Investors Brace for Bank Verdict on EU Plan

By STEPHEN FIDLER

BRUSSELS—European governments and investors await Monday a verdict on the summit accord hammered out late last week from the one institution they believe can halt the euro zone’s downward debt spiral: the European Central Bank.

In an agreement finalized early Friday, the 17 euro-zone governments and potentially others in the 27-nation European Union agreed to a greater centralization of their budgets and automatic punishment for budget busters.

Many investors cautioned that while progress had been made, the region’s crisis was far from resolved. "There’s been progress, but this is not enough to constitute a satisfactory resolution" of the debt crisis, said John Lonski, chief economist for Moody’s Analytics’ Capital Markets Research Group.

In Europe, stock markets fell soon after the opening. The Stoxx Europe 600 index fell by 0.7% to 241.25 in recent trading.

Meanwhile, London’s FTSE 100 was down
o.4% to 5509.76, Frankfurt’s DAX lost 1.2% to 5914.23, while Paris’s CAC-40 was down by 1.1% to 3193.54.

Mujtaba Rahman, Europe analyst with Eurasia Group, a New-York based consultancy, said in a note to clients that "a number of risks and implementation challenges" remain over the agreement.

For starters, the accord is a novel arrangement among up to 26 governments because the U.K. refused to back treaty change for the whole EU. The agreement will require ratification from national parliaments—and a possible referendum in Ireland.

The summit disappointed some analysts by failing to bolster substantially the resources for the euro zone’s bailout funds—though it promised an extra €200 billion for the International Monetary Fund.

At German insistence, it also ruled out moves for now toward common euro-zone bonds—one way in which the resources of the stronger and weaker governments could be pooled. Berlin also succeeded in excluding direct links between the euro bailout funds and the ECB, which would have given the funds substantial extra firepower.

In an effort to encourage investors, the leaders agreed to soften their insistence that private investors should take losses in future euro-zone bailouts. That step adds credibility to their insistence that Greece, already negotiating a deal that implies losses for bondholders, is a unique case.

Mr. Rahman says that whatever the verdict of the ECB, it is unlikely to announce it. Instead, the key is whether the ECB begins more aggressive purchases of government bonds of Italy and Spain in an effort to bring down the borrowing costs of those countries.

Mario Draghi, the ECB’s president, told reporters Friday that the accord was a "good basis" for a fiscal pact, a message he had also delivered privately to euro-zone leaders, senior EU officials said.

Euro-zone governments are also awaiting another verdict: that of the rating companies. Earlier this month, Standard & Poor’s said it would review all euro-zone governments not already under review for a potential downgrade.

That list included Germany, regarded as the strongest economy, but also France, the country viewed by analysts as most in peril of losing its coveted triple-A rating.

German media characterized the summit’s outcome as a clear victory for Chancellor Angela Merkel that had left the U.K. marginalized. "Merkel succeeds—Great Britain isolated," read the weekend front page of Süddeutsche Zeitung, a leading German daily.

But Mats Persson, director of Open Europe, a euro-skeptic think tank based in London, said that Britain’s veto of an EU treaty change played into the hands of French President Nicolas Sarkozy.

He had opposed a full-blown EU treaty change, diplomats said, because that would have shifted power away from national capitals to the European Commission, the EU executive, and the European Court of Justice.

It also provided an opportunity for Mr. Sarkozy to pursue a long-held French ambition: to advance a smaller union, without Britain and some Eastern European states, in which France would have more influence.

For businesses across the EU, analysts say that could lead to a weakening of the impetus toward a single market—the one EU achievement that the British seem to value.

"Britain is as isolated as it’s ever been in the 25 years I’ve been following the EU," said Charles Grant, director of the pro-EU Centre for European Reform. "If I had to put money on it now, I think Britain will leave the EU in the next 10 years."

At the summit, British Prime Minister David Cameron had linked his agreement to treaty change to conditions that protected the City of London, Britain’s profitable financial sector. But Mr. Cameron obtained no concessions and no supporters.
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among the 26 other leaders.

"It's disastrous for the City," said Mr. Grant. "Now it's more likely that the 26 will caucus against Britain on financial regulation."

Britain wasn't being asked to participate in the tighter fiscal union. It was only being asked to agree to allow others to do it. But that was still a problem for Mr. Cameron because it would have required a vote in the House of Commons.

Because of a likely rebellion among the euro-skeptic wing of his own Conservative Party, Mr. Cameron would probably have had to rely on the opposition Labour Party for support, a serious political embarrassment.

Mr. Cameron said on Friday that his move, which appeared to boost his popularity at home, wasn't the start of a process of disentanglement from the European Union and he is expected to repeat that view in parliament, according to a person familiar with the matter.

According to a poll published in Britain's Mail on Sunday, 62% said he was right to wield his "veto" to an EU treaty, with 19% disagreeing. The online poll by Survation interviewed 1,020 people.

"The EU now knows that this Prime Minister can say 'No,'" said John Redwood, a Euro-skeptic former Conservative minister, on his blog.

Still, Mr. Cameron's move appeared to have damaged relations with his more pro-European Liberal Democrat coalition government partners. Deputy Prime Minister Nick Clegg told the British Broadcasting Corp. that the veto was "bad for Britain" and could leave it "isolated and marginalized."

Last week's summit accord isn't the only issue confronting investors in Europe. They are also turning a sharper focus toward the European economy. This week's data include euro-zone manufacturing figures, which analysts expect to reveal deepening contraction, and Germany's closely watched ZEW business index.

"We are flirting with risk, if not the certainty, that Europe is going into a recession," said Eric Upin, chief investment officer of Makena Capital, an endowment-style investment firm based in Menlo Park, Calif.

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