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THE OPERATORS: “THERE’S A FEAR THAT THE REFORMS WILL BE DISMANTLED, STARTING WITH THE ‘FORNERO LAW’”

The markets fear a populist executive.

“The worst political scenario is in Italy”

Milan’s stock exchange closes with a fall, while spreads are increasing even with Spain

The case

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The stock market

0.96%

is the fall recorded on the FTSE MIB at yesterday’s closing bell

The spread

+25%

is the increase in the spread with Spanish securities from Friday till yesterday

Fourteen points. That’s how much the spread between Italian 10-year Treasury bonds (BTPs) and Spanish bonds (Bonos) of the same duration has risen since Friday [4 May]. It will be important to keep a close eye on that particular spread over the coming days and weeks, even more than on the German bund. Both Italy and Spain are peripheral euro zone countries, both have problematic economies and both have a complex political situation. They’re often lumped together in the markets’ perception. That sharp 14-point increase, from 50 at the close last Friday to 64 yesterday, which as one asset manager explains translates into +25%, is the price of the political risk linked to the new government. The fact is that in recent days, after the Eurostat data on the performance of the region, selling has affected all the peripheral countries. And the widening of the differential with Spain has no other explanation than the uncertainty linked to what the new government could do.

“For the time being people are watchful rather than worried. They’re watching in an attempt to understand what direction the new government will take on a number of issues: from pensions to the relationship with Europe to strict control of the public coffers”.

In the last few days, from Friday to yesterday [10 May], the return on 10-year BTPs rose by 18 points, from 1.75% to 1.93%. The spread with the German Bund closed yesterday at 139 points, up from 123 last Friday. “The European Central Bank has slowed its purchase programme, and the spread is reacting more normally again. If the possible new government promises fiscal expansion rather than rigour, it's obvious we'll see an increase in the cost of debt", says Banor's Francesco Castelli.

Milan stock exchange (ANSA archive photo)

"The movements we've seen in the last few days are even more significant, if you consider that the ECB's purchases tend to flatten yields", explains a manager specialising in government paper.

The political uncertainty is also making itself felt in Milan's Piazza Affari, which yesterday was the worst performing stock market in continental Europe. There's no need for a red alert yet: the FTSE MIB closed down 0.96%, just above the psychological threshold of 24,000 points. But in Piazza Affari there's another factor to take into account. Last Monday [7 May] stocks reached their highest levels of the last nine and a half years. Investors took advantage of the climate of uncertainty to sell and pocket their gains

"In the period just after the election a Five Star plus Northern League government was viewed as the worst-case scenario", says an operator citing a note issued by the DBRS ratings agency on 7 March. The main concern is that they could dismantle the reforms of the last few years – starting with the "Fornero Law" – and take a more hardline approach on Italy's European obligations.