

European crisis and Italian sovereign risk

Since the very idea of nation came to the fore, political and cultural specialisms took the form of superiority over the others. Thus, for example, my people, my language, my traditions are better than yours. Various nationalism bursts have happened since the late 1800s with exploitations and wars usually their end result. We are now in the middle of a new nationalism revival. This new wave has become global very quickly, with a weird synchronization that connects the most disparate countries on several common issues.

Is Europe in Crisis?

Yes it is. Can it still be saved from itself? Yes probably, but failure cannot be ruled out either. If Merkel can say “Europe faces many challenges, but that of migration could become the make-or-break one for the EU,” before the start of the June European Council meeting, evidently the moment is extremely delicate for the European project. Merkel was facing pressure internally from the CSU party to tighten regulations on refugees.

Europe is plagued by many political tensions - for example Brexit, the Polish decision to curtail the independence of the judiciary, the power grabbing in Orban’s Hungary, the dispute over the use of the name Macedonia - and of course the fight over the migration policy. Like Merkel pointed out in her speech, the latter seems to be the common ground over which the emerging nationalist parties have based their success.

It is not entirely surprising to see a flaring of nationalistic and protectionist sentiments in the Old Continent especially considering the long period of low - if not negative - economic growth and the lacklustre increase in salaries and wealth for the medium classes and hence for the majority of people. What is probably more surprising is the unison international synchronization of these new waves, which all seem to connect on a platform of immigration rejection, rise of protectionism, contempt of the “global elite” and hostility to international institutions and treaties.

In Europe we have several prominent examples of countries which are governed by, or have coalitions with, right-wing parties: Hungary, Poland, Austria and Italy for example. Even in countries in which right-wing parties have been defeated or are in the opposition, like France, Germany or the Netherlands, they have been able to shape the debate and stir the attention of the public opinion towards their agenda.

Germany

The European Union project was born as a tool for bringing together the countries after the wounds of the world wars and try healing them by connecting people and cultures to avoid new conflicts. **Notwithstanding the criticisms that can be directed to the institutions of the Union, by and large the project has been successful** in achieving this goal. Germany has been instrumental in setting the policies and pushing them through. Hence, if Merkel, who strongly believes in them, falls, then it would be easy to see how the present rise of nationalism and protectionism would derail the overarching goal of deeper integration and reforms.

Are we heading for a post-Merkel era in Europe? According to a school of thought, which incidentally I share, this is one of the biggest risk the European project is facing. The stability of the Union and the continuation of the integration could stumble and even stop if Germany, the biggest country in Europe under several aspects, decides to take the backseat or even

	Refugees	Tot Population	%
Total at year end 2017			
Germany	1,413,127	82,800,000	1.71%
France	401,729	67,186,638	0.60%
Italy	354,698	60,483,973	0.59%
Sweden	327,709	10,151,588	3.23%
Austria	172,570	8,823,054	1.96%
UK	162,229	65,648,100	0.25%
Netherlands	111,629	17,200,671	0.65%
Greece	83,418	10,768,477	0.77%
Bulgaria	68,623	7,101,859	0.97%
Spain	54,026	46,698,151	0.12%
Denmark	47,927	5,785,864	0.83%
Finland	26,704	5,509,717	0.48%
Poland	25,965	38,433,600	0.07%
Belgium	21,956	11,358,357	0.19%
Cyprus	21,063	1,170,125	1.80%
Ireland	12,539	6,572,728	0.19%
Malta	9,389	460,297	2.04%
Hungary	6,508	9,797,561	0.07%

Source: UNHCR, Wikipedia

opposing new reforms. **Should this happen we can easily forecast EUR weakness vis a vis the rest of the world.**

It is interesting to note that by pursuing their own similar nationalistic policies, for example on immigration, the single countries are heading towards almost inevitable conflict. Central and Eastern European countries sternly oppose quotas and want to be able to deport immigrants back to the countries of first landing, while those countries, i.e. Italy, Greece and Spain, want to share the burden of all the refugees who land on their coasts from the Mediterranean sea. Those are opposing goals, and although it is not impossible to reconcile them, it is very difficult to reach a compromise. Finally, as can be seen in the Table, the level of governments' complaints against immigration does not necessarily reflect the reality of the numbers involved.

Italy

Italy is another prominent risk, not only for financial markets, but also in the bigger picture of the stability of the European Union, given that it is the Union's third largest economy.

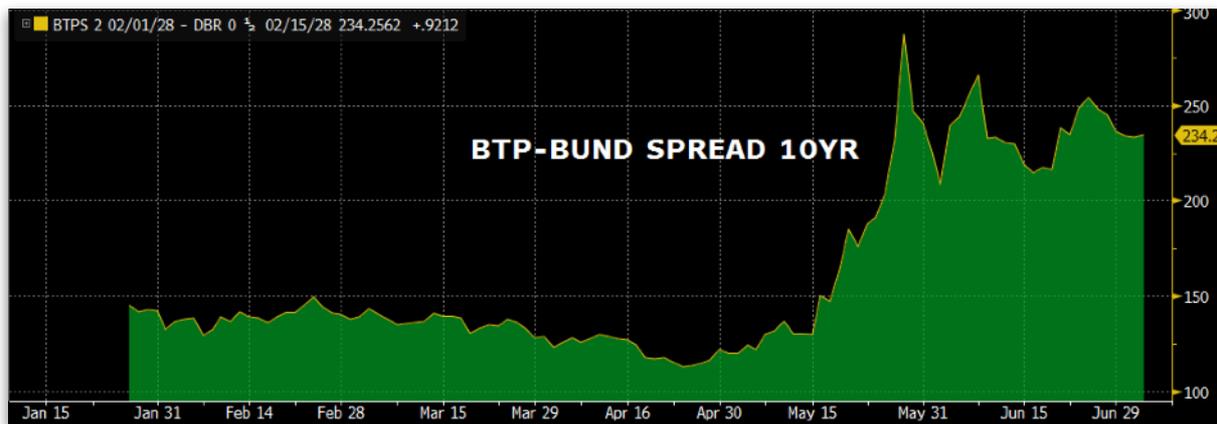
The latest round of elections has produced an unlikely coalition, between the 5Star Movement and the Lega. The two parties ruled out cooperating during the campaign, but eventually managed to strike a deal on the main policies to implement.

The recent nervousness of the financial markets stems not from the formation of an unlikely coalition, its political colors or its anti-establishment stance: all of those factors were also present in other foreign governments without generating any risk aversion from investors. What has spooked investors in the BTP (the Italian government bond) market is the fact that the two parties have strong anti-euro stances: it is not a secret that some exponents favour an exit of Italy from the common currency. The fact that a hidden agenda might be creeping in through the corridors of the government - notwithstanding the reassurances of the Finance minister, Mr Tria - has contributed to the increase in the BTP-Bund spread. This spread is the real thermometer of potential future global financial problems. Another reason for the widening of the spread, is that on paper the two parties have plans to significantly increase the fiscal spending and the budget deficit to levels that could derail not only the adherence to EU rules, but also the management of the public debt, which currently stands at around 130% of GDP.

The government has yet to pass important fiscal laws and the jury is still out on whether it will be reasonable or reckless.

Conclusions

The June EU Council Meeting has for now managed to achieve a win-win solution, vaguely enough to allow all the countries to declare victory. Nonetheless, the pressure on Merkel from the Bavaria-based CSU party will not magically disappear and more aggressive demands might show up at a later stage. At the same time, the Italian government has focused mostly on the low-hanging fruit of the refugee problem, which admittedly has boosted its approval, but soon it will need to deal with the more difficult and technical fiscal issues, which are also inherently more contentious.



Source Bloomberg. BTP-Bund spread in 2018.

