Europe’s Headway on Greece, Banks Masks Deeper Divisions (1)

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(Adds Merkel quote in third paragraph. See TOP CRIS for more on Europe’s debt crisis.)

By James G. Neuger and Rebecca Christie

Dec. 13 (Bloomberg) -- European policy makers made headway in fighting the three-year-old debt crisis, keeping Greece’s lifeline intact and laying the groundwork for a bank supervisor to prevent financial miscues.

Finance ministers declared the two-front victory hours before a summit of European leaders that is set to expose differences between a German-led bloc and France and its allies over the long-term retooling of the euro zone.

“We have achieved a lot,” German Chancellor Angela Merkel, the dominant figure in the crisis management, said on her way into the Brussels summit. “It was a very laborious year but it was also a year in which we made great progress.”

The decisions underscore the move away from the austerity-driven measures that characterized European leaders’ first attempts to counter the crisis that emerged in Greece in 2009. Financial-market tensions have abated, thanks mainly to a pledge by the European Central Bank, first made in late July and yet to be acted on, to put a floor under the bond markets of vulnerable countries such as Spain or Italy.

Greek bonds rallied, with the 10-year yield dropping 17 basis points to 13 percent, near the lowest since a March debt restructuring. The euro was little changed at $1.3085 at 5:40 p.m. in Brussels.

With the summit deadline looming, finance ministers from all 27 European Union countries opened a packed day and night of decision-making with a 4:30 a.m. accord to make the ECB the hub of bank supervision in the euro area.

Bank Supervision

About 200 of the 17-nation euro area’s biggest banks will come under direct ECB oversight when the system becomes operational, targeted for March 2014. Disputes are still percolating over a further step that would give authorities the power, and the financing, to deal with failing banks.

“There are still some thorny issues,” Julian Callow, London-based chief international economist at Barclays Plc, said today on Bloomberg Television. “What about the financing, bank resolution, what about deposit insurance?”

At stake is when the 500 billion-euro European Stability

Mechanism rescue fund would get the power to recapitalize banks directly, essentially using European money to clean up mistakes made at the national level. ECB President Mario Draghi may also need to hire hundreds of new staff to cope with the added workload.

Direct Recaps

The bank-supervision framework could enable direct recapitalizations as soon as 2013 if creditor countries agree. German Finance Minister Wolfgang Schaeuble called the need for direct intervention “relatively unlikely” and said it would require parliamentary approval in Berlin.
Disagreement on that will drag through 2013, as will the question of how to stabilize Greece, still on financial life support after obtaining 240 billion euros of loan pledges and conducting history’s biggest writedown of privately held debt.
Seven hours after the bank-supervision deal, euro-area ministers approved the payout of 49.1 billion euros of loans for Greece through March and committed to “additional measures” in case the country’s debt reduction veers off track.
The disbursement will be the first in six months, concluding what Economic and Monetary Affairs Commissioner Olli Rehn called an “odyssey” that started with two Greek elections and concerns that popular opposition to bailout terms would force Greece out of the euro.

Additional Measures

While another cut in Greece’s bailout-loan rates and an increase in infrastructure funding would help fill in any remaining gaps, the policy makers hinted that outright debt relief -- still a taboo topic for Germany and its top-rated creditor allies -- would be on the table as well.
“Other tools are possible and it doesn’t make any sense to be more precise on these possible tools,” Luxembourg Prime Minister Jean-Claude Juncker said after chairing the meeting on the Greek package.
International Monetary Fund Managing Director Christine Lagarde, less constrained by European political sensitivities, was more explicit, saying the euro governments made “assurances to provide additional debt relief if necessary.”
The fate of Greece -- slammed by 17 consecutive quarters of recession with unemployment at 25.4 percent -- hangs over the next crisis-management steps and the summit debate over how the euro zone will be governed in the next five to 10 years.

Hollande-Merkel

On the way into the meeting, Merkel and French President Francois Hollande aired German-French differences over economic management that have marked the debate ever since the first, aborted, bid to create a common currency in the 1970s.
A half year of brainstorming over the euro's future has tilted ever further in Germany's direction, with any thought of the shared issuance or redemption of debt banished from a roadmap to be discussed at the summit.
A less ambitious proposal for euro countries to pay into a common fund to offset economic shocks was also too much for Merkel, who said the emphasis should be on steps to shrink deficits and promote competitiveness.
Hollande claimed credit for the breakthroughs on crisis handling, saying his election in May on an anti-austerity platform was "one of the elements that enabled us to arrive at this result." He sought a further loosening of spending constraints, saying "investments in the future" shouldn't be counted in official deficits.
EU leaders will grapple with the euro roadmap at their summit that began at 5 p.m. before turning to foreign-policy issues such as Syria when the summit ends tomorrow.
"I don't expect any excessively important decision from this summit," Juncker said.

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