EU Eyes December Start for Rescue Fund

By James G. Neuger - Nov 8, 2011

European finance ministers pledged to roll out a bulked-up rescue fund next month, leaving Greece and Italy on the front lines until then in the fight against the debt crisis.

Greece was ordered to provide written acceptance of bailout terms in order to win an 8 billion-euro ($11 billion) loan installment by the end of November, while Italy was pressed to turn budget-cut promises into reality.

“It’s a two-way street; we do our part, Greece is expected to do its part,” European Union Economic and Monetary Commissioner Olli Rehn told reporters late yesterday after finance ministers met in Brussels. “It is essential that the entire political class now restores the confidence that had been lost.”

Europe is battling to regain the upper hand in the debt crisis after political dramas in Greece and Italy provided unexpected distractions and soured international confidence in a package of measures hammered out last month.

“This isn’t a crisis you can solve quickly, it is a monster with many heads,” Dutch Finance Minister Jan Kees de Jager said.

European officials are consulting investors and credit-rating companies over two options for translating the rescue fund’s 440 billion euros in guarantees into as much as 1 trillion euros of spending power.

‘Protection Certificates’

The first idea is to bring down troubled countries’ borrowing costs by issuing “partial protection certificates,” a form of insurance for bond sales. One undecided point is whether the certificates would remain attached to the bonds or trade freely.

The second option is to create one or more special investment vehicles that would court outside investment in weaker European states’ bonds, potentially from sovereign wealth funds, private investors or cash-rich emerging markets such as China and Russia.

Known as co-investment funds, the special vehicles would consist of two or three layers: a first-loss guarantee from the EFSF, a freely tradable equity tranche and, potentially, a freely traded senior debt tranche. The funds may be channeled through an International Monetary Fund trust fund or administrative account.

G-20 Summit

Finance ministers intend to complete “legal and operational work” by the end of November, with “implementation” set for December, according to a presentation by the rescue fund, known as the European Financial Stability Facility.

“Both options would achieve the objective of enlarging the capacity of the EFSF without increasing the euro-area member states’ guarantee commitments,” EFSF chief Klaus Regling said.
Efforts to attract international donors hit a roadblock at last week’s Group of 20 summit in France, when the heads of the world’s up-and-coming powers called on Europe to do more to help itself first. Russia would channel more aid through the IMF in exchange for more influence on IMF decision-making, the Kremlin said yesterday.

Meantime, Japan’s government said today that it purchased 10 percent of the 3 billion euros of bonds sold by the EFSF yesterday. By contrast, Japan bought more than 20 percent of the fund’s initial issue of five-year securities in January. China’s central bank declined to comment on any Chinese participation in yesterday’s sale.

**Hard-Hit Countries**

Also unsettled is whether the European Central Bank will continue to buy hard-hit countries’ bonds once the rescue fund assumes that task. Over opposition of Germans on its council, the ECB has bought 183 billion euros of bonds since May 2010.

European leaders scratched a reference to the ECB’s bond-buying program from a summit communiqué on Oct. 27, loath to make public demands on the independent central bank. Irish Finance Minister Michael Noonan said the ECB can’t shed the market-support duties.

The central bank “must continue to play a role until the EFSF firewall is put in place, whenever that may be,” Noonan said. “And even when it has been put in place it’s going to be tested, so I think the ECB must carry out a parallel function until it’s quite clear the new firewall is doing its job.”

Europe’s immediate focus was on Athens. Greece struggled to form a cross-party government yesterday after last week’s call by Prime Minister George Papandreou for a referendum on the next bailout led European leaders to speak publicly about pushing the country out of the euro.

**Emergency Government**

The stratagem brought down Papandreou, who prepared yesterday to hand over to an interim leader to run an emergency government with the power to enact austerity measures and pave the way for new elections. Negotiations on a new government will continue today.

The Greek turmoil contributed to a 2.5 percent slump in the euro last week. The currency slipped 0.2 percent today to $1.3750 as of 8:01 a.m. in Brussels.

*Europe* is asking of Greece what it got from Portugal earlier this year: a pledge during an election campaign by both main political forces that whoever wins will stay the austerity course. Portugal’s victor, Pedro Passos Coelho, was rewarded with a 78 billion-euro aid package.

European governments approved Greece’s latest installment on Oct. 21, only to retract it after the referendum gambit threw Greece’s budget cuts into doubt. Finance chiefs agreed yesterday that the money won’t be released until Papandreou’s Socialists and the center-right New Democracy party headed by Antonis Samaras deliver a signed pledge to enact the cuts.

**Debt Load**

Italy, with Europe’s second-biggest debt load, prepared to host European Commission inspectors charged with making sure that planned budget cuts and economic reforms become reality. That mission, starting today or tomorrow, will be in cooperation with the ECB, said Luxembourg’s Jean-Claude Juncker, who leads the group
Prime Minister Silvio Berlusconi denied a report in Il Foglio that he is on the verge of resigning to make way for an Italian version of a unity government with a budget-cutting mandate. A test of strength comes today on a normally routine vote to rubber-stamp last year’s budget report that may show whether Berlusconi still has a majority in the 630-seat Chamber of Deputies.

Italy was investors’ chief target yesterday. The extra yield on Italian bonds over 10-year German bonds rose to as much as 491 basis points, a euro-era record.

“Italy is not in a situation that’s comparable” to Greece, German Finance Minister Wolfgang Schaeuble said. “Italy’s real figures don’t justify this nervousness in markets.”

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