Italy elections – more uncertainty

SUMMARY

- **Italians elected another hung parliament, according to early exit polls,** likely prolonging the political uncertainty that has hurt its recovery from the global financial crisis.
- **The centre-right coalition, led by former Prime Minister Silvio Berlusconi, is likely to win the largest number of seats,** although the new populist 5-Star party will probably emerge as the single largest party, according to the exit polls.
- **A grand coalition of the centre-right and centre-left parties (similar to Germany), is likely to be the best outcome for investors**. A coalition between the far-right Northern League and the populist 5-Star parties would revive concerns about economic and political stability in the Euro area's third-largest economy.

BACKGROUND

- **Hung parliament**. The centre-right coalition of Forza Italia (headed by Berlusconi), anti-immigrant Northern League and Brothers of Italy, are forecast by the exit polls to win 33%-36% of the vote, which could translate into 225-265 seats, short of the 316 needed to win a lower house majority. The 5-Star party is likely to win 29%-32% of the vote. Italy's ruling Democratic party is likely to get 21%.
- **High unemployment, immigration dominate election.** Italy's economic output remains 5.7% lower than pre-global financial crisis levels, with its economic recovery lagging the rest of the Euro area. Unemployment at 11% remains well above the Euro area's 8.7% rate. However, the economic growth has been recovering over the past year after the recapitalization of some troubled lenders.

WHAT DOES THIS MEAN FOR INVESTORS?

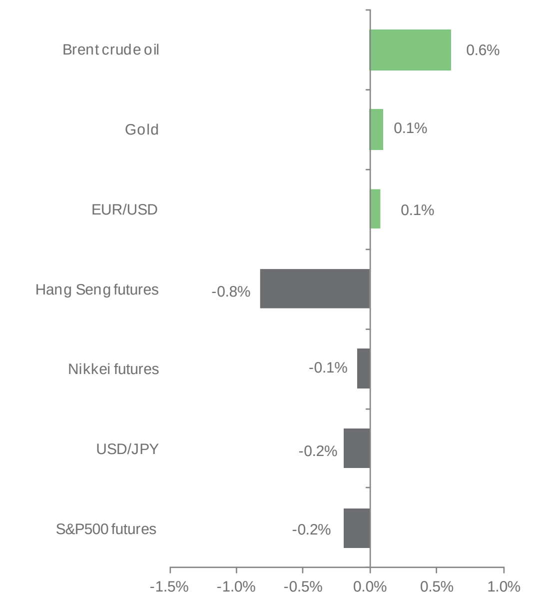
- **Prolonged uncertainty likely to dampen investor confidence**. A long-drawn negotiation to form a government risks hurting business and consumer confidence and slow Italy's ongoing recovery. Italy's bond yield premium over German bunds had declined significantly and equities had recovered over the past year.
- **We retain Euro area stocks as a core holding and remain bullish on EUR**. The broader Euro area recovery remains on track, as seen in strong economic, corporate earnings and bank lending growth. This supports our constructive view on the EUR.

WHAT TO WATCH OUT FOR

- **Final results at around 2 PM Hong Kong/Singapore time.** Exit polls in Italy have not been too reliable in the past. The new electoral system, where a third of the seats will be based on the first-past-the-post system and the other two-thirds on proportional representation, makes it more challenging to call the elections. Thus, the announcement of the final results will be closely watched.
- **Negotiation among parties to form a government**. The first test of the strength of the various coalitions is likely to be the election of the speaker of the lower House and the Senate on 23 March. Italy's President could decide to invite a leader to form a government based on the outcome of the speaker's elections.

Safe-haven assets such as JPY, gold and the EUR have been little changed following the release of the Italian exit polls results

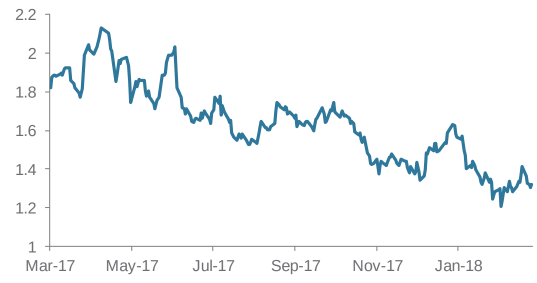
Change in asset prices, 05-Mar-2018 vs. 02-Mar-2018



Source: Bloomberg, Standard Chartered

Italian bond yield premiums have been declining over the past year on the back of an economic recovery

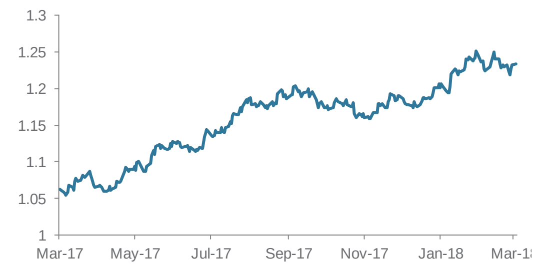
Italy 10yr bond yield premium over German bunds, %



Source: Bloomberg, Standard Chartered

The EUR remains on an uptrend, helped by a broad-based economic recovery and reduced political uncertainty

EUR/USD



Source: Bloomberg, Standard Chartered

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