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Direttore Responsabile Lionel Barber

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Mounting woes force Italy to weigh EU bond-buying support

Economic fears

Rome is waiting to hear more about the ECB's plans at today's meeting in Frankfurt, writes **Guy Dinmore**

Italy's worsening economic crisis and high debt costs have led senior officials in Rome to warn that the country may be forced by the end of the year to apply for an EU bond-buying programme in exchange for implementing further tough economic reforms.

Rome's public position is that it does not need to request purchases of its sovereign bonds by the eurozone's bailout fund – for the moment – but that if it did, only "light" conditions should be attached, given the measures already adopted by Mario Monti since he became prime minister last November.

But Mr Monti's hand could be forced within months, according to officials involved in internal talks, who say Germany, among others, is likely to insist on tough conditions – in part to lock in whatever government replaces the prime minister's technocrats after elections expected early next year.

For the time being, Italy and investors holding its €2tn sovereign debt are waiting to see if the European Central Bank will reveal more details of its planned bond-purchasing programme after its policymaking meeting today. Spain's weaker financial position puts it first in line as an applicant for market support, but Italy's worsening recession may force it to follow, economists say.

Official economic forecasts for 2012 are being revised down. Italy's economy is seen contracting by more than 2 per cent, against the last forecast of a 1.2 per cent shortfall, while the budget deficit is likely to be revised from 1.7 per cent of gross domestic product to about 2.2 per cent, officials said. Unemployment is set to continue rising sharply.

Tax increases have hit consumer spending, while high rates on Italy's sovereign bonds have also driven up borrowing costs for the private sector. Giorgio Squinzi, leader of employers' lobby Confindustria, said yesterday Italian companies faced a "torrid autumn".

"Monti is in a very tough position," said one senior official, referring to looming general elections in both Italy and Germany next year. "Germany and the Bundesbank will ask for firm commitments on future reforms. This is very hard for Monti," he said.

Mr Monti relies on support in parliament from the two main parties, Silvio Berlusconi's centre-right People of Liberty and the centre-left Democrats led by Pierluigi Bersani. Both oppose going cap in hand to Brussels and the ECB, knowing that voters would punish them for a perceived loss of sovereignty in the event of tough conditions being imposed, such as Greek-style spending cuts and forced privatisations.

> 'Germany and the Bundesbank will ask for firm commitments on future reforms'

Moreover, it is not clear whether Mr Monti will be able to rely on the full loyalty of his cabinet as elections draw near.

By some counts, as many as 10 "technocrat" ministers want to advance their political careers by joining forces with various parties. It is not clear if they would have to resign to take part in campaigning. Among them is Corrado Passera, economic development minister and a former banker, who is seen backing the centrist Catholic UDC, a likely king-maker in a future coalition government.

Francesco Giavazzi, an economist and government adviser opposed to requesting EU-ECB support in the run-up to elections, has urged the two big parties to make public pledges not to reverse pension reforms and property taxes implemented under Mr Monti.

"The uncertainty of what happens after the elections is the biggest worry of investors we are asking to buy our public debt," Mr Giavazzi wrote in Corriere della Sera.

"If in coming months we cannot tranquillise the markets over keeping our finances in order after the elections, then interest rates will remain high. This is an uncertainty that not even the European Central Bank can cancel out."

Speaking after talks in Rome on Tuesday between Mr Monti and François Hollande, the French president, an Italian government aide said the two leaders saw themselves as the "guardians" of the commitments taken by the EU summit in late June to bring down the borrowing costs of countries such as Spain and Italy. This applied also to the "conditionality" attached to bond-purchasing programmes, the aide said, denying reports that Italy was under pressure from its peers to follow Spain in requesting help.

Mr Monti reiterated that the spread or yield gap between Italian and German government bonds "have no underlying economic justification". But commentators have noted that Mr Monti has refrained from making further public statements on possible conditionality, other than repeating that Italy has "done its homework".

Additional reporting by Giulia Segreti

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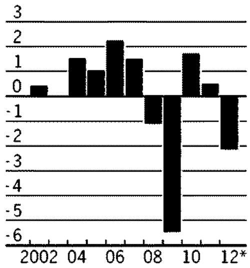
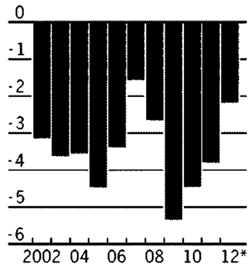
Monti's problems

Mario Monti, centre, and François Hollande, French president, in Rome this week Bloomberg

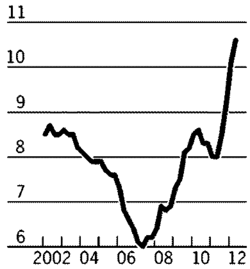
Italian economic growth is forecast to contract...
Italian GDP growth
(annual % change)



...while its budget balance remains in deficit...
Italy budget balance
(as % of GDP)



..and unemployment is rising rapidly
Per cent



* Forecast
Sources: Thomson Reuters Datastream; OECD