

Italy Macro Monitoring

The results of our small data survey

On the basis of the data we collected in Italy between the end of January 2018 and the first week of February 2018, and our own analysis, we reiterate that a future M5-led government remains a very plausible scenario, at least as likely as a centre-right victory, in our view. The centre-right is indeed very popular, although we have not noticed a pick-up in the approval rating since our survey last summer. The support for PD has dropped further since then and, for the first time, we note that a wide share of its electorate is so disillusioned that many may not go to vote this time.

As always, we interviewed people across income distribution, across the country and over the 18-to-75 years age spectrum. We usually interview only active voters, but this time we created a tiny sample of non-voters to assess what would encourage that segment of the electorate re-engage and whether their perceptions were materially different from the voting public. The results show that, while the economic data signal a rather brisk recovery, the country is getting older, more tired and increasingly disillusioned in reality. Those that plan not to vote, do so because they do not feel represented nor heeded at all in terms of their needs and desires. Their answers were not materially different from most, but their disillusionment was one step worse than those that will show up to vote anyway.

In terms of policy priorities, there is overwhelming support for supporting entrepreneurs and job creation, a thorough tax reform and cutting the retirement age. Increasing spending on the healthcare system and education were the next two most commonly cited priorities, followed by a reduction in the VAT rate.

We discussed the housing market again in this survey, and the results suggest that the current stabilisation is very frail as there is practically no upward structural demand. Those that would like to buy a house are cut off from the market, and those that have the cash are not in a rush to get on the ladder. Rents are seen universally as too high for what they offer.

The perception of the EU(ro) has not improved: it remains largely negative, but a solid majority stated clearly that they believe it is largely impossible to exit the Eurozone, or simply too costly probably. This confirms that all parties did well in rephrasing their positions, in our view, and they have stated that Italy will first engage in dialogue to change the EU; we will see how things evolve going forward.

ADA's assessment last year vs currently (%):

Party	Approval rating 1st of August 2017	ADA expectations in 2018 in August 2017	Current approval rating 12th Feb 2018	ADA latest expectation for March 2018 election
Democratic party	28	23-28	22-23	20-23
5 Stars	28	25-33	27-28	28-35
Forza Italia	14	10	15-16	15-18
Northern League - Salvini	14	20	14-15	15-18
Brothers of Italy	4	5	5.5	5-7
Small Left Parties*	4	8-12	5-6	4-7

How to use this report

This report is based on ADA's proprietary small data survey technique, which is a methodology for gathering local information primarily about government policies and voters' political views. We have developed and perfected this technique over the past two years, testing it in various ways during the UK EU referendum (2016), the US presidential elections (2016), the Italian Constitutional referendum (2016), the French presidential elections (2017) and the UK general elections (2017), and we have also used it for other EU countries. Our sample as of today is of 600 people in various European countries.

We have built our small data surveys to create a standardised methodology to assess political shifts, as well as the effectiveness and implementation of macroeconomic and fiscal policies. Our methodology has proven successful in correctly predicting major shifts in opinion polls with a lead of several months. Perhaps even more importantly, the insights we gather have a long shelf life as, *de facto*, we look for signals about emerging long-term trends (positive or negative) in a given country.

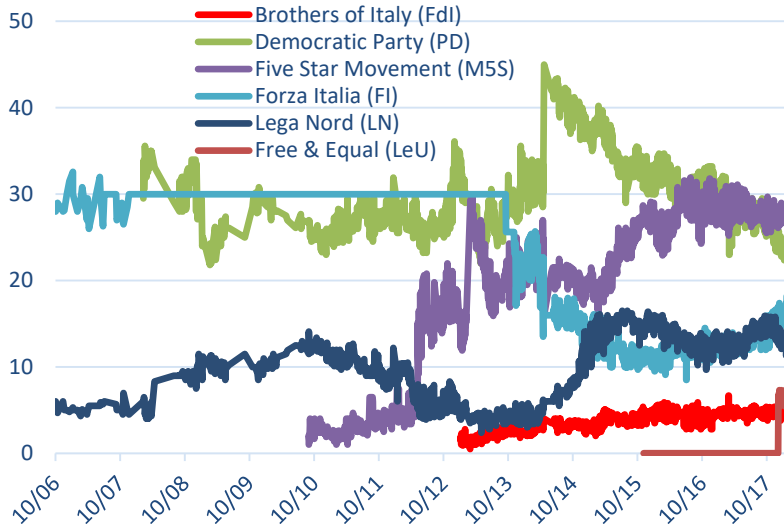
"Small data" means that our sample is smaller than a normal opinion poll, and much smaller than the much discussed "Big data" methodologies used to infer consumer trends, for example. However, what we lack in size, we make up for in content as we spend significant amounts of resources, strategy and time on gathering evidence on what people think and why, what they are experiencing and what they perceive to be a likely or desirable outcome.

We believe that you should see this report as complementary to opinion polls/big data analysis/country reports provided by international institutions and any other type of research you use currently.

We welcome suggestions and, if you would like to investigate a particular topic, we will add your questions to our next survey for free.

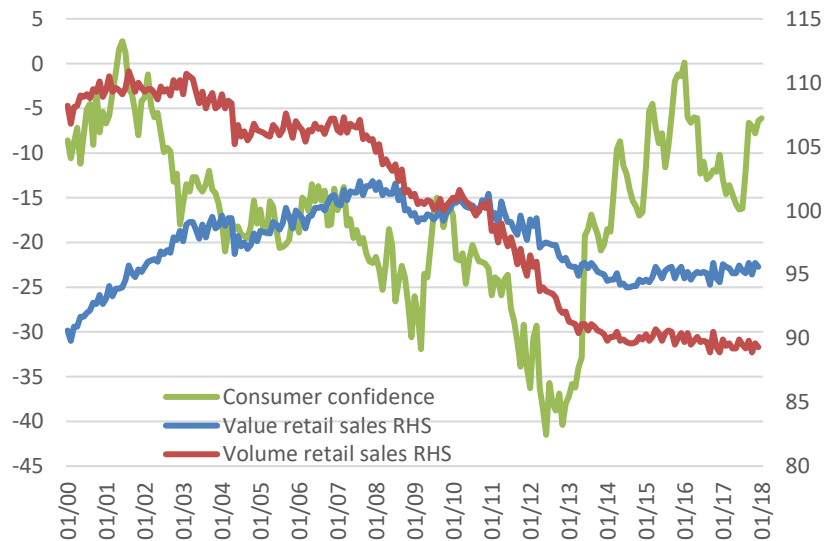
The status quo – what the data say about Italy currently

Current opinion polls: PD and 5 Stars trending close to each other



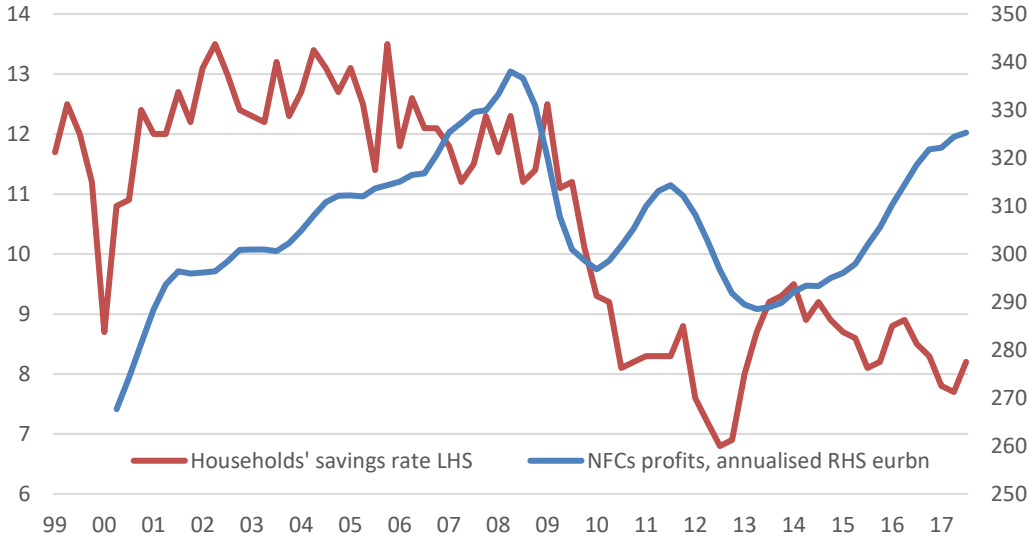
Source: Macrobond, ADA Economics Ltd. LEU: spin off of PD called Free and Equal, M5S = 5 Star Movement, FI = Forza Italia (Berlusconi's party), LN = Northern League (Salvini's party), PD = Democratic party (Renzi's party)

Confidence up, but spending falls



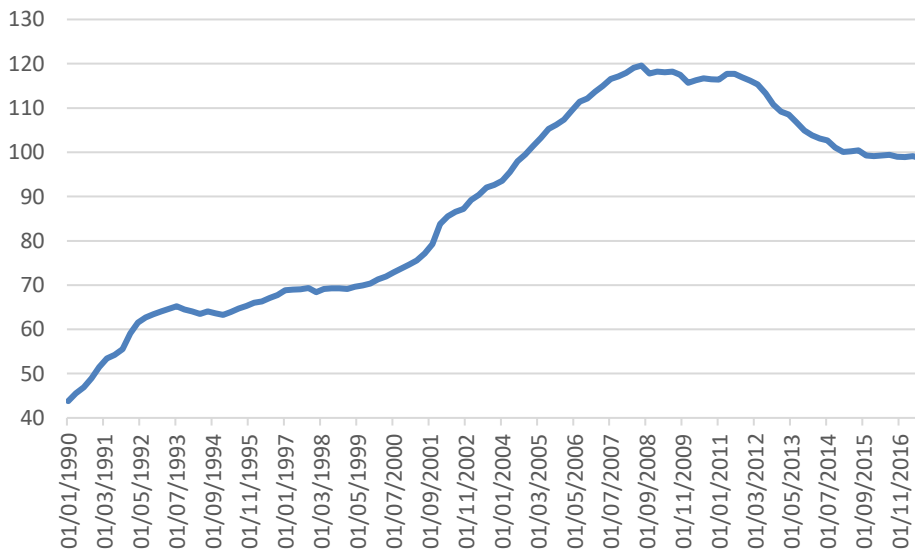
Source: Macrobond, ADA Economics Ltd.

Households savings rate falling, while NFCs profits remain tiny



Source: Macrobond, ADA Economics Ltd. Notes: Gross profits showing as 4q rolling sums, EURbn

Stagnant house prices do not necessarily mean they have adjusted enough



Source: Data reported by Macrobond for BIS index of nominal house prices, ADA Economics Ltd.

What about Italy today? A reality check

Before we delve into the details of our findings, it is useful to have a simple picture in mind of what Italy is like today or, rather, how Italians perceive Italy today. Whilst the GDP statistics suggest a rather brisk recovery, with job creation, modest inflation and even a stabilising housing market, on the ground, most see the country as stagnant, with a serious scarcity of companies, with rather high inflation, which is eroding their purchasing power (also given the ongoing wage compression).

More so than any of the previous surveys we have run, the feedback repeatedly discussed the issue of ageing: people feel they are getting older, more frail and, while they have little illusions on a public pension, they are under strain because the healthcare cuts have imposed on them higher expenditures as they have to switch to the private sector. Those with children are struggling more than the rest, especially women with children. Savings buffers are falling.

Support for political parties: M5 could surprise us

Our field study has highlighted five strong trends. We found widespread support for M5 across the country, with small gains relative to our previous surveys in areas where the party did not used to be strong, such as the northern part of the country or among the most affluent part of the income distribution. The approval rating for the Democratic party appears fairly assessed in the opinion polls, at around 22-23% currently; its base, in our view, is thin and, more importantly, its voter base is becoming increasingly disillusioned, to the point that part of it may not show up to vote. The centre-right is strong indeed, although we did not register a pick-up relative to our last survey last summer, but the support for Northern League and Forza Italia appears even between the two parties. Support for the small left parties, of which LeU is the strongest one, is very feeble, largely because they are not visible to most, including those that would be obvious voters.

ADA's assessment of approval ratings, %

Party	Approval rating 1st of August 2017	ADA expectations in 2018 in August 2017	Current approval rating 12th Feb 2018	ADA latest expectation for March 2018 election
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Source: *Macrobond, sondaggipoliticoelettorali.it ADA Economics Ltd, %*

M5: young, less corrupt and the last untested option

Similarly to our previous surveys, we found that the approval rating for M5 is high because, although they lose some votes, they gain new ones and their approval rating is well-spread across income brackets (although it is less strong among young female voters, 18-25 years old). This time, we noticed some further widening of support both in terms of regions, which seems to be getting stronger also in the northern part of the country (where the centre-right is dominant), as well as taking tiny steps forward among the affluent segment of society.

Those that plan to vote M5 claim to do so usually on the basis of one of the following three reasons. First, they agree ideologically with some of the party's key points, of which the reduction in the wages of politicians and limits in the number of terms in office are the most common reasons mentioned. Secondly, they do so because it is a young party, with many young representatives: in a country that is rapidly getting old, this is seen as a bonus. Thirdly, it is the last option to try out. It is not uncommon for people to claim to be torn between the right and M5, or the left and M5. Either way, voters often say that they have tried everything before, so why not give M5 a chance. The party's lack of experience is a well-known fact, but not a critical issue in a country where the common perception is the mismanagement of previous governments. That said, should an M5-led government materialise, it would be held to a higher standard than most and, should it fail to deliver some changes, in our view, the electorate would split between those that would stop engaging and those that would move further right.

PD: major strategic mistakes that will be difficult to correct

The feedback we gathered suggests that the democratic party has made three major strategic mistakes, which have alienated almost its entire voter base, to the point that we suspect there is a high risk that many of its potential voters will not vote this time. **Key mistake number one:** the EUR 80 payment to families. Ironically, as it was intended to "buy" votes and reduce poverty, in our view, this measure has backfired because there are widespread cases of people that received the payment but had to return the cash later in the year as their income was too high, or that they thought they would classify but did not receive the payment. **Second key mistake:** the mishandling of the banking sector has left the electorate suspicious of banks and even more of the Renzi government. **Third key mistake:** underestimating the impoverishment of the country, and how that is changing the perception of what would be a fair policy towards migrants. In a country where many perceive rents as too high and they have a very tight budget to square, admitting so many immigrants, without any system to integrate them into the workforce, and providing them with housing and a daily cash allowance, appears to be unfair to most.

We found that these three issues have underpinned a strong distrust in the party, shifting votes elsewhere, while the new programme is not perceived as a game changer.

Centre-right – well-placed to win, but not gaining any further

Our research has confirmed that the centre-right coalition is well-placed to win, but we did not find any changes in support relative to last summer, rather we found that the relative weight between Northern League and Forza Italia is more balanced than what it appeared last summer. The coalition has gained on the back of its promise to reduce taxes; although the electorate is sceptical about how much can be done, there is an expectation of a strong government that will pay more attention to the needs of the country and will take a stronger stance against immigration.

We found that the support base between Northern League and Forza Italia was evenly split, but Northern League is gaining popularity across geography and type of electorate, while Forza Italia leverages mostly on its legacy voter base.

Once again, we found that most do not agree with the ideology behind a flat tax system for households: most perceive that those that earn more should pay more. Many also suspect that it will not reduce tax evasion. That said, there is an overwhelming desire to simplify the tax structure, if only just the number of payments made, which makes the centre-right's proposal appealing.

LeU: Free and Equal is missing an opportunity

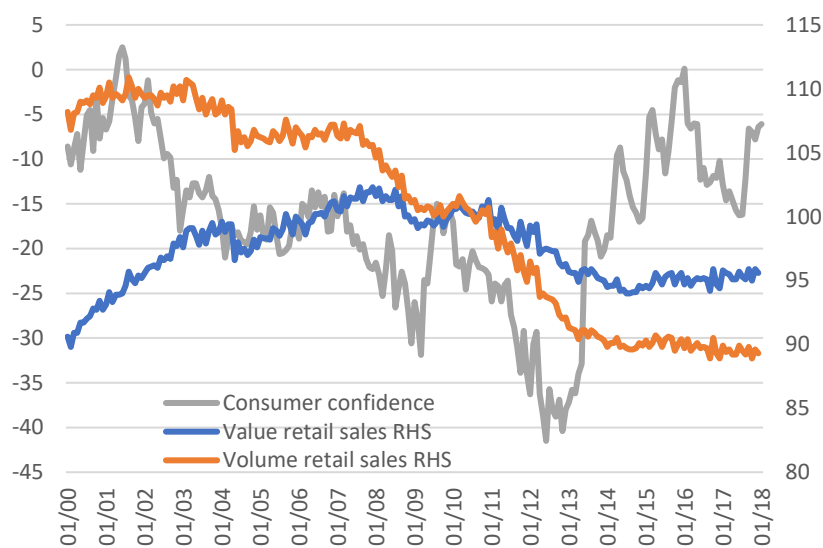
Contrary to six months ago, LeU (Free and Equal) – the spin-off of PD that is currently polling around 5-6% – has failed to reach its full potential in terms of approval rating (in our last survey, we saw potential interest of 8-12%), largely because it does not appear to be sufficiently visible to the electorate. We found that the vast majority of respondents – especially in the lower income brackets, which should be more likely voters for LeU – had never heard of the party, or simply did not know enough to consider it. If we add all the small left-leaning parties together, including LeU, then it is plausible to get to a more significant approval rating of around 10%, however in our view it appears that most of the other tiny parties will not breach the 3% minimum representation threshold necessary to enter Parliament.

On the economy and voters' expectations

Stagnant standards of living, despite the job creation

The vast majority of the people we spoke with stated that their standard of living had been stagnant in the past year. This may appear at odds with the fact that consumer confidence is rising; however, our research suggests that most see a fairly rapid cost of living, especially but not limited to taxation and fuel costs. Those that mentioned an improvement in job opportunities related to the jobs act, mentioned in any case that the types of contracts available are temporary and/or their total compensation is stagnant or down.

Improved consumer confidence does not mean higher spending volumes



Source: Macrobond, ADA Economics Ltd, %

High inflation and stagnant prices: two faces of the same coin

We enquired whether people agreed with the inflation estimates published regularly by ISTAT, that prices were stable to up moderately in the past two years. The vast majority of our sample disagreed strongly, but this was largely the case up to the fourth quintile of the income distribution. More affluent voters tended to mention stable prices or even falling in some areas, related to technology or the greater use of Amazon. At the same time, the answers of small entrepreneurs tended to say that their prices had stayed stagnant. In general, we believe that these results suggest that prices have indeed risen rapidly for everyday-use products: fuel, food and utilities, as well as the tax burden. Those most affected by the squeeze in incomes have noticed it more than the rest. At the same time, small companies lament that they lack pricing power, given that demand is weak, and this has been the *status quo* for the past five years at least.

Local production caught in a bind

We asked people whether they would have preferred to see more local production. Our initial interest was to first see whether Italy was going to experience what is already visible in eastern Europe: consumers complain that the now widespread market power of foreign retail chains has led to a perceived reduction in the quality of products, to the detriment of local suppliers and no price gain. We also wanted to assess whether the global trend favouring “sustainability” and “environmentally friendly” products could prove to be a stronger factor in supporting small, local producers. The responses we gathered suggest that, while people do, on average, prefer the quality of local products, primarily food items, the squeeze of incomes forces them to switch to a cheaper product, often of foreign production. The latter is, or at least seems to us, the dominant force between the two factors.

House price recovery difficult to see, rents are too high

We investigate the perception of house price valuations and whether there is pent-up appetite for investment in real estate. The responses showed that, while people do see house prices as fairly low, those that would be interested in a future purchase are priced out of the market because the nature of their job contracts does not allow them to access a mortgage. In addition, those that do have the means, do not appear to be in a rush to step in, often mentioning that they already have some fixed assets they would like to liquidate, but cannot find a buyer. This, in our view, is a strong indication that the stabilisation of the housing market may not last if the government does not take a stronger stance to narrow the gap between the flats on offer and demand.

We also discussed rents during our field study, and everyone noted that rents were too high relative to incomes and relative to the quality of the flats on offer. This included student residences, which are perceived as too expensive.

Top policy priorities in order of important: first and foremost, more jobs

Job creation & support to entrepreneurs (especially small and medium companies)

The most mentioned policy priority, one-quarter of responses, was job creation and a thorough rethinking of industrial policies to stimulate the creation of new companies. Support for the flat tax system put forward by the centre-right is still not a solution that the majority of voters like; however, even among those that would support it, it is not seen as sufficient for re-starting the industrial sector.

A thorough rethinking of the tax system: simplification, recalibration and ideally cuts

In our sample, 15% of responses on the top-3 priorities for the next government suggested a thorough rethinking of the tax system, which should be simpler, as a minimum, and with one-to-two payments per year for all types of taxes, rather than the thousands of different taxes and deadlines in place currently. People also mentioned the need to rethink the tax thresholds, to limit discrepancies and avoid tax evasion, as well as a reduction in the tax rates. A cut in the VAT rate in particular was a frequently mentioned priority, for the basic food items and utilities as a minimum.

Cut the pension age!

The third most commonly mentioned priority (13.5%) for the near term was a reduction of the pension age (the repeal of the Fornero law), as a way to encourage both youth employment and productivity overall, as well as a necessary step, as most simply did not think they would be fit enough to work until 67 years of age. This perspective was repeated in essentially the same terms by people across age brackets and, while not dominant among the highest income bracket, it did receive fairly frequent mentions in that segment as well. It may be that these concerns have been accentuated as a result of the reduction in public sector healthcare services, as people feel more vulnerable and less able to remain “fit” over their lifecycle, or it may be that the growing penetration of technology is making older generations feel they cannot keep up as much as they used to.

Next in line: state spending priorities – education, healthcare and tourism

We found a widespread perception across the country that both healthcare and education services are now underfunded and, thus, it should be a priority to invest more in both (20% of responses, evenly split, mentioned this as a top-3 priority for either one or both). The education reform introduced by Renzi was welcomed by a minority of people; even those that welcomed it, mentioned that it would need more resources and greater efforts to make it genuinely advantageous for new generations. It is also worth noting that 5% of responses flagged the need for greater support for families specifically, including disabled persons and adoptions. Another frequently mentioned area of policy priority highlighted was investment in tourism and culture, as 7% noted that Italy is missing an enormous opportunity in tourism and business in general.

The EU(ro) question again!

This is the third survey we have run with a question on the appeal of the EU(ro) and, for the third time, everyone criticised the EU, but a solid majority – 65% – claimed it was undesirable or unviable to leave the Eurozone. Most respondents simply acknowledged that Italy has mismanaged its membership in the European Union, but it is now too late to leave: it would either be too costly for the economy, or even impossible. On the back of this, it appears to us that all parties have done well in re-formulating their views on the EU: those that are Eurosceptic have tempered their positions and, by doing so, they are not running the risk of losing votes (something that, in our view, happened to Le Pen in France last year). Equally, nobody is giving credit to an openly pro-EU message, in our view.

Implications of the survey findings

Election results: do not count on more of the same

We see three plausible election result scenarios, but only two of these are genuinely highly likely: a centre-right coalition government or a government led by M5. The third scenario, a grand coalition between PD and Forza Italia is unlikely, in our view, as, to receive enough support, PD would have to significantly outperform our assessment and the current opinion polls, for which we have found little evidence and, historically, PD undershoots expectations during elections. If Forza Italia outperforms expectations – which is a plausible scenario – its natural coalition formation would be the centre-right, not PD.

A government led by M5 would be complex, but should not be discarded just because of that. If the support for M5 outperforms the current polls, which we see as likely, then its electoral weight would be far above the other parties and its electoral programme could find different types of support depending on the topic. We believe that Northern League would be the closest companion on the basis of its electoral promises, although we acknowledge that it would not be an easy coalition negotiation, nor a simple cohabitation.

It appears to us that neither local bonds nor local equities reflect a likely government change post 4 March. Although M5 is not a serious threat to financial stability, in our view, the market appears complacent to a surprise outcome.

Key macroeconomic indicators, %

	Status quo scenario			Centre-right victory		M5-led government	
	2017E	2018F	2019F	2018F	2019F	2018F	2019F
Real GDP	1.6	1.9	2.2	1.9	3.0	1.6	1.6
HICP, avg	1.5	1.8	2.3	1.9	2.5	1.8	2.1
Unemp. rate eop	10.8	9.5	8.5	9.5	8.2	9.7	9.0
Budget deficit % of GDP	-2.5	-2.2	-1.8	-2.2	-3.0	-2.4	-2.3
Debt % of GDP	131.3	129.0	126.0	129.2	125.0	129.1	126.4

Source: Macrobond, ADA Economics Ltd, %

GDP performance: short-term solid, but not a guarantee for a rosy long term

Recently, we published an estimate of our GDP growth projections under these three scenarios and we stand by these forecasts. **That said, we underscore that the positive GDP numbers mask a still profound structural weakness, which must be forcefully addressed quickly, or it risks becoming a very serious challenge for the long-term sustainability of the economy.** Italy is experiencing an improvement in industrial competitiveness, but it has too few and too small companies these days. NPLs are falling, but the pace is still constrained by NFCs' profitability, which remains weak because Italy has lost pricing power. A much bolder industrial strategy is needed. These are the factors we will be looking for:

- Income support for entrepreneurs.
- Strategic support for micro and small companies, including preferential credit.
- Fiscal support for companies, particularly the "young" segment: from creation to seven years of age.
- Regulatory incentives to make local production more widely distributed.
- Incentivise a much earlier entry into the job market, even on a temporary basis, and make it appealing, financially viable and rewarding to seek and access lifelong learning.

Consumption is stable-modest thanks to past savings. However, savings cushions are being eroded and increasingly concentrated among the affluent parts of society. In addition, the economy will continue to experience wage compression, and the effects of the brain drain and population ageing is taking their toll on productivity and wealth. The housing market, which represents a sizeable chunk of households' total savings, remains very illiquid and there seems to be a sizeable gap between demand and offer, for sales and rentals. Any forceful government intervention in this segment would unlock investment and liquidity for families.

Raffaella Tenconi, 14th February 2018

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