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The Greek patient is getting sicker and Dr Merkel's reputation is at stake

Merkel prescribed a severe cure for Greece's debt crisis but she has little support from either the Greeks or the Germans

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Greek communist supporters protest against austerity measures in April. There has been widespread anger at the scale of spending cuts imposed as part of the country's bailout Photograph: Louisa Gouliamaki/AFP/Getty Images

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Greece was diagnosed as critically insolvent a year ago. It was placed in the eurozone's intensive care ward, treated with an infusion of €110bn and put on a crash diet to thin its bloated state sector. But 12 months on, the patient is getting sicker.

The budget deficit, at 10.5%, is 1.1% more than projected. A promised €50bn privatisation programme is stalling. Tax collection is notional. Recession is deepening. The national debt has grown to €340bn – 18 months of Greek GDP. The rates Athens has to pay to borrow on the bond markets are off the affordability scale. The prospect is of a long vicious circle of recession and deflation that offers no escape from the debt trap.

If this is the cure, the Greeks are telling their eurozone peers, we prefer to take our chances with the disease.

The doctors in Berlin take a dim view of that. They might sugar the pill with another €30bn or so to tide Greece through next year and spare it the pain of the bond markets. They might also agree to a "soft restructuring" by swapping debt for longer-term, lower-interest loans. But they will agree to this only if the medicine is stronger and the Greeks promise to take it all.

The differences between Athens and Berlin – economic, social, political, and cultural – have been stark throughout the euro's troubles. That they have not narrowed is clear from a weekend of high farce and panic surrounding a not-so-secret conclave in a Luxembourg Schloss.

"Ham-fisted, unbelievable. This is how you manage the euro crisis?" said a European diplomat of last Friday's meeting. A small circle of finance ministers, central bankers and Brussels officials failed to settle what to do about Greece and only laid bare more divisions.

A year ago, both poles in the debate produced intense and ugly exchanges. The German press suggested Greece sell Germany its islands or flog off the Parthenon. The Greek government responded that it was about time to revisit the question of second world war reparations.

Athens and Berlin are at it again amid lurid allegations of Greek plots to return to the drachma, triggering a run on the Greek banks and Europe's own Lehman's moment,

"Borderline criminal," said the Greek prime minister, George Papandreou, of German government leaks to the premier German news magazine, Der Spiegel, about the Luxembourg meeting.

A top German economist, Hans-Werner Sinn, said his weekend suggestion that Greece should be kicked out of the euro was "the lesser evil".

It is patently clear that Athens will not be able to meet the terms of the €110bn bailout agreed last year. They were largely scripted in Berlin and include getting its deficit down to 3% by 2014 and being fit enough by next year to return to the markets to fund its borrowing requirements – up to €30bn in 2012.

The issue is what to do about it, which leads on to the question: What does Germany want?

For weeks, top German officials have been leaking discreetly, planting controversial ideas in the public sphere only for the government to row back when the media went berserk.

A Greek restructuring would not be a disaster, said Werner Hoyer, the Europe minister – followed by denials that such a move was being considered.

The weekend leak to Der Spiegel would appear to fit this template. Reports the Greeks were to quit the euro went viral in Germany, as elsewhere. Chancellor Angela Merkel's spokesman duly rubbished them.

But the idea has gained traction, while the horror scenario of a Greek exit is seen by some as an attempt by Merkel to soften up a hostile parliament and public opinion for another, deeply unpopular Greek bailout.

An opinion poll at the weekend showed only one in five Germans supported last year's bailout of Greece. Half believed it to be "wrong".

The highly influential Bildzeitung tabloid piled the pressure on Merkel. "Whether Greece stays in the euro or not, Europe will have to pay off the gigantic debts of the bankrupt state in the end. And that means the German taxpayer."

The front page of the conservative Frankfurter Allgemeine Zeitung agreed. In an editorial on the Greek bailout, headlined "the failure", it warned that Berlin's €22.4bn share of the rescue was a waste of money and the government's argument was disingenuous.

"The constant insistence that the 'rescue' won't cost anything, that the loans will all be repaid, sounds increasingly hollow," it said.

All through the crisis, Berlin has argued that private creditors should suffer "haircuts" or large losses in the event of a debt restructuring and that a "managed" insolvency of a eurozone country must be possible.

Berlin is privately urging a rollover of debt, with Athens "voluntarily" reaching agreement with its creditors to swap its obligations for longer-term securities. But only if the Greeks commit to even more stringent austerity.

Berlin has won few friends throughout its stewardship of the euro crisis, yielding to the bailout culture with deep reluctance, then dictating the terms.

"Merkel has not handled any part of the eurozone crisis well. The Germans are all over the place," said a second EU ambassador in Brussels. "Merkel is intensely tactical and very unstrategic."

She also appears isolated, opposed over Greece by the European Central Bank and the commission. But that does not mean she will not get her way.