

## CIO Flash Bulletin

## Italian politics again test eurozone rules

### Investment Solutions

4 June 2019

**The outlook for the Italian economy, the eurozone's third largest, is sluggish with the lowest growth in the currency region. As it exits its third technical recession in a decade, Italy is now setting up a re-fight with the European Commission over how to accelerate its stalled economy.**

After one year of coalition, the Italian government's cohesion is being tested by the vastly differing European Parliament election results of the far-right Lega party and the anti-establishment Movimento 5 Stelle (Five Star Movement or M5S). While la Lega won 34.3% of the vote in last month's European elections, making it the country's largest party in Italy, in contrast its coalition partner saw its share shrink from 32% in 2018's national elections (making it the biggest single party) to 17.7% in the recent vote May. That dropped M5S to third place.

The coalition built a joint platform last year pledging a universal minimum wage, corporate and personal tax changes and undoing 2011's raised retirement age. Those ambitions set the new government on a collision path with the European Commission.

The European election results strengthen the position of Matteo Salvini, Lega party leader and deputy prime minister, who has called for a 30 billion euro "fiscal shock" to help the Italian economy expand. Under the plan, the government would cut income tax through a "flat tax" funded through a higher deficit. At the time of writing, Bloomberg reported that the two parties were looking for an agreement with the possibility that M5S would back the plan. Unless M5S, led by the government's other deputy prime minister Luigi Di Maio, agrees to the plan, Salvini has threatened to dissolve the coalition.

The average lifespan of Italian governments in the post-war period is 14 months. It remains to be seen whether the current coalition can survive longer than most. It will be tested as it becomes clear to all parties just how difficult it will be to fund the 2020 budget without alienating their voters. In the short term, investors appear to show little faith in the current coalition (the spread to Greek sovereign debt is around 15bps), although in the long run, the Italian economy has proven resilient.

### A stagnant economy

Italy is nevertheless the weakest economy in the eurozone in terms of growth. First quarter Gross Domestic Product was revised down to 0.1% last week, according to the country's statistics agency [Istat](#), after Italy was technically in recession in the second half of last year. In comparison, the eurozone recorded growth of 0.3% over the three-month period.



Stéphane Monier  
Chief Investment Officer, Lombard Odier Private Bank

### Key takeaways

- Italy's economy is sluggish with the lowest growth in the eurozone and is now in a dispute with the European Commission
- The eurozone's governments are committed to a 60% ceiling on debt to GDP ratio, while Italy's ratio is expected to rise to 135% this year
- Italy faces the prospect of a 3.5 billion euro fine
- The European Parliament election results have increased tensions between the Italian government coalition's parties as they look to fund a 2020 budget without alienating their supporters
- While the European Commission/Italian government frictions are likely to impact the euro, the Italian economy remains fundamentally sustainable
- We are watching developments as the European Commission prepares to review the Italian budget on 5 June.

**Important information:** Please read the important information at the end of the document.

Weekly publication of Lombard Odier - Contacts: Investment Solutions, [investment-solutions@lombardodier.com](mailto:investment-solutions@lombardodier.com)

Data as of 4 June 2019 unless otherwise stated.

Lombard Odier · CIO Flash Bulletin · 4 June 2019

The country's debt to GDP is expected to rise to 135% this year, from 132% in 2018. Italy's debt to GDP ratio has fallen below 100% only once in the last two decades (in 2007 when it was 99.79%, according to FactSet data). Today's Italian debt is the second highest ratio in the eurozone after Greece at 182%. Cyprus and Belgium have also already received European Commission warnings while Spain and France are also forecast to continue exceeding the deficit ratio.

However, political tensions do not mean that Italy's economic fundamentals are threatened. Italy's debt profile remains sustainable with reasonably long maturities. Unemployment is at a seven-month low and remains one of the lowest in the eurozone. In addition to running a primary surplus (tax income is higher than spending excluding interest on debt), the country also has a current account surplus (see chart) while interest rates remain low and the worst of the Italian banks have been cleaned up.

The spread between the Italian benchmark government 10-year notes and German sovereign debt was 287 bps on 31 May, the widest since February 2019. Five-year credit default swaps, which indicate the cost of insuring Italian debt, rose as high as 22.81 last week, the highest in almost four months. The yield on Italian 10-year government paper rose to 2.589%<sup>1</sup>. Rating agencies Moody's has Italian government debt on a "negative" outlook, while S&P's agency rates it "stable." But should spreads widen above 300 bps, concerns about Italy's debt sustainability will likely start growing.

A re-escalation of frictions between Italy and the European Commission should also have some negative impact on the euro. This is likely to be mostly visible in downside pressures on EURCHF, given the franc's sensitivity to European risk premia (CHF has been positively correlated with the BTP-Bund yield spread in periods of Italian-related stresses). However, to the extent that these disputes are largely seen as idiosyncratic, our central scenario, rather than pose systemic risks to the euro area, the impact should be limited in both size and duration.

### 3.5 billion euro fine

And now, once again, Italy's debt trajectory is escalating tensions between Italian government and the European Commission and raising the prospect of sanctions. Under the eurozone's Stability and Growth Pact, the European Commission has to warn governments in the eurozone about breaching a 60% debt to GDP ceiling as part of "excessive deficit procedure."

In December, the Italian government reached an agreement with the European Commission to side-step any sanctions by agreeing to postpone public spending. That commitment has since been ignored, according to the European Commission.

"Based on notified data for 2018, Italy is confirmed not to have made sufficient progress towards compliance with debt criterion in 2018," a letter from the European Commission to the Italian government read last week.

The common currency's treaty allows for a fine of as much as 3.5 billion euros, equivalent of 0.2% of Italy's GDP. However, any fine would need the approval of the EU's finance ministers and the Commission has never fined a eurozone economy over budget rules.

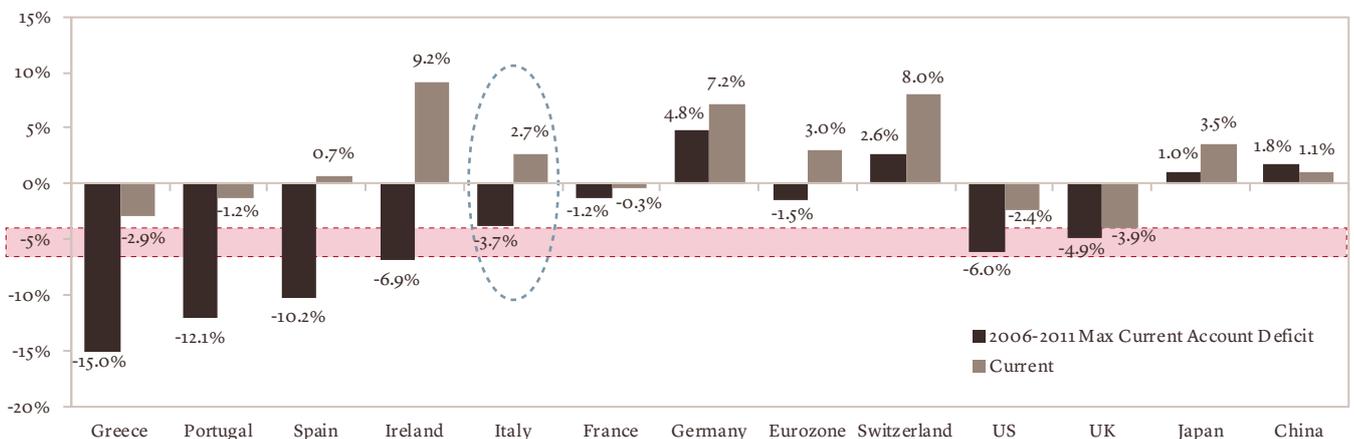
"I think Italians gave me and the government a mandate to completely, calmly and constructively re-discuss the parameters that led to unprecedented job instability, unemployment and anxiety," Bloomberg reported Salvini saying last week.

Faced with a choice between further destabilising Italy's coalition and disappointing supporters by reneging on their own election pledges, or a fight with the European Commission, the Italian government looks set to choose the less domestically damaging confrontation with the eurozone's guardians.

In the immediate future, we are watching for signs at a European Commission review of the Italian budget on 5 June whether both sides are looking to calm the dispute, or are for now prepared to see it escalate further.

<sup>1</sup> Data as at 3 June 2019

Chart 1 - Current account in % GDP



Sources: Bloomberg, Datastream, Lombard Odier calculations

## Important information

This is a marketing communication issued by Bank Lombard Odier & Co Ltd (hereinafter “Lombard Odier”). It is not intended for distribution, publication, or use in any jurisdiction where such distribution, publication, or use would be unlawful, nor is it aimed at any person or entity to whom it would be unlawful to address such a marketing communication. This marketing communication is provided for information purposes only. It does not constitute an offer or a recommendation to subscribe, purchase, sell or hold any security or financial instrument. It contains the opinions of Lombard Odier, as at the date of issue. These opinions and the information contained herein do not take into account an individual’s specific circumstances, objectives, or needs. No representation is made that any investment or strategy is suitable or appropriate to individual circumstances or that any investment or strategy constitutes personalised investment advice to any investor. Each investor must make his/her own independent decisions regarding any securities or financial instruments mentioned herein. Tax treatment depends on the individual circumstances of each person and may be subject to change in the future. Lombard Odier does not provide tax advice. Therefore, you must verify the above and all other information provided in the marketing communication or otherwise review it with your external tax advisors. Some investment products and services, including custody, may be subject to legal restrictions or may not be available worldwide on an unrestricted basis. The information and analysis contained herein are based on sources considered reliable. Lombard Odier uses its best effort to ensure the timeliness, accuracy, and comprehensiveness of the information contained in this marketing communication. Nevertheless, all information and opinions as well as the prices, market valuations and calculations indicated herein may change without notice. **Investments are subject to a variety of risks.** Before entering into any transaction, an investor should consult his/her investment advisor and, where necessary, obtain independent professional advice in respect of risks, as well as any legal, regulatory, credit, tax, and accounting consequences. The investments mentioned in this marketing communication may carry risks that are difficult to quantify and integrate into an investment assessment. In general, products such as equities, bonds, securities lending, forex, or money market instruments bear risks, which are higher in the case of derivative, structured, and private equity products; these are aimed solely at investors who are able to understand their nature and characteristics and to bear their associated risks. On request, Lombard Odier will be pleased to provide investors with more detailed information concerning risks associated with given instruments. **Past performance is no guarantee of current or future returns, and the investor may receive back less than he/she invested.** The value of any investment in a currency other than the base currency of a portfolio is subject to the foreign exchange rates. Exchange rates may fluctuate and adversely affect the value of the investment when it is realised and converted back into the investor’s base currency. The liquidity of an investment is subject to supply and demand. Some products may not have a well-established secondary market or in extreme market conditions may be difficult to value, resulting in price volatility and making it difficult to obtain a price to dispose of the asset. **This marketing communication is not issued by the organisational unit of the Bank Lombard Odier & Co Ltd responsible for the production of financial research**, as defined under the Swiss Bankers Association Directives on the Independence of Financial Research. Consequently, it is not prepared in accordance with the provisions of the referred Directives or any other legal requirements designed to promote the independence of the production of financial research. Opinions expressed in this marketing communication may differ from the opinions expressed by other divisions of Lombard Odier, including Bank Lombard Odier & Co Ltd’s Research Department. Nevertheless, if opinions from financial analysts belonging to the Research Department are contained herein, such analysts attest that all of the opinions expressed accurately reflect their personal views about any given instruments. In order to ensure their independence, financial analysts are expressly prohibited from owning any securities that belong to the research universe they cover. Lombard Odier may hold positions in securities as referred to in this marketing communication for and on behalf of its clients and/or such securities may be included in the portfolios of investment funds as managed by Lombard Odier or affiliated Group companies. Lombard Odier recognises that conflicts of interest may exist as a consequence of the distribution of financial instruments or products issued and/or managed by entities belonging to the Lombard Odier Group. Lombard Odier has a Conflict of Interests policy to identify and manage such conflicts of interest. **European Union Members:** This marketing communication has been approved for use by Lombard Odier (Europe) S.A. in Luxembourg and by each of its branches operating in the following territories: **Belgium:** Lombard Odier (Europe) S.A. Luxembourg • Belgium branch; **France:** Lombard Odier (Europe) S.A. • Succursale en France; **Italy:** Lombard Odier (Europe) S.A. • Italian Branch; **Spain:** Lombard Odier (Europe) S.A. • Sucursal en España; and **United Kingdom:** Lombard Odier (Europe) S.A. • UK Branch. Lombard Odier (Europe) S.A. is a credit institution authorised and regulated by the Commission de Surveillance du Secteur Financier (CSSF) in Luxembourg. **Notice to investors in the United Kingdom:** Lombard Odier (Europe) S.A. • UK Branch is authorised in the UK by the Prudential Regulation Authority (PRA) and is subject to limited regulation by the Financial Conduct Authority (FCA) and the PRA. **Details of the extent of our authorisation and regulation by the PRA/regulation by the FCA are available from us on request. UK regulation for the protection of retail clients in the UK and the compensation available under the UK Financial Services Compensation Scheme does not apply in respect of any investment or services provided by an overseas person.** In addition, this marketing communication has also been approved for use by the following entity domiciled within the European Union: **Spain:** Lombard Odier Gestión (España) S.G.I.I.C., S.A.U., an investment management company authorised and regulated by the Comisión Nacional del Mercado de Valores (CNMV), Spain. **Panama:** This marketing communication has been approved for use in Panamá by Lombard Odier (Panamá) Inc., an entity authorised and regulated by la Superintendencia del Mercado de Valores de Panamá. Licensed to operate as an Investment Adviser. Res. SMV No.528-2013.

**Israel:** This marketing communication has been approved for use in Israel by the Israel Representative Office of Bank Lombard Odier & Co Ltd, an entity not supervised by the Supervisor of Banks in the Bank of Israel, but by the Swiss Financial Market Supervisory Authority, which supervises the activities of Bank Lombard Odier & Co Ltd.

**South Africa:** This marketing communication has been approved for use in South Africa by the South Africa Representative Office of Bank Lombard Odier & Co Ltd, an authorised financial services provider Registration number 48505.

**Switzerland:** This marketing communication has been approved for use in Switzerland by Bank Lombard Odier & Co Ltd Geneva, a bank and securities dealer authorised and regulated by the Swiss Financial Market Supervisory Authority (FINMA).

**United States:** Neither this document nor any copy thereof may be sent to, taken into, or distributed in the United States of America, any of its territories or possessions or areas subject to its jurisdiction, or to or for the benefit of a United States Person. For this purpose, the term “United States Person” shall mean any citizen, national or resident of the United States of America, partnership organised or existing in any state, territory or possession of the United States of America, a corporation organised under the laws of the United States or of any state, territory or possession thereof, or any estate or trust that is subject to United States Federal income tax regardless of the source of its income. This marketing communication may not be reproduced (in whole or in part), transmitted, modified, or used for any public or commercial purpose without the prior written permission of Lombard Odier.

**Media:** Lombard Odier would like to offer you for your information the enclosed CIO Flash Bulletin. In connection with the use of the enclosed document Lombard Odier kindly draws your attention to certain particular items/conditions. The information sent is for your personal use only. In case of quoting please cite Lombard Odier in no other capacity than as source of information only. For the sake of good order Lombard Odier would like to remind you that responsibility regarding quoted content and compliance with applicable regulations rests with you. The information provided does not constitute the provision of investment advice or an offer of any financial services especially not to the public.

**Data protection:** You may be receiving this communication you have provided us with your contact details. If this is the case, note that we may process your personal data for direct marketing purposes. If you wish to object to this processing, please address your objection to the Group’s Data Protection Officer: Bank Lombard Odier & Co Ltd, Group Data Protection Officer, 11, Rue de la Corraterie, 1204 Geneva, Switzerland. E-Mail: [group-dataprotection@lombardodier.com](mailto:group-dataprotection@lombardodier.com). For more information on Lombard Odier’s data protection policy, please refer to [www.lombardodier.com/privacy-policy](http://www.lombardodier.com/privacy-policy).

© 2019 Bank Lombard Odier & Co Ltd – all rights reserved. Ref. *LOCH/LOESA-MWNPR-en-062019*.

## SWITZERLAND

### GENEVA

#### Bank Lombard Odier & Co Ltd<sup>1</sup>

Rue de la Corraterie 11 · 1204 Genève · Suisse  
geneva@lombardodier.com

#### Lombard Odier Asset Management (Switzerland) SA

Avenue des Morgines 6 · 1213 Petit-Lancy · Suisse  
Support-Client-LOIM@lombardodier.com  
*Management Company regulated by the FINMA.*

### FRIBOURG

#### Banque Lombard Odier & Cie SA · Bureau de Fribourg<sup>1</sup>

Rue de la Banque 3 · 1700 Fribourg · Suisse  
fribourg@lombardodier.com

### LAUSANNE

#### Bank Lombard Odier & Co Ltd<sup>1</sup>

Place St-François 11 · 1003 Lausanne · Suisse  
lausanne@lombardodier.com

### VEVEY

#### Banque Lombard Odier & Cie SA · Agence de Vevey<sup>1</sup>

Rue Jean-Jacques Rousseau 5 · 1800 Vevey · Suisse  
vevey@lombardodier.com

### ZURICH

#### Bank Lombard Odier & Co Ltd<sup>1</sup>

Utoschloss · Utoquai 29-31 · 8008 Zürich · Schweiz  
zurich@lombardodier.com

## EUROPE

### BRUSSELS

#### Lombard Odier (Europe) S.A. Luxembourg · Belgium branch<sup>2</sup>

Avenue Louise 81 · Box 12 · 1050 Brussels · Belgium  
brussels@lombardodier.com

*Credit institution supervised in Belgium by the Banque nationale de Belgique (BNB) and the Financial Services and Markets Authority (FSMA).*

### LONDON

#### Lombard Odier (Europe) S.A. · UK Branch<sup>2</sup>

Queensberry House · 3 Old Burlington Street · London  
W1S 3AB · United Kingdom ·  
london@lombardodier.com

*The Bank is authorised and regulated in the UK by the Prudential Regulation Authority (PRA) and subject to limited regulation by the Financial Conduct Authority (FCA) and the PRA. Details of the extent of our authorisation and regulation by the PRA and regulation by the FCA are available from us on request. Registered in Luxembourg No. B169 907.*

#### Lombard Odier Asset Management (Europe) Limited

Queensberry House · 3 Old Burlington Street · London  
W1S 3AB · United Kingdom ·  
london@lombardodier.com

*Investment firm authorised and regulated by the Financial Conduct Authority (FCA register No.515393).*

### LUXEMBOURG

#### Lombard Odier (Europe) S.A.

291, route d'Arlon · 1150 · Luxembourg · Luxembourg  
luxembourg@lombardodier.com

*Credit institution authorised and regulated by the Commission de Surveillance du Secteur Financier (CSSF) in Luxembourg.*

#### Lombard Odier Funds (Europe) S.A.

291, route d'Arlon · 1150 · Luxembourg · Luxembourg  
luxembourg@lombardodier.com

## MADRID

#### Lombard Odier (Europe) S.A. · Sucursal en España<sup>2</sup>

Paseo de la Castellana 66 · 4<sup>a</sup> Pl. · 28046 Madrid · España · madrid@lombardodier.com

*Credit institution supervised in Spain, by the Banco de España and the Comisión Nacional del Mercado de Valores (CNMV).*

#### Lombard Odier Gestión (España) S.G.I.I.C, S.A.U.

Paseo de la Castellana 66, 4<sup>a</sup> Pl. · 28046 Madrid · España · madrid@lombardodier.com

*Management Company supervised by the Comisión Nacional del Mercado de Valores (CNMV).*

## MILAN

#### Lombard Odier (Europe) S.A. · Succursale in Italia<sup>2</sup>

Via Santa Margherita 6 · 20121 Milano · Italia  
milano-cp@lombardodier.com

*Credit institution supervised in Italy by the Commissione Nazionale per le Società e la Borsa (CONSOB) and la Banca d'Italia.*

## MOSCOW

#### Bank Lombard Odier & Co Ltd · Representative Office Moscow

Letnikovskaya st.2, bld.1 · 115114 Moscow · Russian Federation · moscow@lombardodier.com

*Under the supervisory authority of the Central Bank of the Russian Federation.*

## PARIS

#### Lombard Odier (Europe) S.A. · Succursale en France<sup>2</sup>

8, rue Royale · 75008 Paris · France. RCS PARIS B 803 905 157 · paris@lombardodier.com

*Credit institution supervised in France by the Autorité de contrôle prudentiel et de résolution (ACPR) and by the Autorité des Marchés Financiers (AMF) in respect of its investment services activities. Business permit No.23/12. Registered in Luxembourg - No.B169 907.*

*Insurance intermediary authorised by the Commissariat aux Assurances (CAA) No.2014 CM002. The registration with the CAA can be verified at www.orias.fr.*

## AFRICA | AMERICAS | MIDDLE EAST

### ABU-DHABI

#### Bank Lombard Odier & Co Ltd · Abu Dhabi Global Market Branch

Al Maryah Island · Abu Dhabi Global Market Square · Al Sila Tower · Abu Dhabi · abudhabi@lombardodier.com

*Arranging Deals in Investments · Advising on Investment or Credit · Arranging Credit. Regulated by the ADGM Financial Services Regulatory Authority.*

### BERMUDA

#### Lombard Odier Trust (Bermuda) Limited

3<sup>rd</sup> Floor, Victoria Place · 31 Victoria Street · Hamilton  
HM 10 · Bermuda · bermuda@lombardodier.com

*Licensed to conduct Trust, Investment and Corporate Service Provider Business by the Bermuda Monetary Authority.*

### DUBAI

#### Bank Lombard Odier & Co Ltd · Representative Office Dubai

Conrad Business Tower · 12th Floor · Sheikh Zayed Road · P.O. Box 212240 · Dubai · UAE · dubai@lombardodier.com

*Under the supervisory authority of the Central Bank of the UAE.*

### ISRAEL

#### Israel Representative Office ·

#### Bank Lombard Odier & Co Ltd

Alrov Tower 11th floor · 46 Rothschild Blvd. · Tel Aviv  
6688312 · Israel · telaviv@lombardodier.com

*Not supervised by the Supervisor of Banks in the Bank of Israel, but by Swiss Financial Market Supervisory Authority which supervises the activities of Bank Lombard Odier & Co Ltd.*

## JOHANNESBURG

#### South Africa Representative Office ·

#### Bank Lombard Odier & Co Ltd

140 West Street · Sandton · Johannesburg 2196 · South Africa

johannesburg@lombardodier.com

*Authorised financial services provider Registration number 48505.*

## MONTEVIDEO

#### Lombard Odier (Uruguay) SA

Luis Alberto de Herrera · Torre 2 · Oficina 2305  
11300 Montevideo · Uruguay

montevideo@lombardodier.com

*Supervised by Banco Central del Uruguay.*

## NASSAU

#### Lombard Odier & Cie (Bahamas) Limited

Goodman's Bay Corporate Centre · West Bay Street · P.O. Box N-4938 · Nassau · Bahamas · nassau@lombardodier.com

*Supervised by the Central Bank of the Bahamas and the Securities Commission of the Bahamas.*

## PANAMA

#### Lombard Odier & Cie (Bahamas) Limited · Representative Office in Panama

Oceania Business Plaza Torre 2000 · Oficina 38-D · Blvd. Pacifica · Urb. Punta Pacifica · Corregimiento de San Francisco · Panamá · panama@lombardodier.com

*Supervised by the Central Bank of the Bahamas and the Superintendencia de Bancos de Panamá.*

#### Lombard Odier (Panama) Inc.

Oceania Business Plaza Torre 2000 · Oficina 38-D · Blvd. Pacifica · Urb. Punta Pacifica · Corregimiento de San Francisco · Panamá · panama@lombardodier.com

*Supervised by the Superintendencia del Mercado de valores de Panamá. Licensed to operate as an Investment Adviser.*

*Res. SMV No.528-2013.*

## ASIA - PACIFIC

### HONG KONG

#### Lombard Odier (Hong Kong) Limited

3901, Two Exchange Square · 8 Connaught Place · Central · Hong Kong · hongkong@lombardodier.com

*A licensed entity regulated and supervised by the Securities and Futures Commission in Hong Kong.*

### SINGAPORE

#### Lombard Odier (Singapore) Ltd.

9 Raffles Place · Republic Plaza #46-02 · Singapore  
048619 · singapore@lombardodier.com

*A merchant bank regulated and supervised by the Monetary Authority of Singapore.*

### TOKYO

#### Lombard Odier Trust (Japan) Limited

Izumi Garden Tower 41F · 1-6-1 Roppongi, Minato-ku · Tokyo 106-6041 · Japan · tokyo@lombardodier.com

*Regulated and supervised by the Financial Services Agency (FSA) in Japan. It holds a trust business license (FSA No.208) and is registered with Kanto Local Finance Bureau for Financial Instruments Business Operator (No.470).*

<sup>1</sup> Private bank and securities dealer authorised and regulated by the Swiss Financial Market Supervisory Authority (FINMA).

<sup>2</sup> Branch of Lombard Odier (Europe) S.A., a credit institution based in Luxembourg, authorised and regulated by the Commission de Surveillance du Secteur Financier (CSSF) in Luxembourg.