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EU summit to raise pressure on Merkel

By Peter Spiegel in Brussels and Patrick Jenkins in London

European leaders are drawing up a series of crisis-fighting proposals to raise at an informal EU summit this week that have in the past been rejected by Germany putting further pressure on Chancellor Angela Merkel.

The proposals, which could include empowering the eurozone's €500bn rescue fund to directly recapitalise faltering European banks and commonly backed eurozone bonds, have been backed by some leaders in the past but forced off the agenda by the German chancellor's objections.

The discussions have gained urgency amid signs of stress in parts of the banking system that some analysts have likened to a slow motion bank run.

Their resurrection is the latest sign François Hollande's election in France has shifted the terms of the eurozone crisis debate, giving advocates of such measures – who include José Manuel Barroso, president of the European Commission, and Mario Monti, Italian prime minister – a powerful new ally.

It also reflects the growing belief among some leaders that instability in Greece necessitates revisiting the crisis procedures to ensure they are sufficient to deal with a Greek eurozone exit.

"If we let Greece go down, the ring fence for the rest of the eurozone will [have to] be much more solid," said one senior politician involved in the deliberations.

European officials cautioned that Wednesday's summit would focus on proposals to spur growth rather than crisis-response measures. But one senior European official said the Greek crisis has spurred "parallel" discussions, particularly on ways to shore up Europe's banking sector.

Senior officials said those talks have focused on using the €500bn European Stability Mechanism to directly inject capital into banks, discussions that have intensified in the run-up to the summit. Mr Hollande also said after the weekend's Group of Eight summit he had backing from other leaders to raise the eurozone bond issue.

Another controversial measure back on the public agenda is unlimited purchases of Spanish and Italian sovereign bonds by the European Central Bank, a proposal opposed by Germany but advocated by the Polish finance minister in an article published in Monday's Financial Times.

"Europe must escape the devil's alternative of not being able to keep Greece in the euro, and not being able to risk it leaving," writes Jacek Rostowski. "We need the ECB's readiness to intervene massively in sovereign bond markets only in the case of a country actually leaving the euro."

Officials said while eurozone bonds remain controversial, the bank bailout scheme appeared to be gaining traction, even though Germany has blocked it in the past. "We lost the battle last time around and I'm not sure there's been enough movement in the member states, particularly one member state," said one advocate involved in negotiations.

Currently, EU rescue funds intended for banks can only be lent to national governments, who then recapitalise weak banks based in their country. Such lending adds to a nation's sovereign debt, however, essentially solving one problem but creating another.

The issue has gained new urgency in Spain, facing renewed concerns over the cost of supporting its banks, given the extent of the property crash there. Some analysts estimate the sector needs €50bn-€100bn of fresh capital to allow banks to recognise latent losses on property loans, money that may be hard to raise without EU aid.