



R&R Weekly Column
By Brunello Rosa



A Government Crisis In Italy Erupts Just Days Before The ECB Unveils Its Anti-Spread Facility

A government crisis occurred in Italy last week. The Five Star Movement (M5S), a major component of the national unity parliamentary majority, did not participate in the confidence vote over the Draghi government's large package of fiscal aid for households and businesses hit by the cost-of-living crisis. The M5S's parliamentary group had recently splintered as the faction loyal to foreign minister [Luigi Di Maio formed a new group](#) (*Insieme per il Futuro, IPF*) to support Draghi in his anti-Russian and pro-American stance.

Theoretically speaking, Draghi, having received the confidence vote both from the Chamber and the Senate (in this latter case, with an absolute majority), could have continued to govern and disregard this rebellion. But Draghi wanted to highlight the political relevance of the event. [He went to Italy's President Sergio Mattarella to resign](#), but Mattarella rejected the resignations and invited Draghi to [go back to parliament this Wednesday, to "verify"](#) the existence of its parliamentary and political majority. What will happen next?

Draghi is reportedly tempted to give up. Apparently he is tired of the cross-vetoes on all major pieces of legislation from the parties supporting his government. We anticipated that the various components of his composite majority could start dis-engaging with one another by autumn or winter, as the 2023 elections approached. But clearly the M5S wanted to exploit the first-mover advantage and leave the majority before anyone else, to spend a few months in opposition and regain the sort of anti-system credentials it has often had before the general election.

The problem is that, once a component element of Draghi's parliamentary majority leaves, there is a strong incentive for all other components to do the same, instead of being held responsible for continuing to support a semi-technocratic government, even if for the greater good of the country. Thus Draghi will either manage to obtain a strong commitment from all remaining parties (and the component of the M5S that is still loyal to him), that they will support his government until the end of this parliament, without undermining his action with continued cross-vetoes – in which case the government will carry on – or else Draghi will clarify in parliament that the conditions to continue his tenure do not exist anymore, and he will resign.

Whatever happens, something is clear: political risk is on the rise in Italy. And with it, the 10y BTP-Bund spread, which has reached 220bps recently. And all this is happening [during the week in which the ECB is expected to unveil its new anti-fragmentation facility](#), which is aimed exactly of containing the widening of spreads, when *unwarranted* by fundamentals. Italy is expected to be the largest and most relevant beneficiary of this facility. And just at the time when the technocrats in Frankfurt need to decide the crucial details of this facility, Italy is providing a clear example of a *warranted* increase in its sovereign yields and widening of the spreads, justified indeed by the rise of domestic political risks.

Italy is also supposed to be the largest recipient of the recovery funds from the EU, agreed upon during the pandemic. These funds can only be unlocked if Italy approves the necessary reforms, with the last batch expected to be finalised at the end of the year.

So, in theory money could be ready to help Italy recover from its traditional economic underperformance and defend its sovereign bonds from speculative attacks. But the recent political turmoil risks jeopardising this favourable course of action. Clearly, the events of these days are not bringing any favour to the country's cause.

Our Recent Publications

📄 [Flash Preview: ECB To Start Its Policy Rate Normalisation and Launch Its Anti-Fragmentation Facility in July](#), by Brunello Rosa, Nouriel Roubini and Nato Balavazde, 15 July 2022

📄 [Bold and Intriguing Reforms in Post-Qaboos Oman](#), by Gulf State Analytics, 7 July 2022



Looking Ahead

The Week Ahead: Headline Inflation To Accelerate, While Core Inflation To Fall in EZ And UK; PMIs To Fall In DMs

In the US, in June, flash estimates are likely to show: *i*) manufacturing PMI decreasing to 52 (*p*: 52.7); and *ii*) services PMI declining to 52.6 (*p*: 52.7).

In the Eurozone, the ECB is likely to increase its key interest rates by 25 basis points and to launch its anti-fragmentation facility.

In the EZ, in June, headline inflation is likely to surge to 8.6% y-o-y (*p*: 8.1%), whereas core inflation is expected to ease off slightly to 3.7% y-o-y (*p*: 3.8%). Monthly inflation is seen remaining unchanged at 0.8%. In June, flash estimates are likely to show: *i*) manufacturing and services PMI decreasing to 51 (*p*: 52.1) and 52 (*p*: 53) respectively; and *ii*) composite PMI declining to 51 (*p*: 52).

In the UK, June's unemployment rate is expected to stay unchanged at 3.8%. In June, headline inflation is likely to increase to 9.2% y-o-y (*p*: 9.1%), whereas core inflation is seen cooling down to 5.8% y-o-y (*p*: 5.9%). Monthly inflation is expected to stay unchanged at 0.7%. Retail sales are likely to shrink further to -5.3% y-o-y (*p*: -4.7%). In June, flash estimates are likely to show: *i*) manufacturing and services PMI decreasing to 51 (*p*: 52.8) and 53.1 (*p*: 54.3) respectively; and *ii*) composite PMI declining to 52.5 (*p*: 53.7).

The Quarter Ahead: 2022 Italian Government Crisis; Biden's Visit To Saudi Arabia; China's GDP Growth Contracts In Q2

Rome plunges into a political crisis. On July 13, Giuseppe Conte reported that the M5S would abstain during the confidence vote on the government bill worth about EUR 23 bn aimed to help combat surging inflation. Despite having largely won the confidence vote, Mario Draghi said he would quit as Italian leader after a party in his coalition government sat out a confidence vote, a result of the broken 'pact of trust'. However, Draghi's resignation was rejected by President Sergio Mattarella.

Biden meets the Saudi crown prince. Biden once vowed to make Saudi Arabia a global pariah over its human rights records, including the 2018 murder of journalist Jamal Khashoggi. As the president said, they accomplished 'significant business' in normalizing relations. Amid rising gas prices, Biden discussed oil supply during the meeting.

Following the COVID-19 lockdown, China's economy shrinks sharply in Q2, recording the slowest growth since the start of 2020. COVID-19 restrictions weighed on industrial activity.

Last Week's Review

Real Economy: Headline Inflation Rose, While Core Inflation Fell In US; QoQ GDP Shrank In China; Economic Sentiment Fell In EZ

In the US, June's headline inflation increased by 9.1% y-o-y (*c*: 8.8%; *p*: 8.6%), whereas core-inflation decreased to 5.9% y-o-y (*c*: 8.8%; *p*: 8.6%). Monthly inflation stood at 1.3% (*c*: 1.1%; *p*: 1.0%). In June, retail sales rose by 8.4% y-o-y (*p*: 8.2%). Also in June, IP increased by 4.2% (*p*: 4.8%). According to a preliminary estimate, July's Michigan consumer sentiment rose slightly to 51.1 (*c*: 49.9; *p*: 50).

In the EZ, in July, Economic Sentiment index deteriorated further to -53.8 (*p*: -28). May's IP increased by 1.6% y-o-y (*c*: 0.3%; *p*: -2.5%).

In the UK, May's IP increased by 1.4% y-o-y (*c*: -0.3%; *p*: 1.6%).

In China, in Q2 GDP growth decelerated to 0.4% y-o-y (*c*: 1.0%; *p*: 4.8%). The economy shrank by -2.6% q-o-q (*c*: -1.5%; *p*: 1.4%).

Financial Markets: Equities Fell; US Yield Curve Inverts; Dollar Is Up, Whereas Oil And Gold Prices Are Down

Market Drivers: Investors paid a close attention to the week's important inflation data. As readings came hotter-than-expected, markets went sharply lower. Investors remained pessimistic, as the key yield curve inversion deepens, especially in the US. In the US, shares slip as the ECB is likely to tighten monetary policy to tame rampant inflation. Europe energy crisis further weigh on recession fears, sending euro below parity with the U.S. dollar.

Global Equities: Decreased w-o-w (MSCI ACWI, -1.6%, to 598.71). The US S&P 500 index fell (-0.9% w-o-w, to 3,863.16). In the EZ, shares were down (Eurostoxx 50, -0.8% w-o-w, to 3,477.2). In EMs, equities decreased (MSCI EMs, -3.8%, to 961.85) following China's dampening economic growth. Volatility rose to 25.4 (VIX S&P 500, 52w avg.: 23.0; 10y avg.: 18.1).

Fixed Income: w-o-w, 10-year US treasury yields fell (-15 bps to 2.93%). The 2-year US Treasury yields were up too (+3 bps to 3.13%). The German 10-year bund yield decreased (-22 bps to 1.13%).

FX: w-o-w, the US Dollar Index was up (DXY, +0.9%, to 107.8; EUR/USD -1.0%, to 1.00). In EMs, currencies weakened (MSCI EM Currency Index, -0.9% w-o-w, to 1,645.23).

Commodities: w-o-w, oil prices fell (Brent, -5.5% to 101.1 USD/b). Gold prices decreased w-o-w (-2.1% to 1,706.5 USD/Oz).



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The picture in the front page comes from [this website](https://www.rosa-roubini-associates.com)



Abbreviations, Acronyms and Definitions

a	Actual	LN	Northern League, Italy
AKP	Justice and Development Party, Turkey	MSS	Five Star Movement, Italy
ann.	annualized	m-o-m	Month-on-month
ARS	Argentinian Peso	mb	Million barrels
avg.	Average	mb/d	Million barrels per day
bn	Billion	MENA	Middle East and North Africa
BoC	Bank of Canada	MHP	Nationalist Movement Party, Turkey
BoE	Bank of England	mn	Million
BoJ	Bank of Japan	MPC	Monetary Policy Committee
bpd	Barrels per day	NAFTA	North-American Free Trade Agreement
bps	Basis points	NATO	North Atlantic Treaty Organization
BS	Balance sheet	OECD	Organization for Economic Cooperation and Development
c	Consensus	Opec	Organization of Petroleum Exporting Countries
C/A	Current account	p	Previous
CB	Central bank	P2P	Peer-to-peer
CBB	Central Bank of Bahrain	PBoC	People's Bank of China
CBK	Central Bank of Kuwait	PCE	Personal Consumption Expenditures
CBT	Central Bank of Turkey	PE	Price to earnings ratio
CDU	Christian Democratic Union, Germany	PM	Prime minister
CNY	Chinese Yuan	PMI	Purchasing managers' index
CPI	Consumer Price Index	pps	Percentage points
DJIA	Dow Jones Industrial Average Index	pw	Previous week
DJEM	Dow Jones Emerging Markets Index	QCB	Qatar Central Bank
d-o-d	Day-on-day	QAR	Qatari Riyal
DXY	US Dollar Index	QE	Quantitative easing
EC	European Commission	q-o-q	Quarter-on-quarter
ECB	European Central Bank	RE	Real estate
ECJ	European Court of Justice	RBA	Reserve Bank of Australia
EIA	US Energy Information Agency	RRR	Reserve Requirement Ratio
EM	Emerging Markets	RUB	Russian Rouble
EP	European Parliament	SWF	Sovereign Wealth Fund
EPS	Earnings per share	tn	Trillion
EU	European Union	TRY	Turkish Lira
EUR	Euro	UAE	United Arab Emirates
EZ	Eurozone	UK	United Kingdom
Fed	US Federal Reserve	US	United States
FOMC	US Federal Open Market Committee	USD	United States Dollar
FRB	US Federal Reserve Board	USD/b	USD per barrel
FX	Foreign exchange	UST	US Treasury bills/bonds
FY	Fiscal Year	VAT	Value added tax
GCC	Gulf Cooperation Council	VIX	Chicago Board Options Exchange Volatility Index
GBP	British pound	WTI	West Texas Intermediate
GDP	Gross domestic product	WTO	World Trade Organisation
IMF	International Monetary Fund	w	Week
INR	Indian Rupee	w-o-w	Week-on-week
IPO	Initial public offering	y	Year
IRR	Iranian Rial	y-o-y	Year-on-year
JPY	Japanese yen	y-t-d	Year-to-date
k	thousand	ZAR	South African Rand
KSA	Kingdom of Saudi Arabia	2y; 10y	2-year; 10-year



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