Germany backs Draghi bond plan against Bundesbank

Germany's director at the European Central Bank has thrown his weight behind mass purchases of Spanish and Italian debt to prevent the disintegration of the euro, marking a crucial turning point in the eurozone debt crisis.

Mr Asmussen was appointed to the ECB by German chancellor Angela Merkel and is close to her inner circle. Photo: AP

By Ambrose Evans-Pritchard, International Business Editor

9:39PM BST 20 Aug 2012

Comment

"A currency can only be stable if its future existence is not in doubt," said Jörg Asmussen, the powerful German member of the ECB's executive board.

He signalled full backing for the bond rescue plan of ECB chief Mario Draghi, brushing aside warnings from the German Bundesbank that large-scale purchases would amount to debt monetisation and a back-door fiscal rescue of insolvent states in breach of EU treaty law.

Mr Asmussen told the *Frankfurter Rundschau* that the surge in Club Med bond yields over recent months “reflects fears about the reversibility of the euro, and thus a currency exchange risk” rather than bad economic policies in struggling states.

The choice of wording is crucial. If it can be shown that the ECB is acting to avert EMU break-up – known as “convertibility risk” – bond purchases would no longer be deemed a bail-out for Italy and Spain.

Mr Asmussen confirmed that purchases may be “unlimited” in scale, a far cry from the half-hearted intervention of the past two years, which failed to stem capital flight.

The Daily Telegraph can confirm reports in *Der Spiegel* that ECB technicians are examining plans to cap Spanish and Italian bond yields, among other options. This may prove to be the “game changer” that critics around the world have been demanding for two years.

The ECB’s director-general of market operations, Ulrich Bindseil, is spearheading the plans in talks with experts from the ECB’s family of national central banks. Market, monetary policy and risk management committees are working to put together a draft.

“They don’t take sides. They just lay out the pros and cons and leave it to the governing council to decide,” said one EU diplomat.

Mr Asmussen was appointed to the ECB by Germany’s chancellor, Angela Merkel, in January and is close to her inner circle. He was on holiday when the ECB council – 17 national governors and six board members – backed the Draghi Plan earlier this month. It was unclear at the time whether he would acquiesce or join the Bundesbank in protest.

His support for Mr Draghi is crucial. While the ECB can, in theory, enforce its policy by majority vote, it would be hazardous to do so against German opposition. “This is a significant turning point,” said Raoul Ruparel from Open Europe. “Asmussen was hand-picked for the role by Merkel. It means that Draghi has managed to crack what seemed like a solid German wall.”

Chancellor Merkel said last week that the Draghi Plan is “in line” with German policy so long as the conditions imposed on Spain and Italy are tough enough, but Berlin has been sending mixed messages. Finance Minister Wolfgang Schauble said on Sunday that ECB financing of state deficits was anathema: “If we start doing that, we won’t stop. It’s like when you start trying to solve your problems with drugs.”

The Bundesbank slammed the Draghi Plan in its monthly report yesterday, saying bond purchases entail “considerable risks for stability”.

It is far from clear who will win this battle for Germany’s monetary soul but for now it seems that Mr Draghi has secured just enough leeway from the German establishment to press ahead.

Whether his plan is enacted soon depends on the Spanish government. The ECB will not intervene until debtor states request a formal bail-out from the eurozone's EFSF and ESM rescue funds, and sign a "memorandum" giving up fiscal sovereignty.

These funds act as enforcer, allowing the ECB to come in behind with real firepower. This dual action is the condition for Mrs Merkel's tacit support.

The Spanish are bargaining over terms. Finance minister Luis de Guindos said over the weekend that he would not trigger the mechanism until the ECB pledges unlimited bond purchases.

Spain is already pushing through €102bn in cuts. Bank of America says this amounts to fiscal tightening of 4.8pc of GDP this year and 2.7pc next year when adjusted for the cycle. With unemployment above 24pc, Madrid is likely to resist demands for further austerity.