Italy’s inconclusive election triggered renewed market convulsions over Europe’s debt crisis as recession-scarred voters repudiated budget rigor and established former comedian Beppe Grillo as a political force.

In the four-way race, pre-election favorite Pier Luigi Bersani won the lower house by less than a half a point. Silvio Berlusconi, the former premier fighting a tax-fraud conviction and charges of paying a minor for sex, called for a recount and won a blocking minority in the Senate. In its first national contest, Grillo’s group got more than 25 percent support.

“The political situation across Europe is effectively a race between austerity and reforms on the one hand and the rise of populist movements on the other,” said Alberto Gallo, head of European macro credit research at Royal Bank of Scotland Group Plc. “Austerity is painful, and if reforms are not implemented in time, you run the risk of social unrest and populism. It hasn’t happened so far in Greece, it hasn’t happened in Portugal or Spain, but we are very close in Italy.”

Berlusconi and Grillo, the candidates running to reverse the austerity implemented by incumbent Premier Mario Monti to contain the region’s financial crisis, scored about 55 percent of the popular vote. The euro fell to a six-week low, Italian bonds declined and U.S. Treasury notes rose as the results trickled in.

**Five Star Movement**

Bersani’s coalition polled 29.54 percent in the lower house, or Chamber of Deputies, compared with 29.18 percent for Berlusconi’s group and 25.55 percent for Grillo, making the Five Star Movement the biggest single party in the Chamber. Bersani and his allies got 31.63 percent of votes in the Senate, compared with 30.72 percent for Berlusconi and 23.79 percent for Grillo, according to final figures from the Interior Ministry.

“It will make people pause and take some risk out of their portfolios,” said Joseph Balestrino, senior fixed-income strategist who helps oversee $51.4 billion of assets at Federated Investors in Pittsburgh.

The Italian Treasury sells 8.75 billion euros ($11.4 billion) of six-month bills today, followed by an auction of as much as 6.5 billion euros of five- and 10-year bonds tomorrow.

The election result may lead President Giorgio Napolitano to install an interim government, such as
the one headed by Monti, to write a new election law as the prelude to another vote. Bersani signaled he may seek an alliance with Grillo, who has rejected such overtures. No formal steps can be taken until a new parliament convenes March 15.

**Seats in Senate**

An Italian government requires a majority in both houses. Current rules make it difficult for a party to win both. In the Chamber of Deputies, the coalition gaining the most votes automatically gets 54 percent of the seats. The Senate is apportioned regionally, diffusing the bonus-premium effect.

Bersani took 340 seats in the 630-seat lower house. His aides claimed victory and said he should get a chance to form a government. Berlusconi refused to concede. Monti took 10.6 percent, the Interior Ministry said.

Bersani had 113 seats in the 315-member Senate, according to the Ministry. Berlusconi’s share was 116, with Monti getting 18. Grillo, who ruled himself out as a candidate due to a manslaughter conviction in the 1980s, got 54 seats.

Italian 10-year yields climbed 32 basis points, or 0.32 percentage point, to 4.81 percent, the highest since Dec. 11, as of 8:14 a.m. The benchmark FTSE MIB stock index rose 0.7 percent yesterday, paring a gain of as much as 4 percent.

**Vote on Austerity**

The vote gave Italians their first chance to weigh in on the austerity demanded by European leaders as a remedy for the European sovereign debt crisis.

Monti, 69, was named by Napolitano in November 2011 to replace a discredited Berlusconi when Italy’s 10-year borrowing costs soared to a euro-era record of 7.5 percent, fueling doubts about whether the world’s third-biggest debtor could stay in the euro.

In his first weeks in office, the one-time Goldman Sachs Group Inc. adviser and president of Bocconi University pushed through a raft of measures to calm financial markets with the backing of 80 percent of lawmakers. They included 20 billion euros of deficit cuts, including a tax on primary residences, and an overhaul of the pension system.

The unelected premier’s tax increases pushed Italy further into recession. Voters were given alternatives by Berlusconi and Grillo, who pledged to overturn Monti’s legacy of budget rigor. Bersani said he would maintain most of his policies.

**Hung Parliament**

“A hung parliament would be a guarantee of paralysis both in terms of economic program and structural reforms,” Annalisa Piazza, a fixed-income analyst at Newedge Group in London, said in an e-mail. “Such a scenario would be the worst-case outlook.”
Bersani ally Enrico Letta said a hung parliament in the third-biggest euro-area economy would challenge the European Union’s embrace of austerity championed by German Chancellor Angela Merkel.

“This possible outcome would have very heavy consequences for Italy at the European level,” Letta, deputy head of Bersani’s Democratic Party, said on RAI 3 television. “Based on these projections, more than half of Italians expressed a vote against austerity, against the euro, against Merkel.”

Monti’s budget cuts may buy Italy time with investors, even if gridlock prevents further reforms from making Italy’s slumping economy more competitive.

“Italy merely needs to hold the line,” Holger Schmieding, Berenberg Bank AG’s chief economist, wrote in a note to clients. “We maintain our view that, in purely economic and fiscal terms, a political stalemate without major new reforms would be unfortunate but not a disaster.”

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