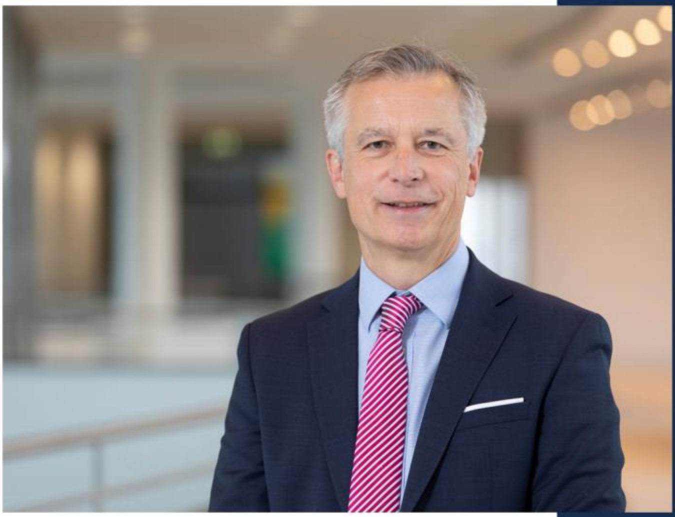

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To the point!

Cross-Asset- and Strategy-Research

Italy before the elections

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A Meloni government will be less radical than many fear

On Sunday the parliament will be re-elected in early elections in Italy. All polls point to a victory for the right-wing conservative alliance. Thus, in all likelihood, Giorgia Meloni will become Italy's first female prime minister. Abroad, many worry about the political direction of a Meloni-led government. After all, in her youth she was a self-confessed admirer of Benito Mussolini and active in a neo-fascist party.

The attitude of Italy's new government will probably become more value-conservative. Yet in terms of economic policy, many of the dreaded nasty surprises are unlikely to materialize.

Meloni emphasizes economic and political continuity

In contrast to the previous election in March 2018, there are no adventurous plans such as the introduction of a parallel currency or the exit from the euro zone. There will also be no repeat of the outbid of non-financeable benefits between the populist coalition members. Coalition negotiations that were far removed from reality shocked the financial markets in 2018 (see figure).

Today, the presumed head of government, Meloni, is rather moderate in terms of economic policy. She promises continuity to such an extent that one wonders why her party, the "Brothers of Italy," was the only one not to join the national unity government under Mario Draghi.

The markets appear to be honoring the course. Despite a massive energy crisis and the threat of recession, the risk premiums are lower than after the previous election. The ECB's hasty promise to stand by Italy if necessary may play a role here. However, doubts about the design and constitutionality of the announced

The markets face the election (still) relatively calmly. Rightly so.

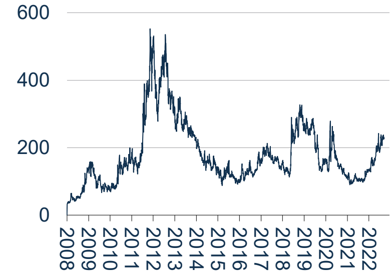
intervention instrument may limit the comforting effect of the promises of the ECB. Investors are not (yet) in panic mode. There are good reasons for it.

Why Italy cannot afford a state bankruptcy

Italy's financial situation is better than it has been for decades. On the backdrop of high budget deficits, high inflation reduces the real burden of national debt (almost 150% of GDP). The interest burden has fallen drastically thanks to a long low-interest policy. The average sovereign debt coupon is just over 2%, half what it was during the financial crisis. And due to the long average maturity (more than seven years), it will take a long time before the interest burden really takes off. Massive expected transfers from the EU Corona Financing Program (NGEU) will further alleviate the refinancing burden.

The most acute risk to Italy's public finances is political. At the same time, Meloni will understand that the main victims of a sovereign debt crisis would not be foreign creditors, but Italians: households, banks, insurance companies and the Italian central bank. The proportion of domestic creditors has increased from 60% to 70% since the financial crisis. A debt crisis would be political harakiri. Having just arrived at the political summit, Meloni will have little desire to immediately gamble away power, again.

Risk spreads of Italian government bonds (basis points over Bunds, 10 years)



Source: Refinitiv

Meloni does not want a debt crisis