

Italian Elections: Uncertainty Seems to be a Certainty

Italy has long been a country characterised by a fragmented political landscape and unstable governments. The latest elections are unlikely to yield anything different.

From a financial markets perspective, the results of this latest election could be even further reaching, carrying the potential to create a sharp spike in market volatility and to call into question the future of the eurozone project. Such concerns are driven by the recent momentum that has been enjoyed by the far-right Northern League party and its charismatic leader Matteo Salvini, which aims to purge Italy of what it classes as illegal immigrants.

Immigration and the weakness of the Italian economy have been the two central pillars of the election campaign, which has ridden the recent Europe- and US-wide wave of political populism. The Euro currency may also be under threat from a successful campaign by the Northern League and its centre-right coalition – the party has promised to take Italy out of the single currency and so the prospect of electoral success by Northern League would likely put downward pressure on the Euro.

The key impediment in trying to find political stability in Italy is structural. In general, the Italian political stage is divided into three distinct and ideologically conflicting parts.

First there is the center-right coalition that comprises the parties of Forza Italia and Lega (Northern League). The combined weight of these parties should see them gain the largest vote, but not a majority. They will need a coalition partner.

Then there is the Five-Star Movement, a party that is generally considered to be populist, anti-establishment, environmentalist, anti-globalist and Eurosceptic. This 'movement' may be the largest single party in terms of votes, but it is expected to fall behind the centre-right coalition. Moreover, the Five Star leaders have stated that they don't want to join with the other parties in coalition. Finally, the centre-left coalition, led by the Partito Democratico is the most centrist option for voters, but this party is expected to remain the smallest of the 3 options in terms of votes won.

So, what's the likely outcome?

Some form of coalition seems the inevitable outcome of the election, albeit the durability of a 'grand coalition' looks set to be short-lived (again) – given the diverse nature and beliefs of the underlying parties. If this is the case then the prospect of new elections in the coming months will weaken the macro outlook for Italy – and if Eurosceptic Five Star are part of the post-election coalition then the Euro will also likely come under pressure over the coming days.

04 March 2018

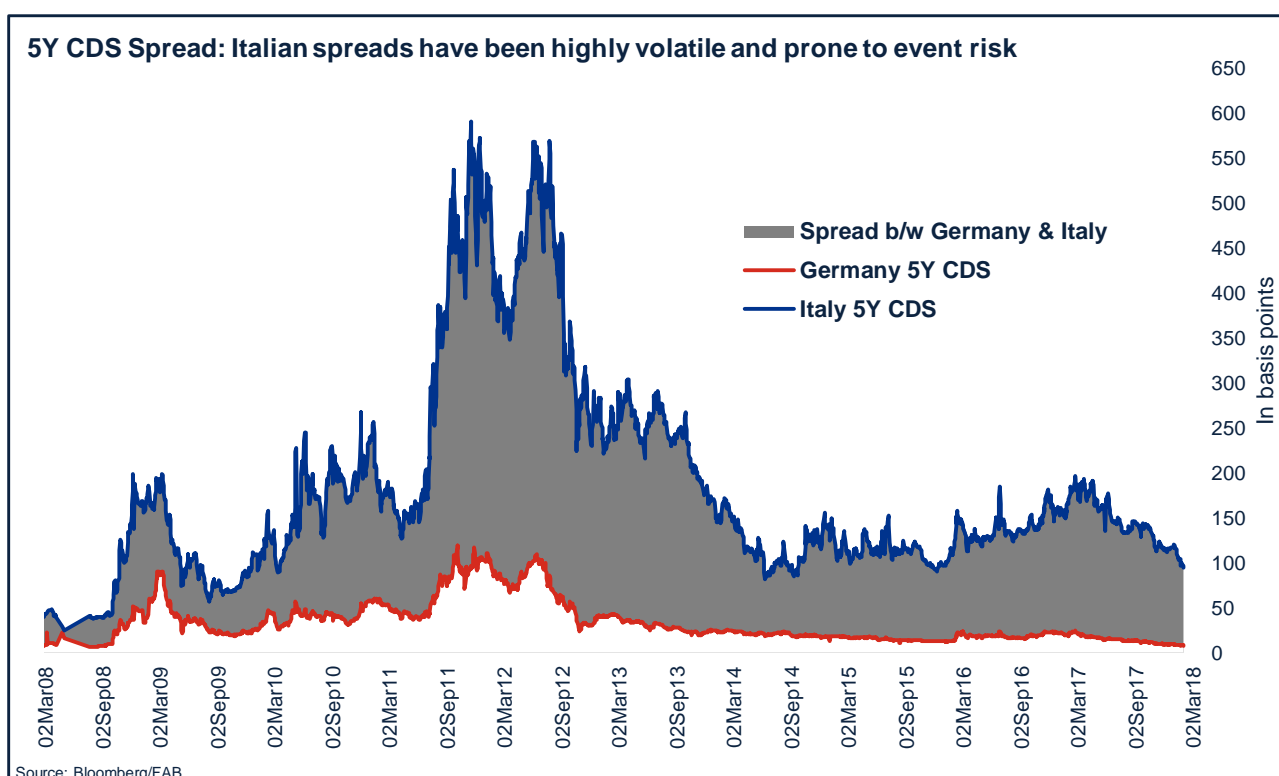
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Then of course there is the prospect of a return of the centre-right, with Silvio Berlusconi and his Forza Italia party back in the limelight, although polls seemed to expect the centre-right to fall short of being able to form a coalition. If they are strong enough to form a coalition though, the question will be who would run it. Berlusconi is barred from holding office. Aforementioned Salvini would want the job, but the market reaction would likely be negative to such a result, for the reasons listed above. Perhaps the most market-friendly solution would be Antonio Tajani, the current president of the European Parliament. He would be seen as continuing the status quo and a stabilising factor in terms of Eurozone cohesion and Rome's relationship with Brussels.

Bottom line:

Italy appears to be facing yet further macro-political uncertainty in the coming weeks and months, with the spectre of new elections before the end of the year, if today's results are inconclusive. This will likely put pressure on Italy risk prices. Keep a close on how well the Northern League do; any surprise strength in their vote will likely fuel Euro convertibility risk and put downward pressure on the single currency.



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