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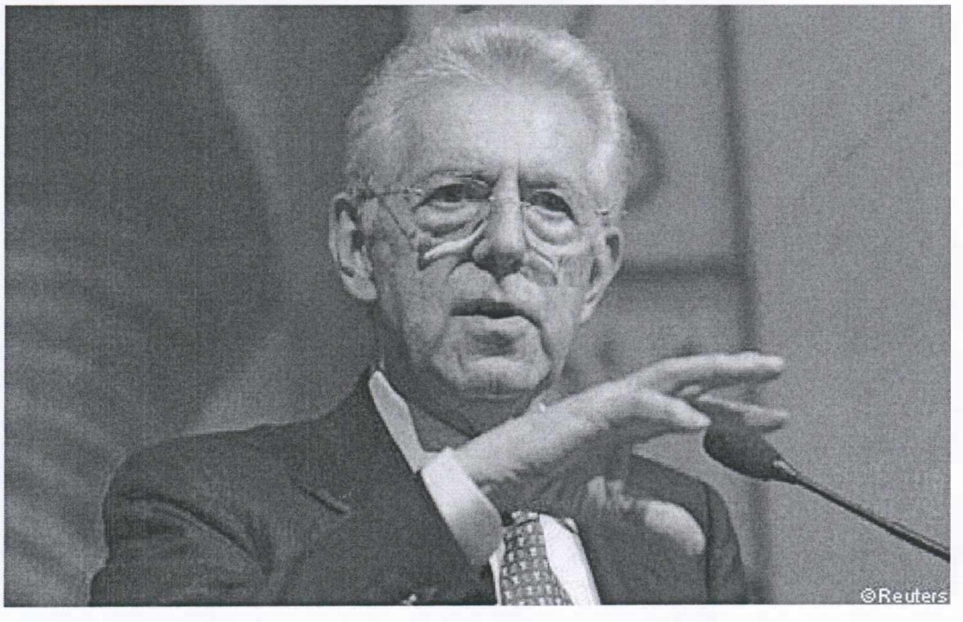
30

The wishes and worries of a parenthetic revolutionary

By Peter Spiegel and Guy Dinmore

Italy's technocratic prime minister has no criticism of ratings downgrades – just of persistent policy weakness at the European levelI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If there is anyone who should be angered by Standard & Poor's raft of eurozone downgrades, it would seemingly be the prime minister of Italy, whose debt was cut two notches with a warning of more to come. But on the first trading day after the credit rating agency's verdict, Mario Monti – a respected economist who became Italy's technocratic premier after the resignation of Silvio Berlusconi in November – is buoyant.

In an interview, not only does Mr Monti tell the Financial Times he agrees with almost everything in S&P's analysis, but he jokes that he could almost have written it himself.

"If I ever dictated anything, it must have been what S&P had to say about domestic Italian economic policy," he chuckles, before quickly correcting himself: "I never said the three letters BBB," a reference to Italy's new S&P rating of triple B plus. Apart from Cyprus, it is the lowest standing of any country in the eurozone not to have undergone a recent bail-out.

So pleased is Mr Monti with the report that on Monday he almost bounds to pick up a copy. It lies on his desk, a grandiose antique befitting the gold leaf, chandeliers and frescoed ceiling of his Roman office but cluttered with the detritus of a workaday economist: teetering stacks of paper, a half-empty plastic bottle of water, a personal inkjet printer.

The reason for his pleasure is apparent as he reads from the report. "It's very interesting when they go through the various factors, and concerning the political risk factor they say there is one negative: 'The European policymaking and political institutions, with which Italy is closely integrated'," he says. "And then they go on, saying, 'Nevertheless, we have not changed our political risk score for Italy. We believe that the weakening policy environment at European level is to a certain degree offset by a strong domestic Italian capacity'."

The upshot is clear: Mr Monti's 60 days in office have been enough to convince the agency that his government is on a path of reform that could return the country to growth and shrink its debt levels, but that European Union mismanagement of the eurozone debt crisis is dragging down struggling countries, including Italy with its €1,900bn ($2,400bn) debt mountain.

The prime minister's endorsement of the judgment is all the more remarkable as it comes as many of his counterparts have spent the days since last Friday's downgrades condemning the analysis. Olli Rehn, economics chief at the European Commission, the EU's executive, regretted the downgrades and called them "inconsistent", while other Commission officials intimated that S&P was improperly trying to inject itself into decision-making. Wolfgang Schäuble, German finance minister, opined that the rating agency had misunderstood how much progress had been made.

"I think I'm the only one in Europe not to have criticised the rating agencies," Mr Monti boasts.

His challenge to European economic orthodoxy could mark a new, uncertain direction for management of the eurozone crisis. Until now, leaders in the single currency's debt-laden periphery who fell into the EU elite's "good student" category – Ireland's Brian Cowen, Spain's José Luis Rodríguez Zapatero, Greece's George Papandreou – were cast aside once they lost domestic political support.

But at 68, Mr Monti appears unwilling to play the good student and comes with the credibility and stature those others lacked. He spent 10 years holding two of the European Commission's most important economic portfolios – taking on Microsoft and General Electric as competition commissioner, after five years overseeing financial regulation and the EU's internal market – while the likes of Angela Merkel of Germany and France's Nicolas Sarkozy were still junior ministers.

His long résumé in Brussels may leave him vulnerable at home, where his lack of formal political allies and electoral mandate complicates his reform efforts, a point he readily admits. But that same international standing poses an unprecedented and potentially uncomfortable dynamic for high-level decision-making in Brussels, particularly since Mr Monti is seen – rightly or wrongly – as having been the EU leadership's preferred candidate to replace the troublesome Mr Berlusconi. He is, in that sense, a challenger from the inside.

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Over the course of the 90-minute interview, Mr Monti is careful not to challenge his counterparts directly. Asked whether the S&P analysis is a condemnation of Ms Merkel, who is widely viewed as the driver of the current response to the eurozone crisis, he is diplomatic: "I don't think we can really single out one country or one person," he says.

Later on, when asked how concerned he is that strikes by taxi drivers and pharmacists could derail his reforms at home, he insists that when he wakes up in the morning, he is more concerned with "European leadership" than domestic unrest. "European leadership – not the German chancellor," he quickly clarifies.

Despite this diplomacy, his ensuing analysis directly challenges the Berlin consensus that financial markets will respond in a positive manner only to hefty doses of bitter austerity medicine. Growth and not austerity should be the focus of eurozone policymaking, Mr Monti says, and more effort should be made to drive down borrowing costs of the struggling periphery – a stance that German officials have pointedly resisted, fearing it will relieve pressure on Greece, Spain and, most prominently, Italy to reform.

"I am never saying to Italians that I'm asking for huge sacrifices because Germany or the ECB or the EU asks us to do so," Mr Monti says. "This would be disloyal, and I'm convinced it is for the good of future generations of Italians. But as the country approaches a structure that is the one that Europe wants each country to have, there has to be a visible improvement somewhere else. In a country like Italy now, the somewhere else can only be interest rates [on Italian bonds]."

The relationship between Mr Monti and Ms Merkel could prove the pivotal one in the next phase of the crisis, particularly as Mr Sarkozy becomes more preoccupied with his own survival with French elections just months away. Ms Merkel has showered praise on Mr Monti's efforts. But by pressing for help in pushing down bond yields, he is making clear that he wants something in return – be it a commitment to so-called "eurobonds" backed by all 17 eurozone members or an increase in the €440bn eurozone rescue fund. Both of those would rely heavily on Germany's balance sheet and both have been resisted by Berlin.

"I'm convinced, and the IMF is also convinced, that the more pledges are made [to the rescue fund], the higher the volume of pledges made, the smaller the probability that a single euro of cash will have to be disbursed," Mr Monti says.

Corrado Passera: A banker makes the tricky transition to politics

Among the notable figures chosen by Italian prime minister Mario Monti for the technocratic reformist government formed in November is Corrado Passera, former chief executive of Intesa Sanpaolo, the country's largest retail bank, writes **Rachel Sanderson**.

The urbane Mr Passera has one of the heftiest portfolios in the cabinet – he is a so-called "super-minister" with responsibilities for both economic development and infrastructure.

He is also considered one of the most likely to use his position among Mr Monti's suite of academics and business experts to segue into a full-blown political career, probably as a pro-growth centrist seeking the Roman Catholic vote. He has already begun opening up restricted professions, cutting red tape for businesses and selling off parts of the state's extensive property portfolio.

Appointing a senior banker to the cabinet would trigger public and political outcry in the US or UK today. But Mr Passera has made the shift with an ease that reflects his significant diplomatic skills but also the

The relationship could prove difficult, not least because of the battering Italy took from EU leaders during Mr Berlusconi's reign. Mr Monti makes clear he feels the need to show Italy his economic reforms are being driven by more than "just a pat on the shoulder to the prime minister by chancellor Merkel". Italians can be won over only if they "see that the country is well-respected in Europe – don't underestimate this aspect", he adds.

Germany may be the most important EU economy but at the same time "it is one of us and it also has obligations to which it normally complies", Mr Monti says, recalling run-ins he had with Berlin as a commissioner. "Certainly the bigger you are the more responsibilities you have and I think that, as also I hope, there will be an EU push for growth, just as a push in fiscal discipline; Germany will have to play a huge role."

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Italy's next push for growth comes on Thursday when the cabinet is set to approve what Mr Monti calls a "huge set of measures to open competition". Targets are taxi operators, pharmacies, energy providers and professions such as doctors, lawyers and notaries. The move is aimed at "the little and big rents and privileges that were the sedimentation of decades of private anticompetitive practices" as well as restrictions imposed by the public sector.

Although he sees his administration as a "parenthesis" before the return of a democratically elected government, Mr Monti agrees he could be bringing about a "revolution", at least in terms of the number of measures he intends to pass before elections due next year.

Will it last? If Italians see their nation's cost of borrowing falling, "the political parties will not dare stop the experiment before it has to stop", he replies. "And in my view the political parties will not dare go back to the acrimonious, superficial and tough confrontation that animated parliament. The image and style of the public debate has changed."

Despite the net €20bn austerity package of higher taxes and cuts in public spending passed last month, aimed at eliminating the budget deficit by 2013, Mr Monti has little to show so far in terms of restored market confidence. Already back in recession, Italy risks a death spiral of falling output requiring more austerity. The yield gap between Italian and German 10-year bonds remains at

importance of his deep understanding of the country's lenders at a time of crisis.

The downgrade by credit rating agency Standard & Poor's of Italy's sovereign debt to triple B plus, coupled with demands by the European Banking Authority for some of the largest domestic banks to raise more capital by June or risk nationalisation, has put lenders and businesses under renewed strain. Four of the largest financial institutions need to raise more than €15bn in additional capital at a time when investors willing to buy into Italy are in short supply amid fears of sovereign debt contagion.

Having often spoken out about the strains on the sector in the dying days of Silvio Berlusconi's government, Mr Passera continues to address the issue in his new role – even though oversight remains with the Italian central bank. When shares in UniCredit last week took a hammering, as Italy's largest bank by assets and one of Europe's most systemically important launched a €7.5bn rights issue demanded by European regulators, Mr Passera told Corriere Della Sera that lenders who had waited until now to raise capital were showing signs of difficulty, but that the system was solid.

The minister, who trained at McKinsey, the US consultancy, and has a masters degree in business administration from the Wharton School, maintains that the banking sector is robust. He says low exposure to property and high savings among consumers mean fears are overdone.

Asked about his future he was less frank, but did not rule out extending his political career. "Occupying oneself with public matters is extraordinary," he said. "It will be up to Italians to decide if I've done a good job."

around 5 percentage points, at a rate close to an unsustainable 7 per cent.

"Monti is putting pressure on Germany because the markets are heaping more pressure on Italy. S&P's downgrade brings Italy's credit rating closer to junk status," says Nicholas Spiro, a London-based sovereign debt analyst. "Italy has its back up against the wall and has not been the master of its own destiny for some time."

For the moment, Mr Monti has public support behind him. He notes that "monumental" pension reforms adopted last month – to the envy of France – were met by only three hours of strike action. His approval rating as measured by Ipsos, a polling agency, stands at 61 per cent, more than double Mr Berlusconi's and comfortably above that of Pierluigi Bersani, whose centre-left coalition would probably win elections if the government were suddenly to fall.

Too much success could also be a problem, Mr Monti says. Parties could become "jealous" if they see public support for technocrats remaining high while confidence in political parties remains low. Mr Berlusconi's People of Liberty and Mr Bersani's Democrats are in such disarray over policies and future leadership that they are in no state to risk early elections, which most Italians do not want.

"If and when success comes, you will find us not really taking credit," he says. But returning to his favourite theme, the prime minister concludes: "My ambition is that Italy becomes a boring country, in relative terms. It is really in the hands of Europe."

Additional reporting by Giulia Segreti