

Italian Government Leaning Toward Populism

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Talks have stalled since Italy's general elections in March, but it appears that a governing coalition of the 5-Star Movement (M5S) and League may occur by this Sunday. The M5S-League alliance, including other right-wing parties, would produce a working administration, but the coalition would also signal an important change in Italy's political path from a long-time centrist style government to one of populism. Notably, Italian stocks and bonds were only slightly down this week in response to the potential of an anti-establishment government. The M5S had been pursuing a coalition with the center-left Democratic Party, and though former PM Matteo Renzi rejected this overture, interim leader Maurizio Martina remained open to a coalition as long as the M5S severed ties with Silvio Berlusconi's right-centered Forza Italia and Matteo Salvini's far-right League.

The country has been led by an interim government (headed by current PM Paolo Gentiloni), since the resignation of Mr. Renzi in late 2016. If indeed a coalition is not reached this weekend, President Sergio Mattarella will ask parliament for a confidence vote to allow another "caretaker" government to run the country, dealing with agenda items such as the 2019 budget and electoral law changes. However, the main coalition parties are unlikely to cooperate, especially the M5S which could seek a snap election as early as June.

Italy's markets have been buoyant with stocks surging since late 2016, and 10-year sovereign yields at 2% or lower. This may not last due to the imminent change in political climate. Italy continues to struggle with an underperforming economy, a high national debt and fragile though slowly improving banking sector, and labor reform and immigration issues.

A populist party in Italy would be a challenge for the EU, which is overwhelmed by many issues including its relationship with the U.S administration, Brexit and anti-euro sentiments in other member countries such as the Netherlands, France and Spain. The powers that be in Brussels (Chancellor Merkel and Co) need to work constructively with all their members, especially Italy. Though politically dysfunctional for years, Italy understands that significant changes need to be implemented internally as well as in its relationship with the EU. While not endorsing a populist regime, President Mattarella today stated "the European project has lost its ability to meet the expectations of large portions of the population". The Italian coalition agrees.

It remains unclear if a populist government will improve Italy and its EU relationship. Spectrum believes however, that the prospect of an Italian exit is unlikely, given that most voters want to remain in the euro.

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