European Leaders Struggle to Overcome Fresh Crisis Stalemate

By Patrick Donahue - Sep 23, 2012

European leaders are struggling to overcome a crisis-fighting stalemate as they face discord over a banking union, Greece’s ongoing debate on how to meet bailout commitments and foot-dragging by Spain and Italy on financial aid requests.

Chancellor Angela Merkel and President Francois Hollande underlined Franco-German disagreement over the weekend as they clashed on a timetable to introduce joint oversight of the region’s banking sector, with Merkel rebuffing Hollande’s appeal to activate it “the earlier, the better.”

Financial markets “that are watching Europe want to see results,” Merkel said at the meeting on Sept. 22 near Ludwigsburg, Germany, celebrating the two nations’ reconciliation after World War II. Still, “it has to be thorough, the quality has to be good and then we’ll see how long it takes,” she said.

Markets that surged this month on the back of a European Central Bank rescue plan and clarity over bailout funding may not offer European leaders the time they need as an easing in market pressure raises the risk of policy complacency. Deadlock over the banking union could delay until next year a key building block in resolving the crisis, compounding turmoil that’s so far engulfed five of the euro area’s 17 nations.

“Complacency seems to have affected European policy- makers,” Joachim Fels, chief economist at Morgan Stanley in London, wrote yesterday. “One case in point is the disagreement between governments about the nuts and bolts of a banking union, which remains crucial to break the negative feedback loop between banks and weak sovereigns.”

German Doubts

The euro slid 1.1 percent against the U.S. dollar last week, falling to $1.2980 after gaining more than 4 percent in the previous two weeks on optimism that ECB intervention and a German high-court decision allowing bailout funding will help provide an endgame to the three-year-old crisis.

The differences outlined at the weekend summit underscored Germany’s doubts about placing the ECB in charge of supervision of all banks in the euro area, beginning Jan. 1. German Finance Minister Wolfgang Schaeuble led resistance by a group of northern European countries this month at a meeting in Cyprus against what they view as a rush to common oversight.

Supervision is a condition for direct bailout funding for failing banks, a way around piling more debt on states’ books. Michel Barnier, the European Union’s financial services chief, said in a Sept. 20 interview that he was confident a compromise could be found on ECB oversight before the year was out and that he’d found “no German resistance” in meetings in Berlin.

Castle Meeting

Their meeting in the 18th-century Ludwigsburg castle was also the latest in which Merkel and Hollande struggled to find common ground since the French president won office in May on a platform of opposition to Merkel’s austerity agenda.

Merkel, asked about her relationship with Hollande, said they are “friendly.” Hollande shrugged off a question about the closeness between the German chancellor and his predecessor, Nicolas Sarkozy, that led to them being dubbed “Merkozy.” He refused to bless an equivalent “Merkhollande.”

“We don’t need to put our surnames together to put a name on European policies,” Hollande said.

Another point of contention is the terms on which ailing states should request bailout assistance, with Schaeuble warning against a Spanish application. Schaeuble said Sept. 21 he’s “steadfast” in his opinion that the 100 billion euros ($130 billion) in banking aid for Spain is enough to see it through.
Spanish Reluctance

Spanish Prime Minister Mariano Rajoy has displayed reluctance to seek more help after ECB President Mario Draghi unveiled the central bank’s bond-purchase plan, linked to conditions for recipient states, on Sept. 6. Spanish Deputy Prime Minister Soraya Saenz de Santamaria said last week Spain will consider a bailout if conditions are acceptable.

Rajoy “needs to come to terms with the unavoidable stigma that comes with a program,” Erik Nielsen, chief global economist at UniCredit SpA (UCG) in London, wrote in a note yesterday.

With Italian and Spanish borrowing costs having retreated since Draghi’s plan emerged, the two countries are unlikely to request bailouts unless yields jump again, Gianfranco Polillo, Italy’s undersecretary of finance, said in a Sept. 20 interview.

“There won’t be any nation that voluntarily, with a preemptive move, even if rationally justified, would go to an international body and say, ‘I give up my national sovereignty,’” Polillo said in Rome. “I rule it out for Italy and for any other country.”

Fund Leverage

Germany’s Der Spiegel magazine reported that the euro’s permanent bailout fund, the European Stability Mechanism, could be leveraged with outside capital to generate more than 2 trillion euros in emergency funds. While Germany’s Schaeuble welcomed the idea, Finland has objected, the magazine said. Spiegel didn’t say where it obtained the information.

In Greece, the government and its international creditors took a week-long break from negotiations on additional funding as Prime Minister Antonis Samaras’s coalition struggles to carve out 11.5 billion euros in budget cuts. The troika of creditors -- the International Monetary Fund, the ECB and the European Commission -- said on Sept. 21 they’ll take a “brief pause” after making "good progress" in talks.

Der Spiegel also cited a preliminary troika report as identifying a 20 billion-euro gap in Greece's budget. Samaras said he's confident the government will overcome differences over more than 7 billion euros in cuts to wages, pensions and benefits as Greece confronts a fifth year of recession and more than 25 percent unemployment.

Interest Rates

Even as the euro area faces a recession and rising unemployment, a return of confidence in the bloc’s outlook and the threat of inflation may prevent monetary policy makers from cutting interest rates further, ECB Executive Board member Benoit Coeure said in the West Bank city of Ramallah.

“At the current juncture, the jury is open as to whether there should be another rate cut,” Coeure told reporters at the conference. “It’s not absolutely obvious that another rate cut would be necessary in light of recent economic indicators and in light of inflation developments. As you know, inflation developments at the end are what matters most for us.”

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