Schroders
QuickView

# Monti's resignation brings uncertainty back to Italy

## A view from Azad Zangana, European Economist, and Rory Bateman, Head of European Equities

**10 December 2012**

**Azad Zangana**
European Economist

**Rory Bateman**
Head of European Equities

### Azad Zangana:

- **The timing of Monti's resignation is earlier than expected**
- **The 2013 budget is expected to be voted into law by the end of the year, but the key question will be whether austerity and structural reforms will continue**
- **We expect to see another bout of stress in peripheral markets, however, with Italy close to running a primary budget surplus, and with an austerity-friendly party more likely to win the election, this may represent another buying opportunity of Italian bonds and equities**

### Azad Zangana:

**Politics in Rome has never been easy, but the ancient city is set to see another battle unfold over the coming months. Mario Monti, Italy's technocrat prime minister, has announced that he intends to resign once parliament passes the 2013 budget. His year-long tenure will come to an end after passing widely unpopular austerity measures and structural reforms designed to boost long-term growth.**

Monti was always expected to make way for democratic elections in 2013, but the timing of his announcement is about two months earlier than expected. Investors had hoped that Monti would return to office after the election, due to the ongoing need for the implementation of tough, unpopular reforms, however, it seems that political divisions have sharply reduced the likelihood of a Monti encore.

Monti's declaration of his intention to resign follows a difficult week in parliament. Silvio Berlusconi's centre-right People of Liberty party all but announced an expression of no confidence for Monti after they abstained from voting on two bills.

The 2013 budget is expected to be voted into law by the end of the year, making an election in February likely. The key question for investors will be whether austerity and structural reforms will continue once Monti has left. The centre-left Democratic party, led by Pier Luigi Bersani, is expected to continue along the road-map Monti had laid out. This should become easier to sell as most of the hard work has been done by Monti, and as we highlighted in the October edition of the Economic and Strategy Viewpoint, the 2013 budget envisages next year to be the final year of austerity. However, Berlusconi's party appears to be prepared to campaign on an anti-austerity ticket, raising fears in markets. At the time of writing, the FTSE MIB equity index is down 3.4%, while the yield on 2-year Italian government bonds is up 47 basis points to 2.40%.

In our view, this is a disappointing development which clearly raises the risk of an anti-austerity result from the election derailing the positive momentum peripheral markets have recently enjoyed. With about a 20 point lead in recent polls, Bersani should defeat Berlusconi in February. Berlusconi's popularity has taken a hit with recent criminal convictions, while some members of his own party had been against him leading the party into the next election.

We expect to see another bout of stress in peripheral markets over the start of 2013 while uncertainty over the election continues. However, with Italy close to running a primary budget surplus, and with an austerity-friendly party more likely to win the election than not, this may represent another buying opportunity of Italian bonds and equities.

**Rory Bateman**
Head of European Equities

## Rory Bateman:

- **The most likely scenario now is that the Democratic Party will win, but it's still unclear who is going to be its main ally**
- **The timing of his resignation has simply brought forward the Spring election with Bersani as the likely victor**
- **The uncertainty will, for a while, impact markets**
- **We continue to believe that the 'Draghi put' is very much in place and the political will for euro-crisis resolution remains**

## Rory Bateman:

**The most likely scenario now is that the Democratic Party (Partito Democratico – PD) will win, but it's still unclear who is going to be its main ally. Probably, the PD will run with the SEL movement, a leftist-ecologist movement headed by the current governor of Puglia, Mr Vendola. In November, the PD held its primaries elections to choose its prime minister candidate; over 3 million people went to the polls to choose the current party leader, Mr Bersani (please note that voting was not for free; people had to pay EUR 2). As a result, the PD will not support Monti as a prime minister candidate.**

Mr Monti hasn't categorically excluded that he's not going to run, but for the time being it's unclear who will support his candidacy, apart possibly from the Union of Christian and Centre Democrats (UDC) party. But it seems that Mr Monti's role in the political arena isn't finished yet. He might come back as finance minister or even president (the presidential mandate is up for renewal too).

An unwanted outcome is that the vote is fragmented and that the anti-politics Five Star Movement led by comedian Beppe Grillo gathers enough support to prevent the creation of a working majority (especially in the senate). The Five Star Movement always said it doesn't want to make any alliance with the existing political parties; it is against Europe and austerity.

A comeback from Berlusconi seems unlikely at this stage. His withdrawal of support for Monti clearly relates to his personal situation and it's difficult to envisage his desperate populist campaign (probably anti-austerity, anti-German) gaining much traction. The approximate 20 point gap in the polls is a huge mountain to climb especially given our sense that Italians generally feel this could be a once in a generation opportunity for structural change.

In an ideal world we would have liked to have seen Monti continue his reform programme with an extended period as technocrat government. In reality this was unlikely and Monti's resignation after the passing of the 2013 budget has simply brought forward the Spring election with Bersani as the likely victor.

The uncertainty will, for a while, impact markets particularly given the period of stability we have seen since the summer. Profit taking in both fixed income and equity markets is inevitable given the rally over recent months, but we continue to believe that the 'Draghi put' is very much in place, the political will for euro-crisis resolution remains and, perhaps most importantly in Italy, the people want structural reform.