



## What does a 'no' vote in the Italian referendum mean?

In all probability the Italian electorate is likely to reject Prime Minister Renzi's proposals for constitutional reform. Essentially, Renzi wants to reduce the power of the Senate - the upper chamber of parliament, allowing for smoother implementation of legislation and potentially a more stable political system. However, the referendum has turned into a vote on Renzi himself, whose popularity has taken a sharp dip since his election in September 2014.

A 'no' vote will reduce hopes of advancing the structural reform agenda, resulting in weaker growth for an already struggling economy. Italy's growth rate in 2016 has been one of the weakest among its euro peers, weighed down by high unemployment rates and a stalling credit cycle. Loan growth has fallen back into negative territory and demand is expected to be further constrained by tighter credit standards for both mortgages and corporates.

Economic confidence relies on a healthy and functioning banking system. Italian banks' ability and willingness to support investment remains a key headwind to economic growth, given high levels of non-performing loans (NPL). There have been some improvements to asset quality, but stronger growth is vital to avoid any further increase in NPL stock and support the drive to improve banks' capital buffers and future profitability.

In addition, Unicredit and Monte di Paschi plan to raise capital in December and these events will be another key gauge of investor sentiment. In the short term, we are likely to see further risk aversion in Italian assets, particularly bank shares. However, it may not be all bad news. European Union rules prevent any state intervention to support the banks unless their capital ratios fall below a certain level. If we were to see a significant fall in bank shares, then the negative impact on capital buffers would probably allow for government support, which would be a longer term positive to restoring the health of Italy's weak banks.

More broadly, we expect the political fallout to be contained. Even if Renzi resigns, recent history suggests that there is more probability of a technocrat government being installed. If a general election were to happen, the likelihood is that it would result in a fragmented coalition government that would find it difficult to pass legislation, owing to the very parliamentary system that Renzi is trying to reform.

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## Contact

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