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Italian politics hurts markets

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ROME – Investors are reacting with concern to the possibility that Italy's government might collapse this week, but experts say the political turmoil has not yet reached the point where it threatens to re-ignite Europe's financial crisis.

Milan's stock exchange was down 1.9 percent at 17,309.71 on Monday, the first day of trading since Silvio Berlusconi demanded that the five ministers from his political party quit Premier Enrico Letta's coalition government.

Berlusconi had demanded the resignations in a show of solidarity ahead of a Senate vote to strip him of his seat because of his tax-fraud conviction. But at least three ministers said they would only reluctantly comply in a rare challenge to Berlusconi's leadership.

Letta has called a confidence vote in Parliament this week to determine if his 5-month-old government can survive.

Credit rating agency Fitch said that the potential collapse of the government puts at risk efforts to reduce the country's deficit and heavy debt load "and creates uncertainty at a crucial period where the 2014 budget should be finalized."


REUTERS PHOTO/REMO CASILLI

Berlusconi demanded to five ministers to quit from the coalition gov't.

Several analysts said, however, that Italy's political troubles hadn't reached the point where they threaten to disrupt economic policy completely and re-ignite turmoil in the eurozone government bond market.

Markets are still reassured by the European Central Bank's promise made 13 months ago to purchase the government bonds of heavily indebted countries, if they agree to take steps to cut their deficits and debt levels. That means Italy has a backstop from the central bank's theoretically unlimited financial power.

The European economy as a whole is also on a stronger footing than it was six months ago, having returned to growth after six quarters of recession.

"The eurozone economy is less fragile than it was six months ago," economist Christian Schulz from Berenberg Bank wrote in a note to investors. "That reduces the risk that contagion could again spread like wildfire across the eurozone."

Schulz predicted the eurozone is "probably heading for only a modest hiccup" and not a full-blown new crisis.

That holds, however, only so long as the political turmoil does not prevent Italy from being able to agree to the deficit reduction steps that would be required to get the ECB's help.

"The consensus in the markets has been that the vicissitudes of Italian politics do not matter as long as the government in Rome presses on with the reform program," said Stephen Lewis, chief economist at Monument Securities. "The Letta government has hardly done that but, in the period of relative political calm since April, the markets have persuaded themselves that reform is still on track."