

Uncertainty and Complacency Ahead of Italian Elections

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On March 4 Italy will vote for a new government. Though the majority wish to stay in the euro, there are many who are frustrated by high taxes, political corruption, and years of no-to-low economic growth. Younger Italians are further disillusioned by limited job prospects brought about by labor laws favoring older workers. In other European elections, voter dissent has threatened to undermine euro-bloc sovereignty. However, despite the UK's exit from the European Union, a populist government has yet to materialize in core Europe. This is best illustrated by last year's defeat of a far-right French presidential candidate, and the re-election of centrist Angela Merkel as Chancellor of Germany.

The mainstream political landscape in Italy – including right-centered Forward Italy, left-centered Democratic Party, and euro-skeptic Five Star Movement – is fragmented. No one party holds a winner-take-all lead in the polls. The probable election outcome of a hung parliament would necessitate a party coalition to govern Italy. A centrist coalition of Forward Italy and the Democrats would be optimal, but not assured. In addition, any winning party or coalition will need to clear a 40% majority under new complex electoral laws. With no effective coalition, the recently *appointed* and popular Democratic Prime Minister, Paolo Gentiloni, could lead the country until another election is held.

Debt and equity investors like Italy. Following its last recession, Italy has been posting positive GDP gains since 1Q14. However, as the third-largest European economy, the country has consistently underperformed its peers. Spain, another periphery sovereign, has not only surpassed Italy but has outperformed Germany for most of Europe's ongoing recovery. As a percentage of GDP, Italy's debt is among the highest in the world, and political issues continue unabated. In this election, politicians will try to attract voters on promises to fix Italy's economy and high debt burden, as well as immigration challenges and a weak banking system.

Italy is a paradox of uncertainty and complacency which has been the norm for years. The last elected PM was Matteo Renzi, who resigned in late 2016 when his referendum for constitutional reform was rejected by the electorate. Now the country is faced with yet another difficult choice for leadership. Either Italy stays the course of inclusion in the euro or it meanders down the path of populism, which could threaten its sovereignty as well as the EU. While the election could be a messy, protracted process, a coalition-led centrist government should prove to be workable. **Spectrum believes Italy will not jeopardize its global economic standing, especially in Europe.**

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