



Renzi rocked: what Italy's no vote means for investors

By **Chris Sloley, Federico Simonelli** / 05 Dec, 2016 at 09:19



The eurozone has once again entered a period of uncertainty with the Italian electorate voting against reforms to the constitution, which led Matteo Renzi to resign as Prime Minister.

The immediate outcome saw Italian banking shares drop dramatically, while the benchmark index, the FTSE MIB, was down 1.4% in opening trading. Meanwhile, 10-year sovereign bond yields spiked above 2% following the outcome.

Given Italy's shaky performance over the course of 2016, most notably in its banking sector, will this latest development derail longer-term recovery efforts in the Southern European state?

Pioneer's [Cosimo Marasciulo](#), who is head of European government bonds at Pioneer Investments, said the outcome will create relative uncertainty. However, he said Marasciulo believes there is a focus on pricing in political risks at present.

'We thought that the market was overshooting ahead of the referendum. A "no" victory was partially discounted in Italian assets, and we believe there is value in Italian government bonds,' he said.

'We expect volatility in the short term and the ECB to be ready to frontload purchases of BTPs. What is not priced in is prolonged political instability: the inability to form a caretaker government, an early election with the current electoral law, the risk of 5 Star winning it and then pushing for a referendum to leave the euro.

'But we consider this scenario unlikely - even in the case of an early election, 5 Star should not win the majority in both houses as they will likely win only a third of the seats in the Senate (which is still elected under a standard proportional system).'

Banks matter not PM

Speaking to *Citywire Selector's* sister site *Citywire Italy*, [Francesco Castelli](#), who runs an absolute return bond fund at Banor Capital, said the resignation of Renzi is not the main focus. The main concern will be on the banking sector reaction.

'The real political fact to be observed on the market today is not really the resignation of Renzi, as the outcome of the Monte Pasche di Siena capital increase. If this goes through, there will be positive developments for UniCredit and also for other Italian banks that may need to seek money in the near future.

'The opening of the Italian BTP was more composed than expected, probably due to the fact that we know that the ECB will intervene. The political fact of Renzi's defeat is tough, but not so disruptive. We expect a technical government, preferably in a short time. In any case expect some market pressure.'

His comments on the ECB were echoed by [David Simner](#), CitywireA-rated fixed income manager at Fidelity, who said the next meeting of the central bank will have a greater bearing on the country's economic future. 'We expect an extension of the QE programme by at least another six months after March 2017.

'The ongoing ECB support to European government bonds makes any meaningful widening in BTP spreads unlikely in our view, and a higher market uncertainty will support a dovish

stance by the Governing Council. We would therefore see any selloff in peripheral government bonds as a buying opportunity.

‘Blessing in disguise’

The rejection of reforms needs to be viewed against the wider market picture, Columbia Threadneedle’s [Philip Dicken](#) has said. Dicken, who is head of European equity at the group, said it could prove a positive in the long-term.

‘The Italian vote is part of a much bigger jigsaw. The proposed constitutional changes were part of a complicated question which sought to put more power in the hands of the government by reducing the power of the Senate. Renzi made a mistake in threatening to resign in the event of a No, making the referendum a vote on him as much as about constitutional change.

‘This could all be a blessing in disguise. Had the vote gone through, there would have been more chance of an all-powerful anti-EU Five Star win at the next election. As it is, the checks and balances remain in Italy and the electoral process (specifically the Italicum law) is likely to be changed to favour a leading coalition, rather than a leading party.’

ECB still buying

Seamus Mac Gorain, who manages the [JPM Global ex-UK Bond](#) fund with Citywire + rated [David Tan](#), said the markets had been calm as the results had been priced in.

‘Firstly, most market participants don’t expect an early snap election and markets would have disliked the uncertainty caused by an early election. Secondly, investors are mindful that the market reaction after a number of political surprises this year, notably the Brexit vote and the US election, has been short-lived.’

‘Finally and perhaps most importantly, investors are mindful that the ECB remains in the market purchasing Italian government bonds. Investor attention will now shift to the ECB decision on Thursday.’

‘Italian assets had underperformed year-to-date, particularly Italian bonds, but that underperformance has reversed to some extent in recent weeks. In terms of positioning, we think in the environment of a new government formation into late 2017, Italian bond

spreads have room to narrow further.'