



Chart of the week

Markets have remained fairly calm, and for pretty good reasons.

On Sunday, March 4th, Italians delivered a stunning populist defeat to traditional parties of both the center-left and the center-right. As we pointed out in our (see ["A surprise, Italian style"](#)), the anti-establishment Five-Star Movement and the far-right Lega outperformed unadjusted polling averages by a remarkable 9%. In our preview of Italy's parliamentary elections, we had highlighted the plausibility of just such a scenario given how unusually unreliable Italian polling has been in the past. (see ["An Italian muddle"](#))

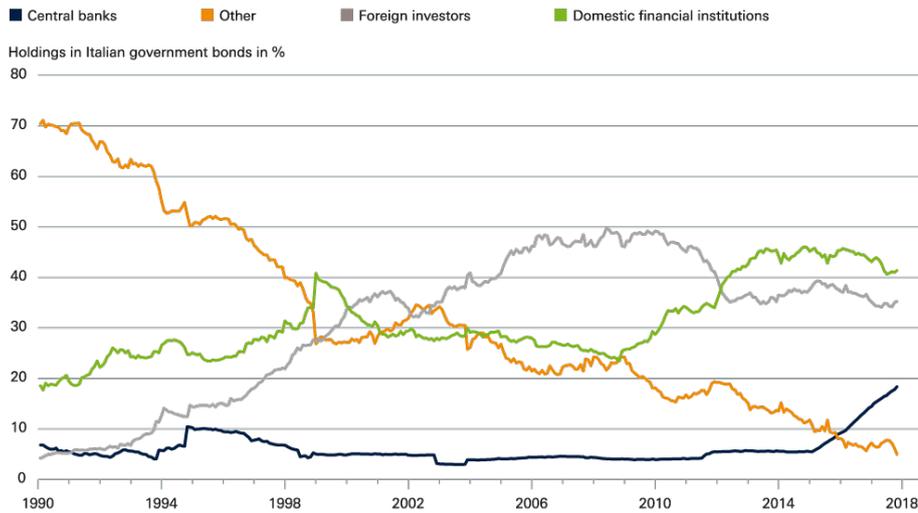
What even we found a touch surprising, however, was the quick restoration of calm in financial markets, following the electoral upset. On a one-month basis, Italian equities have performed pretty much in line with their European peers. Meanwhile, spreads of Italian sovereigns over German Bunds already started to tighten again on Thursday. Even in Italy, it appears that the European Central Bank's (ECB's) policy makers' meeting and uncertainty over U.S. trade policies have been bigger drivers over the past week than domestic politics.

This is consistent with our probability-adjusted views heading into the Italian elections and our positioning since. Italian economic growth appears reasonably strong and corporate earnings growth solid. In itself, we believe the prospect of endless haggling over what sort of coalition might eventually emerge is no reason to sour on Italy. Both the Lega and Five-Star have tuned down their rhetoric on Italy's Eurozone membership. It remains to be seen how much either one of them might increase government borrowing.

And there is one additional reason that gives us comfort, highlighted in our Chart of the Week. Over the past 30 years, Italian households have steadily been reducing their exposure to Italian government bonds. Thanks to the ECB's asset-purchasing programs, 18% is held by central banks, foreign investors hold 35% and 41% is with Italian financial institutions, as of November 2017. Non-financial domestic investors, such as Italian households, owned a mere 5%. Given this split, political troubles in Italy could still prove destabilizing, but more so for the rest of Europe than for Italy itself. To paraphrase that age-old piece of wisdom: "If you have 100,000 euros of debt you find difficult to service, you got a problem. But if you have 2.2 trillion of debt, your problem is everybody else's." Incidentally, this is also one of the reasons why we continue to see a decent chance for some of the necessary reforms to the Eurozone's functioning to emerge – eventually. Not that Italian voters have made this any easier.

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Sources: Bloomberg Finance L.P., Deutsche Asset Management Investment GmbH, as of 3/8/18

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Glossary

Bunds

Bunds is a commonly used term for bonds issued by the German federal government with a maturity of 10 years.

European Central Bank (ECB)

The **European Central Bank (ECB)** is the central bank for the Eurozone.

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.

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.

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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