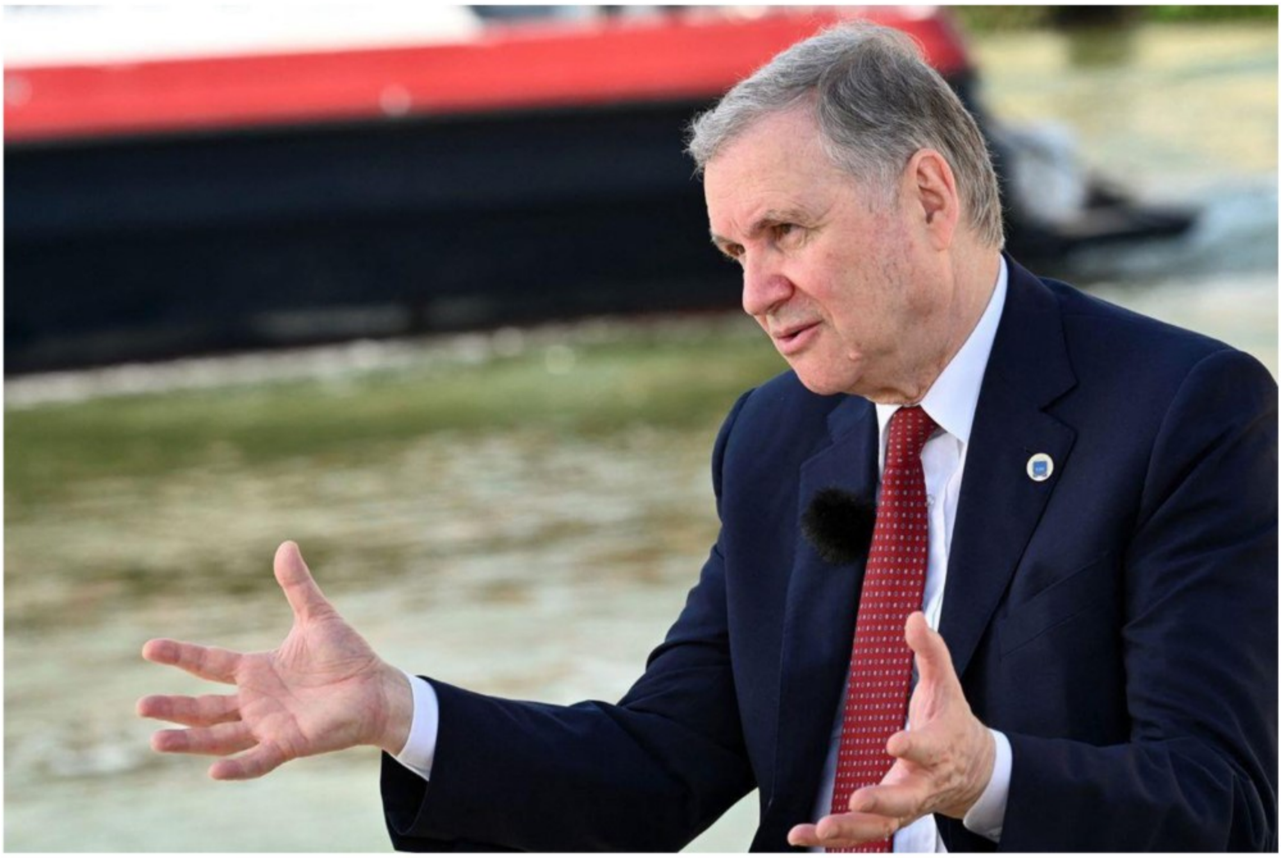
Italian central banker plays down chance of big rate hike in September

The real economy 'is not terribly encouraging,' according to Italy's central bank chief.



Bank of Italy Governor Ignazio Visco argued that markets are not excessively worried about Italian political turmoil

By Johanna Treeck

ROME — The European Central Bank may refrain from another robust interest rate increase at its next meeting amid the tepid growth outlook in the eurozone, Governing Council member Ignazio Visco has hinted.

In an interview with POLITICO, Visco dampened hawkish hopes of another 50-basis-point (0.5 percent) hike in September, following the ECB's first rate hike in 11 years announced last week.

He declined to say explicitly whether September would see a hike of 25 or 50 basis points, but noted that the central bank's decision will be based on "the developments in prices and in the real economy, because the real economy affects prices."

"What we see in the real economy, certainly it is not terribly encouraging," added Visco, who also heads Italy's central bank.

Last week, the ECB delivered an increase of 50 basis points — larger than it had initially flagged — citing another upside surprise to eurozone inflation, which hit a record of 8.6 percent in June. The Governing Council said it expects to lift rates further in September, with the size hinging on incoming data.

As far as latest growth signals since then, "everything was dismal," Visco said, citing bleak data on consumer confidence, manufacturing and German business sentiment.

"China is an uncertain case, but certainly the zero COVID policy is not helping," he added. "And in the United States, a technical recession cannot be excluded."

Slowing growth could stabilize prices over the medium term, which would allow the ECB to act less aggressively. But Visco also pointed to developments pulling in the other direction that can keep inflation hot. These include the ongoing risks of supply shocks induced by the pandemic and the Ukraine war as well as the euro's weakness against the dollar.

The euro has fallen to a 20-year trough to hit parity with the greenback, adding to the ECB's inflation headache. The main effect is through energy imports, which tend to be denominated in dollars. And a big driver behind euro weakness is the fact that ECB has only begun its tightening policy, while the U.S. Federal Reserve has been hiking for longer and more aggressively.

"In the short term, the interest rate differential between the eurozone and the U.S. certainly has a role to play," Visco said.

It's too early to say where rates would peak, he added.

"I'm not prepared to say that we are going to have another 50 [basis points] in order to go as quick as possible towards the target, which we still don't know really where it is," he said. But the darkening growth prospects aren't grim enough to force the Governing Council to abort its tightening plans after September, because monetary conditions are still very loose, he argued.

Eyes on Italy

Visco struck more positive notes on the ECB's new crisis program, dubbed the Transmission Protection Instrument (TPI), assuring that the Governing Council would be ready to act swiftly if needed. It unanimously signed off last week on the tool, which allows the central bank to buy government bonds of single member states if the country's borrowing costs jump due to market jitters rather than solid economic reasons.

The need for such a program emerged in June as prospects of tighter ECB policies pushed the risk premium that investors demand for holding Italian bonds over top-rated German bunds, the so-called spread, close to 250 basis points.

While the Governing Council set a slew of conditions and eligibility criteria for TPI — such as fiscal sustainability and the absence of severe macroeconomic imbalances — ECB President Christine Lagarde underscored last week that the decision to use it will ultimately depend on its members' judgment.

Visco dismissed concerns that this room for discretion could add to market jitters or even prevent the program's activation.
"This is about an empirical assessment that we may have, it is not ideological," he said. "It is not that it will be subjective. It will be a decision based on a number of objective factors that have to be put together. And putting together these factors requires honest and deep discussion."

What's important, Visco said, is that the ECB has all the necessary information at hand so it can assess macroeconomic imbalances and fiscal sustainability prospects for each member state. Asked whether he thinks the ECB could launch purchases within 24 hours, he said: "I think so. Why not?"

The question of urgency isn't a theoretical matter, as the swift collapse of the Italian government under Mario Draghi showed last week. That jolted concerns that Draghi's departure could further boost Italy's borrowing costs.

However, Visco took a calmer view, arguing that markets are not excessively worried about Italian political turmoil. He pointed out that German-Italian spreads are still below the levels seen in mid-June, when Draghi's post was still secure. He also described the most recent movement in spreads as a function of investors seeking reassurance at a time when tighter ECB monetary policy and slower growth in Italy may make it difficult for the country to whittle down its debt pile to meet EU fiscal rules.

On Wednesday, spreads on Italian 10-year bonds resumed their upward movement, while the rating agency S&P Global changed its sovereign rating outlook to stable from positive.

As for Rome's commitments made under the EU recovery fund — paving the way for more EU funds and unleashing the economy's growth potential — Visco said he's optimistic the government will come through, regardless of who takes power after the September 25 elections.

“I take it that [Rome] will deliver,” he insisted.

Policy not politics

Visco, a fan of the novel "The Pillars of the Earth" by Ken Follett — an epic tale of anarchy and power — said Italy needs to be judged by its policies, not its politics.

For all the saber-rattling expected during the campaign ahead, the election's winner will have to understand they aren't free to do whatever they want, he noted. "It's crucial for the rate of growth to go back to relatively decent rates," he said. "To achieve this, Italy set objectives under the Recovery and Resilience Plan."

While the precise policy mix to deliver these objectives may change, "any next government will have to maintain the objectives that have been put together over the last few years," he added.

Far from fearing that Italy's economic troubles will push the eurozone into the next debt crisis, "the economy in Europe is extremely more resilient and much more united," he insisted. Exactly 10 years after Draghi's famous “whatever it takes” speech, which is widely credited for saving the eurozone, Visco sees "zero risk" of the currency union falling apart.

Rather, the key challenge for the eurozone today is to ensure growth and build on its joint fiscal capacity.

"In Europe, you need the fiscal capacity and [movement] towards a fiscal union," he said. "You cannot have one monetary policy and 19 different fiscal policies."