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Germany and France divided on Spain policy

NICOSIA

Ministers' mood upbeat despite different opinions on need for quick action

BY JAMES KANTER

A widening split between France and Germany over the urgency of supporting the ailing Spanish economy, and over the scope of a banking regulation for euro nations, emerged on Friday at a meeting of European finance ministers.

The discord threatened to dampen the mood of an otherwise rare show of optimism in the region's three-year debt debacle, as the finance ministers and international officials began a two-day meeting in Cyprus.

Since the European Central Bank e[illegible] this month announced a program to buy the short-term debt of financially vulnerable countries, there has been a significant easing of market pressures on countries like Spain. In that sense, the gathering had little of the crisis mood that has surrounded so many of these meetings in recent years.

For once, the finance ministers had the opportunity to consider broader policy goals, like plans for further economic and financial integration of the euro currency union.

Still, there were signs of growing tensions between France and Germany, the two countries that so often determine how fast Europeans can turn words in action. Although often allies in the struggle to keep the euro zone together, it is clear that they are still feeling out their new relationship since François Hollande became president in June and appointed a new finance minister, Pierre Moscovici.

Wolfgang Schäuble, the German finance minister, weakened expectations on Friday that a single banking supervisor for the euro zone would be in place by the end of the year.

The timing is hugely significant for Spain, because the creation of a single supervisor under the aegis of the European Central Bank is a precondition for allowing money from a new bailout fund, the European Stability Mechanism, to be used to support banks directly, a longstanding request of Spain.

The Spanish banking system is in desperate need of rescue loans from Europe that were agreed to in June.

But the country has been reluctant to begin receiving it, unless the money goes directly to the banks and does not

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get counted as adding to the Madrid government's own staggering debt load.

"My concern is always that there is the risk to raise expectations with financial-market participants that can't be fulfilled later," Mr. Schäuble said Friday. "I don't see the possibility of a direct bank capitalization from the European Stability Mechanism as of January 1."

T[illegible] broad outlines of a new banking supe[illegible]visor for the euro zone were spelled out on Wednesday by the European Commission. But there is disagreement over the size of that supervisor's purview — whether it should oversee all 6,000 or so European banks, or only the largest ones that can have the biggest impacts on the financial markets.

Leading German officials including Chancellor Angela Merkel have said it is unrealistic to expect the E.C.B. to be able to oversee 6,000 banks effectively, as the plan proposes, because regulators would be spread too thin. Extending the system to all euro zone banks also would lead to greater scrutiny of Germany's politically important smaller regional and local institutions — unwelcome scrutiny in many Germans' view.

Mr. Schäuble also discouraged Spain from seeking any fuller form of international assistance, saying in an interview wit[illegible]oomberg News on Thursday that such a request risked a new round of financial market turmoil.

But Mr. Schäuble's French counterpart, Mr. Moscovici, took opposite tacks at a news conference here Friday. He said that Europe's plans for a single bank supervisor were well advanced, and that direct infusions of money from the bailout fund to euro zone banks should be able to proceed soon.

"I am not in agreement with him," said Mr. Moscovici, referring to his German counterpart's comments on the banking rules.

It should be possible "during 2012, and to go quickly," to finish plans for a single bank supervisor. "To lose time, and to not go quickly," he said, "that's an error in view of the European situation."

In a remark apparently aimed at his German counterpart, Mr. Moscovici said the crisis had an effect "on everyone, even Germany, which is today ex-

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periencing an economic slowdown."

Mr. Moscovici also suggested that the Spanish government itself probably could seek some form of outside aid to forestall any worsening of its debt crisis. "We have all the tools now to put into force the appropriate decisions to deal with the Spanish situation," he said.

German officials have emphasized a different approach, saying continued economic overhauls in Spain might help continue to keep a lid the country's borrowing costs without the need for outside aid.

"If they say they don't need a program, then I trust their words," said a German official on Friday, referring to the Spanish authorities. The official spoke on condition of anonymity because the negotiations between ministers were being conducted in private.

Part of the show of German caution could be tactical on the part of the government led by Ms. Merkel, analysts said.

"We suspect domestic politics may have been partly behind this move," Evelyn Herrmann, a European economist at BNP Paribas, wrote in a briefing note on Friday. "A new program for Spain would require a new round of parliamentary approval in Germany," she wrote, and "it might prove quite challenging to achieve a clear majority for a full Spanish bailout within the ruling coalition."

Despite the disagreement between Mr. Schäuble and Mr. Moscovici, there was a general spirit of elation at the meeting about the reduction in borrowing costs in Spain and Italy in recent days.

On Friday, the interest rate on Spain's 10-year bonds was 5.73 — compared with 7.5 at its most recent peak in late July. Italy's 10-year bond was at 4.99, down from a late-July peak of 6.5 percent.

"If we continue going this way, one has to be optimistic," said Mario Draghi, the president of the European Central Bank, referring to improved market conditions. Countries also had made "significant progress," he said at a news conference here.

Christine Lagarde, the managing director of the International Monetary Fund, who is also here, said she hoped that "momentum, which is clearly positive, will be maintained in order to take stock and consolidate the gains that have been recently seen on the markets."

Jack Ewing contributed reporting from Frankfurt.