AN ITALIAN GAME CHANGER?

The apparent collapse of the populist coalition government in Rome could have far-ranging repercussions for the Eurozone.

Italian politics is in turmoil once again. The ruling populist coalition between the far-right Lega and the Five-Star movement appears to have collapsed. Giuseppe Conte, the country's technocratic prime minister, has signaled that he stands ready to face a vote of no confidence in parliament.

For many investors, political instability in the south of the Eurozone may evoke a sense of déjà vu. Since the Eurozone crisis began to unfold almost 10 years ago, fits of political disarray have been a regular occurrence only for fiscal-policy making to remain fairly unadventurous, no matter who was nominally in charge.

It is possible that ties within Rome's fractious coalition partners might be patched up, as previous rifts have been before. The cause of the latest conflict is a trans-Alpine high-speed rail link with France, which has already been in planning for decades. Lega, business groups and what is left of Italy's political establishment is in favor. Five Star, which partly began as a green protest movement has long been campaigning against TAV, as the rail link is known. On Wednesday, August 7, Five Star tried to block the project in the Senate, but was outvoted by Lega with help from the opposition.

It might therefore appear odd that it is Lega now trying to pull the plug on the coalition. But tensions have been growing for months, especially after Five Star backed Ursula von der Leyen in her successful bid to become president of the European Commission. All of which is a reminder that while both Lega and Five Star may have been labelled populists by political scientists and various commentators, they have vastly different political priorities. Indeed, pretty much the only issue the two have consistently agreed on is their fierce opposition to the Eurozone's stability and growth pact, which they blame for preventing the sort of fiscal easing both promised their respective voters.

This is also precisely why we think investors might be wrong to view the latest drama unfolding in Rome simply as a case of déjà vu. As yet, it is still far from clear if and when snap elections might happen. This is first because Italian polling has notoriously been unreliable, making it uncertain whether Lega's polling strength could actually translate into a centre-right majority. Lega's leader Matteo Salvini might also fear further revelations on recent party-funding allegations known as "Moscowgate". The earliest a general election could be held would probably be in late October or early November, increasing the risks to the Lega of their electoral performance being completely different from recent polling and election results earlier in the year. To complicate matters, any electoral campaign around that time play out just as the Italian government of the day is supposed to submit a new budget to the European Union (EU). If it does not, Italy might be forced to raise value-added tax (VAT).

So, no matter what he says in public, Mr. Salvini might not be all too unhappy privately if elections are delayed and an alternative government implements a budget containing unpopular spending cuts.

Second, Lega's polling strength came largely at the expense of Five Star. So, while Lega may have incentives to engineer a snap election, the opposite remains true for Five Star, especially as many of its lawmakers appear to be rather enjoying the perks that come with holding high office.

Third, it is not up to the current coalition to decide on whether and when to hold yet another snap election. Under Italy's constitution, only the president has the power to dissolve parliament. President Sergio Mattarella is likely to do his very best to prevent such an outcome, perhaps by encouraging the centre-left Democratic Party (PD) to come to some sort of an agreement with Five Star. Such a combination is likely to face fierce opposition within both groups. Perhaps, though, another government heavy on technocrats such as Mr. Conte and finance minister Giovanni Tria could make it palatable for enough lawmakers to secure comfortable majorities in both houses of the Italian parliament.

In the short term, most investors probably wish that snap elections can be avoided. They should be careful in what they wish for. One thing that has become increasingly clear: being highly critical of austerity and trying to resist "reform suggestions" from Brussels may be Italian government policy for the foreseeable future, no matter which of the major groups is in power. At the same time, the rest of the European landscape is already changing, with the electoral victory of Spain's socialists and the looming departure of Angela Merkel in Germany. All this might well influence the composition of the new European Commission and could lead to more "flexible interpretations" of the EU deficit criteria concerning highly indebted countries such as Italy. Having supported Ms. Von der Leyen, a left-wing populist government in Rome might even find powerful allies not just in Madrid, Athens and Paris, but even in Brussels.

When it comes to European sovereign bonds, markets have lately been firmly following the script of the Eurozone turning Japanese, in the sense of interest rates remaining low as far as the eye can see. Inflation risks have largely been priced out, not just for the immediate future but we believe for decades to come. Of course, there are still ways to deal with negative returns, as we have recently shown (see Chart of the Week: How one might beat negative government-bond yields as of 8/2/19). Shifts in monetary policy on both sides of the Atlantic could well see the trend towards ever lower yields and ever more expensive bonds to continue for quite a bit longer. But when it comes to the Eurozone, it will certainly seem to us that history and the continent's changing political economy suggest an obvious alternative to Europe turning Japanese. A risk worth keeping in mind is that in the medium to longer term, it could instead turn a little more like Italy was before the creation of the common currency two decades ago. That mean looser fiscal policies, and, eventually, higher inflation rates than many market participants have gotten used to.

GLOSSARY

European Commission (EU Commission)
The **European Commission (EU Commission)** is the executive body of the European Union (EU) which represents the interests of the EU.

European Union (EU)
The **European Union (EU)** is a political and economic union of 28 member states located primarily in Europe.

Eurozone
The **Eurozone** is formed of 19 European Union member states that have adopted the euro as their common currency and sole legal tender.

Five Star Movement
The **Five Star Movement** is a populist political party in Italy. It is led by the popular comedian and blogger Beppe Grillo, who was also among its founders in 2009. It is considered anti-establishment, environmentalist, anti-globalist and Eurosceptic.

Inflation
Inflation is the rate at which the general level of prices for goods and services is rising and, subsequently, purchasing power is falling.

Lega
The **Lega** (formerly "Lega Nord") is a right-wing populist party in Italy. It was founded in 1991 through the merger of various parties. It is considered anti-globalist and Eurosceptic.

Monetary policy
Monetary policy focuses on controlling the supply of money with the ulterior motive of price stability, reducing unemployment, boosting growth, etc. (depending on the central bank's mandate).

Sovereign bonds
Sovereign bonds are bonds issued by governments.

Technocratic
Technocratic means a form of government dominated by experts rather than politicians.

Value-added tax (VAT)
A **value-added tax (VAT)** is a consumption tax that is collected based on the incremental value added in each stage of production (as opposed to a sales tax where only the final consumer is taxed).

IMPORTANT INFORMATION: EMEA

The following document is intended as marketing communication.

DWS is the brand name under which DWS Group GmbH & Co. KGaA and its subsidiaries operate their business activities. Clients will be provided DWS products or services by one or more legal entities that will be identified to clients pursuant to the contracts, agreements, offering materials or other documentation relevant to such products or services.

The information contained in this document does not constitute investment advice.

All statements of opinion reflect the current assessment of DWS Investment GmbH and are subject to change without notice.

Forecasts are not a reliable indicator of future performance. Forecasts are based on assumptions, estimates, opinions and hypothetical performance analysis, therefore actual results may vary, perhaps materially, from the results contained here.

Past performance, [actual or simulated], is not a reliable indication of future performance.

The information contained in this document does not constitute a financial analysis but qualifies as marketing communication. This marketing communication is neither subject to all legal provisions ensuring the impartiality of financial analysis nor to any prohibition on trading prior to the publication of financial analyses.

This document and the information contained herein may only be distributed and published in jurisdictions in which such distribution and publication is permissible in accordance with applicable law in those jurisdictions. Direct or indirect distribution of this document is prohibited in the USA as well as to or for the account of US persons and persons residing in the USA.

IMPORTANT INFORMATION: UK

Issued in the UK by DWS Investments UK Limited. DWS Investments UK Limited is authorised and regulated by the Financial Conduct Authority (Registration number 429806).

DWS is the brand name of DWS Group GmbH & Co. KGaA. The respective legal entities offering products or services under the DWS brand are specified in the respective contracts, sales materials and other product information documents. DWS, through DWS Group GmbH & Co. KGaA, its affiliated companies and its officers and employees (collectively “DWS”) are communicating this document in good faith and on the following basis.

This document is a financial promotion and is for general information purposes only and consequently may not be complete or accurate for your specific purposes. It is not intended to be an offer or solicitation, advice or recommendation, or the basis for any contract to purchase or sell any security, or other instrument, or for DWS to enter into or arrange any type of transaction as a consequence of any information contained herein. It has been prepared without consideration of the investment needs, objectives or financial circumstances of any investor.

This document does not identify all the risks (direct and indirect) or other considerations which might be material to you when entering into a transaction. Before making an investment decision, investors need to consider, with or without the assistance of an investment adviser, whether the investments and strategies described or provided by DWS, are suitability and appropriate, in light of their particular investment needs, objectives and financial circumstances. We assume no responsibility to advise the recipients of this document with regard to changes in our views.

We have gathered the information contained in this document from sources we believe to be reliable; but we do not guarantee the accuracy, completeness or fairness of such information and it should not be relied on as such. DWS has no obligation to update, modify or amend this document or to otherwise notify the recipient in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate.

DWS does not give taxation or legal advice. Prospective investors should seek advice from their own taxation agents and lawyers regarding the tax consequences on the purchase, ownership, disposal, redemption or transfer of the investments and strategies suggested by DWS. The relevant tax laws or regulations of the tax authorities may change at any time. DWS is not responsible for and has no obligation with respect to any tax implications on the investment suggested.

This document contains forward looking statements. Forward looking statements include, but are not limited to assumptions, estimates, projections, opinions, models and hypothetical performance analysis. The forward looking statements expressed constitute the author‘s judgment as of the date of this document. Forward looking statements involve significant elements of subjective judgments and analyses and changes thereto and/ or consideration of different or additional factors could have a material impact on the results indicated. Therefore, actual results may vary, perhaps materially, from the results contained herein. No representation or warranty is made by DWS as to the reasonableness or completeness of such forward looking statements or to any other financial information contained in this document.

PAST PERFORMANCE IS NO GUARANTEE OF FUTURE RESULTS.

IMPORTANT INFORMATION: APAC

DWS is the brand name of DWS Group GmbH & Co. KGaA. The respective legal entities offering products or services under the DWS brand are specified in the respective contracts, sales materials and other product information documents. DWS Group GmbH & Co. KGaA, its affiliated companies and its officers and employees (collectively “DWS Group”) are communicating this document in good faith and on the following basis.

This document has been prepared without consideration of the investment needs, objectives or financial circumstances of any investor. Before making an investment decision, investors need to consider, with or without the assistance of an investment adviser, whether the investments and strategies described or provided by DWS Group, are appropriate, in light of their particular investment needs, objectives and financial circumstances. Furthermore, this document is for information/discussion purposes only and does not constitute an offer, recommendation or solicitation to conclude a transaction and should not be treated as giving investment advice.

DWS Group does not give tax or legal advice. Investors should seek advice from their own tax experts and lawyers, in considering investments and strategies suggested by DWS Group. Investments with DWS Group are not guaranteed, unless specified.

Investments are subject to various risks, including market fluctuations, regulatory change, possible delays in repayment and loss of income and principal invested. The value of investments can fall as well as rise and you might not get back the amount originally invested at any point in time. Furthermore, substantial fluctuations of the value of the investment are possible even over short periods of time. The terms of any investment will be exclusively subject to the detailed provisions, including risk considerations, contained in the offering documents. When making an investment decision, you should rely on the final documentation relating to the transaction and not the summary contained herein. Past performance is no guarantee of current or future performance. Nothing contained herein shall constitute any representation or warranty as to future performance.

Although the information herein has been obtained from sources believed to be reliable, DWS Group does not guarantee its accuracy, completeness or fairness. No liability for any error or omission is accepted by DWS Group. Opinions and estimates may be changed without notice and involve a number of assumptions which may not prove valid. All third party data (such as MSCI, S&P, Dow Jones, FTSE, Bank of America Merrill Lynch, Factset & Bloomberg) are copyrighted by and proprietary to the provider. DWS Group or persons associated with it may (i) maintain a long or short position in securities referred to herein, or in related futures or options, and (ii) purchase or sell, make a market in, or engage in any other transaction involving such securities, and earn brokerage or other compensation.

The document was not produced, reviewed or edited by any research department within DWS Group and is not investment research. Therefore, laws and regulations relating to investment research do not apply to it. Any opinions expressed herein may differ from the opinions expressed by other DWS Group departments including research departments. This document may contain forward looking statements. Forward looking statements include, but are not limited to assumptions, estimates, projections, opinions, models and hypothetical performance analysis. The forward looking statements expressed constitute the author’s judgment as of the date of this material. Forward looking statements involve significant elements of subjective judgments and analyses and changes thereto and/or consideration of different or additional factors could have a material impact on the results indicated. Therefore, actual results may vary, perhaps materially, from the results contained herein. No representation or warranty is made by DWS Group as to the reasonableness or completeness of such forward looking statements or to any other financial information contained herein.

This document may not be reproduced or circulated without DWS Group’s written authority. The manner of circulation and distribution of this document may be restricted by law or regulation in certain countries, including the United States.

This document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, including the United States, where such distribution, publication, availability or use would be contrary to law or regulation or which would subject DWS Group to any registration or licensing requirement within such jurisdiction not currently met within such jurisdiction. Persons into whose possession this document may come are required to inform themselves of, and to observe, such restrictions.

Unless notified to the contrary in a particular case, investment instruments are not insured by the Federal Deposit Insurance Corporation (”FDIC“) or any other governmental entity, and are not guaranteed by or obligations of DWS Group.

In Hong Kong, this document is issued by DWS Investments Hong Kong Limited and the content of this document has not been reviewed by the Securities and Futures Commission.

In Singapore, this document is issued by DWS Investments Singapore Limited and the content of this document has not been reviewed by the Monetary Authority of Singapore.

Publisher: DWS Investment GmbH, Mainzer Landstraße 11-17, 60329 Frankfurt am Main, Germany