

Italian Populist Risk

June 12, 2018

Prime Minister Giuseppe Conte is now leading Italy, backed by the coalition of the 5-Star Movement (M5S) and right-wing League. Italians voted for change, but a new populist government could elevate sovereign risk, especially at a time when the economy is expanding — albeit at a slower pace than the rest of the euro bloc — and bank asset quality, capital and profit metrics are gradually improving.

The differing ideologies of the two parties could send mixed signals. The League has built its reputation as an anti-Euro (anti-immigration) party, and the M5S as an anti-establishment (anti-corruption) party. Italian citizens may resent the status quo, but most do not want their country to leave the euro. With the inclusion of the M5S, the coalition has softened its anti-euro stance. **Spectrum believes an exit as well as currency redenomination are remote risks.**

It is unlikely Italy would hurt its reputation as one of the largest economies and debt markets in the world. A contentious confrontation with the EU would not end well for any one. Prior to the new government, 10-year Italian debt plummeted 12% at the end of May (from its mid-April high), and yields reached 3.15% (denoted by arrow in yield chart below), versus ~2% for most of 2018. The Italian 10-year is currently at around 2.80%. Volatility will likely persist near term as Italy attempts to prop up its economy and banking system, while maintaining a working relationship with the EU. **In our opinion, contagion risk is limited.**



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