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I.M.F. makes plea for euro stimulus

FRANKFURT

Fund's deflation warning may provide rationale for E.C.B. bond buying

BY JACK EWING

The International Monetary Fund, warning Wednesday of "a sizable risk" that some euro zone countries could suffer a debilitating decline in prices, called on the European Central Bank to pump money into the region's economy by buying huge volumes of government bonds.

NEWS ANALYSIS

Such bond buying, which the U.S. Federal Reserve has undertaken in recent years to stimulate the U.S. economy, is a move the E.C.B. has been reluctant to take, one that would probably stir outrage among the fiscal disciplinarians of Germany.

And it is unclear whether the I.M.F.'s public push for big spending by the E.C.B. would make it more or less likely for the bank's president, Mario Draghi, to take action. He, like any central banker, wants to appear immune to outside pressure.

But the I.M.F. is a respected international organization, and the warning Wednesday of a destructive plunge in prices — known as deflation — could help give the E.C.B. the economic rationale to use the stimulus of buying billions of euros worth government bonds.

In a report highly critical of euro zone policy, the I.M.F. said there was a 25 percent risk of consumer price deflation before 2014, and that the danger was greatest in countries like Italy where growth is slow and the government is counting on tax increases to help pay down its staggering debt.

"A deeper euro area crisis would have substantial global implications," the I.M.F. said in its report, which also warned of other possible shocks to the euro currency bloc, like the failure of a big bank.

The E.C.B. did not comment on the fund's report.

Deflation is typically a feature of severe economic decline and soaring unemployment that far outweighs any benefit to consumers from falling prices. A downward spiral in prices would make it even harder for countries like Greece, Italy and Spain to get government debt under control, the I.M.F. said, because falling prices and wages would further depress tax receipts.

The Italian prime minister, Mario Monti, has been a leading euro zone proponent of government bond buying by the E.C.B. And Spanish leaders have been pleading with the E.C.B. to buy their bonds and hold down borrowing costs.

The E.C.B. has spent €212 billion, or $260 billion at the current exchange rate, buying government bonds since 2010 but has so far resisted calls for it to mimic the much larger purchases made by the U.S. Federal Reserve and the Bank of England in their respective countries.

The Fed has conducted two rounds of such purchases, totaling hundreds of billions of dollars, since the financial crisis of 2008. And many economists say this quantitative easing, as it is known, is a reason the U.S. economy recovered more quickly from the crisis than most European ones have.

Richard Barwell, an economist at Royal Bank of Scotland, said he thought it unlikely that the E.C.B. would follow the I.M.F.'s advice unless there was evidence of deflation throughout the euro zone, not just in a few troubled countries.

"I think they would view it as being counterproductive," Mr. Barwell said. "It would be alleviating all pressure on policy makers to solve the underlying cause of the problem."

But I.M.F. officials framed their call

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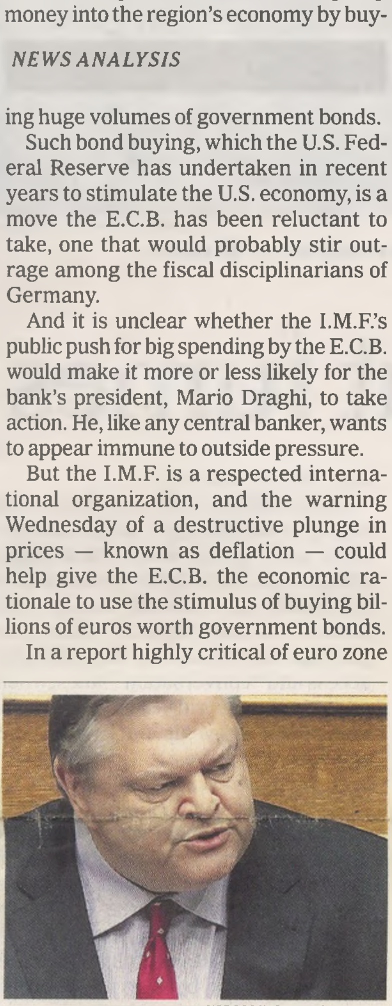

YORGOS KARAHALIS/REUTERS

MORE BUDGET CUTS FOR GREECE
The Greek Socialist leader Evangelos Venizelos said Athens would do more to trim operating costs. *PAGE 14*

Deflation warning could encourage E.C.B. to buy bonds

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for big bond purchases as a way for the E.C.B. to maintain its control over interest rates and hold down borrowing costs for troubled countries.

"It is an essential part of the E.C.B. fulfilling its mandate," Helge Berger, an adviser in the I.M.F. European Department, said during a conference call Wednesday with reporters.

Quantitative easing is the tool that central banks use to stimulate the economy when they have already pushed interest rates as low as they can go. This month, the E.C.B. cut its benchmark interest rate below 1 percent for the first time, to 0.75 percent. But quantitative easing is opposed by Germany, the biggest contributor to the E.C.B., since it would amount to use of the central bank to finance governments. And German sentiment carries weight with the E.C.B., which is reluctant to cause further divisiveness in the euro zone.

Mr. Draghi has not given any clear signals that the bank is seriously considering quantitative easing or other radical measures. But on Tuesday, in a meeting in Frankfurt with Ireland's finance minister, Mr. Draghi tentatively addressed a widespread concern that E.C.B. bond buying hurts more than it helps. For instance, it could make the central bank a senior creditor over other bond buyers, who would then be at greater risk if a government defaulted on its bonds.

This year, when the central bank, I.M.F. and European Union agreed to another rescue of Greece, the E.C.B. refused to share in the losses that private investors were required to take on their holdings of Greek bonds. That position inadvertently increased the perceived risk of other governments' bonds, by signaling that private investors would be last in line to collect in case of any future losses.

ANDREA COMAS/REUTERS

Jobseekers in Madrid. Deflation would make it harder for countries like Spain and Italy to get their debt under control, the I.M.F. said.

But Mr. Draghi, in his meeting Tuesday with the Irish minister, Michael Noonan, apparently indicated that the central bank is reconsidering the E.C.B.'s insistence that it rank above private investors when it holds a government's bonds. "Mr. Draghi noted that the question of burden sharing with senior bond holders is evolving at the European level," the E.C.B. said in a statement following the meet[illegible] with Mr. Noonan.

The I.M.F.'s warning about deflation came as part of a report on euro zone policies in which the fund again criticized European leaders for the way they have handled the euro crisis. "The deepening of the crisis suggests that its root causes remain unaddressed," the I.M.F. said. It faulted what it said was a lack of "ambitious policies to restore strong and balanced growth across the euro area."

"The viability of the monetary union itself" is in doubt, the I.M.F. said.

The I.M.F. praised progress made by European leaders in recent weeks to create a banking union with a central regulator — based at the E.C.B. — which it said would help prevent national regulators from pursuing policies designed to protect their banks at the expense of those of other countries.

But the I.M.F. said that euro zone countries needed to go further, eventually issuing common debt and ceding some authority over their national finances. Germany and some other countries remain firmly opposed to common debt — so-called euro bonds — unless they have more control over spending by other euro zone countries. France and other countries are in favor of euro bonds but have not been willing to give up control over their own budgets.

The I.M.F. acknowledged that it would take time to build a more durable currency union, and said that E.C.B. action was needed in the meantime.

In a response to the report on behalf of E.U. institutions, Ambroise Fayolle, a member of the executive board of the I.M.F. who represents France, said that officials are "in broad agreement" with the fund's conclusions. He highlighted the progress that European leaders have taken to impose more spending discipline on each other and strengthen the banking system. "The authorities reiterate their resolve to take all the necessary actions to preserve the integrity and stability of the euro area," Mr. Fayolle said in a statement.

Without regulatory input, credit default swaps will stay ripe for rigging

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trade a certain amount of derivatives. In the wake of the 2008 financial crisis, there are fewer such firms, and they have consolidated their influence and over our capital markets.

The committee operates as a quasi-Star Chamber. It makes decisions without having to publish its reasoning and almost never has. There isn't any appeal process. The committee itself says it isn't bound by precedent.

In a terse statement last year about a decision that raised some experts' eyebrows, the committee wrote: "This statement is not, and does not purport to be, binding," even if the panel were presented with another situation that "relates to similar facts."

In other words: Ask us again tomorrow and you might get a different answer.

The biggest concern is that there's no prohibition against committee members deciding cases in which they may well have an economic interest. There is no recusal process. Indeed, it is almost impossible for the major dealers to not have a stake in the outcomes, since they are the major dealers.

A spokesman for the association contended that "there are safeguards built into the process which work to support integrity of process." The voting, if not the reasoning behind it, is publicly disclosed. The committee requires a supermajority for decisions — 12 of the 15 votes — so the dealers can't gang up on the other members. And it's entirely possible that banks might be on different sides of a trade, with some banks having sold protection and some having bought it. The hope would be that the conflicts of interest cancel each other out.

To the market's credit, there is no evidence that the process has become corrupted by big banks. Given the evidence of collusion in the rate-manipulation case, however, trusting it to remain that way doesn't seem like a good plan.

Oversight might be helpful here. But the new financial regulation under the Dodd-Frank reform law, while pushing most derivatives of the plain-vanilla kind onto clearinghouses, doesn't address this issue.

Sure, regulators can now get access to dealers' positions. And if that eases your concerns, I'm sure Barclays would like to make you a loan tied to the London interbank offered rate, the bious benchmark at the center of t scandal.

Other remedies seem pretty appar ent. Banks could disclose their positions ahead of rulings. The committee could issue its reasoning, which the as sociation says it's planning to do. The could be an appeals process.

That banks haven't taken these st yet is a display of the industry's cas disregard for any significant check their cartel businesses. It's a situati that has become so routine on Wall Street as to almost be unremarkabl