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The Aftermath of the Italian Referendum

Changing governments in Italy is almost as commonplace as changing the oil in your car. Since 1946, the country has had 63 governments. Number 64 is coming, given the resignation of Italian Prime Minister Matteo Renzi following Italy's "No" referendum results yesterday.

Because the referendum outcome was expected by investors, the market reaction—thus far—has been rather muted. The referendum was not as market-significant as Brexit and the U.S. presidential election; it was about reforming Italy's constitution but became a vote of confidence in the Renzi government. Italian equities and the euro sold off sharply initially, but have since recovered. U.S. equities traded higher in Monday trading.

Adding to the relatively quiet backdrop: Rather than dissolve the parliament and trigger new elections, Italian President Sergio Mattarella is expected to name a caretaker government to govern until the next parliamentary elections, due in early 2018.

Yet another market pacifier—yesterday, a moderate, liberal candidate won the Austrian presidential elections versus the far-right nationalist candidate, who was demanding a referendum on Austria's European Union membership. The march of populism in Europe, for now, has been slowed.

The mandate of the Italian caretaker government will be nominal and narrow. The next government is expected to focus on rewriting the electoral law for the two chambers of the parliament ahead of the general election, in 2018. The expectation is that the redrafted law will be watered down to give a coalition—rather than one single party—a clear majority in the parliament, thereby making it harder for the populist Five Star Movement to gain control of the parliament. The party favors a non-binding referendum on eurozone membership, an event risk that is unlikely to come to pass. The recapitalization of a handful of Italian banks is also expected to move forward. Not much else is expected on the policy front, which is in line with market expectations.

For country-by-county exposure to Italian banks, see Exhibit 1.

Looking forward, the first real test for Europe's centrists and populists will be the Dutch general elections on March 15; France will follow in April. The Germans head for the polls in October.

Italy's referendum is expected to have limited market impact over the near term, with investors more focused and sanguine about improving U.S. economic and global prospects.

Exhibit 1: Countries' Bank Cross-Border Exposure

Exposure to…	Belgian banks	French banks	German banks	Greek banks	Irish banks	Italian banks	Portuguese banks	Spanish banks	UK banks	U.S. banks
Belgium		$187.5 bn	$29.5 bn	$456 m	$923.6 m	$7.4 bn	$310 m	$6.2 bn	$10.5 bn	$21.0 bn
France	$26.5 bn		$177.2 bn	$862 m	$4.8 bn	$39.9 bn	$4.2 bn	$55.7 bn	$155.3 bn	$167.5 bn
Germany	12.2 bn	$159.5 bn		$269.6 bn	$842.2 m	$178.2 bn	$1.0 bn	N/A	$142.4 bn	$164.8 bn
Greece	$25 m	$1.2 bn	$24.6 bn		N/A	$666.6 m	$191 m	N/A	$5.5 bn	$7.7 bn
Ireland	$15.5 bn	$39.7 bn	$50.7 bn	$197 m		$7.1 bn	$2.6 bn	N/A	$83.6 bn	$71.0 bn
Italy	$8.9 bn	$297.3 bn	$96.8 bn	$345 m	$1.7 bn		$8.3 bn	$52.5 bn	$34.0 bn	$60.4 bn
Portugal	$455 m	$13.1 bn	$15.6 bn	$86 m	N/A	$2.9 bn		$76.0 bn	$9.1 bn	$3.5 bn
Spain	$9.9 bn	$114.9 bn	$75.7 bn	$181 m	$2.4 bn	$43.4 bn	$15.9 bn		$22.3 bn	$42.2 bn
UK	$18.8 bn	$225.6 bn	$400.8 bn	$9.8 bn	$72.2 bn	$41.5 bn	$2.9 bn	$397.5 bn		$451.6 bn
Russia	$263 m	$26.0 bn	$9.6 bn	$287 m	N/A	$19.1 bn	$69 m	N/A	$6.2 bn	$12.0 bn

Data for foreign claims by nationality of reporting banks, immediate borrower basis.
Sources: Bank for International Settlements; U.S. Trust Market & Thematic Strategy Team. Data as of March 2016.

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