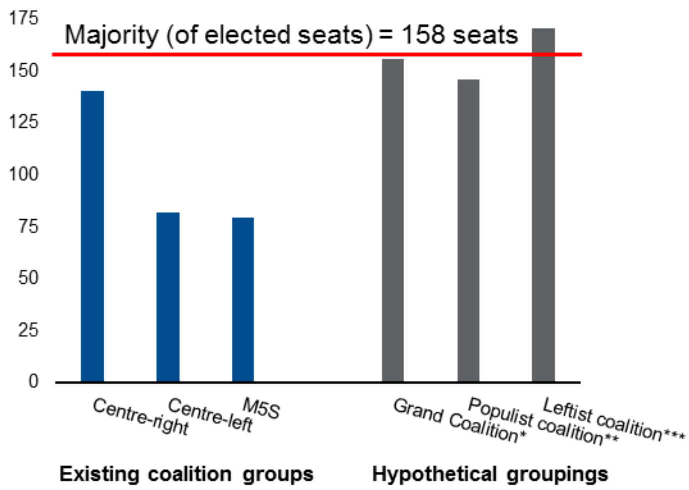
Figure 4: Seat projection, Chamber of Deputies



*Grand Coalition = PD, Forza Italia, Popular Civic, More Europe, Together, We with Italy
**Populist coalition = M5S, Lega, FdI
***Leftist coalition = M5S, PD, Together, Free and Equal

Source: YouTrend (25 January and 1 February), Scope Ratings calculations

Figure 5: Seat projection, Senate



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Source: YouTrend (25 January and 1 February), Scope Ratings calculations

Shown in Figures 4 and 5, while a theoretical leftist coalition of M5S, PD alongside smaller left-wing parties might achieve a hypothetical governing majority. However, such an arrangement is untested and may be implausible unless parties (particularly PD) are backed up against the wall.

Even were election results to surprise on the upside for one or multiple parties facilitating a potential majority for a grand coalition or other configurations, such broad arrangements could prove challenging in settling on a shared platform, and success that such coalitions will be negotiated (and remain viable) is not assured.

While M5S has opened the door to coalition talks with those that agree with its legislative programme (altering its former refrain from any consideration of alliances), and Lega's Matteo Salvini has made overtures, some differences in ideology remain. In the scenario of grand coalition talks, though Renzi is PD's PM candidate, a compromise candidate may have to be sought.

Current PM Gentiloni could stay on in a caretaker role

Should a hung parliament be the immediate election outcome, uncertainty may take hold as government formation attempts meet roadblocks. Under Italy's system, it's up to President Sergio Mattarella to consult with party leaders post-election and decide who should be asked to form a government, and he does not have to hand a mandate to the largest party. In the instance of extended coalition negotiations, the president could ask current premier Paolo Gentiloni to remain as prime minister in a caretaker role.

Five scenarios

Five scenarios

In Scope's assessment, taking into account the possibility that there may be surprises on election-day with so many votes to be determined, five alternative scenarios (in no specific order) might emerge. These are:

i) Formation of a grand coalition, particularly if results for PD and/or Forza Italia come in stronger than anticipated;

ii) A centre-right government;

iii) Fragmented results lead to no governable majority, forcing down the line a repeat election, ensuring months of uncertainty;

iv) A stronger-than-anticipated victory for the populists, giving M5S scope to negotiate an agreement with Lega and Fratelli d'Italia;

v) A leftist coalition, involving M5S, PD and smaller left-wing parties, is agreed on, with a compromise candidate for the premiership.

No matter the end destination, the road to this destination may be difficult. Given the probability of a fragmented parliament, a minority government version of one of the above permutations is, moreover, not ruled out. As M5S has indicated now its willingness to participate in a unity government, its participation in some form of a grand coalition is moreover not unconceivable, even if this will not be the first option for any of the parties.

In 2013, a grand coalition featuring PD and Forza Italia lasted under a year, when Forza Italia left with Berlusconi's eviction from the Senate imminent on a tax fraud conviction.

Electoral reform makes a stable government potentially elusive

Rosatellum debuts

In October 2017, Parliament approved the long-awaited electoral reform (Rosatellum), under which 61% of seats in both the lower and upper houses are to be assigned on a proportional basis and 37% on first-past-the-post ballots (with the remaining 2% decided by Italians abroad). The law harmonises the electoral systems for the Chamber and the Senate, after a failed constitutional reform left the lower house elected including a majority bonus (under 2015's Italicum), but the Senate elected on a proportional basis.

Under Rosatellum, with the majority bonus in the Chamber removed[3], the risk of the M5S, as the single party with the most votes according to polls, capturing an outright majority in the Chamber has dropped dramatically. In addition, M5S is among the most penalised in the first-past-the-post constituencies, owing to the party's refusal to join pre-election coalitions.[4]

The largely-proportional system is problematic in a highly divided political landscape

But, while the risk of significant misalignment between the Chamber and the Senate and the possibility of an outright victory for M5S have been reduced under the new system, the largely-proportional electoral system in conditions of a highly divided Italian landscape make a stable and reform-oriented government also potentially elusive.

This, in Scope's view, may impede the economic recovery and usher in a difficult political phase characterised by weak governance, little progress on structural reform and recurrent worries about early elections.

Populist electoral programmes incompatible with challenges

Italy faces multiple challenges

Italy faces multiple challenges. Despite the ongoing economic recovery (2018 growth is forecasted by the IMF at an above-trend 1.4%, after 1.6% in 2017), real GDP remains 6% under pre-crisis levels. The overall jobless rate is 10.8% as of December, amongst the highest in Europe. Since the introduction of the Jobs Act, 1.4 million jobs have been created to Q3 2017, however 830,000 of these have been on temporary contracts.

At 134% of GDP as of Q3 2017, Italy's debt remains 33pp higher than Q3 2008 levels and the second-highest in the euro area, after Greece. Moreover, the government that

[3] Even before the October 2017 reform, the removal of the majority bonus had been partly assured after amendments by the Constitutional Court in January 2017, which removed the run-off second round for an outright majority when no party captures 40% in the first round

[4] According to calculations from Generali Investments, in the case of no coalitions, M5S would be the largest party in municipalities representing 40.2% of voters. This share would fall to only 23.3% should coalitions be allowed. https://www.generali-investments.com/wp-content/uploads/2017/10/171010_GI_Research_Market_Commentary.pdf

emerges after 4 March will need to find a solution to clear banks' balance sheets of non-performing loans, an ongoing issue.

Lack of a stable government constrains meaningful structural reform

At present, given the possibility of post-election uncertainty and the chance for a weak, multi-party alliance being formed in time, the likelihood of a new government coming into office capable of addressing the country's competitiveness dilemmas and adopting far-reaching structural reforms appears unlikely.

Amidst competition over a divided electorate, populism has instead propagated: proposals range from Silvio Berlusconi's 23% flat tax to M5S's minimum income for the unemployed to a repeal of a controversial pension law – all expensive, and largely uncovered via fiscal tightening elsewhere.

The cost estimates include: i) the cancellation of the *Fornero* reform proposed by Lega costing about EUR 350bn by 2060, ii) raising pensions to EUR 1,000 per month requiring EUR 18bn per annum, iii) M5S's citizenship income costing EUR 15bn to 29bn per annum, and iv) PD's TV user tax elimination at EUR 1.7bn per year.

However, these proposals will run into the reality of governance within a divided government. As such, the impact of proposals should not, as yet, be taken overly literally. In practice, the most many parties can hope for is to pass an eventual toned-down version of some. A larger dilemma might be that areas in need of significant reform might be overlooked, with absence of a clear long-term vision.

M5S platform focuses on boost to public spending

As summarised in **Table 1** below, the main electoral platforms from M5S centre on a boost to public spending in front of a deep revision of the overall public spending structure. In Scope's view, the M5S platform is unrealistic, requiring an exceptional effort from countervailing expense rationalisation. Large measures to achieve the proposed debt reduction (of some 40pp over ten years) are not defined apart from, for example, the unquantified fight against large-scale tax evasion, even assuming a hypothetical increase in growth potential. The track record of M5S in government has been poor: the party appointed candidates with little experience in the city administrations of Turin and Rome, though party leadership intends to appoint more experienced experts as possible ministers. The cost of M5S's programme has been estimated at EUR 75bn per annum.

The centre-right's proposals lean on heavy fiscal relaxation

The centre-right alliance between Forza Italia and Lega does not have a fully integrated programme, as the parties remain divided on policy areas. Despite this, the main proposals are summarised in **Table 1**. The programme leans on fiscal relaxation, though Berlusconi has reportedly pledged to keep the Italian budget deficit within the EU's rule of 3% of GDP. Proposals for tax cuts are in line with the ideas of Berlusconi's past campaigns. Short term support to the economy would be supplied through a boost to subsidies, pensions and infrastructure spending, while the fiscal burden on individuals would be reduced through measures including a flat tax.

Renzi's proposals are also costly

The main arguments of PD, summarised in Renzi's "*100 points for Italy*" include measures on taxes, pensions and subsidies, which weigh on fiscal accounts, balanced by new targets for the reduction of tax evasion. In December, the party proposed compliance with the 3% Maastricht deficit criterion, but wants to exclude investments in infrastructure, human capital and research from the deficit calculation. Matters tied to the green and blue economies are in line with those proposals of M5S; the labour policy seems less striking with some measures in support of permanent contracts, but no cancellation of the Jobs Act. The programme ambitiously *intends* on a reduction in the public debt ratio to 100% in 10 years (despite plans for "a slower reduction of the nominal fiscal deficit than earlier planned"). PD promotes a 'positive' attitude on immigration through the *ius soli* (birthright citizenship), though it also proposes to revise the EU's Dublin Regulation. The cost of PD's programme has been estimated at EUR 40bn.

Table 1: Campaign platforms: M5S, centre-right and centre-left

	M5S	Centre-right	Centre-left
Public finances	• 40pp reduction in debt to GDP ratio over 10 years, while cutting income taxes and tackling large-scale tax evasion • Create public investment bank for small businesses, farmers and families	• Introduction of a flat tax, with restructuring of tax collection system • Fewer constraints from Europe, 'no' to austerity policies	• Reduction of debt to GDP ratio to 100% in 10 years (about a reduction of 30pp)
	• Reduce IRPEF and fiscal wedge • Raise tax-free income threshold to EUR 10,000	• Abolition of taxes on cars, primary homes, inheritance and a regional tax (IRAP)	• Reduce tax wedge from 33% to 29% • EUR 30bn of collection of tax evasion in next 5 years
Pensions	• Increase of minimum pensions, revision of *Fornero*, and cuts to extra-high pensions	• Increase in pensions to EUR 1,000 a month, cancellation of *Fornero*	• Wider application of the APE; contributory pension for low-income young people
Labour	• Boost to labour market through green economy investments • Citizenship income	• Overhaul Jobs Act to create more permanent contracts • Minimum monthly dignity income of EUR 1,000	• Introduction of a minimum hourly wage • Introduce compensations for abuse of temporary contracts
Public spending	• Increase in public spending on technology, public health, education, strategic sectors	• Increase spending on police	• Invest in education, culture, research and innovation • Spending against poverty
	• Shift to renewable energy	• Infrastructure investment in the south	• Boost to green and blue economies, infrastructure
	• Child subsidy, reform employment centres	• Birth plan (FdI)	• Child/mother subsidies • Temporary free transport for needy
Immigration / Security	• Strict but quick application of immigration policy, with reduced visa application times and effective repatriations • More law enforcement and prisons	• Stricter implementation of immigration controls at acceptance and repatriations; higher spending on police	• Resubmission of the *ius soli*, to grant citizenship to immigrants born in Italy • Reform Dublin Regulation and *Bossi-Fini*
Banks	• Banking reform (akin to Glass-Steagall), tighten bank supervision • Ease ability of ailing banks to recover assets from troubled creditors • Reimburse savers who have been 'cheated' of money	• No public aid to banks (Lega)	• Completion of EU banking and capital markets unions
Europe	• Renegotiate EU laws, with referendum on euro "a last resort"	• No common platform on Europe • Revise European treaties	• Fundamental commitment to Europe • Larger EU budget
Other	• Support to 'Made in Italy'	• Support to Made in Italy	• One month of compulsory civil service
	• Reform laws against corruption, reduction of legal process duration • Reduce bureaucracy, abolish useless laws	• Justice reform • Reduce bureaucracy	• Digitise public administration, while facilitating more young people to join government

Source: Termometro Politico, La Repubblica, Sole 24 Ore, Il Fatto, Corriere della Sera, Today, Scope Ratings

Lack of programme compatibility constrains coalition options

According to an analysis by Sole24Ore (29 January) on the compatibility of various party programmes (evaluated on a scale of 0-10, with 10 representing ideal compatibility), the lack of convergence on party programmes could constrain coalition options. **Table 2** shows that the highest convergence is between Forza Italia and Lega, though also with PD. M5S could agree on some points with Lega, as well as with Free and Equal. The low compatibility between either M5S or Free and Equal and PD speaks to the challenges that such a permutation would face.

Table 2: Compatibility of party programmes (0-10 scores)

	FI	Lega	M5S	PD	LeU
FI		5.1	3.2	5.0	1.7
Lega			4.6	1.9	2.2
M5S				1.7	4.5
PD					3.3
LeU					

0.0 - 2.5	Extremely low
2.5 - 5.0	Low
5.0 - 10.0	Medium to high

Source: Sole24Ore, Scope Ratings

Risk of 'Italexit' is limited

An important concern of many market participants is the euro exit debate in Italy, pushed by the platforms of euro-sceptic groups like M5S and Lega. According to a Eurobarometer poll released in November, only 34% of Italians said they trust the EU, the lowest level of support in the bloc outside of in Greece, the United Kingdom and France.

A euro referendum has been relegated to 'a last resort' by M5S

For years, the M5S has floated the concept of a referendum on the euro. But, calls for a referendum have more recently been relegated to 'a last resort', as the party has sought to adopt a more moderate stance. Instead, party officials have stated their intention, if elected, to pursue reforms of the EU's rules and institutions, with the option of an exit referendum only to be acted on should there be no concessions from the EU. Recently, the referendum did not feature in the 20-point programme of party leader Luigi Di Maio.

The centre-right is divided on the euro topic

The Northern League's Salvini has also reiterated his opposition to the single currency – pledging to renegotiate EU treaties to regain sovereignty, and touching on the introduction of an (illegal under EU law) parallel currency. The centre-right is divided on the euro topic, however, with Berlusconi stating that Italy should remain in the currency union, though he also has considered the idea of a parallel currency.

Scope believes the probability of an Italian exit from the euro is limited under relevant horizons

In Scope's view, the probability of an 'Italexit' is limited under near- to medium-term horizons, with much of the populist rhetoric not considering the significant economic, financial and political toll probable in such a scenario. We believe the moderation of M5S's position on the euro is a reflection of this.

In addition, exiting the euro would require cross-party political backing as well as a difficult legislative process in the case of Italy, with a constitutional amendment (requiring two votes at a two-thirds majority in each house of parliament, or failing that, a referendum just to facilitate a euro referendum) needed before such a referendum on the euro could be held (Italy's Constitution bans the abrogration of international treaties via a popular vote).

Election's impact on markets

Volatility could increase in Italian markets in the period ahead

Scope believes that volatility in Italian asset markets may increase in the period ahead, distracting from attention on the resurgent economy.

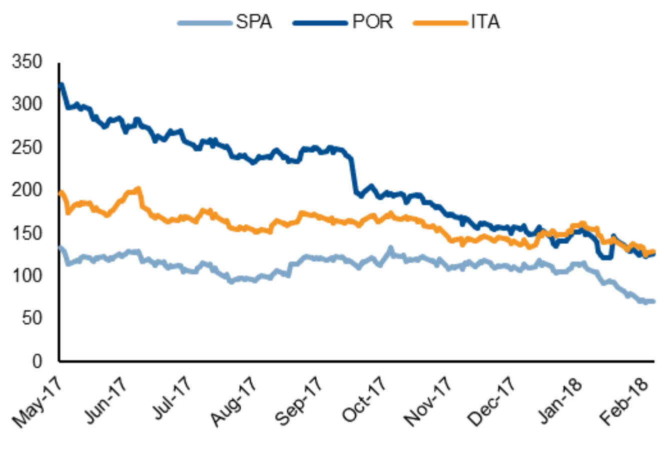
While a government will surely be formed in time, and Scope does not believe there is imminent risk of euro exit, a lengthy period of a post-election hung parliament, repeat elections or even formation of a populist government (that seeks to undo earlier reforms) cannot be ruled out, and could result in higher volatility within Italian markets as we get closer to and/or in following the election.

To date in 2018, even with the political uncertainty, Italian stocks have joined a broader upswing in markets (with the FTSE MIB index up about 5% year-to-date, even accounting for the recent correction in global equity markets). In debt markets, even though Italian yields have risen (owing predominantly to rising global rates), the 10-year yield premium on Italian debt to German Bunds (**Figure 6**) is now back down currently at about 127 bps (near its lowest levels since September 2016), after having briefly risen following the announcement of the election date in December.

Some Italian risk premium priced in under otherwise benign market conditions

The spread premium on Italian debt versus Spanish or Portuguese debt has widened (with Spanish and Portuguese spreads narrowing more significantly) – implying a degree of risk premium tied to Italian politics is being accounted for within otherwise benign market conditions. However, Italian spreads at recent lows imply nonetheless room for a more meaningful repricing should election outcomes arise more adverse than anticipated. This impact could be somewhat accentuated as the ECB's gradual exit from asset purchases continues in the backdrop.

Figure 6: 10-year government spread to Bunds, bps



Source: Bloomberg, as of 5 February 2018

Election risk to be largely idiosyncratic

In Scope's view, election risk impacting Italian markets will be largely idiosyncratic, with the degree of spill-over to other European markets to be limited under prevailing accommodative economic and financial conditions. Scope does not anticipate, even in a more adverse scenario, the market response to the elections to cause a financial crisis akin to the events of the euro debt crisis.

Impact on sovereign ratings

The impact on Italy's ratings hinges on several factors

The impact of the elections on Italy's A-/Stable credit ratings depends on the election result, the economic, fiscal and financial reform agenda of the next Italian government, the stability of governments in Italy more broadly and capacity to enact reform, alongside, to a lesser extent, any repricing in Italian financing rates.

Italy's A- rating reflects multiple credit strengths

While Scope does not expect a government capable of enacting deep structural reforms to arise, we note that Italy holds multiple credit strengths, underpinning its present rating. The impact of any change in financing rates would be mitigated by the relatively long average maturity of the debt stock (near seven years), nearly 70% of which is held by residents (the latter amongst the highest such ratios in the EU). Italy is, as such, less exposed to sudden shifts in international investor confidence.

In addition, once pension- and healthcare-related liabilities are included, Italy's debt burden is in line with that of many euro area peers. And, the banking system is undergoing important changes, which have raised the provisioning against (high but falling) non-performing loans and strengthened credit availability.

A grand coalition may be the most rating-supportive outcome

A grand coalition of the centre-left, centre and centre-right might be the most supportive outcome to an affirmation of Italy's ratings. However, the potential instability and incoherence of such a unity government may restrict its ability to pass meaningful reforms that boost productivity and potential growth, and allow the required fiscal consolidation to sizeably reduce the public debt ratio. Instead, a lack of institutional overhauls under a weak future government and threat of early elections might constrain Italy's longer-term outlook.

A centre-right government would raise concerns of fiscal backsliding

A centre-right government would raise concerns of fiscal backsliding and, depending on who leads such a government, may elevate concerns around a more confrontational stance towards European institutions. While many of the fiscal and structural proposals of Forza Italia and Lega would not come to pass once the realities of governance set in, acts that reverse earlier structural reforms (like on pensions or on labour markets) would be considered by Scope to be credit negative.

A government featuring M5S would be highly disruptive

A government that includes M5S would raise questions about the sustainability of Italy's debt, the resolution of ongoing banking issues alongside, potentially in markets, Italy's euro membership. The market's response in this scenario might be significant, with a sharp sell-off possible, even if the likelihood of a M5S government acting on many of its promises is more doubtful. Similarly, in this scenario, the rating implications would depend on who leads the government and what the overall policy agenda looks like.

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