

It's No Brexit, But Still

Q&A on the forthcoming Italian Constitutional Referendum

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Key Points:

- The proposed constitutional amendments would dismantle the current 'perfect bicameralism'
- A NO vote could have implications for political and financial stability in Italy and Europe
- A victory of the YES camp would likely strengthen the mandate of the current government

Save the date

The Italian Cabinet announced that the awaited referendum on Constitutional amendments will take place on Sunday, December 4th – prior to the European Central Bank (ECB) and U.S. Federal Reserve (Fed) meetings, on December 8th and December 14th respectively. This is not a [Brexit referendum](#) kind of event; nevertheless, a negative outcome could have implications for Italy's financial stability which in turn could create the prospect of contagion across other financial sectors in Europe.

The Constitution of the Italian Republic dates back to 1948. Following World War II (WWII) and the fall of the Fascist regime, the Constituent Assembly that abolished the monarchy and enacted the Constitution of the Italian Republic was deeply antifascist. The result of that political sentiment was a Constitution that included extensive measures to prevent the executive branch of the government from having the ability to turn the country back into an authoritarian regime. In that vein, the Italian legislative body was set up in the form of what is known as 'perfect bicameralism'. What that means is that the Italian Parliament is constituted of two chambers with symmetrical power: the Chamber of Deputies and the Chamber of the Senate. Any legislative bill must be passed independently by both chambers for it to turn into law. Moreover, for a government to come to and remain in power, it must earn a vote of confidence from both chambers.

While this framework has been successful in preventing any reversal of the Italian democratization process that took place post-WWII, it contributed to political instability by creating an environment in which governments would have a hard time reaching the end

of a mandate. Indeed, this could be the ultimate outcome of the forthcoming constitutional referendum itself. The current government, led by Prime Minister Matteo Renzi, is a promoter and supporter of the constitutional reform which the referendum will approve or dismiss. A NO vote would likely lead to pressure Prime Minister Renzi to resign, prior to the end of the mandate.

Note that since the 1940s Italy has had over 60 governments. Since then, the average duration of an Italian government has been about one year. Only one government managed to complete the five-year term; that was the government lead by Prime Minister Silvio Berlusconi between 2001 and 2006. Throughout his term, he proposed a bill that included amendments to the Italian constitution which were going in the same direction of this forthcoming referendum.

What are Italians voting for?

In a nutshell, the proposed constitutional amendments would dismantle the current 'perfect bicameralism' by shrinking the size of the Chamber of Senate to about a third of its current size and restricting its legislative power to specified areas like European Law and Budget Law. In addition, the Senate would coordinate legislation between the central government and local governments, as well as contribute to the process of appointment of constitutional judges.

The Chamber of Deputies, on the other hand, would retain its current composition and functions, and it would remain the only entity to pronounce itself in favor (vote of confidence) or against a government.

What if the NO vote wins?

At the time of this writing, opinion polls are not offering a clear gauge of what the final result could be given that the share of undecided consistently revolves around one-third. As it is often the case, important referendums of this sort tend to reflect the rate of approval of the current government. In this particular case, a failure to pass the proposed constitutional amendments (NO vote) would likely lead to the resignation of Prime Minister Renzi, given his support of the constitutional reform.

The potential resignation of Prime Minister Renzi is not the only political consequence. Constitutional changes currently require a supermajority in Parliament, two-thirds of the members of each chamber. In the case of the current proposed constitutional amendments, it took over two years (!) to pass the proposed reform through Parliament. However, the reform did not pass with the two-thirds majority and that makes a popular referendum necessary as the final arbiter. A NO vote would be a major setback given that a potential new proposal would have to return back to Parliament. Additionally, ushering a Constitutional reform proposal back through the Parliamentary process would likely delay discussions on other important structural reforms which are greatly needed for future sustainable economic growth.

Even though political instability is the norm for Italy, a NO vote would likely be a concern for European markets and potentially global markets as it would increase the chances of a populist protest vote in the 2018 elections, or possibly earlier. The anti-euro party Movement 5 Stars (M5S), which has been calling for a referendum on whether Italy should remain in the Eurozone (EZ), appears to be well positioned to benefit from a NO vote. Fortunately, Article 75 of the current Italian Constitution does not allow for referenda on International Treaties.

Last but not least, a turbulent political environment would not constitute fertile ground for a much needed private recapitalization of the [Italian banking sector](#) – something we wrote about recently. A banking sector failure in Italy, admittedly a low probability scenario, could send the Italian economy back into recession and create contagion across an economically and politically fragile Europe.

What if the YES vote wins?

A victory of the YES camp would likely strengthen the mandate of the current government. Potentially easing the way for further important structural reforms and to a smooth recapitalization of the Italian banking sector.

The YES vote could bring the prospect of increased future political stability, which is certainly a positive break from the past. However, the combination of a new single legislative chamber and the new electoral law, dubbed Italicum, would result in a much stronger position in Parliament for any winning party. Italicum, the new electoral law, assigns a majority premium of 340 seats out of 617 to the winning party (i.e. 55% of the seats in Parliament). Therefore, a YES vote is an opportunity for Prime Minister Renzi to capitalize on a stronger mandate and implement a strong agenda for much needed economic growth, which potentially could include some fiscal expansion. However, failure to do so could feed into the increased popularity of M5S, something that markets would perceive as a threat to financial stability in Italy and Europe.

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