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Eurozone woes

Call to limit Greek bond losses

European officials fear 'credit event'

Investor agreement key to next deal

By Peter Spiegel in Brussels, Hugh Carnegy in Paris and Ralph Atkins in London

Senior European policymakers are insisting any deal that would mean Greek bondholders taking a bigger hit in a new bail-out for Athens must avoid a formal default, a condition that could limit the size of investors' losses.

Officials in Paris, at the European Central Bank and the European Commission are pushing to avoid a so-called "credit event" under any attempt to reduce Greece's debt burden, fearing it would trigger insurance policies against a default and spread panic through the financial system.

Under a deal struck in July as part of a new €109bn ($150bn) bail-out for Greece, private holders of Greek bonds are being asked to take an average writedown of 21 per cent. A group of countries led by German now wants to increase the size of the loss.

To avoid a credit event, any writedown would need bondholders' co-operation. Investors involved in the talks said it would be impossible to get a voluntary deal with "haircuts" as big as 50 per cent, a level pushed by some in Berlin.

German officials are divided on how far to go. The majority view in Berlin, European officials say, is to avoid a credit event but some hardliners want a default now, fearing a deal with banks would put eurozone governments on the hook if it were to occur later.

In an interview with the Financial Times, Jean-Claude Trichet, the outgoing head of the ECB, who has been an adamant foe of writedowns for bondholders since the beginning of the crisis, reiterated his position that the EU should avoid a "compulsory solution". The ECB took an even tougher line in its monthly bulletin, saying attempts to involve private investors "may put at risk the financial stability of the currency area as a whole".

Similarly, the French finance ministry said that while it accepted the need to revise the existing deal – the voluntary 21 per cent writedown – it would support only a "selective default" co-ordinated with investors. "What we reject is a credit event because that is dangerous," said one senior ministry figure. A top European Commission official said Brussels was equally opposed.

Talks between government and bank negotiators have begun, according to people familiar with the discussions. On Monday, Vittorio Grilli, the Italian treasury chief, who heads a key committee of national officials, met bank executives to confirm the current deal would be reopened.

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New talks […]
on lowering […]

rates and extending maturities, moves negotiators say could move haircuts to a more acceptable 40 per cent range. In addition, eurozone governments may push to guarantee only a portion of […]

Emerging countries in talks on IMF boost

Push to raise firepower for eurozone crisis

Nations look at ways to pump in more cash

By Alan Beattie in Washington and Alex Barker in Brussels

Emerging market countries are working on ways to contribute money rapidly to expand the effective firepower of the International Monetary Fund, with the aim of increasing its role in combating the eurozone sovereign debt crisis.

The discussions, in parallel to talks in the eurozone about creating a bigger "bazooka" to intervene in financial markets, are aimed at producing a confidence-boosting announcement by the Group of 20 heads of government summit next month.

People familiar with the discussions say governments are considering either funding an IMF-run special purpose vehicle (SPV) or lending to the IMF by buying special bonds. Although details have not been worked out, the increased firepower could be used to finance IMF credit lines to prevent contagion from the Greek crisis spreading to Italy and Spain, or to recapitalise European banks.

A European official said: "We're increasingly coming to the view that the eurozone crisis is too big a problem for Europe to solve on its own. If you want to sort it out properly you need American and Chinese money, which means the IMF."

The IMF declined to comment.

The size of the funding plan is also still under discussion, but any lending facility making a significant impact on the eurozone crisis will need to run into hundreds of billions of dollars. Such a move would be likely to give the IMF a stronger say in shaping eurozone rescue plans.

In practice the US may have difficulty contributing on a large scale, but people familiar with the talks say that China and Brazil – one of the driving forces behind the plan – have already shown interest. Guido Mantega, the Brazilian finance minister, mooted the idea of assistance from the Bric (Brazil, Russia, India, China) countries to Europe at last month's IMF meetings in Washington.

IMF staff have produced a range of options at the behest of emerging market governments, of which two are most likely. One is an SPV which would lend money under the auspices of the fund, but would take in money separately to the normal government contributions to the IMF. Another option is to repeat a procedure used early in the crisis, where emerging market governments pledged to buy special bonds issued by the IMF.

Eswar Prasad, formerly head of the IMF's China division, said the proposals would allow big emerging market countries to help bail out Europe without buying eurozone sovereign bonds directly, which would expose them to loss. The plans could also be wound up after a number of years.

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FT interview
Jean-Claude Trichet

'There are more reasons now for Europe to unite'

The departing central banker says policymakers in the eurozone must strengthen banks' balance sheets, restore credibility to sovereign debt and agree on tough economic scrutiny.
By Lionel Barber and Ralph Atkins

For 30 years, whenever economic crises hit the world, Jean-Claude Trichet has been at the centre of the action. As his career draws to a close – his eight-year term as European Central Bank president ends in three weeks – the former French finance official and Banque de France governor is in the midst of his biggest crisis yet.

"It is undoubtedly a historical event of the first magnitude, the worst financial crisis since the second world war," he exclaims. "It could have produced a Great Depression had appropriate decisions not been taken at the appropriate time."

At its epicentre is the 17-nation eurozone. The bloc's leaders are scrambling to assemble a rescue package that will finally restore the stability of Europe's 13-year-old monetary union. In an interview with the Financial Times, however, Mr Trichet sees the crisis as broader – as a crisis of the west. "All advanced economies are being X-rayed by the present crisis and revealing their skeletons and the weaknesses in their skeletons. It's true for all of us – for Japan, for the US, for Europeans."

Drawing lessons in his final days in office, Mr Trichet is convinced the long-term result will be that Europe is propelled towards greater economic integration – extending the European "project" for which he has pushed for much of his life. "We are presently experiencing history in the making in Europe. All that I know makes me think that no leader, no individual and no country will take the responsibility of going backwards. That's the reason why I am confident in the future of Europe."

The burden on him, especially over the past four years, has been enormous. At endless global meetings, he has helped co-ordinate – or at least avoid clashes between – the world's central banks. In Europe, he has pushed for action at emergency summits that have sometimes descended into haranguing matches. In Germany, the ECB has faced fierce resistance over the massive extension of its lending to banks and intervention in government bond markets.

Resting his spectacles on his iPad in the Financial Times' London offices, his silver hair neatly trimmed, Mr Trichet looks weary. But in an hour-long discussion he is as combative as ever. For Europe, he says, what the "X-rays" have exposed are not weaknesses in the euro as a currency – the ECB president says it is "credible and solid" – but in eurozone governance.

The region's crisis erupted after Greece and others pumped up their economies on cheap credit and allowed international competitiveness to plunge. Eurozone fiscal rules were ignored, including by Germany, while financial markets encouraged a period of "benign neglect" – for instance, by demanding only the same low interest rate on Greece's government debt as on Germany's.

Eurozone policymakers, says Mr Trichet, now have to break a vicious cycle in which government debt woes are fuelling investor nervousness about banks. Their responsibilities are twofold. Attention has focused in recent days on the need to strengthen banks' balance sheets. But the central bank chief also wants steps "to restore as completely as possible the credibility" of sovereign debt.

In the ECB's eyes, politicians have escalated the crisis unnecessarily by undermining confidence in the security of eurozone government bonds. Germany has led demands that when countries such as Greece are bailed out, private sector investors should take a hit. As early as last October, at a European summit, Mr Trichet warned Angela Merkel, German chancellor, and Nicolas Sarkozy, French president, that this risked simply driving up borrowing costs.

Since then, his warnings have been vindicated – but have gone unheeded. In July, eurozone leaders agreed on a "private sector involvement" in Greece's bail-out that implied a 21 per cent writedown on Greek debt holdings. Now, Germany and others are pushing for more. In its monthly bulletin on Thursday, the ECB warned of the dangers of such steps, saying they put financial stability in jeopardy.

Whatever his private thoughts, Mr Trichet – famously disciplined in his communication – chooses his words carefully. He is clearly anxious not to add public spats to the eurozone's problems. Its political leaders "have said very clearly that Greece is a special case and that as regards all other countries, they reaffirm their inflexible determination to honour fully their own individual sovereign signature. I would say it was important to avoid any ambiguity in this respect," he says in a well-rehearsed response.

The ECB itself has reached the limits of what it can do, Mr Trichet argues. If Greece is pushed into default, the central bank would no longer be able to accept its government's bonds as collateral from Greek banks seeking its lifesaving liquidity. As a result, other eurozone governments would have to backstop Athens' financial system to avert economic catastrophe.

For the eurozone as a whole, Mr Trichet stresses measures it has taken to support banks – last week it announced two offers of unlimited one-year loans, on top of the unlimited weekly, monthly and three-monthly liquidity already available. But he makes clear that the ECB will not act as a "lender of last resort" to governments. Its bond-buying programme – more than €160bn ($220bn) so far in mostly southern European government debt – is aimed simply at ensuring monetary policy decisions are "transmitted" via functioning bond markets into the real economy.

"I think that the ECB has done all it could to be up to its responsibilities in exceptional circumstances . . . The ultimate backstop is, of course, the governments. To do anything that would let governments off their own responsibilities would be a recipe for failure." The governments have an instrument in place – the €440bn European financial stability facility – that Mr Trichet says could be leveraged to provide a firewall, for instance to prevent the crisis spreading to Spain and Italy.

In seeing a restricted role for the central bank, Mr Trichet is in line with the tradition of Germany's conservative Bundesbank, on which the ECB was modelled. When he arrived in Frankfurt in November 2003, he was seen – especially by his own countrymen – as an inflation "hawk" and as much of a "Bundesbanker" as was possible for a Frenchman.

The crisis, however, has rewritten the ECB's relationship with Germany. The country's conservatives fear its bond-buying programme has already set the wrong incentives for governments and that its support for banks had piled up dangerous risks on its balance sheet. Earlier this year, Axel Weber resigned as Bundesbank president and from the ECB's governing council after voicing public opposition to bond buying. In September, his compatriot Jürgen Stark announced his resignation from the ECB's executive board for similar reasons.

Asked if he has lost German support for Europe's economic integration, Mr Trichet is, again, diplomatic. "I don't know what 'the Germans' means . . . We are living in cultures that are very deep, very profoundand very complex, obviously, and where fortunately you have a lot of different opinions." He pays tribute to Mr Stark, who has not spoken out publicly against ECB policy, as "a very close friend" and committed European – although notably fails to mention the more forthright Mr Weber.

What about the view, widely held in continental Europe, that governments should not be pushed around by markets? Mr Trichet laughs. "I think we are proud to live in market economies because they have proved the right way of producing wealth and all other experiments have proved catastrophic," he says. "That said, market economics have to be disciplined. You must have rules. You cannot rely too naively on the spontaneous functioning of markets."

His concern now is that the politics of the eurozone rescue are being complicated because those driving financial markets – the private sector bankers – continue to award themselves excessive pay and bonuses. "We have a real problem here. It is a question of values. Our democracies do not understand some behaviour," he warns.

Steps have already been taken to buttress the eurozone over the longer term, Mr Trichet points out – including the better monitoring of fiscal policies and competitiveness, the latter being an issue on which the ECB president says he has long campaigned. But he wants to go further, with European Union treaty changes empowering European institutions to impose decisions on miscreant eurozone countries.

In June, in a speech in Aachen when accepting the Charlemagne prize for services to European unity, Mr Trichet proposed the eventual setting up of a European finance ministry. It is an idea on which he is happy to expand. He sees a future finance tsar as having three main tasks. The first would be economic "surveillance" with powers to impose decisions where necessary. Second, he or she would oversee Europe's financial sector – ensuring that the fate of banks in individual countries was not linked, as now, to the strength of their government's finances. Third, they would represent the eurozone in global financial institutions.

Ultimately, he sees this as a project for the entire 27-country EU including members, such as the UK, that remain outside the eurozone. That is a notion at which Britain and others will bristle. "Of course, the possibility of imposing decisions would not apply outside the euro area – that goes without saying," he hastens to add.

Is it a realistic agenda? Are Europeans not tired of economic integration – and, in countries such as Germany, increasingly worried about its cost? Mr Trichet is adamant. "There are more reasons today for the Europeans to unite in economic, financial and monetary fields than there were at the beginning of the 1950s," he says. "I really think that the structural transformation of the world, the formidable economic success of the emerging countries – of China, India, of all emerging Asia, of Latin America – calls for the Europeans to unite.

"One of the main lessons of the crisis is precisely that Europe needs more unity. In my opinion, this is not necessarily perceived spontaneously or communicated appropriately to the public, but I think these are truths that are there."

Trichet on . . .

The financial crisis
'All advanced economies are being X-rayed by the present crisis and are revealing their skeletons and weaknesses'

Division of powers
'The ECB has done all it could. To let governments off their own responsibilities would be a recipe for failure'

Capitalism and regulation
'Market economies are the right way to produce wealth but have to be disciplined. You must have rules'

What he does next
'I will meditate on the historical future of Europe and give more time to my four granddaughters'

Speed read

- **Wider woes** Leaders in the 17-nation eurozone are scrambling to assemble a rescue package to restore stability. But Jean-Claude Trichet sees it as a broader crisis of the west
- **Athens anxiety** A "private sector involvement" in Greece's bail-out that would bring a writedown on debt holdings is opposed by the ECB as likely to drive up borrowing costs and destabilise the banks
- **New oversight** A European finance ministry should be created with powers to impose decisions and ensure the fate of banks is not linked to the strength of their home government's finances

On the web

A full transcript of the FT interview with Jean-Claude Trichet is at **www.ft.com/trichetinterview**

From prominence to purdah

Financial fixer extraordinaire

And for his next trick? Jean-Claude Trichet's career as a public servant started in the 1970s. After training as a mining engineer, he joined the French Treasury. By the 1980s, as a series of economic crises hit the world's developing economies, he was chairing Paris Club meetings of international creditors.

When Europe was engulfed by the exchange rate crisis of the early 1990s – an experience that led to the euro's launch at the end of the decade – Mr Trichet first headed the Treasury and then moved to the Banque de France. In 2003, he succeeded the Netherlands' Wim Duisenberg, the ECB's first president.

Aged 68, Mr Trichet says he has no concrete plans for his future. "I have not yet reflected on what I will do afterwards, because I have to say that even in the three weeks which I still have, there are a lot of things to do – 24 hours a day," he explains.

He is expected to return from Frankfurt to Paris, with more frequent excursions to his house in St-Malo on France's Britanny coast. "I will certainly continue to meditate on the historical future of Europe and I will give more time to my four granddaughters," Mr Trichet adds.

He will also "read much more than I do today". At the ECB he maintained his interest in European literature – often sprinkling speeches with references to the continent's great authors; his father and grandfather were Greek and Latin professors.

Departing ECB governing council members are required to adhere to a one-year "cooling off" period before taking jobs that might create clashes of interest. That would prevent any early move into the financial sector; Mr Trichet has also ruled out entering French politics.

The outgoing ECB chief sees a period of public silence as his duty to the colleagues he leaves behind. But those who have watched him in action over his eight-year term doubt he will be able to remain inactive for long.

Money monitor: Jean-Claude Trichet (top) this year and (right) at the Banque de France in 1996
AP/Reuters