Euro Leaders Seek Crisis Fix as Greek Talks Drag On

By Patrick Donahue - Jan 23, 2012

European officials will forge ahead today with crafting a long-term plan to tackle the region’s debt crisis, as banking and government negotiators continue trying to reach an agreement that will lighten Greece’s debt burden.

European Union finance ministers will meet in Brussels to discuss new budget rules, a financial firewall to protect indebted states and a Greek debt swap, with EU leaders racing to cobble together a firm rescue response in the coming weeks. Meanwhile, cash-strapped Greece and private bondholders said they had made progress in talks over the weekend in Athens.

As investors ignored this month’s euro-area downgrades by Standard & Poor’s and last week sent the single currency to its first gain in seven weeks, leaders including German Chancellor Angela Merkel are set on exploiting the momentum to lock in a final response to the crisis and hold the euro-area together.

“The most likely thing to happen is that everybody's still in it, including Greece” at the end of the year, Jim O’Neill, chairman of Goldman Sachs Asset Management, said in a Jan. 20 interview with Charlie Rose, referring to the 17 states that share the euro. “The costs of exit are so unknown.”

The euro rose 2 percent against the dollar last week, the biggest weekly gain since Oct. 14. Spain, Greece and the euro bailout fund, the European Financial Stability Facility, sold bonds at lower rates, signaling greater demand for the assets. The currency was down 0.3 percent to $1.2887 at 8:33 a.m. in Brussels.

ECB Assistance

The debt auctions show that “trust is cautiously returning” on the markets, German Finance Minister Wolfgang Schaeuble said yesterday in an interview on ARD television.

The European Central Bank provided assistance last month by issuing 489 billion euros ($632 billion) in unlimited three-year loans to euro-region banks, an injection that diminishes the chances the debt crisis could transform into a financial crisis.

“While it obviously can’t solve deep fundamental issues facing euro-area economies, it certainly has dramatically reduced the chances of a systematic banking crisis,” Goldman’s O’Neill wrote in a note to investors yesterday.

In Athens, private creditors and Greek officials cited progress in talks aimed at lowering the country’s debt and winning a second round of international financing before it faces a 14.5 billion-euro bond payment on March 20. A 4-1/2 hour meeting with officials representing the creditors and Prime Minister Lucas Papademos broke up about 1 a.m. Jan. 21.

Greek Coupon

The parties were nearing an agreement under which old bonds would be swapped for new securities with coupons averaging between 4 percent and 4.5 percent, according to a person with knowledge of the discussions.
three days ago. Germany and the International Monetary Fund are now insisting on an agreement closer to 3 percent, the New York Times cited officials involved as saying.

“The situation gets worse as long as the problem isn’t fixed, because the longer it takes, the more demands the official sector makes, because the situation keeps worsening in Greece,” Otto Dichtl, a London-based credit analyst at Knight Capital Europe Ltd., said yesterday by phone.

European officials and the nation’s private bondholders agreed in October to implement a 50 percent cut in the face value of more than 200 billion euros of Greek debt by voluntarily exchanging outstanding bonds for new securities, with a goal of reducing Greece’s borrowings to 120 percent of gross domestic product by 2020.

**Investor Demand**

Charles Dallara, managing director of the Institute of International Finance, which represents creditors, said Jan. 21 that “the elements of an unprecedented voluntary private-sector involvement are coming into place.”

Dallara told Greece’s Antenna TV in comments broadcast late yesterday that it’s now up to EU officials and the IMF to take the banks’ offer.

Investor demand for short-term sovereign debt such as Spanish and Italian two-year notes has rallied across the euro area since the ECB’s cash injection on Dec. 21. Still, with yields remaining near record levels for longer-term securities, the three-year loans may offer only a temporary respite.

EU governments negotiating for a new rulebook on fiscal policy are hewing to an agenda championed by Merkel and the ECB. The latest draft of the fiscal pact bows to ECB President Mario Draghi’s call for governments to honor their commitment on spending discipline to restore credibility.

**Permanent Rescue Fund**

The proposed treaty will require a centralized “correction mechanism” to be triggered automatically in cases of “significant” deviations from a target structural deficit of 0.5 percent of GDP, according to a draft dated Jan. 19 obtained by Bloomberg News. Reflecting German demands, countries would have to enact “binding and permanent” balanced-budget rules.

Ministers today will also discuss a separate draft accord on Europe’s planned permanent rescue fund that eases earlier provisions on debt restructuring. The proposed agreement still calls for clauses in bond contracts that would prevent small groups of investors from blocking a decision, while deeming write-offs “exceptional” and subject to International Monetary Fund standards, according to a draft.

Schaeuble reiterated that leaders will assess the amount of bailout funding in March. The permanent fund, the European Stability Mechanism, will remain at 500 billion euros for the time being. “We’ll take that time,” Schaeuble told ARD.

**World Economy**

Merkel was scheduled to meet with IMF Managing Director Christine Lagarde late yesterday. The IMF is proposing to raise its lending capacity by as much as $500 billion to insulate the world economy from the euro crisis.

German Foreign Minister Guido Westerwelde said the EU remains committed to the euro common currency and underscored the importance of sufficient financing to indebted states.
“We have to erect a firewall,” Westerwelle said in an interview on Bloomberg television in Washington on Jan. 20. “We have to show solidarity. We have to support those countries that are now in serious trouble.”

“A long-term solution” is being sought, he said.

To contact the reporter on this story: Patrick Donahue in Berlin at pdonahue1@bloomberg.net

To contact the editor responsible for this story: James Hertling at jhertling@bloomberg.net