EU shaken by Italian banking crisis

Marianne Arens and Peter Schwarz
14 July 2016

Less than three weeks after the vote by the United Kingdom in favour of Brexit, another banking crisis is gripping the European Union. It not only threatens wide-ranging economic consequences, but also a further intensification of the EU's political crisis.

The Brexit vote raised doubts about the stability of Europe, sent shockwaves through global financial markets and caused bank stocks to fall sharply. Within two weeks, Deutsche Bank, Germany's largest private bank, lost a quarter of its value.

The impact in Italy has been particularly severe. It provides the perfect example of how the austerity measures imposed at the expense of the working class have not stabilised, but rather deepened, the crisis of the European economy and financial markets.

In spite of the austerity and privatisation measures implemented by three successive governments, led by Mario Monti, Enrico Letta and Matteo Renzi, Italian state debt has risen since 2011 from €1.8 to €2.2 trillion, or 133 percent of GDP. Since the beginning of 2008, GDP has contracted by 8 percent. The amount of toxic assets on the books of the banks has doubled and today amounts to €360 billion, or one fifth of all loans. Of these, €200 billion is considered to be irretrievably lost.

The Italian stock exchange responded sharply to the Brexit. UniCredit, the country's largest bank, lost a third of its value, bringing total losses this year to 60 percent of its market value. Italy's second largest bank, Intesa Sanpaolo, also dropped by 30 percent.

The Banca Monte dei Paschi di Siena (MPS) was especially hard hit. The bank, founded in 1472, is among the oldest banks in the world. Its shares have been trading at just one tenth of their value on paper since the Brexit. At least 40 percent of its assets, €47 billion, allegedly consists of toxic assets.

This confronts the Renzi government with a dilemma. The new bank regulations passed by the EU in response to the 2008 crisis forbid the use of state funds to rescue banks. Before public bailout measures can be taken, creditors and shareholders must be held liable for the bank's losses and bear the cost of at least 8 percent of the restructuring expenses.

Renzi would not politically survive the adoption of such a policy, since tens of thousands of small savers and investors have deposited their funds in banks and would lose them as a result.

Already late last year, when four smaller crisis-ridden banks were dismantled, 12,500 small investors, including many pensioners taken completely unawares, lost their savings. On the advice of the bank, they had placed their savings in so-called sub-prime investments, which turned out to be junk assets. Their dramatic fate, which included the suicide of a pensioner who lost everything, provoked a wave of protest throughout the country.

In addition, it is feared that breaking up MPS, which sold such assets to 60,000 customers, could provoke a run on all Italian banks and unleash a chain reaction throughout Europe. Other Italian banks, including Banka Popolare di Vicenza and the savings bank group Carige in Genoa have problems similar to those of MPS, according to Italian media reports.

After the International Monetary Fund sharply revised downwards its growth prediction for Italy, the euro zone's third largest economy, a study by Barclays Bank estimated the situation facing the financial sector in almost all countries as dramatic. David Folkerts-Landau, chief economist at Deutsche Bank, stated in the *Welt am Sonntag* that €150 billion was required to save Europe's banks.

Under these conditions, Renzi, supported by central bank chief Ignazio Visco, proposed a bailout fund of €40 billion to save Italian banks. The proposal met with strong resistance in Brussels. German finance minister Wolfgang Schäuble and Dutch chief of the euro group

Jeroen Dijsselbloem are insisting upon the maintenance of the EU's banking regulations.

German Chancellor Angela Merkel and the parliamentary fractions of the CDU/CSU and SPD backed Schäuble. "We can't just simply make new regulations every two years," Merkel declared blandly at an EU summit immediately after the Brexit vote.

Deputy chair of the SPD fraction, Karsten Schneider, noted, "The credibility of the regulations to protect all taxpayers in Europe cannot be called into question at the first suitable opportunity." And Joachim Pfeiffer, economy policy spokesman for the CDU/CSU, added, "A breach of these regulations would be unacceptable."

Schäuble and Dijsselbloem have also indicated firm resolve towards Spain and Portugal. For the first time in history, EU finance ministers voted last week for sanctions on both countries, which were not permitted to vote, for violating the rules on budget deficits requiring that they be kept within 3 percent of GDP. Spain and Portugal, which have virtually destroyed their economies with years of austerity measures, will now have to transfer billions in fines to Brussels—making the maintenance of the deficit limit impossible.

Thus, the same conflicts within the EU are breaking out as occurred during the Greek crisis: Germany and a group of richer countries in the north, which have strongly profited from the euro, want to prevent at all costs being held liable for the consequences of their policies in the south of the continent.

Christoph Schmidt, head of the "economic experts," the German government's most important economic advisory body, summed it up when he warned about the EU being turned into a "community of liabilities" if the "recently-created framework for dismantling banks is called into question once again." The need to protect Italian small depositors was no reason to violate the EU's regulations.

However, this policy could prove explosive for the European Union, which the German government has verbally acknowledged. This is shown very clearly in Italy. If Renzi is brought down over the banking crisis, an anti-EU government would almost certainly replace him.

The initial shine of the young politician, who took power with the bold promise to "scrap" the old elites, wore off long ago. Relying on the remnants of the Communist Party and trade unions, he has implemented the largest labour market "reform," radically reduced pensions and cut funding for public services and schools.

The economy has failed to respond positively, and Italy has become a social powder keg. Unemployment is significantly higher than the official figure of 11.5 percent suggests, since the statistics do not take into account of the close to 36 percent of those of working age deemed "inactive." Above all among youth, where official unemployment is 40 percent, there exists no hope of education or a future, particularly in the poor south of the country.

In the recent municipal elections, Renzi's Democratic Party suffered significant losses. In large cities like Rome and Turin, they lost the office of mayor to the Five Star Movement of Beppe Grillo, which with 32 percent support in a recent national poll, finished ahead of the Democrats. Grillo's movement, which is based above all on dissatisfied sections of the middle class, represents nationalist and xenophobic positions and collaborates at the European level with Britain's UKIP, which led the Brexit campaign.

Renzi's right-wing coalition partner Nuovo Centro Destra (NCD), a split from Silvio Berlusconi's Forza Italia, is threatening to leave the government. The ultra-right Lega Nord of Matteo Salvini, which now campaigns throughout Italy, is benefiting from the crisis.

In October or early November, a referendum will take place over a new electoral system and the weakening of the second chamber of parliament, the Senate. If Renzi loses the referendum on the constitutional changes, he plans to resign and call fresh elections. If the banking crisis deteriorates further, this could well prove to be the end of his time in office.

Germany's attempt to impose its economic dictates is breaking the EU apart. Berlin's response is to place greater emphasis on militarism at home and abroad.