

29 June 2012

Monti scores, Merkel out-manouvered

The Summit: What was agreed

- The deal allows for the Eurozone's planned bail-out fund to support struggling banks rather than add to a country's sovereign debt levels.
- In the terms for the €100bn recovery package for Spanish banks, private creditors would enjoy the same status as the Eurozone bailout fund in the event of a debt rescheduling.
- The deal also brings forward a banking union as a matter of urgency – now detailed plans need to be drawn up.



As German Chancellor Angela Merkel heard that her beloved national team had bowed out of the European Championships last night, she must have conceded that the Italians were certainly capable of surprise.

She could not have expected that Germany – the favourites to win Euro 2012 - would lose to Italy quite so decisively.

And yet, in the early hours of the morning, Italian Prime Minister Mario Monti pulled off another coup.

Like the formidable Italian striker Mario Balotelli, the shrewd Mr Monti identified the weak-spots in his opponents' defence.

Ms Merkel entered the latest Summit resolutely opposed to any quick fixes to the Italian and Spanish debt crises. She would at least exact tougher conditions in return for her support.

However, Mr Monti threatened to scupper the €130bn Growth Pact if Angela Merkel refused to agree to emergency measures to ease his country's debt burden.

Short-term action

Germany had been insisting on long-term structural reform and fiscal integration, and along with the Netherlands believed short-term action to reduce borrowing costs was counterproductive unless Madrid and Rome did more to get their own economies in order.

The deal as agreed allows for the Eurozone's planned bail-out fund to support struggling banks rather than add to a country's sovereign debt levels.

Spanish Prime Minister Mariano Rajoy insisted on the changes which will ease Spain's borrowing costs. Only last week, Ms Merkel insisted that she could never agree to funds going to banks directly, because she could not be certain she would get her money back.

Mr Rajoy will also be pleased that, in the terms for up to €100bn for Spanish banks, private creditors would enjoy the same status as the Eurozone bailout fund in the event of a debt rescheduling. Previously the fund enjoyed "seniority" over private investors.

The new European Stability Mechanism will be able to buy government bonds and drive down a country's borrowing costs – without requiring punishing austerity measures.

Banking union “urgent”

The deal also brings forward a banking union as a matter of urgency.

European Commission President Jose Manuel Barroso was initially accused of being fanciful recently when he said a banking union could be put in place within months. Now, it is likely that a banking supervisory system will be in place by the end of this year.

The “Gang of Four” - Herman Van Rompuy, European Council President, Barroso, Mario Draghi, head of the European Central Bank, and Jean-Claude Juncker, Chairman of the Eurogroup of finance ministers responsible for the Eurozone - will have to come up with detailed plans for a banking union that will please everybody.

Ms Merkel has said that stronger European banking supervision is necessary and could be enforced through the ECB. Germany remains deeply sceptical about providing any European system of bank deposit insurance without tighter banking supervision.

The UK has already ruled out joining a banking union and will be eager to safeguard the interests of the City of London financial centre, operating as it does inside the single market but outside a banking union.

There will be battles to come over which banks should be covered and pooled liability.

Irreconcilable positions

The main players in the Eurozone drama – Ms Merkel on the one hand and French President François Hollande, and Messrs Rajoy and Monti on the other - all appeared implacable ahead of the summit and their positions irreconcilable.

Ms Merkel told her Parliament earlier in the week and in no uncertain terms that Eurobonds would happen over “her dead body”.

In fact, there was never any serious danger that Eurobonds would feature in the Council Conclusions, yet on other measures Ms Merkel was out-manoeuvred and forced to concede.



“Horrid” atmosphere

Mr Monti got what he wanted on the whole, but his tactics soured the Summit and only added further tension to an atmosphere, described by one diplomat as “horrid.”

The Summit failed to produce a long-term plan for the Euro – much to Ms Merkel's disappointment – and the Gang of Four's 10 year plan for the Euro was given short shrift by Ms Merkel who called them un-balanced.

“Mrs Nein” says “Ja”

The plan was effectively a manifesto for full-blooded banking, fiscal, and political integration. Although it fell short of calling for Eurobonds, the seven page document proposed "partial common debt issuance." Berlin had already dismissed it as no more than a “wish-list”

Germany remains adamant that a long-term plan for budgetary union is necessary before there is even any consideration of debt-sharing: “As soon as we have a joint EU fiscal policy, we can consider joint liability - the sequencing is key”, said Germany's Finance Minister, Wolfgang Schäuble

Perhaps expectations were very low, but there is much relief over the outcome of the Summit. After all, nobody expected “Mrs Nein” to make any concessions.

In the end, she did and Spain and Italy, with some help from France, have forged a new direction for the future of the Eurozone.

Contact Kevin.Doran@grayling.com