ROSSI:Confident On Greek Crisis Outcome; Little Risk For Italy

By Silvia Marchetti

ROME (MNI) - Bank of Italy First Deputy Governor Salvatore Rossi said that the European Central Bank's asset purchase programme has already had a positive impact on the Eurozone economy. He expressed confidence that a solution to the Greek crisis will be found, and did not want to even consider the hypothesis of a Grexit.

In an exclusive interview with MNI, conducted late last week, Rossi said that Italy's economy was back on track after a double-dip recession and that the government's upcoming plan to let banks get rid of bad loans would help revive lending.

"I am not going to speculate on the probability of a Greek exit from the Eurozone. I am confident that underway negotiations will have a positive outcome. As an economist I can say that the euro area is now in a much better shape compared to 4 years ago when it was at the height of the sovereign debt crisis, so the Greek situation seems to be a quite unique case," said Rossi.

But Greece's shadow looms over markets. "The risk of contagion (for Italy) seems to me very, very little. There are still risks of course, there are always risks. But I think nobody wants Greece exiting Europe and I don't want to even consider such a hypothesis," he added.

Rossi hailed the ECB's quantitative easing: "It is safe to say that the QE is functioning as much as it was expected. Most importantly we see Eurozone growth prospects improving while inflation is again in positive territory. The programme as it unfolds is the right answer to address the problem of a too low inflation for too long a period."

The Deputy Governor said "the programme will not be terminated before September 2016 or in any case before there is lasting and convincing evidence that price dynamics has changed significantly and is in line with the target of price stability."

Asked whether there might be a chance that the programme is extended beyond September 2016, Rossi answered that "in case next year the Governing Council of the ECB is not yet convinced that price stability has been restored the programme will continue."

Rossi does not see either the need of further unconventional measures by the central bank to support growth "at least for now," or of including corporate bonds in the QE, on top of asset backed securities and covered bonds, already included.

"I see no need to modify the purchase programme to address the problem of how to revamp lending to corporates, in particular SMEs. It would introduce non-negligible technical difficulties. How can the ECB buy bonds issued by a tiny firm in southern Italy or France? The TLTRO is the right ECB tool to support the financing needs of corporates, thus contributing to achieve the goal of restoring price stability," he said.

Lending is still weak in Eurozone, and Italy does need more credit but not for all its firms, Rossi argued, who made a clear distinction.

"Seven years of recession have triggered a polarisation of our corporate sector. The best portion of firms is profitable, they exports, have a positive cash flow," Rossi said. "They do not need much bank lending. The worst portion are small firms in trouble that should rather exit the market and be replaced by start-ups."

"The main problem is with the middle portion, representing between one-third and one-half of the corporate sector, not performing as well as the top firms, but with a clear potential of recovery: they deserve to be financed," he added.

Rossi explained that monetary policy alone cannot do miracles. It can cure the cyclical but not the structural lack of growth and employment which needs to be addressed by structural policies.

The Italian government's ambitious structural reform plan, set to push Italy's GDP up to +3.6% by 2020, goes in the right direction and is exhaustive in addressing all chapters of a radical, structural change of the economy and society.

"The results up to now are mixed, in some cases there's a clear advancement, in others the programme is lagging behind but all main issues are considered. What is prominent in my view is to change the legal system and education. These are the pillars of a new, reformed Italy able to put our country on track with the evolution of modern times."

Following the QE launch the Bank of Italy raised growth forecasts to exceed 0.5% this year and be around 1.5% in 2016. And the outlook is already moderately positive, Rossi noted.

"Italy's recovery is clearly underway," he declared. "The official data for the first quarter of this year, +0.3% q-o-q, was higher than analysts' and our own expectations. But the most important figure is the +1.5% growth of investments: it's what we have been badly waiting for at least a year. Investment is now finally picking up and this will make the recovery more sustainable."

A return to growth is key to curbing Italy's soaring public debt, set to reach a peak of 132.4% this year according to government data, but it will then start to fall to 130.9% in 2016, 127.4% in 2017 and 123.4% in 2018.

"In order to reduce debt you need above all a primary surplus (Italy had one for years), and a sustained economic growth," Rossi said. "Privatisations of public owned companies can help if well prepared and well implemented, but growth is key."

The existing flexibility in the EU fiscal rules can also play a role in striking a balance between the need to continue fiscal consolidation and the need not to hamper the recovery: "This is nothing new, we need to exploit rules that are already there and this has already been agreed between Italy and EC."

The creation of a capital market union is crucial for Italy, too. "We must shift from a bank-centred to a more capital market oriented financial structure," said Rossi.

Corporates must rely less on banks. They should boost their capital and increase the recourse to bond issuance for investments. "This is not an easy task and requires a medium term process."

Rossi turned-down the risk that investors might have less confidence in Italy's financial system following the ECB's comprehensive assessment which has brought to light capital shortfall in some Italian banks.

"All banks passed the AQR and just two did not pass the adverse scenario of the stress tests, notwithstanding the fact that the Italian economy was hit by the recession more than the rest of Europe, and that public support to banks was negligible in comparison with other important member states. On the overall, taking into account these factors, it's a good result" that shows the resilience of Italy's banking system.

That does not mean though that it's all plain sailing. The financial system is in need of a structural evolution. The reform of the big cooperative banks is a first step: it will make those banks more competitive and able to raise capital more easily, on the market when needed. Another important step is the agreement recently signed between the Ministry of Economics and Finance and the Association of Banking Foundations, strengthening the autonomy of banks which have foundations among their shareholders.

Rossi said progress was being made in a government plan aimed at getting rid of non-performing loans (NPLs) sitting on banks' balance sheets and which have climbed to E350 billion.

"The government is working at it, with the technical assistance of the BoI. There's a market failure there, worth a public intervention respectful of the EU rules on state aid."

The plan would first of all remove some inefficiencies in insolvency procedures to reduce the very long credit recovery period in Italy (on average, almost eight years!), thus lowering the spread between the price at which banks are willing to sell NPLs and that at which private specialised entities are willing to buy.

"These measures would help a lot, but the government is also trying to figure out a vehicle, an asset management company (AMC, better defined as an 'opportunity bank'), that would play in this market as a central figure, and is discussing with the EC on how to make this plan work without infringing EU rules against state aid," said Rossi, adding that a true "bad bank, like the one set up in Spain three years ago for banks which were not viable, and massively supported by European public funds, would be inappropriate in our case, and is anyhow now ruled out by EU legislation."

MNI London Bureau; tel: +44 207-862-7495; email: mbaccardax@mni-news.com