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Italian death spiral might draw in IMF

By Alan Beattie in Washington

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As turmoil continues in Italian sovereign debt markets, the possibility rises again that the International Monetary Fund will be called in by the new government.

To do so would most likely mean abandoning some of the current policy stances in Europe, notably the European Central Bank's insistence that it will not finance a direct bail-out for Rome. But if Italy looks to be heading towards a death spiral, then the red lines established by eurozone policymakers may start to recede – as they have before.

Current and former policymakers say that getting the IMF involved, even if only to contribute credibility rather than a lot of cash, could help the ECB overcome its deep reluctance to be seen doing a bail-out. The IMF is already involved in "intensive monitoring" of Italy's economic policy – essentially a more comprehensive and frequent version of the regular health checks it does on all member countries.

Domenico Lombardi, who formerly represented Italy on the IMF's governing board and is now at the Brookings Institution think-tank in Washington, says: "What is needed is a framework that can encourage the ECB to intervene later if market turmoil does not subside." He said that even a relatively small IMF lending programme, such as the €50bn loan reportedly offered to Italy at last week's G20 meeting in Cannes, would have a signalling effect that might reassure the ECB.

"The ECB doesn't have the capacity to do conditionality," said one finance official familiar with the international deliberations, referring to the strings attached to rescue lending. "But if it can push the conditionality responsibility to the IMF, it might give them some comfort."

To increase the size of the intervention, one intriguing suggestion that has been floated is for the ECB to lend to the IMF – either directly into the organisation's general pot of resources or into a special trust fund – and then for the IMF to lend to Italy. This would mean that the IMF, rather than the ECB, would take on the credit risk of lending to Rome, and also that the fund would be in charge of setting conditions.

The ECB's founding protocol permits it to borrow from and lend to international organisations, though since the bank is not itself a member of the IMF it is not clear what legal standing such money would have.

But officials say that eurozone policymakers seem focused for the moment on trying to increase the firepower of the European financial stability facility, the zone's bail-out

fund. “First, the Europeans have to realise that leveraging the EFSF isn’t going to work, before they turn seriously to options that might,” the finance official said.

One option to increase the size of the EFSF is to revisit the “special drawing rights” option canvassed at the G20 in Cannes but initially rejected by the Bundesbank. The SDR, a reserve asset based on a basket of leading currencies and used by the IMF, can be created at will by the fund’s shareholder countries and is distributed to them. The SDR option would involve eurozone governments clubbing together to lend their holdings, possibly augmented by a fresh allocation, to Italy via the EFSF.

On Wednesday, following meetings with Wolfgang Schäuble, German finance minister, members of the German Bundestag reported that the government had not entirely abandoned the idea of pooling the eurozone’s SDRs to boost the EFSF. One senior MP from a party in the governing coalition said confusion arose after a Sunday newspaper article erroneously conflated SDRs and Germany’s jealously guarded hoard of gold.

Additional reporting Gerrit Wiesmann in Berlin

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