

European economy

Italy: Renzi concedes defeat and plans to resign

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- Exit polls suggest that Italy has voted "No" to constitutional reform. Prime Minister Matteo Renzi has conceded defeat and plans to resign on Monday afternoon. A snap general election is unlikely, in our view.
- Electoral reform will be a key focus for whatever administration takes power in the months ahead. We do not expect elections to be held until such reforms are completed, which is unlikely before 3Q17.
- Although markets seemed to be positioning themselves for this result, we could see volatility increase, with risk premiums remaining elevated for a while.



Source: iStock

"No"

The referendum exit polls suggest that the Italian public has voted to reject the government's proposals for constitutional reform. The margin of defeat for the government looks to be larger than expected, somewhere in the region of 59% for "No" and 41% for "Yes" (source: LA7), according to the exit polls and votes already counted, at the time of writing. The participation rate was much higher than expected and could give the result greater political significance.

Prime Minister Matteo Renzi made a speech soon after the polling stations closed, conceding defeat, indicating that his time in government is at an end. He will convene a cabinet meeting and hand in his resignation to President Sergio Mattarella on Monday afternoon. There is a small chance that he will remain in office as the president could ask him to lead the next government. If he rejects, which we think is likely, Mattarella will look to find a new technocratic leader for the country. Current candidates being mentioned include Pier Carlo Padoan (finance minister, and seen as the market's favored option), and Graziano Delrio (favored by the Democratic Party) who could be considered as a more political appointment. Our assumption is that whoever is asked to form the next government would win the confidence of parliament, reducing the chances of a snap election soon.

Electoral reform is high on the agenda

The key focus of the government in the months ahead will be on reform of the current electoral law (the so called the Italicum law), in our view. To be sure, a fair amount of time will also be dedicated to the restructuring currently taking place in the banking sector, but the established parties will be keen to see changes to the Italicum law before fresh elections are held. We expect that this process will not be complete until 3Q17, meaning that 4Q2017 may be the earliest date that we envisage an election.

Related research

- Italy: Referendum primer, 1 December
- France: Fillon to run for President, 28 November
- The Trump win and European markets, 9 November

Long-term outlook

- The future of Europe, 13 January 2016

Source: UBS

Market reaction

Although most markets seemed to have positioned for a "No" vote in the days leading up to the referendum, we expect to see further volatility while the markets initially digest yet another political shock. The euro is around 1% weaker in initial trading, equity futures point to a modest decline when markets open. Risk premiums could remain elevated until greater clarity emerges about the likelihood of a near-term election. Another immediate concern could be the banking sector recapitalizations in Italy, which may become tricky if a period of political instability ensues.

That said, even if Renzi does leave office, focus on reform of the electoral law makes a near-term election unlikely, in our view, and we think it possible that the ECB could slightly tweak its quantitative easing (QE) program to temporarily support Italian government bonds. We also still expect the Governing Council to extend QE by another six months (from March 2017) at its meeting on Thursday to the tune of EUR 80bn a month. This should help maintain the very supportive monetary conditions until more clarity emerges on the Italian, French, and US political fronts. Moreover, this should also see Eurozone inflation move measurably above 1%, most likely in the first half of next year.

Overall, we remain neutral on Eurozone equities in our global tactical asset allocation and believe investors should keep a long-term focus through the political noise.

Appendix

Terms and Abbreviations			
Term / Abbreviation	Description / Definition	Term / Abbreviation	Description / Definition
1Q, 2Q, etc. or 1Q11, 2Q11, etc.	First quarter, second quarter, etc. or first quarter 2011, second quarter 2011, etc.	A	actual i.e. 2010A
COM	Common shares	Shares o/s	Shares outstanding
UP	Underperform: The stock is expected to underperform the sector benchmark	CIO	UBS WM Chief Investment Office

Appendix

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