The CIBUK Clear Water Partnership

News Bulletin

Welcome!

From: **Ben Philips** Communications Director and Editor of the CIBUK Clear Water News Bulletin

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EUROZONE LATEST

'Stresses & strains, debts & defaults':

Life inside the Single Currency

INTRODUCTION

As the whole of Europe sizzles under a baking sun with accompanying threats to life and property, another kind of firestorm threatens to engulf it economically.

With Italy once again on a political and economic knife-edge, it is to the European single currency that we must return as policy makers weigh up the options about what to do next.

Once again, the fundamental paradox at the heart of the project - monetary union without fiscal union – is playing itself out to devastating effect. And unless or until the EU grasps that nettle, the strains on the pillars now supporting monetary union in its present form may be too great to bear, causing them to buckle or even to collapse.

SUMMARY

- We begin with a summary by *Reuters* on the immediate causes of the emergency:an Italian sovereign debt crisis, brought on by its failure to use a huge Coronavirus Recovery Fund from the EU to kick-start its economy and escape its high-debt, low growth trajectory path of the previous twenty years.
- The fact that the policy has not succeeded would suggest that once again it was made in hope rather than expectation. Will they ever learn?
- In a key-note article for *Brexit Watch*, Financial Consultant Bob Lyddon exposes the fundamental flaws at the heart of the single currency including the European Central Bank's attempts to impose a single interest rate on nations with widely divergent economies.
- As the sovereign debt crisis plays itself out, claims by the ECB that its impartial intervention is anything other than an Italian bail-out will fool no one.
- We conclude however, on a more uplifting note with a piece by our affiliate organisation **Facts4EU** on the joys of life outside the single currency.
- With the Euro spiralling down and the Pound continuing to rise, recent data suggests the UK is also outperforming its Eurozone rivals in its rate of economic growth.
- And finally, for lovers of euro-art, we provide a link to a special piece you may all have been searching for.

Ten years on, Italy faces debt crisis Draghi may not solve

- by Francesco Canepa and Gavin Jones for Reuters

We begin with an account from Reuters on the political and economic fall-out in Italy as the European Central Bank faces up to yet another sovereign debt crisis within its ranks.

"Ten years after Mario Draghi's "whatever it takes" pledge saved the euro, Italy is once again in the middle of a debt crisis - but the country's prime minister and former head of the European Central Bank may struggle to solve this one.

Just like a decade ago, investors are questioning whether some euro zone countries can continue to roll over their public debts, which have ballooned during the pandemic and are becoming more expensive to refinance as the ECB prepares to raise interest rates.

This time, however, the epicentre of the crisis is Italy's secular lack of economic growth, rather than the financial excesses that landed Greece, Portugal, Ireland and Spain in trouble 10 years ago."

Once again the strains within the European monetary system are beginning to creak:

“Italy's benchmark 10-year yield rose to a high of 3.5% on Thursday and the spread over safer German Bunds widened to 227 points by the close, having more than doubled since the start of the year.

"Things just got worse; how much worse is difficult to tell," said Dirk Schumacher, an economist at Natixis.”

As one of the ‘big three’ eurozone economies

“Italy is big enough to bring down the rest of the euro zone periphery as its 2.5 trillion euro ($2.52 trillion) government debt pile is larger than those of the other four countries combined and too big for a bailout.”

The underlying cause behind the present crisis has been Italy’s historic economic under-performance according to Moritz Kraemar, chief economist at LBBW:

“Italy has been a growth underperformer for two decades. And the fiscal situation is not the cause, it's the consequence of that weakness."

Following the 2012 sovereign debt crisis, Ireland and the Club Med states cleansed their banks and even Greece introduced new pension and labour market laws.

“Italy, by contrast, has not done enough to kick-start growth despite some changes to its pension system, labour market and, under Draghi, its notoriously slow justice system.
As a result, the country that was once seen as the best of a bad lot is now paying the highest premium to borrow on the bond market after Greece - a country that defaulted twice in the past decade and is still rated "junk".“

The latest ‘deal’ between Italy and the ECB smacks of more wishful thinking:

"As ECB chief, Draghi regularly stressed the importance of fiscal and other reforms by governments. But as premier of Italy he has had to spend much of his time mediating between parties with very different views on economic policy, meaning contentious issues like tax and pension reforms have been largely kicked down the road.
Draghi did finalise a plan presented to the European Union in return for almost 200 billion euros of pandemic recovery funds and ensured a solid start in meeting the hundreds of so-called "targets and milestones" it contains.
But these are mostly small-scale tweaks to legislation - a total of 527 of which will need to be ticked off by 2026, long after Draghi is due to leave office.”

LONGER TERM DECLINE
As the enclosed report acknowledges,

“Italy's malaise is much older than the global financial crisis. Its GDP per capita is lower now than 20 years ago, when it was only a touch below France's and Germany's.
All other European countries have grown over that period except Greece which has shrunk by less, leaving Italy as the worst performer in the bloc.”

Cultural bias and long-term strategic errors have played their part:

*“Some economists including Chicago Booth School of Business professor Luigi Zingales say Italy essentially missed the digital revolution and blame what they call **the Italian disease** of entrepreneurs who opt to keep a small business in the family rather than grow it with the help of outside investors.*
By joining the euro, Italy also lost the quick fix of being able to devalue its currency - a trick that helped Italian industry prosper for decades by making its exports cheap.
"We chose the wrong growth model back in the 1980s," said Francesco Saraceno, economics professor at Rome's Luiss University and Sciences-Po in Paris.
"To respond to globalisation we tried to compete with emerging markets by lowering costs instead of following the German example of investing in higher-quality production."

The full report can be found here with a link to the original below:

https://www.reuters.com/markets/europe/ten-years-draghi-faces-debt-crisis-words-wont-solve-2022-07-14/

Why the euro threatens to be the EU’s Krakatoa

- By Bob Lyddon for Brexit Watch

As a follow-up to the article above, financial consultant Bob Lyddon analyses the strains within the euro-system and the conflicting choices now facing the European Central Bank as it attempts to reconcile a one-size-fits-all monetary strait jacket on economies as widely divergent as Germany and Italy.

One of the principal challenges facing the ECB is not to allow the financing costs of the most indebted euro members to soar into non-viable territory.

[It is worth spending a moment to reflect on why this is a problem. Debt sustainability is the first concern but the relevant factor there is the absolute yield (or, more precisely, debt servicing cost versus cashflow), not the spread. If Italy is forced to pay 7% for its 10-year paper (as was briefly the case during the sovereign debt crisis), then debt sustainability will be a concern regardless of what Germany pays.

While the threat of default is remote, widening spreads have the ECB governing council worried about uneven transmission of monetary policy, with a broad range of monetary environments coexisting within the euro area.

*Accordingly, the governing council held an emergency meeting last week and issued a statement announcing that the relevant committees are **designing a new anti-fragmentation instrument** to be announced at the July monetary policy meeting.]*
(from the Official Monetary and Financial Institutions Forum)

Bob Lyddon takes up the story:

“Mere rumours of a major ECB intervention have now brought Italian 10-year yields down to 3.3%.
The instrument may even be announced at the next ECB policy meeting on 21 July, although there will be many disagreements and technical issues, such as how such an instrument might function as and when the ECB does decide to increase its official interest rates: they are currently 9-10% below the rate of inflation.”

Covid has only exacerbated the problems and the strains within the system are already beginning to tell. ECB stipulations on debt to GDP ratios for instance have already been swept aside:

"After 10 years of buying up member state government bonds and pressing down yields for investors, the member states still have a wide array of Debt-to-GDP ratios, the target of a unified 60% ratio has been suspended, and some of the biggest member states have the worst ratios: France 112%, Spain 118% and Italy 150%. The same countries had 2021 fiscal deficits of 6.5%, 6.9% and 7.2% of GDP respectively, against a target of 3%."

Any pretence that the Euro is any longer a Single Currency should now be discarded:

"Now Italy has found itself unable to raise new money on what it would view as acceptable terms, and the difference between what it has to pay – 3.3% - and what Germany has to pay – 1.3% - proves that the euro is not a Single Currency, if two forms of its so-called 'central bank money' attract such different returns.
Actually, they do not represent 'central bank money' because they carry quite different credit risks: Germany's bonds are an AAA risk (on Standard and Poor's scale) and Italy's a BBB one."

And what of the anti-fragmentation instrument?

"it will attempt to counteract the recent 'fragmentation' of yields by doing more of what the ECB has done since 2012: its Asset Purchase Programme that now owns €3.2 trillion of bonds and its Pandemic Emergency Purchase Programme which owns €1.7 trillion.
The new programme may go under a name like Outright Monetary Transactions, and it must be dressed up as a monetary policy operation because it cannot be seen as a bailout: Italy, or any other user, must not be forced as Greece and Cyprus were to rein in its spending, and anyway the available bailout mechanisms do not have the firepower to support a large member state.[6]

This new instrument will in effect enable the ECB to intervene on behalf of one member state or another, a clear departure from its original mandate to control inflation and act impartially between all eurozone members.

"Perhaps the instrument will cause the very socialization of member states' debts that Northern Europe fears is the ECB's objective, or maybe the oxymoronically named 'fragmentation instrument' will do exactly what it says and precipitate the Eurozone's fragmentation."

The full article can be read here with a link to the original below.

https://www.brexit-watch.org/why-the-euro-threatens-to-be-the-eus-krakatoa

For a synopsis on how the anti-fragmentation instrument may work, click here

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Brexit Britain's economy shoots forward again and the pound rises

Meanwhile, the Eurozone currency is in freefall as the EU's crises deepen

In a change of perspective from outside the eurozone, we are delighted to be able to assess the performance of the UK economy relative to its European counterparts across a range of comparative data.

Insulated from the worst aspects of euro-contagion, the UK continues to outperform it European rivals, underlining the wisdom of those who insisted Britain should never enter the EU's toxic monetary circle.

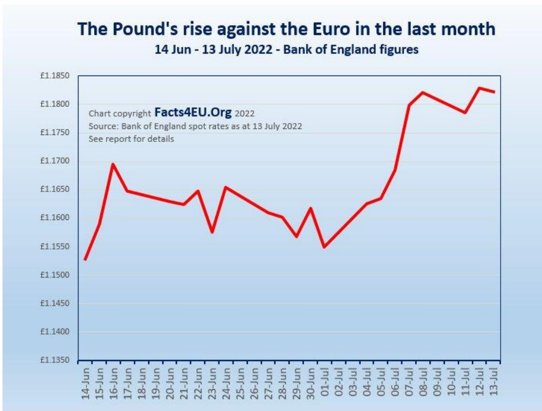
UK & EU ECONOMIES

- UK's economic output (GDP) : +0.5% in May
- GDP growth over last 12 months: +3.5%
- UK economy now well above pre-pandemic levels
- EU economy still well below pre-Covid levels
- Pound rises against the euro
- Euro falls against the US dollar

[Sources: Latest data from ONS, EU Commission, BoE, and ECB.]

CURRENCIES:

The Pound RISES against the Euro



Britain’s economy continues to grow post-Brexit

- UK GDP rose by 0.5% in May
- UK growth in the 12 months to May 2022 was a very healthy 3.5%.
- According to the ONS *“Manufacturing increased by 1.4% in May 2022 with twelve of the thirteen sub-sectors rising on the month.*

Euro continues to fall

- In the last five months of this year alone it had fallen by 10.1%.
- Near parity with the dollar: at €1 = $1.0067

Notwithstanding the considerable headwinds which every nation has had to contend with over the past twelve months, the resilience of the UK economy in the face of such prolonged assault should provide enormous inspiration for our new Prime Minister and government.

Fully freed from the shackles of the EU, the UK’s performance could be even better. We will not rest until that day comes.

The full article can be read here: https://cibuk.org/british-pound-rises-euro-falls/

EURO-ART ANYONE?

And finally, for all you keen art collectors out there:

“The most widely used symbol for stories on the European Central Bank is now up for sale: The big blue euro sculpture outside the central bank's former headquarters in Frankfurt.”

“The 14-meter-tall sculpture was erected along with the introduction of euro bank notes in 2001 and has weathered the financial and the sovereign debt crises. But now, it has simply become too expensive to maintain.

The iconic art piece by German artist Ottmar Hörl has been maintained by the non-profit organization Frankfurter Kultur Komitee for the past 21 year under the leadership of Manfred Pohl. Pohl said increasing vandalism and lack of sponsoring forced the committee's decision to auction off the piece by this October.

“We have contacted 110 banks over the past 12 months, and 90 didn't even bother answering,” Pohl said.”

So anyone who's a big fan of the single currency and wants to acquire art, more information is here — but be aware that the sculpture weighs 50 tons.”

The full article can be read here with a link to the original below:

For sale: Frankfurt’s iconic euro sculpture – POLITICO
