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Talks with IMF to boost EFSF

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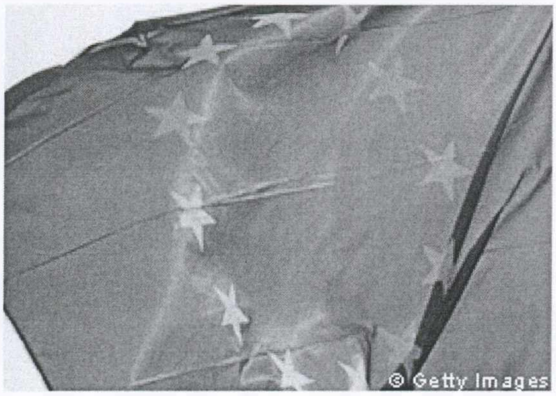
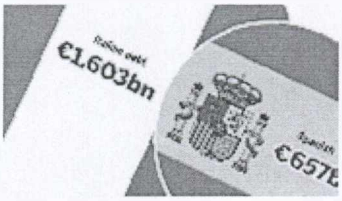
By Alex Barker and Joshua Chaffin in Brussels



Eurozone finance ministers are weighing more radical options to strengthen their firewall against the sovereign debt crisis, after acknowledging that plans to expand the €440bn eurozone rescue fund could deliver as little as half the extra punch that was anticipated.

Exploratory discussions at a meeting in Brussels on Tuesday evening covered options to leverage the European financial stability fund further or establish new ways to provide credit lines, including by funnelling European Central Bank loans via the IMF to struggling countries.



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After the meeting, Olli Rehn, Europe's economic affairs commissioner, said talks were already under way to try to furnish the IMF with more lending capacity, but declined to specify who might provide it.

"We are – together with the IMF – consulting potential contributors through bilateral loans," he said. "Among the euro area member states, there's very broad support to increase the IMF's resources through bilateral loans."

ECB financial support for Italy via the IMF would require a massive policy U-turn by the central bank, and would run into fierce opposition from Germany's Bundesbank. The ECB is wary about relaxing the pressure on Rome for fiscal and structural reforms.

In addition, ministers signed off on the European Union's share of the latest €8bn loan payment to Greece, following a letter from Greek opposition leader Antonis Samaras, which endorsed the broad targets in the country's bail-out programme.

Ministers endorsed the two options to expand the European Financial Stability Facility rescue fund – an insurance scheme on bond losses and a vehicle for outside investors – that eurozone leaders initially hoped would leverage the €250bn spare capacity of the rescue fund four or five fold, to more than €1,000bn.

But Klaus Regling, head of the EFSF, told the meeting that the sharp deterioration in market conditions over the past month meant that the final firepower of the rescue fund was likely to be well short of this €1,000bn target. He declined to make public an exact estimate.

- Some senior European officials say a target of two or three times leverage is now more realistic, which would boost the spare capacity of the EFSF to around €600bn, a sum that most analysts consider too small to act as a firewall for Spain or Italy.

There are also doubts over the co-investment vehicle, which has yet to secure any pledges from outside investors. Mr Regling said he expected investors to participate if offered a "commercially sound product". But he added: "We do not expect investors to contribute large amounts of money in the next few days or weeks. Leverage is a process over time."

Analysts are increasingly arguing that only the ECB has the wherewithal to tackle the eurozone crisis. But it is so far been restrained by legal restrictions on its operations, strictly interpreted by Germany. Channelling its resources through the IMF is a possible way to throw off such constraints.

Luc Frieden, Luxembourg finance minister, said: "I think the EFSF alone will not be able to solve all the problems, we have to do so together with the IMF and with the ECB, within the framework of its independence."

As well as tapping credit lines from the ECB via the IMF, ministers also assessed some other options to boost the EFSF.

Given the opposition to granting a banking license to the EFSF, one option is to permit it to swap any sovereign bonds it purchases for loans from commercial banks, which in turn would be able to use the assets as collateral for ECB liquidity.

The complex structure would significantly increase the EFSF's firepower. But it carries big risks and would be reliant on ECB approval and participation, which are far from certain.