III. The Doomed Trans-Atlantic System

Italian Bank Deal Postpones Eurozone Financial Collapse—But for How Long?

by Claudio Celani

What were you doing on Tuesday, Jan. 26? Were you expecting the collapse of the entire Euro system that day? European bankers and the European Commission were. In order merely to put off that collapse to another, future, day, on Jan 26. they suddenly pushed through a violation of their own rules. They decided to allow the Italian government to "bail out" the bad debts of its banks,— contradicting their new rules which came into effect Jan. 1, which supposedly ruled out further "bailouts," and required banks to seize, or "bail in" the assets of bondholders, shareholders, and even depositors to make good their losses. As in Cyprus in 2013.

The Italian banking system was collapsing on Jan. 26. But Italy is not Greece or Portugal, or even Spain. A blowout of the Italian banking system would have brought down the whole Euro house of cards immediately. —ed.

Feb. 1—A last-minute deal struck between the European Commission (EC) and the Italian government avoided an early collapse of the Eurozone on Jan. 26. A simple trick was pulled to allow the Italian government to extend guarantees on bad bank loans, temporarily relieving speculative pressures which were crashing the entire Italian banking system. However, the cause of the crisis, the bankruptcy of the entire European and Wall Street banking system, was not addressed, and therefore the threat of an implosion was only postponed. Meanwhile, Italian economist Paolo Savona is calling on Italy to present an ultimatum to the EU, and if necessary to leave it before Italian sovereignty is totally destroyed as Greek sovereignty was destroyed.

creative commons/Vyacheslav Argenberg

Headquarters of the Italian bank, Monte dei Paschi di Siena, one of the southern European banks hit by the flight of deposits to Germany, Luxembourg, and Holland.

European banks are loaded with one trillion euros of bad loans, according to official (and unreliable) statistics. Italian banks alone account for 40% of that mountain. But this is only a potential trigger, not the real problem. On top of the bad loans, there is an incalculable mountain of financial derivatives in the hundreds to thousands of trillions. Deutsche Bank alone reported over 22 trillions in notional value of over-the-counter derivatives in 2014. There is the real dynamite.

The mudslide on global financial markets unleashed by the collapse of the commodity and oil bubbles, has produced a bloodbath of bank shares in Europe, in many cases halving their prices. The introduction of the new EU bail-in rules in 2016, which forbid a conventional government "bailout" unless preceded by a "bail-in" of shares, bonds and deposits, has unleashed an additional run on banks, aggravated by the usual vulture funds shorting their bets on those same banks.

The Italian banking system has been targeted as the weakest point for economic reasons. Initially, the introduction of the euro currency had raised the prices of Italy's exports while cheapening its imports. But the negative effects of the post-2008 depression were worsened by the austerity policy imposed on Italy by the EU, through the Monti government in 2011-2013.

Then Obama's sanctions against Russia further collapsed Italian export industries. As a result, Italy has lost one fourth of its manufacturing capacity, consumption has collapsed, and workers have lost their jobs. It is calculated that 800,000 families are unable to make payment on mortgage and personal loans.

This is a large part of the banks' non-performing loans, which are officially at 200 billion euros, plus another 160 billion at a critical point, on the verge of non-perforemance. (Some sources say the real figures are much higher.)

The rest of the non-performing loans are owed by insolvent firms in construction and manufacturing. These losses cannot be kept off the balance sheet, unlike the financial losses which the investment banks can hide with derivatives or by trading schemes.

Italian banks, with one exception, did not need a government bailout in 2008, because they were less exposed to toxic trading than other European banks, but are now threatened with insolvency because of the collapse of loans tied to the productive economy. And now they cannot be bailed out because the European rules have changed.

Capital Flight

Now, within the EU system, only a bail-in procedure is allowed, with which the Italian government had experimented last December, when four minor banks were put through a special resolution scheme which involved bailing-in (seizing) subordinate bonds of bank customers. The backlash was so large, that such an action cannot be repeated in the future.

The fact is that many Italian depositors have put their money in bank bonds, without being informed that they were to be considered as "investments" and thus, subjected to the bail-in rule. It is calculated that at least 30 billion euros of subordinate bonds are in the hands of retail customers. When the four banks were bailed-in, it was discovered that thousands of depositors had been cheated by being convinced to buy such bonds, and many of them lost all their savings. One pensioner in Civitavecchia, Rome, committed suicide, and this case shocked the country.

Thus, the government cannot allow any bail-in in the future. Moreover, the fear of a bail-in has caused a real run on deposits. Data put together by financial analyst Mike Shedlock show that large-scale flight of capital (deposits) out of southern Europe, especially Italy, is flowing into banks in Germany, Luxembourg, and Holland. The new deposits are in turn put into the ECB, despite the -0.3% interest rate of the ECB for such deposits. This so-called flight capital in fact amounts to an organized, classic bank run, such as Franklin Delano Roosevelt faced when sworn in as President in 1933. Analyst Shedlock explains, under the headline "Europe Fears Bail-Ins," that what is driving the large and growing capital flight is "fear of bail-ins, confiscations, capital controls, and bank failures like [those] we have seen in Greece and Cyprus. Recent examples include Portugal and Italy."[1] Euro deposits parked at the ECB increased from 36.6 billion euros in January 2015, to 196 billion euros in December 2015.

Especially targeted by the capital flight are Italian banks Monte dei Paschi di Siena (MPS) and Cassa di Risparmio di Genova (Carige), which are seen as candidates for a bail-in. Since the beginning of 2016, the Siena bank has lost almost 30% of its stock value. According to an article in *Il Fatto,* depositors with more than 100,000 Euros have pulled one billion out of the

World Economic Forum/swiss-image.ch/Moritz Hager

On Jan. 19, Eurogroup head Jeroen Dijsselbloem and European Central Bank board member Andreas Dombret called for downgrading sovereign bonds held by Eurozone banks. The European Union intends to crush the nations that stand behind that sovereign debt. Here, Jeroen Dijsselbloem.

---

1. http://finance.townhall.com/columnists/mikeshed lock/2016/01/12/europe-fears-bailins-capital-flight-intensifies-in-italy-france-spain-are-german-banks-safe-n2102864 Analyzing the ECB data on the "imbalances" thus created within the Euro death zone, known as Target2, Shedlock shows this is largely flight money of deposits from those who are first in line under the EU bail-in schemes. Shedlock presents a chart on the ECB Target2 imbalances: the minuses, first Spain—"worst since 2012;" Italy—"worst negative ever;" France—"worst negative since 2011;" and then some of the winners with positive numbers, Germany—"highest since 2012;" and Luxembourg—"highest ever."

News Tv2000/Standard YouTube license

World Economic Forum

Paolo Savona (left) is one of the Italian economists calling for a moratorium on the bail-in regime. Ignazio Visco (right), Governor of the Bank of Italy, took the unprecedented step on Jan. 30 of demanding a review of the bail-in rules.

bank since Jan. 1. The rate of withdrawal is 2 billions a month. Liquidity at MPS has gone down from 20 billion to probably 17 billion, the "target" level of one tenth of assets. A default is not far away.

Had the Italian government not reached an agreement with the EU Commission, allowing for a de facto government backstop on bad loans, reintroducing a "Too Big To Fail" principle, this dynamic would have rapidly evolved into a major banking crisis expanding into a sovereign debt crisis.

The agreement allows a government-owned institution, Cassa Depositi e Prestiti, to buy credit-default swaps for securitized bad loans, whose price will be set such that vulture funds will buy them. Ultimately, the Italian taxpayer will pay the bill. The deal is another measure aimed at protecting the markets and not the citizen, and is not going to work. Only a Glass-Steagall banking reform is going to work, but this means that the current EU system must be overthrown.

To Destroy Italy as a Nation

EU authorities have already signalled that their intention is the destruction of the sovereign nation of Italy, in the same way they have destroyed Greece. On Jan. 19 both Eurogroup head Jerome Dijsselbloem and ECB board member Andreas Dombret came out pushing for a downgrading of sovereign bonds held by Eurozone banks. This is the proposal contained in the draft paper submitted to the Bundestag by German Deputy Finance minister Jens Spahn in December, as a first step before pushing for it at the European level. If approved, such a proposal would force many southern banks, which have a high rate of investments in the sovereign bonds of their countries, to pay higher interest rates and increase their reserve requirements. Outstanding in this respect is the situation of Italian banks, for which the EU seems intent on aggravating an existing crisis. It also reveals the intention to crush the nations that stand behind that sovereign debt.

The conflict between the Italian government and the EU authorities has just started. The Jan. 26 deal marks a temporary setback for the Commission, but the conflict is set to escalate. There is a growing outcry in Italy to suspend or review the infamous bail-in rules. Economists such as Luigi Zingales and Paolo Savona have publically asked for a moratorium on the bail-in regime. On Jan. 30, central banker Ignazio Visco took the unprecedented step of demanding a review of the bail-in rules in a speech in Turin, revealing that Italy's financial authorities had warned the EU commission that implementing a bail-in retroactively would cause a dangerous backlash. Visco pointed to a clause in the BRRD (Bank Resolution Directive), which allows for reviewing the rules. The Commission reacted with an arrogant statement, saying that "there is no plan to change the BRRD," and "It has been known for one and a half years that creditor bail-ins would protect taxpayers."

There is no solution within the current system. As Proesssor Savona says, the Italian government should "take pen and paper and write down, as [British Prime Minister] Cameron did, what the conditions are for us to remain in Europe, establishing the date for a referendum after the deadline set for an answer. Will there be speculative attacks? We will prepare in advance, finding new foreign policy alliances."

The Italian government must also change its mind on Glass-Steagall, and lift the blockade on a Parliamentary debate on the various draft bills on banking separation, filed by almost all political forces. Just in the Senate Banking Commission alone, there are six bills which have been stalled because the government has pushed other priorities, most of them useless or destructive. They must take steps now against the coming catastrophe, of which Jan. 26 was only a very mild foretaste.