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# Draghi's sleight of hand saves ECB from losses

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By Ralph Atkins in Frankfurt

Eurozone finance ministers trying to plug holes in Greece's second bail-out plan turned to the European Central Bank in the early hours on Tuesday morning.

But while agreeing to forgo up to €5bn in potential profits on its Greek bonds, the euro's monetary guardian has protected itself against forced losses on its bond holdings and will not make direct payments to Athens.

Ahead of the meeting Mario Draghi, president, had ruled out taking losses on its portfolio. It was acquired for an estimated €40bn under a "securities markets programme", launched by Jean-Claude Trichet, his predecessor in May 2010, when the eurozone debt crisis first threatened to blow out of control. The ECB, he said, could not embark on "monetary financing", or central bank funding of governments, which is banned under European law.

With Mr Draghi's agreement, however, finance ministers were able to earmark €5bn in profits the ECB expects to earn on its Greek bonds over three years. Once distributed, governments will use the funds as compensation if their own financing costs are higher than the lower interest rate they agreed to charge on official loans to Greece.

The ECB's sleight of hand fitted with Mr Draghi's pragmatic leadership style since he became president on November 1. In December, the ECB pumped €489bn in unprecedented three-year loans into the eurozone's banking system, triggering a significant improvement in some of the region's government bond markets.

"It is a thin line that [Mr Draghi] is walking," said Martin Lück, European economist at UBS in Frankfurt. "On the one hand, he needs to be flexible and the position of the ECB needs to become a bit softer. At the same time, he must not go so far as to violate directly the treaty ban on monetary financing."

The ECB sought special protection for its Greek bond holdings. Ahead of Tuesday's meeting it had swapped them for new bonds which will be excluded from "collective action clauses" Athens is expected to insert retroactively into other bonds to force, if necessary, losses on private sector investors. The ECB argued it had bought its bonds for policy reasons – as part of efforts to restore the proper functioning of markets – so should be treated differently.

On top of the SMP purchases, however, individual eurozone central banks also hold Greek government bonds with a face value of €12bn in investment portfolios. Here the ECB faced a

tougher fight. The ECB objected formally to part of the report on Greece's finances prepared for eurozone finance ministers that suggested subjecting those bonds to the same "haircut", or losses, as privately held Greek bonds. Instead, they will also be excluded from the so-called "private sector involvement", the polite term for debt restructuring. Profits expected from those portfolios up to 2020 were also earmarked for helping Greece, however.

The ECB's negotiating position was controversial with its 23-strong governing council. Germany's Bundesbank opposed the ECB being given preferential treatments compared with private sector bond holders by being exempt from collective action clauses. A significant fear was of upsetting other bond market investors by signalling the ECB had "senior" status. It also worried about legal action by disgruntled private sector bond holders.

A broader worry was that the ECB's political independence would be undermined as a result of horse-trading with governments. Central banks should be prepared to take losses, in order to preserve their freedom credibility, the argument went.

But analysts suspected that the Bundesbank's opposition also reflected its long-standing objection to the ECB's intervention in bond markets. Jörg Krämer, chief economist at Commerzbank, said that the ECB had at least been consistent in opposing its involvement in any "private sector involvement" the Greek bail-out. "The good news is that the ECB is not damaged in terms of credibility."

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