French Finance Minister Pierre Moscovici declared the era of austerity over after his German counterpart offered flexibility on deficit cutting, an interpretation that portends renewed bickering between Europe's two biggest economies.

“We're witnessing the end of the dogma of austerity” as the only tool to fight the euro debt crisis, Moscovici said yesterday on Europe 1 radio. “We've been pleading for a growth policy for a year. Austerity on its own impedes growth.”

The gap between the French Socialist finance chief's view and the election-year positioning of Germany's Wolfgang Schaeuble underscores the divergence between their economies and the wrangling that has marked the crisis fight since Francois Hollande replaced Nicolas Sarkozy as French leader a year ago.

With German Chancellor Angela Merkel campaigning for a third term in a Sept. 22 vote, policy making among Europe’s elected leaders has ground to a crawl, with European Central Bank President Mario Draghi set to take the initiative. The risk is that they’ll back off policies needed to spur competitiveness and restore growth.

“Markets should be fine with” slowing austerity “as long as governments keep focusing on structural reforms,” Joachim Fels, co-global head of economics at Morgan Stanley (MS) in London, wrote in a note yesterday. “All fingers crossed.”

**Berlin Meeting**

The task was underscored last week when the European Commission predicted little relief through next year for the 17-nation euro area’s record unemployment. Average joblessness, now 12.1 percent, will remain above 12 percent through 2014, according to the commission’s May 3 predictions.

With French gross domestic product now seen by the commission as shrinking this year, Moscovici and Hollande have led the charge against German-inspired budget-cutting. Moscovici and Schaeuble are scheduled to meet in Berlin tomorrow, along with Bank of France Governor Christian Noyer and Bundesbank chief Jens Weidmann.

Bond markets greased by the developed world’s central banks are providing room for Europe’s politicians to play to their domestic audiences. France sold 10-year bonds at a record-low yield of 1.81 percent last week. Yields on Italian two-year notes fell below 1 percent for the first time on record. Spain’s 10-year yields fell below 4 percent for the first time since October 2010.

**Missing Targets**

Meantime, following an interest-rate cut to a record low of 0.5 percent last week, Draghi said the ECB had an “open mind” about the unprecedented step of charging banks to keep their cash at the central bank with so-called negative deposit rates.

Moscovici’s declaration today amounts to an acknowledgment that France will avoid a sanction for missing 2012 budget-deficit targets and for failing to reach the European Union ceiling of 3 percent of GDP this year. The shortfall will amount to 3.9 percent of GDP this year and 4.2 percent next year with no policy change, the commission said.

There is a “certain flexibility” in allowing France, as well as Spain, to meet its deficit targets, Schaeuble told the Bild am Sonntag newspaper in an interview published yesterday. “This comes with clear conditions for the necessary reforms. The commission will make concrete proposals by the end of May which then will be discussed and decided upon among the euro area finance ministers.”

At the same time, Merkel’s allies are pushing back against the two-year extension floated by Olli Rehn, the EU economic and monetary affairs commissioner.
‘Absolute Limit’

“We made it clear to our government, the chancellor and finance minister that in the case of France a one-year delay to 2014 to fulfill the euro’s deficit rules is the absolute limit for us,” Norbert Barthle, budget-policy spokesman for Merkel’s Christian Democratic Union, said in a May 3 telephone interview from his constituency in southwestern Germany. “France must show that it’s willing to tackle structural reforms.”

Mindful of a potential backlash from German voters in an election year, calls by senior coalition lawmakers like Barthle for euro area members to stick to the euro’s deficit rules may limit Merkel’s ability to help France.

At the same time, Hollande pressed Merkel to overcome the demands of electioneering to keep the euro area’s campaign to shore up its finances by keeping the march toward a banking union on track.

“Ms. Merkel has upcoming elections in September, and cannot give the impression that she’s taking greater care of Europeans than of Germans,” Hollande said in a May 3 interview with The Wall Street Journal. “The risk is that Germany may want to wait until after its elections to move ahead on the banking union.”

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