Italy’s central bank governor urges Giorgia Meloni to heed investors’ debt fears

Ignazio Visco says concerns persist about country’s long-term growth prospects

Martin Arnold and Amy Kazmin

Italy’s departing central bank governor has urged prime minister Giorgia Meloni’s government to soothe investors’ fears about the country’s debts by reducing its fiscal deficit and tackling reforms needed to boost growth.

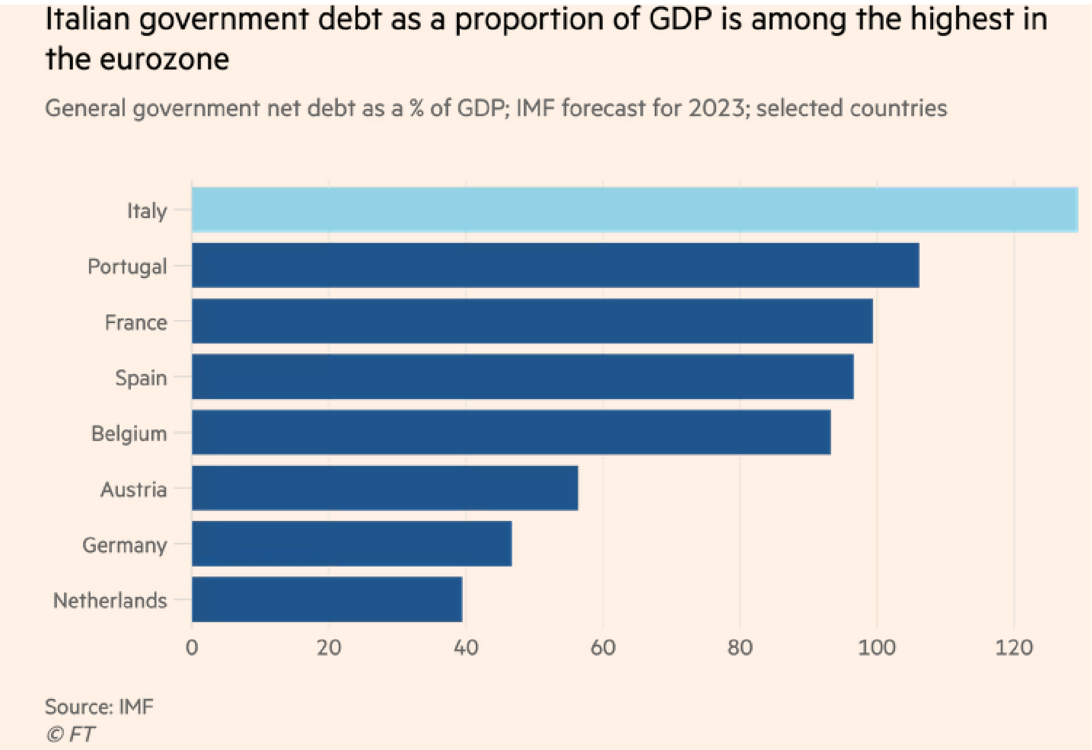
Ignazio Visco, who steps down at the end of this month after 12 years leading the Bank of Italy, told the Financial Times that the recent surge in Rome’s borrowing costs showed investors were “insuring themselves” against a spiral of weak long-term growth prospects and high debt.

“Obviously you need to understand why markets may be worried,” Visco said. “I don’t think it is speculation against the country. I think it is basically a concern about . . . the long-term potential growth rate of the economy.”

Italy’s benchmark 10-year bond yield last week surged close to 5 per cent for the first time since Europe’s sovereign debt crisis raged 11 years ago. The move came amid mounting tensions in global bond markets, which sold off heavily over fears central banks will keep interest rates higher for longer to tame inflation.

Markets were also spooked when Italy last month raised the country’s planned fiscal deficit for this year from 4.5 per cent of gross domestic product to 5.3 per cent and for next year from 3.7 per cent to 4.3 per cent. It also cut the growth forecast for both years.

The knock-on effect is that Italy's debt — one of the highest in Europe — is set to rise from 140 per cent of output, after two years of declines.



"The increase in the debt-to-GDP ratio has been mostly because of the dismal performance of GDP," Visco said, warning that "even the service sector is slowing down" and a eurozone-wide recession was possible in the second half of this year.

Rather than blame weak growth, some of Meloni's supporters have publicly suggested international investors — and her domestic political rivals — are collaborating to seize on market turbulence in an effort to unseat her government.

Silvio Berlusconi's government was felled in 2011 after a crisis in which Italy's bond yields soared to more than 570 basis points above Germany's.

The closely watched spread between Italian and German 10-year bond yields is close to 200bp — a level that Visco said was "a concern that it is much higher than in Spain or Portugal".

However, Visco said Meloni's government had been "performing better than many had expected" on its budget, avoiding her former UK counterpart's ill-judged tax cuts, which caused a bond market crisis. "Maybe Liz Truss was there to show the way not to make mistakes in communication," he added.

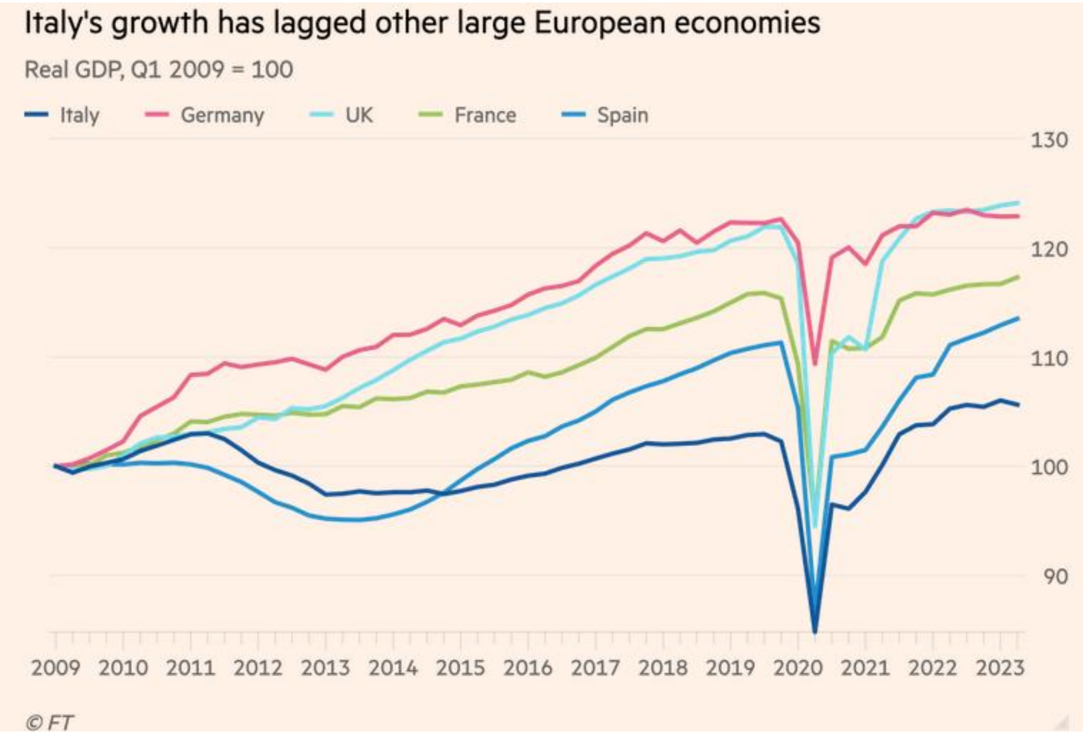
But he urged Meloni's government to recognise that international investors have legitimate concerns in a climate of rising interest rates, high energy costs, tensions in the global trading system and Italy's rapidly ageing population.

"This is why you have to respond to the markets with two things: First, a view of the longer-term plan for growth and second, the action on the short and medium term as far as the fiscal imbalances are concerned," Visco said.

For now, Rome is tapping support from Italians' high domestic savings to meet its borrowing needs. This week, Italian households invested more than €17.2bn in a bond issue targeting local retail investors.

Visco has served eight different Italian prime ministers since taking over from Mario Draghi as head of the central bank, which he joined in 1972.

He remembers writing a paper 32 years ago recommending a freeing up of competition in the services sector, as well as measures to reduce divergence of the poorer south from the richer north and to bring down government debt. "It is no different now," he said.



Yet Visco believes the outlook for Italy is not all gloomy.

Rome has various avenues through which it could bolster growth, including making the most of €200bn in funding from the EU and bringing more women into the labour market. "Italy can grow more and we should not ignore the low levels of private indebtedness and the positive net foreign position of the country," he said.

Currently, Italy has the lowest female labour force participation rate of any major European economy.

“There are a number of things in Italy that are not on a par with what you have in the rest of Europe, like the ability to have children in school for the whole day,” Visco said, adding that Rome could also focus on better integrating immigrants into the workforce and improving training in digital skills.

He was critical of the costly Superbonus scheme designed by a previous government, which offered Italians tradable tax credits worth 110 per cent for home improvements that would cut energy use.

The scheme triggered an Italian home renovation frenzy now weighing heavily on public finances. Though the final cost of the programme — now phased out — remains unclear, Visco said the final tab is likely to exceed €100bn, or about 5 per cent of GDP.

He said it was “unfortunately a good lesson, a very good lesson” in the importance of “targeting and tailoring” in government programmes, and said Rome’s initiatives to assist poor households with high energy costs had been far better designed.

Visco said the Banca d’Italia was “not consulted” before Meloni’s government roiled markets with a windfall tax on commercial banks’ net interest margins. But after it was watered down last month — giving banks the option to bolster capital instead of paying the tax — he “welcomes the changes so far proposed”.