

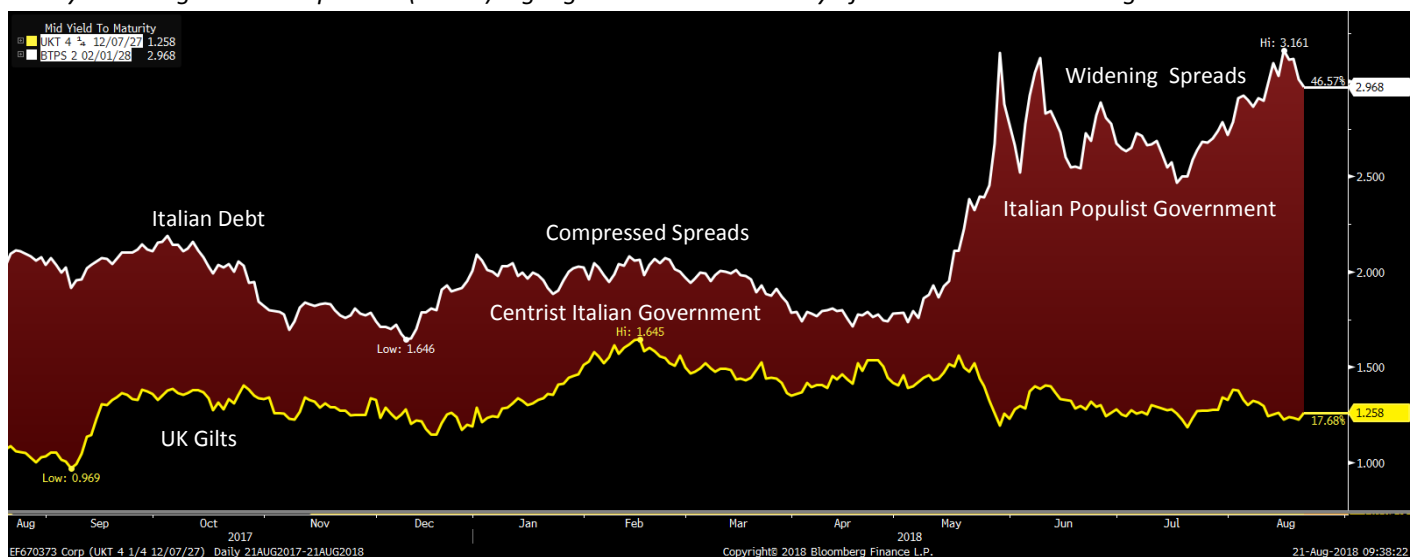
## Brexit Versus Italian Populism

August 21, 2018

Brexit is targeted for completion by March 29, 2019, though the timing and details of a final agreement remain fluid. A major hurdle is parliament's indecision whether to keep close EU ties ("soft Brexit"), or make a clean break from the bloc ("hard Brexit"). Prime Minister May is advocating a soft Brexit, which would retain some aspects of the single market such as free movement of goods within EU borders, or favorable trade rules in the customs union. Another obstacle is whether or not a hard border would be imposed between Northern Ireland and the Republic of Ireland, a EU member. Brexit talks are accelerating ahead of the deadline to avoid a "no deal" situation.

One way to gauge the magnitude of Brexit risk is to compare the UK with Italy. Unlike the UK's strong macro fundamentals, Italy has been in economic and political disarray for years, exacerbated by a newly-elected Italian populist government. The coalition of the 5-Star Movement and right-wing League has been at odds with the euro-bloc, threatening to reject some or all of Europe's rules of fiscal austerity ([see our 6/12/18 report](#)). Moody's stated it will finish its downgrade review of Italy's ratings after the country releases its budget this fall. Brexit should be an orderly process, compared with protracted uncertainty regarding Italian fiscal and reform initiatives.

*A 10-yr sovereign debt comparison (below) highlights the lower volatility of Brexit versus Italian negative euro sentiment.*



UK gilt yields have been steady at an average 1.33% for the past year. The yield spread between the two countries' 10-year debt was 50 basis points from the beginning of 2018 until the Italian election. At the end of May, Italy's centrist government transitioned to a populist regime, driving yields higher. Italian debt is currently priced at about 170 basis points wide to UK gilts. Despite an accommodative central bank, a populist regime engendering negative euro sentiment is a clear and present economic risk for Italy. Conversely, even on the back of bumpy Brexit negotiations, the UK's creditworthiness appears to be resilient given its stable economy and fiscal discipline.

**Our UK banks and insurance investments should remain fundamentally sound as the country takes back its sovereignty.**

Joe Urciuoli  
Head of Research

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