Italy refuses to panic as speculators swarm

Monti's woes

Rome expects an August attack on its sovereign bonds and talk is growing of an early election, says **Guy Dinmore**

Faced with its most serious crisis on financial markets since taking office last November, Italy's technocratic government insists it will not be panicked into taking further emergency budget measures but will keep lobbying for a united European response.

Italy is bracing itself for a speculative August attack on its sovereign bonds in what it commonly calls "dysfunctional" markets where Germany is able to borrow short-term money at negative interest rates while Italian yields are tracking those of Spain close to euro-era highs.

As one Italian official put it, Rome will be paying through the nose to borrow money to help bail out Spain's banks – to the benefit of their creditors in northern Europe which are benefiting from the lowest interest rates on record.

While European leaders are setting off on their summer vacations, Mario Monti, prime minister, is preparing to visit Helsinki next Thursday to press Italy's case.

Finland and the Netherlands have voiced strong opposition to using the eurozone's bailout funds to buy Italian debt, which was agreed in principle at the last European summit in late June although the scope and conditions have yet to be agreed.

A Finnish official reiterated that eurozone purchases of Italian debt on the open market were like "shooting in the dark". But he said Helsinki was willing to consider "a surgical operation" of targeted interventions on the primary market when Italy auctions its debt.

Mr Monti is sending a message to his European partners that Italy has "done its homework" in implementing tax increases, spending cuts and structural reforms and would not be panicked into passing additional budget measures that risk sending the economy deeper into recession.

Rome is being forced into issuing almost daily denials of an "emergency plan B", the latest yesterday being a rejection of reports that the government was preparing to eliminate the December "13-month" payment to civil servants and pensioners.

Italian newspaper headlines have been dominated by market developments with the widening of the yield gap between Italian and German benchmark bonds to 537 points on Tuesday – above the level when Mr Monti took over last November following the resignation of Silvio Berlusconi. Mr Monti held crisis talks with leaders of the two main political parties supporting his appointed technocrats in parliament following a week of intense speculation that Italy is heading towards early elections in November, some six months before the end of the prime minister's mandate.

Part of that speculation has been driven by what many foreign analysts call a mistaken belief that a mandate for a new five-year government – possibly a coalition with Mr Monti being asked to stay on as leader – would remove the political uncertainty that is damaging Italy on the markets.

Pierluigi Bersani, leader of the centre-left Democrats who are leading in opinion polls, emerged after his meeting with Mr Monti to dismiss reports of snap elections as "peculiar" and "simply gossip". However, he did not entirely close the door on the possibility if the main parties reached agreement on a new electoral law. Talks between the Democrats and Mr Berlusconi's centre-right People of Liberty on reforming Italy's widely hated electoral system appear to be heading nowhere however, with each blaming the other for the impasse.

In a display of the tensions between the two main parties backing Mr Monti, the Democrats walked out of the Senate on Tuesday as Mr Berlusconi's party and his former Northern League allies passed a vote to establish a "semi-presidential" system with the head of state elected by the people rather than parliament.

The vote was denounced by the Democrats as a time-wasting electoral campaign exercise, since there is virtually no chance that parliament would have the time or numbers to pass the constitutional changes needed before Giorgio Napolitano steps down as head of state at the end of his mandate next May.

Last August the European Central Bank stepped in to buy Italian bonds on the open market, but officials in Rome are under no illusions that they are facing a long difficult summer.

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Lending remains tight, says survey

Eurozone banks are continuing to make conditions more difficult for borrowers even while demand for loans remains weak, according to a European Central Bank survey that suggests limited scope for a quick upturn for struggling economies, **writes James Wilson.**

The ECB's latest quarterly bank lending survey showed more banks were expected to tighten lending standards further in coming months, after steadily making credit harder to come by for companies and households in the first half of this year.

Eurozone banks also continued to report a significant fall in corporate demand for loans, amid a lack of investment plans from companies hit by the economic downturn. The gloom around bank lending and demand for credit comes despite the ECB's €1tn injection of liquidity into the financial system since December.

Germany's Ifo index also showed concerns over growth spreading to the stronger eurozone core, with the Munich institute's business climate index dropping to its lowest level in more than two years.

And this week, purchasing managers' indices showed German output dropping at the fastest rate in three years.

"Both surveys, Ifo and PMI, increasingly point to a weak economic outlook for Germany in the second half of 2012," said Thomas Harjes of Barclays.

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