



## A surprise, Italian style

### Once again, Italian opinion polls have proven unreliable

Sometimes, financial markets prove to be more efficient than you give them credit for. Take the muted reaction to Italy's parliamentary elections. By any reasonable standard, Italian voters have delivered quite a surprise. The anti-establishment Five Star Movement emerged as the largest party, as expected, with about 32% of the vote and looks set to capture at least a similar share of seats at the time of writing. That's far more than most observers had forecasted. It's a similar story for the far-right Lega. At about 18% of the vote share, Lega looks certain to emerge as the biggest parliamentary force in Silvio Berlusconi's center-right coalition. The populist gains came mainly at the expense of pretty much everyone else, including both Berlusconi's center-right Forza Italia (14%) and Matteo Renzi's center-left Democratic Party (19%). What, if any, government will emerge from these results remains anybody's guess, probably until well after all the votes have been counted and all seats have been declared. (A more or less final tally is expected at some point today, probably in the course of the afternoon.)

Taken together, Five Star and Lega have outperformed unadjusted polling averages by about 9%. In any other country, that would be very unusual. In Italy, it was just another polling error roughly in line with recent experience, as we previously argued "[An Italian muddle](#)".

From a broader market perspective, the calm among investors so far is both reassuring and a touch worrying. The euro weakened only slightly against the dollar. Perhaps, this was because the Italian elections coincided with positive news that Germany will – finally – get a new government, again under Angela Merkel. After much nail-biting, Germany's Social Democrats voted with a surprisingly strong two-thirds majority to once again become junior partners in another grand coalition.

In equity markets, there were some declines in Asia overnight. This probably had more to do with fears over U.S. protectionism than Italian politics becoming even more fragmented. European market reactions were rather muted with only Italy showing signs of volatility, after having outperformed global markets since the start of the year. As for domestic demand, Italy's economic momentum continues to look strong. We expect Italian earnings growth to be well above Eurozone averages, but continued political uncertainty could increase downside risks.

In bond markets, we have seen moderate spread widening of Italian sovereign bonds compared to German bunds. Italian corporate bonds are likely to reverse some of their gains ahead of the elections. But, while we may continue to see some volatility, as election results continue to trickle in, we would not expect a dramatic and lasting reaction.

### In a nutshell

- Taken together, Five Star Movement and Lega Nord have outperformed unadjusted polling averages by about 9%
- The populist gains came mainly at the expense of both the center-left and center-right party
- What, if any, government will emerge from these results remains anybody's guess, probably until well after the final results

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Italy, after all, did not suddenly become ungovernable – the elections merely reinforce previous trends. Nor was it ever especially likely that the new government would enact the sorts of reforms Italy continues to urgently need.

Take a step back, however, and there are risks both in the short and in the longer term. Much of the Five Star and Lega personnel are fairly new to the national political scene, which could create headline risks in coming days and weeks. The election results also reinforce longer-term worries. As in Italy's 2016 constitutional referendum, broadly centrist and euro-friendly forces have suffered another stunning defeat. That will make it no easier to reach a European consensus on measures eventually needed for the common currency and the European Union as a whole to function effectively.

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## Glossary

### 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.

### Italy's constitutional referendum

Italy's constitutional referendum was held on December 4<sup>th</sup>, 2016. By a surprisingly large margin, voters turned down far-reaching changes intended to make Italy more governable. The bill was proposed by then prime minister Matteo Renzi, who promptly resigned.

### 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.

### Momentum

Momentum refers to the rate of growth of an index or security's price. Momentum investors believe that strong growth is likely to be followed by further gains.

### Social Democratic Party of Germany (SPD)

The **Social Democratic Party of Germany (SPD)**, also referred to as the "**Social Democrats**", is a social-democratic political party in Germany that is considered center-left in the German political landscape.

### Sovereign bonds

Sovereign bonds are bonds issued by governments.

### Spread

The **spread** is the difference between the quoted rates of return on two different investments, usually of different credit quality.

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