

Merkel, Sarkozy offer no miracle cure for euro
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BERLIN (Aug 17, 2011): Plans from France and Germany to move toward fiscal union in 2012 got a chilly response from other euro-zone countries and failed to reassure investors worried about the region's debt crisis and weakened economies.

Austria, Finland and Ireland all questioned bold proposals from French President Nicolas Sarkozy and German Chancellor Angela Merkel to give up sovereignty over budgetary policies as a means to shore up their 17-nation currency union.

Market analysts warned that political dissent coupled with failure to deliver any concrete pledges to increase the size of Europe's euro rescue fund, or launch of euro bonds, risks a renewed attack on heavily indebted countries.

"There is little in the way of concrete measures in these decisions," said Wolfgang Leoni, chief investment officer at Sal. Oppenheim. "This is exactly what the markets don't want."

In a sign of investor jitters, flight from the euro currency resumed on Wednesday as money sought the relative safety of the Swiss franc and the US dollar. German debt, another safe haven, was also well bid compared with other euro-zone government debt. The region's stock markets were mixed.

The message left by Merkel and Sarkozy was that, in the short term, responsibility for warding off any new attacks on indebted euro-zone countries rests solely with the European Central Bank (ECB). But the central bank, which already has thrown tens of billions of euros into the bonds of countries such as Italy and Spain is internally divided over the wisdom of that move, creating further anxiety for investors.

"I think the crisis in fact is likely to get worse before it gets better despite the announcements that we had yesterday," Jacques Cailloux, chief European economist at RBS, told Reuters Insider television.

"The ECB is trapped here," Cailloux said, adding that he sees the ECB could end up buying almost US\$300 billion (RM900 billion) worth of Spanish and Italian bonds by late September to fight off waves of speculative attacks.

Political hurdles

The prospect of the ECB essentially bankrolling countries with budget deficit problems throws the central bank into the heart of European politics, territory way beyond its monetary mandate causing tensions within its governing council.

ECB bond buying acts as a bridge until euro-zone parliaments have approved enhancements agreed last month to Europe's rescue fund, which would allow it to start making bond purchases.

That process passed an important hurdle late on Wednesday when the Dutch prime minister secured broad political support for the Greek bailout agreed last month by European leaders, a key test before an official vote due within a few weeks' time..

The Netherlands is a solid backer of the euro project but its coalition government could face

problems with a disillusioned electorate.

Another traditional German ally Austria on Wednesday criticised the Franco-German move towards "economic governance."

Ireland reacted sceptically to a pledge by Berlin and Paris to press ahead with a harmonisation of their corporate tax rates in hopes that other euro members would follow suit.

A separate proposal to write German-style "debt brake" rules into national constitutions across the 17-nation currency bloc by mid-2012 faces big hurdles given Sarkozy himself is struggling to secure a parliamentary majority at home for such a plan.

Finland's finance minister questioned whether the rule would work at all and said she was "not too excited" about making changes to her country's constitution.

Some of the steps unveiled at the news conference in Paris on Tuesday would have seemed almost revolutionary as recently as a year ago.

Merkel bowed to longstanding French calls to hold regular meetings of euro zone leaders and appoint a symbolic president, or spokesman, for the bloc – steps that are bound to widen the divide between euro "ins" and "outs" in the 27-nation EU.

But in the midst of a crippling crisis that has threatened to engulf big countries like Spain, Italy and France, the announcements were criticised by many as "too little too late."

Spanish and Italian 10-year bond yields hovered near 5%, more than a percentage point below where they stood before the ECB first intervened in the markets earlier this month.

Economists said markets could test the resolve of European policymakers again within weeks.

"Markets are looking for a magic bullet and that doesn't exist," said Julian Callow, an economist at Barclays in London. "Instead of a magic bullet we have more of the same. Governments are trying to cut their deficits, that is eating into demand and driving economies weaker."

Both Spain and Italy held out hope that Merkel and Sarkozy would change their minds and embrace joint euro bonds.

Contentious debates

One worry is that the Franco-German proposals re-open a number of contentious debates within the EU, further sapping investor confidence.

Merkel and Sarkozy vowed on Tuesday to press ahead with long-stalled plans for a financial transactions tax. But the UK has long opposed this, and moving ahead without the City of London could end up hurting the financial sectors in Frankfurt and Paris.

Irish Finance Minister Michael Noonan said he would insist that any such tax apply to all 27 members of the EU, not just the 17 that share the euro.

Looming elections in key euro zone member states – Spain votes in November and France

in the spring – could also complicate implementation of the proposals announced by Merkel and Sarkozy.

France's Socialists have strongly opposed the government's plans to introduce a balanced budget rule to the constitution, threatening to turn it into a campaign issue.

On Wednesday Francois Hollande, the leading Socialist candidate to challenge Sarkozy in next year's vote, urged a national debate on the issue. – Reuters

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