
4 Italy, the ECB, and the need to avoid another euro crisis

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Start with the basics, the first two points being the most important.

- The Italian government is behaving extremely responsibly – more so than many.

It is putting health considerations and the control of the epidemic ahead of short-term economic considerations – exactly as it should.

This commitment will have large economic and fiscal costs. But, at the interest rate that prevailed until yesterday (less than 1%), even a large increase in the debt ratio – even of the order of 10% to 20% – does not put debt sustainability into question. As we know, however, there is another equilibrium, one in which investors' fears are largely self-fulfilling.

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By asking for higher rates, they increase the interest burden, make life difficult for the government, and may lead to the very crisis they fear. Such an increase in rates is totally avoidable. It takes some institution to take the opposite side, buy as much as needed, and maintain the low rates. In the euro area, this has to be the ECB.

The ECB can intervene in the context of an Outright Monetary Transactions (OMT) programme. This, however, requires the agreement both of Italy and of all euro members. Italy may be reluctant to accept the conditionality that comes with such a programme. But in this case, conditionality should be very limited, and easy to define: spend what you must on crisis containment and commit to wind down everything once the crisis is over. Full stop. No stigma.

Other countries might balk. They should not. There is no moral hazard here, no need for punishment for past sins. Just help for a member country that needs help, which can be provided at likely zero cost, and in the process saving the euro area.

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The OMT route takes time, however. The ECB, instead, can act directly and stand ready to buy Italian government bonds at a given rate. This is what the Bank of Japan does, and it works (yields have not increased).

The constraints on the scope of intervention by the ECB are the capital key and a 33% limit on ECB holdings of debt of a particular country (which is not yet binding for Italy). Both are justified in normal times. Both can be suspended in exceptional times, and both should be.

The last thing the world needs at this juncture is another euro crisis. The ECB should and can avoid it.

About the author

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