Euro zone steps up pace to find fix for Spain

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FRANKFURT

E.C.B. holds rate steady, keeping the heat on the bloc's political leaders

BY JACK EWING

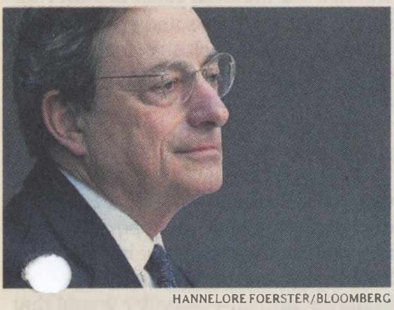
European leaders were scrambling for a solution to Spain's banking crisis Wednesday, after the European Central Bank indicated that it had no immediate aid to offer.

The central bank left its main interest rate unchanged at 1 percent. In a measured response to fears of a banking crisis, the E.C.B. did promise to continue supplying institutions with unlimited short-term, low-interest loans through the end of the year. But Mario Draghi, the E.C.B. president, said the bank had no "silver bullets" to address what he acknowledged was a disturbing situation.

Spain's teetering banks have become the focus of euro zone anxiety. And while some news reports indicated that a German-led solution might be pending, officials gave conflicting statements about whether and how a rescue might happen.

Pierre Moscovici, the French finance minister, said Wednesday that Europe stood ready to help Spain. But a top Spanish official said there were currently no plans to seek a bailout.

The Spanish economy minister, Luis de Guindos, made a surprise visit to Brussels on Wednesday to meet with the European commissioner in charge of competition, Joaquín Almunia, a fellow Spaniard. That fueled speculation that Madrid was laying the groundwork to make a formal request for help sooner



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rather than later. A spokesman for Mr. Almunia, Antoine Colombani, described it as "a very general discussion on the economic situation," but declined to elaborate much more.

The hastily scheduled meeting was arranged at the request of Mr. de Guindos, who then moved on to Paris, where he was to meet Wednesday evening with Mr. Moscovici.

Mr. Draghi, the central bank chief, warned of deteriorating growth and rising tensions in the euro zone Wednesday, but he left the burden on political leaders to deal with fundamental weaknesses in the monetary union and the growing emergency in Spain.

"Some of these problems in the euro area have nothing to do with monetary policy," Mr. Draghi said at a press con-

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ference. "I don't think it would be right for monetary policy to fill other institutions' lack of action."

His comments were another display of how the euro zone debt crisis has devolved into a battle of wills between central bankers and political leaders.

Mr. Draghi and leaders like Chancellor Angela Merkel of Germany are trying to force their vision of economic reform on countries like Spain, Greece and Italy, while politicians in those countries are trying to extract maximum aid for minimum concessions by brandishing the threat of euro zone collapse.

"It is a risky game," said Carsten Brzeski, senior economist at the Dutch bank ING. "You keep up the pressure, but what are you going to do if they don't deliver?"

Mr. Brzeski said the E.C.B. was running low on available monetary policy measures and might want to keep its dwindling arsenal sheathed at least until after the Greek elections on June 17.

The elections could push Greece closer to dropping out of the euro zone if voters choose a government that is unwilling or unable to meet conditions set by the E.C.B., European Union and International Monetary Fund in return for aid.

And with the E.C.B. now indicating that it has no grand gesture to make before June 17, it may be up to euro zone leaders to make some show of resolve before then to remind Greek voters that they are better under the currency umbrella than risking heading alone into the storm.

But the Spanish crisis might need more immediate attention.

Mr. Moscovici said Spain's troubled banks should be able to draw directly on the Union's bailout funds, including the European Stability Mechanism, which is supposed to come on line next month.

But Mr. Draghi cast doubt on that idea. He said the E.S.M. could not bypass governments and give capital directly to weak banks, as Spanish officials would prefer. They want to avoid the appearance of being aid recipients as well as conditions on the way Spain regulates its financial institutions.

Mr. Draghi said that the treaty creating the E.S.M. does not allow direct aid to banks, and that in any case it would be a problem for the fund to become a bank shareholder, which would happen in the course of a bailout.

Spain would have to formally ask the 17 nations of the euro group for help before anything could be done. One European official with direct knowledge of the situation said the group was "not there yet."

A solution may hinge on Germany, and how much its leaders are willing to bend on conditions attached to a Spanish bank bailout.

There are only two players financially powerful enough to back up Spain, and those are the E.C.B. and Germany, said Holger Schmieding, chief economist at Berenberg Bank in London. "There is no other big country with a similar standing in markets as Germany."

"What are you going to do if they don't deliver?"

He added: "Draghi today basically confirmed this view that Spain is a problem for policy makers in Brussels or Berlin to deal with, not for the European Central Bank."

Friedrich Mostböck, chief economist and head of research at Erste Group in Vienna, noted that Spain had lower levels of debt than Germany, and therefore it should be possible to it shore up.

"Germany at some point has to consider whether it really believes that there should be a currency zone or not," he said. "The strategy of plugging holes only works for so long. Eventually you come to the point where a common euro area requires a common fiscal policy."

While most analysts had not expected the E.C.B. to cut rates at its monthly meeting Wednesday, there was growing speculation that the governing council might cut below 1 percent for the first time in an attempt to restore confidence in the euro zone. Many analysts still expect a cut in coming months.

Mr. Draghi said that a few of the 23 members of the E.C.B. governing council had argued for a rate cut, and left open the option of a cut later on. "We will stand ready to act," he said.

Many analysts say the effect of a cut would be mostly psychological because short-term market interest rates are already close to zero.

In an attempt to reassure financial markets, the E.C.B. pledged to continue providing banks with as much low-interest credit as they want, provided they put up collateral.

At the press conference, Mr. Draghi seemed to be groping to appear neither alarmist nor complacent. He said the current level of tension was not as bad as last fall, nor as grave as at the end of 2008 following the collapse of investment bank Lehman Brothers. He said Europe should not take all the blame for slow economic growth in the United States or other parts of the world.

But he also described the interbank lending market, which is crucial to the functioning of the financial system, as "dysfunctional," and acknowledged anxiety among investors.

"To the extent that these market participants express their fears they are certainly not incorrect," Mr. Draghi said. But he added, "They underestimate the strength of the political commitment by the euro area member states."

If European leaders mapped out a long-term vision for how to govern the euro zone, he said, that would provide the necessary reassurance to markets.

But that political commitment was not necessarily on view Wednesday.

Paul Geitner contributed reporting from Brussels, Nicholas Kulish from Berlin and David Jolly from Paris.