



## Euro takeaways: Italy in focus

*The team have recently travelled to meet key Brussels influencers and European officials. Here are our key takeaways and views on the current state of European politics, policy and markets.*

- The optimism that Europe's **economic recovery continues to broaden and deepen**. The recovery is supported by a synchronised global growth backdrop with very little medium term concerns coming from the international trade impulse.
- Looking further ahead, the eurozone crisis now has really **come down to an Italy crisis**. Specifically, concerns around the future QE unwind and

### Market Insight



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what that could mean for periphery banks particularly if sovereign bond spreads moved significantly wider. For the moment there is little in terms of clarity or foresight. Expanding issuance of joint liability sovereign debt in some shape or form could be a solution, but for now, it is important everyone is aware of the reality when the next economic downturn bites.

- We believe there is huge consolidation set to take place amongst smaller banks in Italy. We expect continued focus on Italian nonperforming loans (NPLs) and we should see further disposals in coming months. With European growth being robust **now is the moment to make progress before any cyclical downturn or QE unwinds**. On the latter, we expect the effect on Italian banks will be gradual and manageable. Even if Italian government bond yields rose it would take some time for costs to rise to the extent the debt became unsustainable.
- On the European Central Bank (ECB), our view is that the market overreacted to Mario Draghi's comments at Sintra on 27 June. **We have a more dovish policy outlook for the ECB compared to the market**. We believe they will be prepared to err on the side of caution with withdrawal of stimulus, very keen to avoid a 2011 type mistake. Recent moves in the euro may also tilt the ECB to be more dovish in the weeks ahead.
- On Brexit negotiations, we get a general sense of bemusement on what is going on, but the stance from everyone we meet is always the same: UK politicians and commentators have a fundamental lack of understanding of how the negotiation will work from the EU side. In our view, there is **a real possibility we are going to see a serious escalation of tension** between the EU and UK over the next six months. In this context, a lot of concern expressed over Ireland, not only because of the land border, but also in terms of the peace process and how much the Irish economy may be impacted.

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