

SUMMER SPECIAL

Deal!

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Until then, for him, Italy had always and only been a three-digit number on a computer display. He stared at that number every day, sometimes all day. It stood there, almost perfectly at the center of the GOVI screen of his Bloomberg terminal. But now, the country in front of his eyes looks completely different.

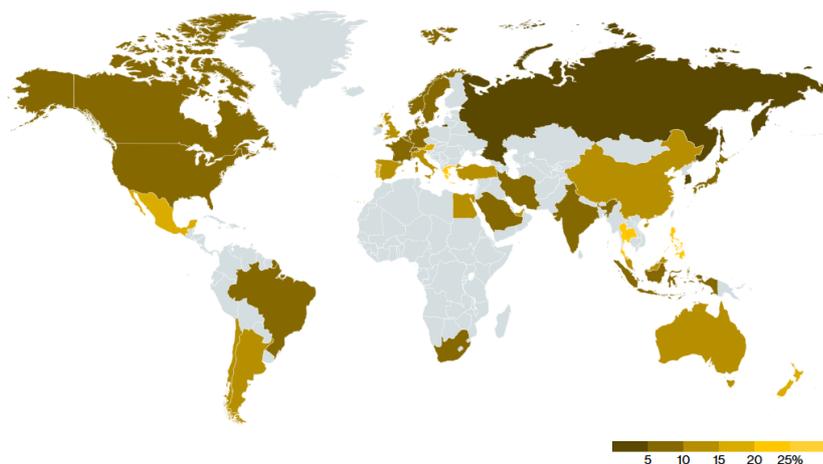
When his colleagues of the Fixed Income desk had learned that he would be spending a weekend in Capri, they were almost speechless. After all, he himself didn't know why he had accepted that invitation, from an Italian friend he hadn't seen for years, all the more so at a time like that.

Covid-19. What initially seemed just a new strain of the cold virus, relegated to a remote city in China's Hubei province, had turned, within a few weeks, into a global epidemic. Over 15 million infections worldwide, more than 600,000 deaths. Italy, driven by the wealthy and productive region of Lombardy, had become one of the epicenters of the pandemic.

For the bond trading team of the Dutch bank he works for, the past few months had been frenzied. An excitement last seen in 2009, some veterans had said, almost managing to perceive the agitation and fervor that would have crossed the trading floor if only they hadn't all been forced to work from home.

But now he's here, in Capri, Italy. Lockdowns have been eased for some time now and in Europe it is even possible to travel across national borders.

Proportion of GDP generated by travel and tourism



Source: Bloomberg, WTTC

Key points of the European deal on the Recovery Fund

* The Recovery Fund's total size is confirmed at €750bn of whom €390bn will be paid in the form of grants (less than the €500bn proposed by the European Commission) and the remaining €360bn will be provided as low-interest loans (from €250bn proposed on the eve of the meeting).

* The European Commission will become one of the largest issuers of euro-denominated bonds. On top of its currently outstanding debt (around €51bn), the EU's executive arm will add both the €750bn Recovery Fund and the €100bn SURE program (although issuance will occur in stages, over several years).

* Italy could be the largest beneficiary of the Fund, receiving around €82bn in grants and €127bn in loans.

* About 1/3 of the money will be used to fight climate change. All expenditure has to be consistent with the Paris Agreement's goal of cutting greenhouse gases.

* Denmark, Germany, the Netherlands, Austria and Sweden will collectively receive rebates for €50bn over the 7 years of the next EU budget. The bloc's 2021-2027 Multiannual Financial Framework will be worth €1.074tn.

* Dutch Prime Minister Mark Rutte has obtained the introduction of an "emergency brake" which will allow the transfer of European funds to be temporarily suspended if a member state raises concerns that another state is not respecting the conditions of economic reform linked to the funds. The final decision is left in the hands of the European Commission.

* A weighted majority of EU governments can block payments to countries that break the rule of law, a measure introduced in light of alleged violations of democratic norms and judicial independence in Hungary and Poland.

* The deal is a victory for German Chancellor Angela Merkel and French President Emmanuel Macron who have presented a first draft of the proposal in May.

* The European Council meeting, which started on Friday, July 17 and continued for over 4 days, until dawn on the following Tuesday, has been the second longest in the history of the EU (just 20 minutes shorter than the European summit in Nice in 2000).

* The deal will now have to be approved by the European Parliament and ratified by all 27 EU member states.

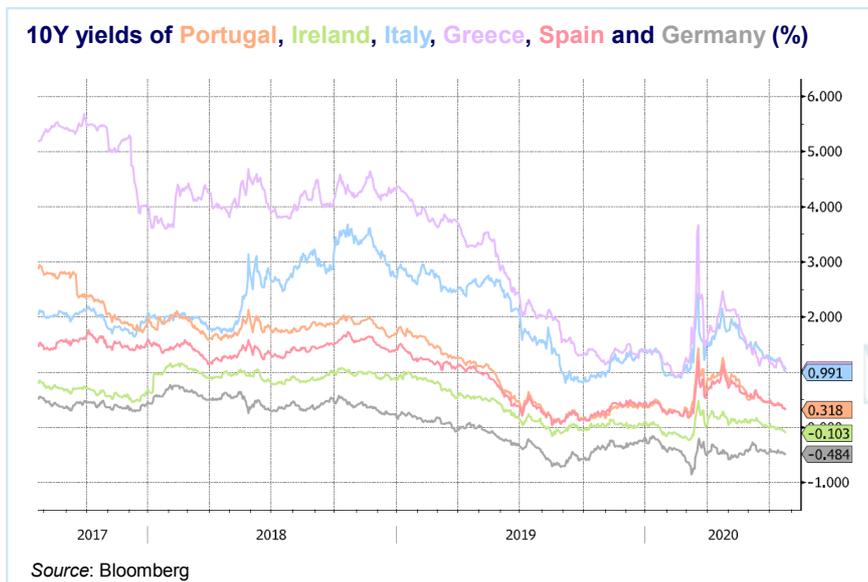
Source: Bloomberg, Reuters, Financial Times

Carlo's invitation came out of the blue. A like left below a LinkedIn post. A chat message. The memories of the months spent together in France during their Erasmus. He hadn't been able to say no. Now Lucas can see him, at the end of the quay where hydrofoils from Naples dock. He almost can't recognize him after all those years. Work, marriage, children. He seems aged.

After Paris, the two men have taken different paths but both work on the "street". Carlo is based in Milan, trader at an Italian asset management company. Lucas works in his hometown Amsterdam, peripheral sovereign debt portfolio manager at "the bank", as he simply calls it.

From the port, the funicular climbs up to the iconic Piazzetta, the parlor of the world. They sit down to have a coffee. The bar is unusually empty for a mid-July morning. Few Italians, even less foreigners. Even on that luxuriant island, tourism is struggling to take off again.

For a while, they manage to avoid talking about their work. But then, like the price of a security relentlessly reverts to its long-term mean, their conversation lands on politics and finance.



«Italian summers are always hot...» says Lucas, nodding his head at the umpteenth newspaper headline about the quarrel between Italy's government and Autostrade per l'Italia.

August 2018 was marked by the collapse of the Morandi bridge, in Genoa. Forty-three fatalities and an entire country divided over the future of the motorway licence entrusted to the Benetton-owned company. The following summer was shaken by the implosion of the Lega-M5S coalition executive, due to a dispute about the high-speed railway line between Turin and Lyon. In 2020, as the reconstruction of the collapsed bridge comes to an end, the new government led by PD and M5S seems to have finally found the squaring of the circle.

«Yeah!» replies Carlo. «But this year, Italy's government will not fall on domestic policy issues. I'd rather look at what's happening in Europe.»

His thoughts turn to a Reuters article he had read just a few days earlier. It was a piece about Italy's four-time prime minister Silvio Berlusconi, the long-time leader of the country's centre-right. The sly old fox of Italian politics is reportedly warming up the engine in view of September, when Giuseppe Conte's fractious cabinet should decide what to do with the European Stability Mechanism's funds.

The anti-establishment Movimento 5 Stelle is against the use of the bailout fund's €37bn credit line. The co-ruling centre-left Partito Democratico wants Rome to tap it. In this division, Berlusconi sees a breach, the chance of returning to power. His party, Forza Italia, has a different view than its eurosceptic partners, Lega and Fratelli d'Italia. According to Berlusconi, ESM loans should be used. His lawmakers are ready to act responsibly.

Wopke Hoekstra
Dutch Finance Minister

I am from the pro-European wing of a pro-European political party. I am critical toward European proposals not because I do not care, but because I care so much.

July 16, 2020

Wopke Hoekstra
Dutch Finance Minister

If you have come up with a responsible position, it's wise not to budge a millimeter. Don't forget that the vast majority of the Netherlands either agreed with the government's position or thought it was too soft.

July 16, 2020

The hint of a smile appears on Carlo's face. He remembers how the Italian word "responsabili" had been translated in the English version of the article: "lawmakers from different parties ready to support another coalition to avoid losing their seats." It is because of this disenchanted clarity that he loves reading the British financial press, he thinks to himself.

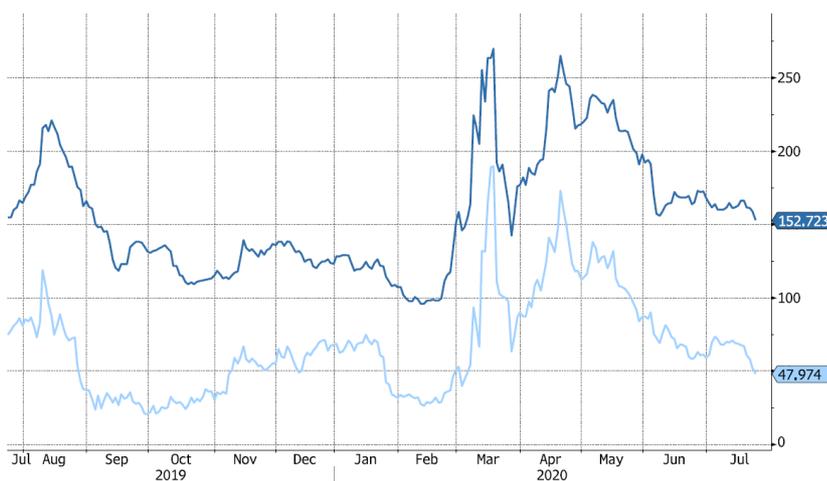
«My fellow countrymen are giving Italy a hard time in Europe. But, you know, at the end of the day my government too, when it negotiates in Brussels, has The Hague in its mind. Everyone has to grapple with its own populists.»

How to blame him. Mark Rutte's tough stance in European talks was paying off in the polls for his coalition government. As next year's general election comes closer and the right-wing parties led by Geert Wilders and Thierry Baudet gather voters' support, Rutte's appeals to proverbial Dutch frugality were proving to be a trump card.

How many times they had talked about it when they were attending university... Before saying goodbye to each other, at the end of that semester, Lucas had even gifted Carlo with a copy of The Protestant ethic and the spirit of capitalism by German sociologist Max Weber.

«We like to portray ourselves as a people of preachers and merchants, sober and thrifty, respectful of Calvin's teachings. It is not so different from the image of light-heartedness that has made Italy, and this very island, a magnet for north European tourists like me. The problem is that so many cannot distinguish stereotypes and marketing from alleged national identity.»

Italy: CDS USD SR 5Y D14 vs. 5Y BTP yield (bps)



Source: Bloomberg

The weekend continues pleasantly but reality keeps invading the relaxed scenario of that Mediterranean island. The passing of the hours seems marked by the news popping up on Lucas' smartphone. About 1376 kilometers north, in Brussels, the heads of state or government of the 27 EU member states are holding frantic talks. At stake there's the size, composition and governance of the Recovery Fund proposed by the European Commission to prop up the bloc's coronavirus-battered economies. Distances between leaders seem unbridgeable.

Investors have moved cautiously throughout the week leading up to the meeting, the first in person since February, and now they are eagerly waiting for a signal to figure out whether the rally of Italy's BTPs is destined to continue or fade away. Lucas is one of those investors.

Should leaders agree on the Commission's proposal -- €500bn as grants and €250bn as low-interest loans -- the number that keeps obsessing the Dutch fund manager could tighten to about 130 basis points. But should talks collapse, the spread between the ten-year yield of Italian and German government bonds could spike up to 200bps, from 166 at Friday's close.

Netherlands: seats in parliament

Parties	Poll	2017
VVD	35	33
CDA	17	19
PVV	17	20
PvdA	14	9
GL	13	14
D66	13	19
FvD	12	2
SP	10	14
CU	7	5
PvdD	5	5
SGP	4	3
DENK	1	3
50+	1	4

Note: House of Representatives (150 seats), poll data as of July 19, 2020, "2017" column refers to the results of March 15, 2017 election, next general election on March 17, 2021.

Source: POLITICO

Dutch political parties

VVD = People's Party for Freedom and Democracy (Leadership: Mark Rutte)

CDA = Christian Democratic Appeal (Sybrand Buma)

PVV = Party for Freedom (Geert Wilders)

PvdA = Labour Party (Lodewijk Asscher)

GL = Green Left (Jesse Klaver)

D66 = Democrats 66 (Alexander Pechtold)

FvD = Forum for Democracy (Thierry Baudet)

SP = Socialist Party (Lilian Marijnissen)

CU = Christian Union (Gert-Jan Segers)

PvdD = Party for the Animals (Marianne Thieme)

SGP = Reformed Political Party (Kees van der Staaij)

DENK = Denk (Tunahan Kuzu)

50+ = 50PLUS (Geert Dales)

Note: The current Rutte III cabinet is a coalition of VVD, CDA (the party Finance Minister Wopke Hoekstra belongs to), D66 and CU.

Source: POLITICO, Wikipedia

«You will see that eventually they will find an agreement, they have to!» breaks the silence Carlo, finally managing to take the Dutchman's eyes away from the screen of his mobile phone. «Maybe the proportion of handouts over loans will be reduced. Perhaps it will also be necessary to concede higher rebates to "frugal" countries on their contributions to the EU's seven-year budget. But regardless of its size -- that someone may even judge marginal in the face of the much bigger economic havoc wreaked by lockdowns -- its symbolic value will be indisputable. And financial markets will cheer.»

Lucas cannot explain it, but Carlo's words have appeased his craving for news. He picks up the phone and turns it off.

* * *

Tuesday, July 21, 2020. 5:31 am, Central European Time. An electronic impulse branches out of a cubic-shaped building covered with a wood-and-glass structure in the center of Brussels. The signal spreads quickly through the fiber-optic cables that connect the palace to the rest of the world.

Carlo is awake, despite the early hour. Since he has started working from home, in his hometown Naples, he sleeps even less than usual. A notification appears on the monitor of his PC. It's a tweet by Charles Michel, President of the European Council. One word, four letters. There's no need for anything else. Deal!



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