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Europe Braces for Economic Impact of Italy's Lockdown

Italy's quarantine and the prospect of other European countries following Rome's move will challenge politicians and policy makers like no postwar financial shock

President Christine Lagarde recently said the European Central Bank was 'ready to take appropriate and targeted measures.'

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Economic fallout from Italy's unprecedented decision to lock down almost one-third of its population due to coronavirus, and the prospect of other European countries following Rome's move, will challenge politicians and policy makers like no postwar financial shock.

European Union officials, who spent years battling effects of the 2008 recession, are looking to some of the same tools, but economists say they won't be sufficient in this crisis. Cutting interest rates and nudging banks to lend, for example, will prove fruitless if employees aren't working and consumers aren't shopping, economists say.

The immediate economic impact of 17 million people in northern Italy ceasing normal life is a collapse in business activity. With cash flow evaporating, companies risk being unable to pay their bills, wages, loans and taxes. Corporate leaders and politicians in Italy and other parts of the eurozone are calling on governments and EU policy makers to relax financial rules, potentially buying companies time for the epidemic to pass and commerce to resume.

"Everything is grinding to a halt and this can cause serious damage," said Massimo Perrella, chief executive of Poliform Lucernari, a producer of skylights in the province of Parma.

He said the current situation is worse than the financial crisis a dozen years ago. "There is a feeling of fear and uncertainty within the company," said Mr. Perrella, who employs 24 people, most with families.

While few economists see rate moves by the European Central Bank as helping significantly, some say they could be beneficial—and that remaining inactive sends a worrying signal to markets, particularly after the Federal Reserve and other central banks took action over recent days.

The ECB is scheduled to meet this week and its president, Christine Lagarde, holds a regular news conference on Thursday. Ms. Lagarde has said nothing publicly about the virus since a restrained statement last Monday said the bank was "ready to take appropriate and targeted measures."

"Central banks can't resolve the underlying shock [from the virus] but they can temper its impact and stop the shock from propagating and becoming a deeper downturn," said Seamus Mac Gorain, a former official at the Bank of England who is now head of global rates at J.P. Morgan Asset Management.

But current and former ECB officials suggest that other major central banks might be overreacting to what could be only a temporary slowdown and a correction in asset prices. An increasing number of these officials are worried about the adverse side effects of negative interest rates and large-scale bond purchases.

"It's not like the financial crisis—people are overreacting," said Panicos Demetriades, former governor of euro member Cyprus's central bank. Once the virus passes, demand will bounce back, he predicted. "I don't think they should go with the big blunt tool of interest rates to deal with a virus."

Big Italian companies with deep pockets and global operations are adapting to the lockdown. Tire maker Pirelli & Co. and car giant Fiat Chrysler Automobiles NV said they would maintain production but are reducing meetings and travel. Smaller companies are already struggling.

The four restaurants in Antonio Viola's Mammina Holding are deserted, even though three are far outside the quarantine zone, he said Sunday. At the other, in Milan, revenue has fallen 70% in the past two weeks and it is now operating at a loss.

"This crisis has had a devastating impact," he said, predicting he might in coming days need to temporarily close all his restaurants, which together employ around 100 people. "It's a disaster."

Economists are urging eurozone governments to increase their spending to support the economy and take some of the strain off the ECB—something Ms. Lagarde and her predecessor Mario Draghi have long urged. In October, she singled out Germany and the Netherlands, arguing they should use their budget surpluses to fund investments that would stimulate the wider eurozone economy.

But while Germany has announced some limited fiscal measures in recent days, German officials are philosophically opposed to deficit spending and trying to smooth out fluctuations in the business cycle

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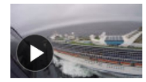

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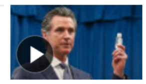

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spending and trying to smooth out fluctuations in the business cycle. Chancellor Angela Merkel's Conservative CDU party, which is particularly skeptical of fiscal stimulus, is in the midst of a battle to decide Ms. Merkel's successor ahead of national elections next year. That makes a departure from fiscal caution improbable.

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With dramatic policy moves unlikely, regulators and policy makers are most concerned with preventing the economic slowdown from spilling into the eurozone's already fragile banking system and mitigating its impact on banks that get hit.

In Brussels, where EU-wide rules are set, discussions are revolving around how to make sure companies, particularly small ones, have enough liquidity to deal with a sharp fall in sales and activities. They also are looking at how to apply clauses allowing for flexibility in the bloc's debt and deficit rules to permit targeted stimulus measures. Options under discussion include granting affected companies relief on tax payments and EU guarantees on small-business credit lines. State guarantees are also being discussed on a country level. European finance ministers are expected to approve a list of agreed-upon options for governments to take when they meet on March 16.

"Something as simple as suspending tax payments for six months would allow the company to operate for a year rather than three months in this situation," said Mr. Perrella, the skylight maker in Parma. The Italian government has launched a support package that includes letting most affected firms postpone certain tax and social-security payments. The EU said any extra government spending to deal with the outbreak won't be counted for budget and debt targets under existing rules.

European officials also are looking at whether state-aid rules could be temporarily eased so governments can assist companies. The ECB is considering not just further interest-rate cuts, to further below zero, but also targeted loans for banks and businesses hit by the virus.

More radical measures could include the ECB extending its bond-buying program to bank bonds, although that is seen as extremely problematic because of the ECB's dual role in setting monetary policy but also supervising banks. Another, which would likely require regulatory change and approval from governments, would be easing rules on how nonperforming loans are classified so banks wouldn't have to take losses on those right away, further denting their profitability and creating a possible credit crunch.

"At the moment they are in a wait-and-see mode," said a person familiar with the talks.

But banks, particularly in Italy, already are calling for moratoriums on loan repayments, or other measures that would protect them from a rise in souring loans. In China, where the coronavirus has already wreaked economic damage, financial regulators said they would allow lenders to delay recognizing bad loans from smaller businesses hurt by the virus outbreak.

"Everything is uncertain," said Mr. Perrella. "If a client asks when I can deliver something, I can only say, 30 days plus coronavirus."

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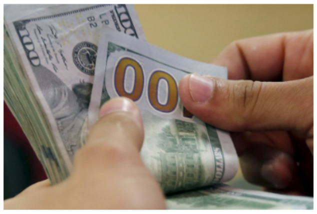

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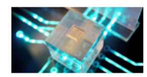

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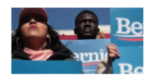

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