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Pagina 6
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Why Italy Crisis Hasn't Ruffled Markets

Government downfall is business as usual; Renzi more than doubled typical tenure

By Jon Sindreu

Among investors, the collapse of Italy's government is stirring less feelings of fear and more of déjà vu.

After all, Matteo Renzi's administration has lasted for almost three years in a country that has had 65 governments in 70 years.

The comparatively veteran leader tendered his resignation Monday, meaning that a caretaker government will likely take over before new elections, which could happen in 2017.

Investors have underlying concerns about Italy's banks and a populist threat to the euro, but they have been mostly unfazed by the news.

Italy's FTSE MIB stock index is up 2.6% since Friday's close, sustaining only a minor slump on Monday. Yields on Italian government bonds rose Monday, but have since come back in.

The lack of response is mainly explained by the fact that investors were widely expecting Italians to vote "no" in the referendum that Mr. Renzi resigned over.

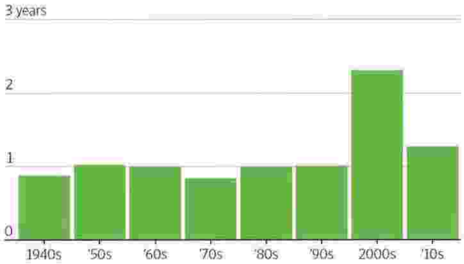
So financial markets had mostly priced in an outcome that Mr. Renzi and others had argued was bad for Italy's moribund economy.

But another factor is contributing to investors taking it easy: The downfall of yet another Italian government is business as usual.

Since the Italian Republic was born in 1946, following the World War II, the average government has lasted 1.1 years, even though parliaments are elected for five years. By this metric, Mr. Renzi's uninterrupted 2.8 years in power look like an eternity.

Italy's Ephemeral Governments

How long Italian governments lasted in power, on average, in each decade.* Parliaments are elected for five years.



*Governments belong to a specific decade depending on when they where formed.
Source: ParlGov
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This means that, unlike Donald Trump's election in the U.S. and the U.K.'s vote to leave the European Union, a "no" vote "is more of a vote to return to status quo" for Italy, said Ian Butler, a fund manager at J.P. Morgan Asset Management.

In fact, it was this unstable landscape that the proposed constitutional reform was looking to change, by stripping power from the legislature's upper house to allow for more-stable governments.

On average, Italian governments since 1946 have been made up of 3.3 parties, which some analysts say creates chaos in Rome. But investors aren't normally particularly concerned about politics. And this time, they may even welcome a bit of instability.

The reason is that Mr. Renzi passed a new electoral law last year awarding extra parliamentary seats to whichever party wins the election, in a bid to minimize the size of the coalitions. But while financial markets are used to Italian coalition turbulence, they saw risk in the potential for the euroskeptic 5 Star Movement being able to take advantage and form a government.

Now, Mr. Renzi's electoral law is widely expected to be overturned.

"If that makes it harder for the populist radicals 5 Star Movement to get into power, then that's a good outcome," said Jeff Taylor, head of European equities at Invesco Perpetual.

Of course, many investors are likely to be disappointed to see the derailing of Mr. Renzi's ambitious economic reforms. Mostly, they are concerned that political turmoil could derail plans to nurse Italy's troubled banks back into health.

When in doubt, however, money managers often stick with the devil they know—even if there is a new one every 1.1 years.