Global Counsel

The Renzi dilemma

Blog post by Partner Stephen Adams, 11 July 2016

What connects a bank in Sienna to a voter in Sunderland? Simple answer: they both have a problem with the EU, or think they do. Matteo Renzi wants a state aid waiver for support for the Italian banking sector, but new EU bail-in rules suggest he will have to force debt holders – many of whom are poorly-informed retail customers – to bear some of the costs of recapitalisation or resolution.

Renzi faces a referendum in October and a rising Eurosceptic 5 Star Movement. Renzi may be wrong to suggest that the post-UK referendum volatility in itself justifies scope for flexibility with the rules, but he is right that a sense that Brussels is tying his hands spells a political problem. In that sense, the Brexit link couldn’t be clearer.

The EU is always divided into politicians whose narrative depends on the rules being enforced, and politicians who rely on them being tactically bent. Countries and politicians change sides opportunistically, but since 2010 the lines have been pretty stark. Politicians in EU creditor states have traded their way through the Eurozone crisis by insisting that EU rules are being robustly followed – even when the reality is more fudged. A structurally weaker group of leaders in the periphery states have had to get by with small concessions on fiscal austerity, bank bailouts and limited forms of debt restructuring. They have paid a high price in general for the inability to flex the EU response.

Italy never took either a sovereign or bank bailout, so it avoided the worst political forms of swallowing EU medicine, although it did suffer the object lesson of having Silvio Berlusconi effectively forced out of power by Angela Merkel’s egging on of sceptical markets in 2013. But dodging the EU’s discipline then is also in part its undoing, because it arguably helped delay tough action on Italy’s endangered banks.

Renzi has inherited the problem at the point at which the issue can’t be dodged. He can’t sidestep the bank issue any longer. He can’t enforce EU rules without tipping his own administration into crisis. He can’t break the rules without running head on into a confrontation with Berlin and Brussels. Berlin and Brussels can’t allow the Italian banking system to go down, or Italians to have one of their periodic bouts of nostalgia for the lira.

Of such things fudge is of course made. We can expect a workaround that gets some state money into Monte dei Paschi di Sienna at least without writing down retail bondholders, although no doubt with conditions attached on rationalisation. The bail in system never properly accounted for the possibility of retail bondholders of this kind and will need to be fixed.

But the bigger problem is the bigger problem. The European banking union single deposit insurance scheme is stalled – like the debate on Greece’s long term future is stalled - because politicians and voters in ‘creditor’ and ‘debtor’ states have such divergent views of their interests and how the EU should reflect them. Anyone who thinks the EU is going to look anymore consensual on its future direction with the UK out of the way just needs to follow the MPS debate. The lesson of Brexit and Sunderland is obviously that there is great political risk in ignoring such views. The problem for the EU is that the problem looks so different in Berlin and Rome.