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This time they may save the euro

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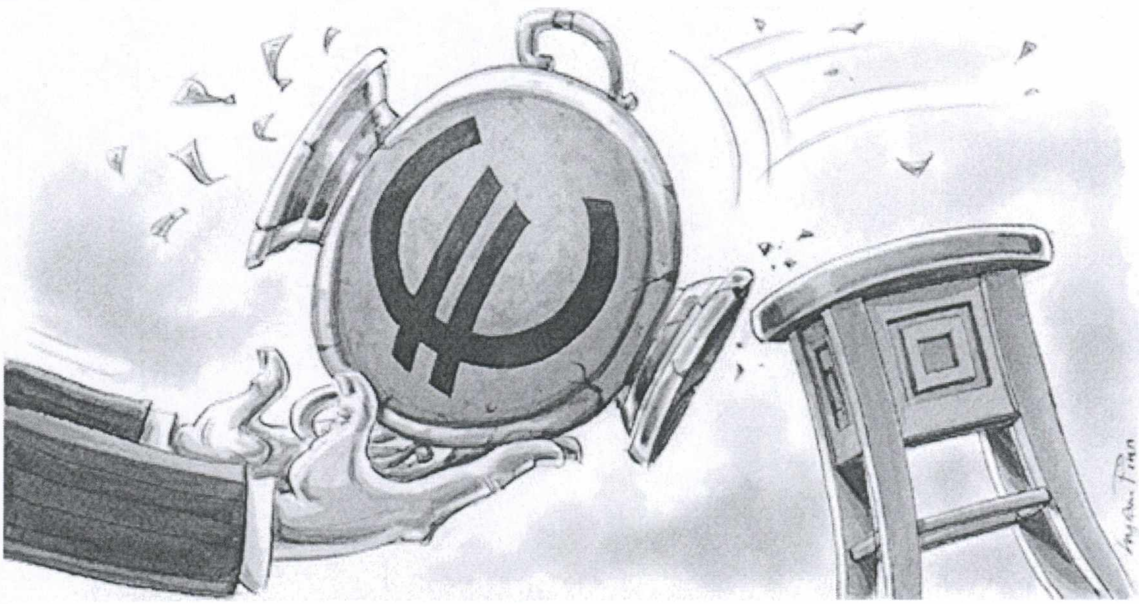

Take a deep breath. Here is a mad proposition: Europe is about to save the euro. Don't bet the bank on it. European leaders have shown an unmatched talent for messing things up. But there has been a change in the political dynamics of the continent's sovereign debt crisis. This time policymakers might just get it right.

Before such thoughts are dismissed as the Panglossian daydreaming of someone who thinks that it is really quite important to rescue European integration, I am happy to concede the case against.

At every turn the story so far has been one of hopes raised and dashed. Angela Merkel, Nicolas Sarkozy and the rest have gone into summits promising to get ahead of the financial markets. They have emerged with packages as halfhearted as they have been half-baked. After a short respite, during which investors and bond traders gave them the benefit of the doubt, the crisis has returned with the fears of the markets redoubled.

No one has lost any money underestimating the quality of political leadership. The problem has not simply been of ineptness on the part of the eurozone leaders or of obduracy on the side of the grey-haired technocrats at the European Central Bank – though both elements, it should be said, have played their part. There have also been differences of principle and substance spanning history and culture, economics and politics. The flaws in the design of the single currency have been brutally exposed.

Germany huddles in the shadow of its experience during the 1930s and has been paralysed by an obsession with moral hazard. Ms Merkel is not about to reward the feckless. On the other side of the debate, the governments under siege from the bond markets know that at some point fiscal austerity becomes a self-defeating strategy.

Berlin's partners – and not just those in trouble – have sometimes been driven to distraction by its myopia. If everyone in Europe were to follow Ms Merkel's advice to match German fiscal rigour and trade performance then Germany would no longer be able to be, well Germany. As for the ECB, it has often seemed that it would rather write the eurozone's (and, of course, its own) obituary than be accused of flirting with moral hazard.

Overlay these points of serious contention with the need to manage the conflicting pressures of domestic politics and political leaders can be forgiven some (not all) of their hesitations. Even now, these arguments are not susceptible to neat resolution.

So why imagine that when they meet next week for yet another of their interminable Brussels summits, the politicians might actually do something to persuade the world that they are at last serious about rescuing the single currency?

Start with a negative. For as long as I can remember people have been saying that the clock is showing one minute to midnight. Somehow, though, the 60-second countdown has not started. This week you could hear the clock ticking.

The intervention by central banks around the world to inject vast amounts of cheap dollars into the European banking system was a source of reassurance and alarm. Reassurance because the central banks seem serious in their resolve; alarm because this was a signal that the financial system has reached the very edge of the precipice. It is not often that central bankers talk, as did the Bank of England's Mervyn King, of trends in the global financial system looking "exceptionally threatening".

My second reason falls on the positive side of the ledger. The replacement in Italy of Silvio Berlusconi with Mario Monti has transformed relations between the three biggest countries. As long as Mr Berlusconi was around, Ms Merkel could never trust Italy to keep its promises.

Mr Monti's appearance on the scene has made possible a deal that would see Germany underwrite the weaker eurozone economies in return for political commitments to put their national finances in order.

Insiders say the departure of Mr Berlusconi has transformed the atmosphere in which negotiations are conducted. There are still big differences, including between Germany and France, but, in the words of one official, negotiators are now looking for points of accord instead of emphasising longstanding disagreements. When I was in Brussels many years ago this was called building bypasses.

A third straw in the wind came with the speech in the European parliament by Mario Draghi, president of the ECB. In its substance Mr Draghi's call for a new "fiscal compact" said nothing much new. Whatever it is called – fiscal union, compact, or bargain – an agreement to share sovereignty over budgets, borrowing and debt must be at the heart of any credible deal.

The interesting part was the hint that binding political commitments on public debt and deficits would bring forth a more proactive response from the ECB. The key word here was "sequencing". I read him as saying "if governments do this, we will do that". The ECB faces pressures of its own. It can refuse to act as lender of last resort, but it cannot shirk its responsibility to fund the banking system.

So the pieces of a grand bargain begin to fall into place. If it happens, it will be neither pretty nor complete. Sceptics will say that even a deal that satisfies the markets will not restore confidence in the medium term. Things have gone too far. Politics will derail austerity plans in weak economies. Who knows? They may be right. To my mind, putting a stop to the haemorrhaging would at least give the euro a second chance.