Italy Teeters on the Edge

Although all eyes may be on Greece, as the European Union and its oversight of national economies seems to disintegrate, it is less the impact upon this relatively small peninsular nation that threatens real collapse in the European Union as the impact upon the other peninsular nations. Iberia has two of the five "PIIGS" — Portugal and Spain — but the biggest nation and the newest edition to the list of wobbling fiscal systems is Italy, the fourth largest economy in Europe and the seventh largest economy in the world. The Italian economy is as large as those of Greece, Spain, Portugal, and Ireland all combined.

The Italian economy is also right on the edge. The latest data shows that the Italian economy shrank during the first quarter of 2012 by .8 percent, which means that the recession which has hold of Italy is growing deeper. That means the GDP is a full 6 percent smaller than in 2008. It also means that Italy, along among the major economies of the world, actually has a smaller per capita GDP than in 2000. The French economy, in the same period, posted zero economic growth.

One consequence is that the interest rates that the Italian government will need to pay in order to service its sovereign debts jumped by 16 points to 5.86 percent on ten year bonds when the bad economic news was released. That means investors want even more revenue from the Italian governments just to pay its existing debt. And that Italian national debt is really big, the third largest of any nation in the world after the €1.9 trillion, smaller only than the United States and Japan.

The current Italian government is led by Prime Minister Mario Monti, and Monti did not come to power in the usual fashion in parliamentary governments, via a general election. Instead Monti assumed the post of prime minister after Silvio Berlusconi resigned late last year. The projections are that Italy's economy will contract at annual rate of 3.5 percent this year, which is three times fast that the so-called "therapeutic" pace adopted by the International Monetary Fund.

Romano Prodi, the prime minister before Berlusconi, said that the European Union is risking "contagion" not only to Spain and to Italy, but also to France, if Greece leaves the union. As Prodi put it, if Greece leaves: "The whole house of cards will come down." Angelo Drusiani of Banca Albertini warned that the European Central Bank must become the lender of last resort or Italy will face "massive devaluation, three to five years of hyperinflation, and unbearable unemployment."

Investors are concerned. Nas Redeker of Morgan Stanley has stated that the European Union's mishandling of the Greek sovereign debt crisis: "The irrevocability of the eurozone is a valuable asset, and they are throwing it away. Global investors are preparing for the day Greece leaves…We are looking at this number very closely." Redeker also noted that almost half of this is owed to foreigners, with Germany, Holland, Finland and Luxembourg looking at fleeing these wobbly nations.

Terrorists in Italy are also reflecting the rising frustration of Italians who increasingly view their political leaders as incapable of solving a crisis that pinches ordinary Italians more tightly each day. Italian banks are caught in the middle. Moody's on Monday downgraded 26 different Italian lending institutions, noting: "Banks are vulnerable to the renewed recession in Italy, given their already elevated levels of problem loans and weakened profitability." The Italian Banking Association struck back, accusing Moody's of being "… irresponsible, incomprehensible, and unjustifiable. Moody's decision is an attack on Italy, its companies, its families and its citizens."

Ominously, the IBA also called on the European Union to clamp down on rating agencies (although such private firms sell information and advice and have little interest to providing a bad product.)

In Britain, David Cameron has defended his comments about the break up of the euro. His remarks came right before a conference with besieged Chancellor Merkel in Germany and incoming Socialist President Hollande of France. Cameron said that it was "… more dangerous to say silent than to speak out." What Cameron had said Wednesday, during Prime Minister Questions in the House of Commons, was that the eurozone "either has to make up or it is looking at a potential break-up."

With the British Prime Minister speaking so bluntly and with Chancellor Merkel, governing by far the largest economy in the eurozone facing such strong and growing opposition, it is hard to see how the default of Greece and then, like dominos, several other nations like Spain and Portugal, will follow. If Italy is forced into even a partial default, the game has grown much bigger. The banks of other nations, particularly France, hold significant amounts of Italian government debt. At the very least, many of the major banks in currently "safe" parts of Europe will have to restrict their lending if the crisis grows worse, which will affect many otherwise healthy businesses in other parts of Europe. The light at the end of the tunnel, if there is any, seems very faint indeed today.

Photo: President of the European Central Bank Mario Draghi, center, talks with Italy's Prime and Finance Minister Mario Monti, left, and Luxembourg's Prime Minister and chairman of the Eurogroup, Jean-Claude Juncker, at the European Council building in Brussels, May 14, 2012: AP Images