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PRESS WATCH - Economic Agenda: The anti-EU revolt is fast gaining impetus

I am writing this from Rome, where Former Prime Minister Matteo Renzi just stepped down as leader of the centre-left Partito Democratico. Italian politics, once again, faces chaos, Liam Halligan writes in The Sunday Telegraph

Renzi previously resigned as Premier, having lost a botched referendum on constitutional change last December. Once tipped as Italy's political saviour, the 42-year-old former Mayor of Florence must now win a renewed leadership battle if he is to restore his political credibility.

But with the PD's left wing in open revolt, Italy's ruling party is now hopelessly split, less than a year ahead of national elections. That helps the anti-establishment Five Star Movement, of course – which wants the eurozone's thirdbiggest economy to quit the single currency. Even before last week's infighting, Five Star sat level with PD in opinion polls.

Italy has barely grown since the euro was launched in the late Nineties. Locked in a high-currency straitjacket, it has endured almost two decades of stagnation and has youth unemployment exceeding 40pc.

While northern Italy remains quite buoyant, some southern regions have unemployment across all ages above 50pc. Even last year, despite ultra-low interest rates and billions of euros of quantitative easing from the European Central Bank, Italy managed growth of just 0.9pc, amid shocking bank failures and a spiralling national debt, now 133pc of GDP. On cue, the European Commission last week warned that Italy's debt represented “a major source of vulnerability”. Brussels once again urged Rome to implement fiscal cuts and other “structural measures” – adding to the growing anti-EU mood and further bolstering Five Star. As PD plunged back into turmoil, Italian bond yields spiked to their highest level since the Greek crisis of mid-2015.

The Italian economy is 10 times that of Greece. A bailout, then, could be impossibly expensive. With $2,500bn of public debt, Italy also has the world's third-largest sovereign bond market – a market now dependent on the on-going drip feed of euro-QE. Much of that debt is held by a domestic banking system swaying under the weight of non-performing loans exceeding 20pc of national income.

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An Italian sovereign default would shake the global financial system to its foundations. It could happen if the banking system slides or an Italian euro exit looms – which would certainly be the case if Five Star wins. Just that prospect could push yields to crippling levels, with Rome unable to service its vast debt pile. With Renzi on the ropes and his party up in arms, that danger just increased.

Given last week's Parliamentary debate on Brexit, Tony Blair's intervention and by-election antics, much attention is being paid to how domestic UK politics will affect our upcoming negotiation with the European Union. With those talks due to start by the end of next month, after Downing Street has triggered Article 50, we should be paying far more attention to what's happening on the Continent.

For as “the European project” comes under more pressure, the UK’s hand gets stronger. The British electorate voted last June for a looser relationship with the EU, restoring national democracy and reversing years of centralisation. Electorates across Europe, even more dramatically perhaps, are pushing for the same.

Yields on short-term German bonds last week hit record lows amid growing fears Marine Le Pen could prevail in the upcoming French Presidential election. Also campaigning to take her country out of the euro, the growing confidence of the Front National candidate, coupled with the faltering of her opponents, saw investors switch from French to German assets.

Polls show Le Pen winning the first election in April, but still losing the May run-off. Yet, in recent months, other “consensus” election predictions have spectacularly failed. Over the last year, the spread between French and German sovereign bonds has quadrupled, to almost 90 basis points – a level last seen during the euro crisis of late 2011 and early 2012.

Most observers think of the eurozone as relatively stable. The bond markets tell a different story – of a crisis barely suppressed. Across Italy and France, investors are now deeply alarmed that domestic politics could be upended, as eurosceptic parties get stronger. That is before we consider the Netherlands, where Geert Wilders' Freedom Party is at the top of the polls ahead of elections next month.

The tragedy that is Greece rumbles on, meanwhile, with yet another bailout heralding more painful cuts. Athens' epic struggle to avert bankruptcy should have been settled back in May 2010 after the EU and IMF bankrolled a €110bn aid programme, the biggest financial rescue in history. Three bail-outs later, and with the latest emergency loan in the balance, this proud country is still struggling to survive in the cruel economic trap which is the single currency.

UK fourth-quarter growth was last week revised up to 0.7pc, meaning our economy expanded by a relatively healthy 1.8pc in 2016. Exports were up 4.1pc. While the UK faces huge challenges, compared to some EU counterparts our economy appears rather buoyant and our domestic politics, in relative terms at least, and despite on-going Brexit dilemmas, astonishingly stable.

Brussels bureaucrats will keep grandstanding over the need to "punish" the UK for leaving. The reality is, though, that by holding a referendum, and engaging in a vigorous debate about the EU, Britain has not only raised our long-term growth prospects but also largely defused the danger of genuine political extremism. Our European neighbours need to learn the same lesson, lest it be forced upon them.

Liam Halligan in The Sunday Telegraph, February 26, 2017

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