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Uncertainty for Italy means uncertainty for us, too [1]

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The political crisis in Italy will just deepen the eurozone's resolve to move faster and deeper into real economic and banking union. With no clear winner emerging, a large vote against austerity measures, and the prospect of another election in weeks, markets already have the jitters. The European Central Bank (ECB) will find itself, inevitably, being drawn in to try to calm them.

Italy is a big country, the third largest European economy. It is not going to be rescued by a few Greek-style bail-outs that are annoying and irritating, but bearable for the other eurozone countries (and for non-euro countries like the UK, which have got sucked into some of the bailouts). Italy really is too big to be allowed to fail. If it did, there would be monetary chaos throughout the eurozone, and beyond. And although a considerable number of Italians gave pro-euro politicians the thumbs down last weekend, the country seems to have no real intention of pulling out of the euro and getting the lira back. Indeed, it went to very strenuous efforts to get into the euro when it was created, and the other eurozone countries were keen to bend the rules and get Italy in (as they did with Greece, so they only have themselves to blame).

Over to you Mario Draghi. He has already indicated that he will do whatever is necessary to keep the euro show on the road. With Italy looking shaky, that can only mean one thing: creating new money and flooding the markets with liquidity until (hopefully) the problem goes away. Quantitative easing, euro-style. It is something that Germany and others have long resisted, some fearing the inflation it could cause and others fearing the enormous power that the ECB would be acquiring. But what is the (politically realistic) alternative?

But such money-creation will probably do little more than it has done in the UK. The new money will go to the commercial banks of the eurozone, who will buy 'safe' assets (like government bonds) with them in order to strengthen their balance sheets in advance of the next Basel deadline. Financial asset prices will rise, but little of the stimulus will get into the real economy and make a real difference to growth.

Which is bad news for the UK too. Continued uncertainty and low growth among our nearest customers is not the way to grow ourselves out of the recession. George Osborne's overview of economic conditions in his budget in three week's time will be... interesting.

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