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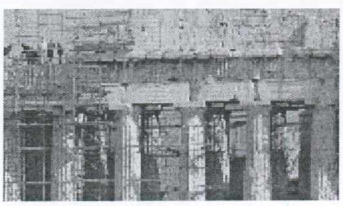
Scepticism at talk of Greek default

By Joshua Chaffin in Brussels and Quentin Peel in Berlin

As whispers grow louder among Greece's creditors that Europe could withstand the aftershocks of a default, the question reverberating in government corridors and financial markets is whether the voices are sincere, or the articulation of a grand, and dangerous, bluff.

For months, it has been a bedrock assumption that a Greek default would not only be a blow to the European Union's prestige but also a disastrous shock along the lines of the Lehman Brothers bankruptcy that precipitated a global financial crisis.



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That assumption appears to have shifted among some policymakers in Germany, the Netherlands and Finland – three of the four remaining triple A rated eurozone governments.

"It would have led to a credit crunch immediately and hurt us all," said a senior eurozone official. "Now, the odds [of such a catastrophic impact] are something like 10-20 per cent. It's still possible, but it's not a certainty."

Such confidence has emboldened those governments to take a hard line in talks over a €130bn bail-out that Athens is relying on to avoid a default next month.

Wolfgang Schäuble, German finance minister, on Wednesday went so far as to suggest Greece might postpone its elections and install a technocratic government free of all political parties, similar to Italy, to ensure that the bail-out programme is implemented.

"The balance of power has definitely changed, where [the Greeks] now understand it's not necessarily going to be a bail-out 'no matter what'," one European diplomat said.

If so, a turning point may have been a meeting of triple A finance ministers in Berlin 10 days ago. It was the first time that they had met since borrowing costs on Spanish and Italian bonds eased at the start of the year and participants took stock of the defences they had built.

The most visible is a permanent €500bn eurozone bail-out fund, set to start in the middle of the year, that could provide a lifeline to vulnerable governments, such as Italy and Spain – although it is only half the size that many analysts predict will be needed.

More importantly, the European Central Bank – under Mario Draghi, its president – has unleashed cheap loans to shore up the continent's banks.

But some fund managers are sceptical. "It's a bluff," one said, speculating the creditor countries were using their last opportunity to put pressure on Greece before they signed off on the loan and their leverage collapsed.

"The fact [bail-out] monies will be so frontloaded and Greece could soon achieve primary [budget] balance speaks to the legitimate concern these countries have about their leverage once the March financing hurdle is overcome," said Mujtaba Rahman, Europe analyst at the Eurasia Group risk consultancy.

Some senior officials involved in the talks said they are becoming increasingly convinced the three triple As are not bluffing, which has unnerved opponents of a default, including the ECB, European Commission and the French government, as well as more vulnerable eurozone economies.

"Everybody should conclude [the bail-out] as quickly as possible because we know from experience that prolonged periods of uncertainty, indecision and doubts about decisions are what has caused instability in the euro," Eamon Gilmore, Ireland's deputy prime minister, said in an interview.

Senior officials in several of the northern countries said there have been debates about the impact of default and some involved in deliberations said they remained genuinely torn over whether a default would be the best option.

Those same officials, however, noted that among the biggest opponents to a default is the person with the most say: Angela Merkel, the German chancellor.

"I can state quite clearly on behalf of the federal government that these rumours are false," Steffen Seibert, the German government spokesman, said of talk that Berlin was pushing for default. "Germany has taken no such decision."

Economists are divided over whether the eurozone can survive a Greek bankruptcy. Guntram Wolff of Bruegel, a Brussels think-tank, said a default that was orderly and kept Greece inside the eurozone could prove manageable. But, "if we were to have a situation where Greece would have to leave the euro, we would have very serious contagion," Mr Wolff said.

Daniel Gros, director of the Centre for European Policy Studies think-tank, said he was worried that policymakers had been lulled into a false sense of security by Mr Draghi's cheap loans.

"Policymakers have a notoriously short time-horizon," he said. "For a couple of weeks, things look better and they say, 'Hey – what's the problem?'"

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