EU Leaders Ease Debt-Crisis Rules on Spain

By Tony Czuczka and Josiane Kremer - Jun 29, 2012

Euro-area leaders agreed to relax conditions on emergency loans for Spanish banks and possible help for Italy as an outflanked German Chancellor Angela Merkel gave in on expanded steps to stem the debt crisis.

After 13 1/2 hours of talks ending at 4:30 a.m. in Brussels today, chiefs of the 17 euro countries dropped the requirement that taxpayers get preferred creditor status on aid to Spain’s blighted banks. They also opened the way to recapitalizing lenders directly with bailout funds once Europe sets up a single banking supervisor. Stocks and bonds in Spain and Italy surged and the euro rallied.

The politicians struggled for consensus on reducing market pressure as surging borrowing costs in Italy and Spain stoked concern among investors and policy makers around the world that the currency union threatened to splinter and risk damaging the global economy. Euro governments were granted access to rescue loans without having to relinquish control of their economies.

“We agreed on short-term measures that should apply to Spain and
“Italy,” said Luxembourg Prime Minister Jean-Claude Juncker, who heads the group of euro finance ministers. “We will keep all options open to do the interventions that need to be done to calm the situation. There is a whole array of possible interventions and measures.”

Make-or-Break

The gathering marked at least the fourth time in the past year that the guardians of the euro faced a make-or-break summit to restore confidence in their currency bloc. They have struggled so far in vain to contain the financial crisis that began in Greece in 2009. The turmoil claimed its fifth victim this week when Cyprus sought a bailout.

The euro surged 1.1 percent to $1.2575 at 12:30 p.m. in Brussels. The MSCI World Index rose 1 percent. Yields on Spanish and Italian debt plunged on optimism the summit deal represented progress in turning the tide. Finance ministers will aim to enact the agreement at a meeting on July 9, European Union President Herman Van Rompuy said, calling the accord a “breakthrough.”

It was the first policy-making summit that Merkel faced without France’s Nicolas Sarkozy as her crisis-fighting partner. New French President Francois Hollande led a rebellion against her austerity-first prescriptions with calls for immediate relief for hard-hit countries.

Countering Germany

“Relative to the gloomy expectations just prior to the summit, and at
around midnight as the summit progressed, more was achieved than was widely expected,” David Mackie, chief European economist at JPMorgan Chase & Co. in London, said in a note. “Nevertheless, this is still a long journey we are on, and it will be bumpy at times.”

Hollande put French backing of a German-inspired deficit-control treaty on hold, and Italy and Spain withheld initial approval of a 120 billion-euro ($149 billion) growth-boosting package until Germany authorized steps to calm their bond markets.

Italian Prime Minister Mario Monti welcomed the result, saying the agreement to consider short-term steps to ease borrowing costs “could be useful to Italy and many other states, too.” Hollande said there was “no blackmail, no pressure” from Italy and Spain.

Monti didn’t get everything he wanted, Dutch Prime Minister Mark Rutte, a Merkel ally, told reporters. Italy “wanted direct bond buying by the aid funds in the secondary market,” he said. “That’s not going to happen. They wanted an interest-rate cap. That’s not going to happen either.”

No Debate

Germany had previously balked at changing the order of seniority on as much as 100 billion euros in emergency loans to Spanish banks and at committing to direct sovereign-debt buying through the euro-area bailout funds, saying on June 21 that such a move is “not up for debate.”

At the summit, euro-area leaders agreed to use the rescue funds “in a
flexible and efficient manner in order to stabilize markets for member states” that respect rules including budget-deficit limits and sign a memorandum of understanding, according to an EU statement issued in Brussels.

Even so, the EU’s two rescue funds may only amount to about 20 percent of the outstanding debt of Italy and Spain, limiting the ability to lower the nations’ borrowing costs.

The rescue mechanisms, the European Financial Stability Facility and the yet-to-start ESM, may have 500 billion euros available for purchases. Italy and Spain have about 2.4 trillion euros combined of outstanding bonds, bills and loans, according to data compiled by Bloomberg.

‘Wrong, Counterproductive’

Pooling of euro-area debt, a tool sought by Spain and Italy that Merkel called “wrong and counterproductive” in a speech to German lawmakers a day before the summit, wasn’t mentioned in the statement. Merkel will explain the deal to the German parliament upon her return to Berlin today before a vote on new EU budget rules and authorization of the ESM.

A German official briefing reporters on the condition of anonymity noted that the Parliament in Berlin gets to approve changes in the ESM’s setup, such as allowing direct bank recapitalizations.

“Our formula hasn’t changed,” Merkel told reporters as she arrived for day two of the summit. “I think we have taken some important
decisions, but we remain true to our philosophy of no help without something in return.”

‘Vicious Circle’

Euro-area leaders are determined to “break the vicious circle between banks and sovereigns” in the debt crisis and will present proposals for joint bank supervision “shortly,” according to the statement.

Once an “effective” system is set up, the ESM could, “following a regular decision, have the possibility to recapitalize banks directly,” according to the statement.

Spain’s Mariano Rajoy sought that condition to avoid taking on additional sovereign debt. He also wanted his official creditors to give up their preferred creditor status in case of default, a step resisted by Germany that helped send Spanish yields higher.

Spain’s 10-year yields exceeded 7 percent yesterday and Italy auctioned 10-year notes at 6.19 percent, the highest yield since December. Germany borrows at 1.5 percent for the same time period.

Relief may not be quick as joint EU banking supervision, seen as a way to make oversight more independent of national regulators, will take time. The EU will consider proposals “by the end of 2012,” according to the statement.

“If you think in terms of, not the short term, of days and weeks, but in terms of sustainability over the medium term, then this will achieve the desired effect,” Thomas Wieser, head of the group that prepares meetings of euro-area finance ministers and that drafted the summit
statement, told reporters.

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