Mood lifts in markets as Merkel edges towards deal to end pain in Spain

Charles Bremner Brussels
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A whiff of optimism returned to financial markets yesterday after it emerged that Germany and Spain were working on a rescue plan to save the stricken Spanish banking industry.

The euro climbed to its highest level against the dollar for a fortnight and Europe's main stock indices rose more than 2 per cent at the news of the talks.

German, Spanish and EU officials are trying to find a way of chanelling EU aid to Spain's banks without triggering a full-scale state bailout, with the stigma of international supervision that comes with it.

Mariano Rajoy, the Spanish Prime Minister, asked for European help on Tuesday but he is resisting a rescue of the humiliating kind supplied to Greece, Portugal and Ireland.

Tens of billions of euros need to be pumped into Spanish banks to make up for a credit shortfall of up to €100 billion (£80 billion). Luis de Guindos, the Spanish Economy Minister, said in Brussels yesterday that there were no plans to apply for a formal bailout. "We are not preparing anything . . . we have a road map," he said.

World leaders heaped further pressure on the eurozone yesterday to deal with the crisis, on the eve of David Cameron's meeting today with Angela Merkel, the German Chancellor, in Berlin.

President Obama spoke to Mrs Merkel and Mario Monti, the Italian Prime Minister, on the need to strengthen the eurozone, the White House said.

"The leaders agreed on the importance of steps to strengthen the resilience of the eurozone and growth in Europe and globally," Jay Carney, the White House spokesman, said.

Downing Street called for "immediate" action to help to save the eurozone, even though the proposed solutions to the crisis are likely to take many months to put put in place.

Downing Street signalled its approval of pooling eurozone bank risk — described by analysts as "eurozone lite" — saying: "The Prime Minister supports the idea of structural reform."

Most eurozone governments and the EU's institutions want the EU's central rescue funds to be empowered to fund Spanish banks, but this had, until now, been resisted by Germany and its allies, which point to rules requiring aid to be sent only to states. Talk of a soft bailout for the banks was publicly dismissed by Volker Kauder, Mrs Merkel's parliamentary floor leader. He said yesterday that Madrid "needs to come under the rescue umbrella".

But German officials were reported by EU sources to be seeking a compromise. This could involve the zone's new €500 billion permanent rescue fund, the European Stability Mechanism, lending directly to Spain's Fund for Orderly Bank Restructuring. Some legal experts questioned the legality of such a step.

Talks are expected to continue into the weekend, before the International Monetary Fund issues a report on Spain's banking sector on Monday. A fund-to-fund rescue could be put in place relatively quickly because the ESM board does not require unanimous approval, making it possible to out-vote expected objections from the Netherlands and Finland.

Moves on a Spanish plan added to other signs that eurozone leaders are striving for the kind of resolute response that the rest of the world has been demanding for the ever-deepening trouble that has afflicted the currency since the autumn of 2009. President Putin of Russia added his own weight yesterday. He telephoned from China to ask Jean-Claude Juncker, the Prime Minister of Luxembourg, who is chief of the currency's ministerial managing "eurogroup", for information on the state of affairs.

"The market's expectation regarding further policy action globally is picking up," said Ian Stannard, an executive director at Morgan Stanley. Expectation is high for a two-day EU summit on June 28, expected to set a vision for the kind of integrated management of the currency that Britain, the US and many others are urging.

The EU Commission proposed a building block for the new architecture yesterday with proposals designed to strengthen the zone's ability to restructure troubled banks. The scheme was billed as a start to the full banking union, which is regarded as a priority by much of the EU, but it might not take effect for more than five years.

Nevertheless, huge political uncertainty still besets the currency — the Greek general election on June 17 may give power to a hard-left coalition that would abandon its bailout pledges. The European Central Bank added to the heat on the politicians yesterday by holding interest rates unchanged and witholding for the moment a repeat of cheap bank loans and other relief measures that it deployed to great effect at the turn of the year.

Mario Draghi, the President of the ECB, made clear that it wanted the politicians to make the much-needed leap to more integrated architecture for the currency. Many of the euro's troubles "have nothing to do with monetary policy", he said, adding that at the June 28 summit "we all expect a clarification of this vision, a path toward this objective with all the conditions that have to be satisfied to achieve this objective".

Mr Draghi rejected a suggestion that Europe now faced a moment comparable to the collapse of Lehman Brothers, the US investment bank, in 2008.

He said: "Is this situation like it was at the time of Lehman? The answer is no. We are rightly alarmed that there has been stress in the markets . . . but I would say that we are still far away from that situation." He reiterated the bank's forecast of gradual recovery in the zone this year.

In further bad news for the eurozone, Moody's Investors Service cut the credit ratings of several German and Austrian banks because of what it saw as greater risk of further shocks stemming from the region's debt crisis.

JOHANNES EISELE / POOL

Angela Merkel may be easing her resistance to aiding Spanish banks directly

● The only eurozone country with a Communist ruler is likely to become the fourth state to require a bailout after using up money borrowed from Russia (David Charter writes). Cyprus, led by Demetris Christofias, arranged a loan of €2.5 billion (£2 billion) from Russia last year after being shut out of international finance markets because of its close links to Greece. But Cyprus now faces a shortfall of €1.8 billion at the end of this month.

Also hanging over Cyprus is the fear of an economic collapse in Athens because it has a €23 billion exposure to Greek banks — a sum equivalent to 115 per cent of its GDP. Senior figures have dropped hints in recent days that the island will call on the European Financial Stability Facility, which would cause embarrassment as Cyprus prepares to assume the presidency of the EU for the first time on July 1.

Rivals vie for the poisoned chalice

Graham Keeley Madrid

Spain will announce the winner of one of the most unenviable jobs in Europe today.

The country will name the new Governor of its central bank just as its financial system threatens to bring the region to its knees and force it down the same road as Greece, Ireland and Portugal — to seek a bailout. The fight for the reins of the central bank has developed into a struggle between Madrid and Brussels to exert control over Spain's increasingly shaky finances.

Luis María Linde de Castro, 67, is the favourite of the ruling centre-right Government and the Bank of Spain. But Mario Draghi, President of the European Central Bank, and Spanish business leaders, economists and bankers prefer José Manuel González-Páramo, who was until recently a member of the ECB executive committee. Both have impeccable records on paper.

Mr Linde served between 1987 and 2000 as a general director at the Bank of Spain and has ample international experience, serving in a former trade ministry at the International Monetary Fund. He has also worked for the Government in Frankfurt and Moscow. But his age is his big handicap. If he were named Governor he would have to give up the post, which has a six-year tenure, in three years on becoming 70, under central bank rules.

His rival, Mr González-Páramo, 53, gave up his seat as the Spanish member of the ECB board in May after completing his eight-year term. Championed by Mr Draghi, he has become the favoured choice for his close relations with the central bank in Frankfurt.

Mr González-Páramo has come out in favour of a federalisation of European finances but is not said to be in favour of the eurobonds scheme. One high-level Spanish banker told *The Times*: "He seems the strongest candidate because of his contacts at the ECB."

But personality differences may stop Brussels' favourite from taking up the post. "His relationship with [the Economy Minister Luis] de Guindos is not good," one observer said.

Observers believe that clashes between the Economy Minister and the Bank of Spain could prove fatal, as they did for Miguel Ángel Fernández Ordóñez, the former Governor who was forced to step down early last month.

Owen's vision for Europe

The European Community
Single trade area for all European countries, co-operating on foreign, environmental and security affairs

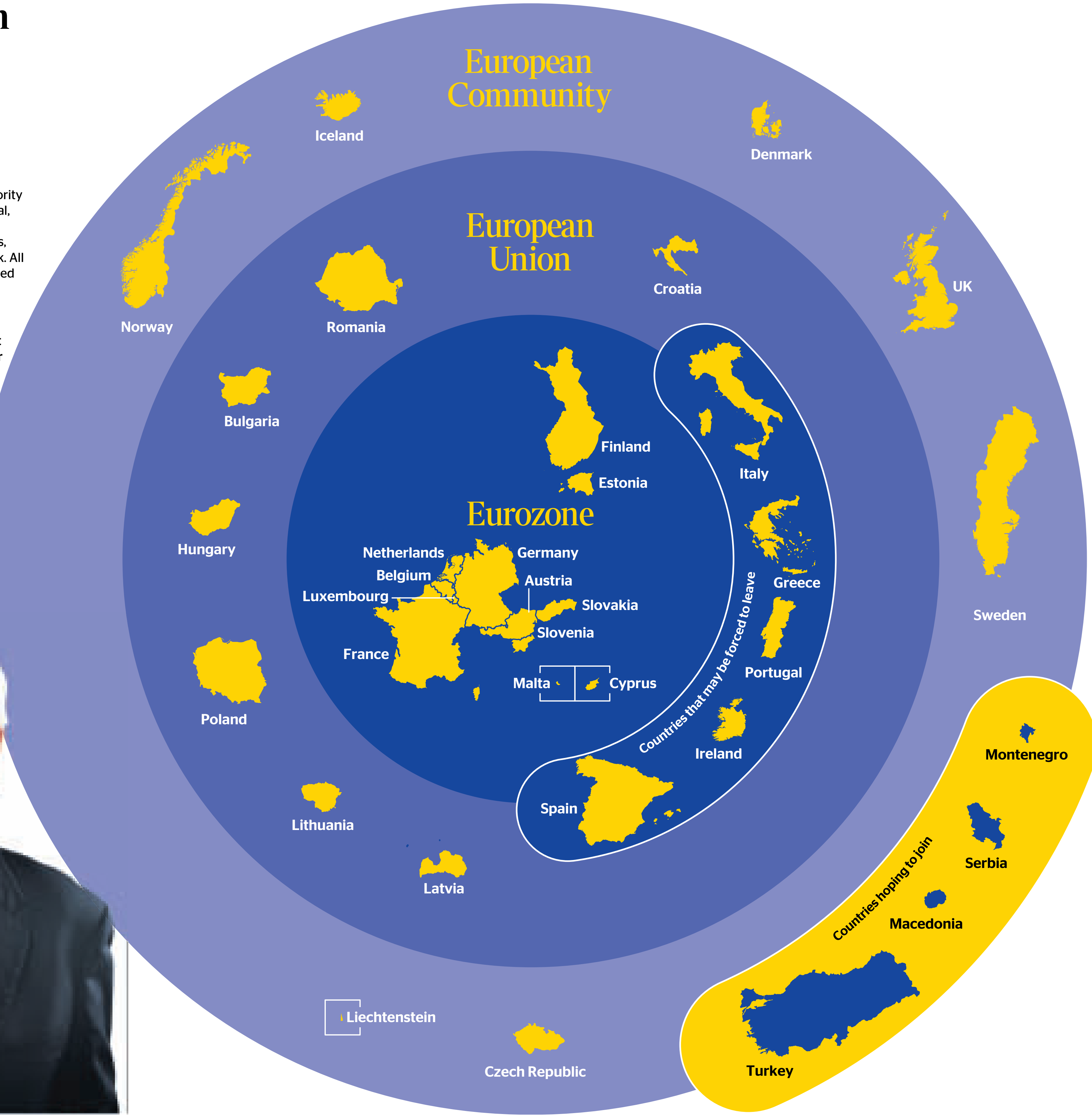
The European Union
A European government with authority for trade, economic, industrial, social, justice, environmental, agricultural, fishing, foreign and defence policies, with a single European Central Bank. All EU member states would be expected eventually to join the eurozone

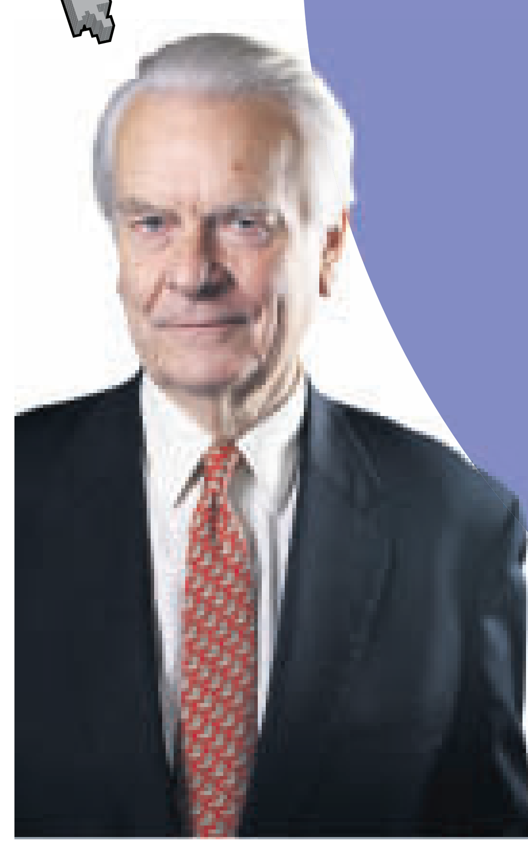
The referendum questions

1 **Do you want the UK to be part of the single market in a wider European Community? Yes/No**

2 **Do you want the UK to remain in the EU, keeping open the option of joining the more integrated eurozone? Yes/No**

Have your say, vote online
thetim.es/owenpoll





The Owen Plan
DAVID OWEN

Voters 'must have chance to decide in referendum'

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says that the eurozone crisis has exposed the incompatibility of the British and German visions for Europe.

"The EU is reaching the point, because of the eurozone crisis, when it cannot continue to be ambivalent about these two models," he says.

"In the UK, but also in some other countries, there are growing public demands for a principled and consistent position to resist any further merging of the two models, because the people in these countries want to remain self-governing, in that they are determined to retain their own currency and remain in control of foreign, defence and fiscal policies.

"Yet these same countries see the argument for greater integration within the eurozone to help resolve its continued crisis. The way these issues can be resolved Europe-wide is to enable those countries within the eurozone who wish to integrate further to do so and to allow those countries who do not ever envisage becoming part of the eurozone to remain in a restructured single market."

Under Lord Owen's vision, up to five countries, including Greece and Spain, could leave the eurozone because they are unable or unwilling to comply with its new requirements. He believes that, in Britain, a referendum on continued membership is now inevitable.

> **"A referendum on EU membership will be lost in Britain if the only option is more integration"**

"At the very least UKIP will be the lever for forcing a Conservative government to concede a referendum on Europe . . . Labour will be forced to concede as well," he writes. However, he warns that a straight referendum on British membership of the European Union would be lost "if the only option is ever greater integration within the EU".

He recomends two questions. The first being: Do you want to be part of the single market in a wider European Community? With a Yes/No answer. The second: Do you want to remain in the European Union, keeping open the option of joining the more integrated eurozone? Again with a Yes/No answer.

Lord Owen resigned from the Labour front bench in 1972 along with Roy Jenkins over Labour's opposition to membership of the European Economic Community. He resigned again from the Shadow Cabinet in 1981 because of Labour's pledge to pull out of the EEC, this time forming the Social Democratic Party. He later became disillusioned by the push for European integration, helping to found the "New Europe" group to keep Britain out of the euro.

Inside today

A compelling answer to the two big questions
Leading article, page 2

Opinion: My vision for a new Europe
Lord Owen, page 24

Is nobody safe from threat of downgrades?
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It would be foolish to call him a Eurosceptic

Profile

Lord Owen first resigned from the Labour front bench in 1972 over his party's opposition to membership of the European Economic Community (Sam Coates writes).

He resigned again from the Shadow Cabinet in 1981 over Labour's plan to leave the EEC, even forming a new political party, the SDP. As Foreign Secretary he had crafted Britain's approach to Europe, to be "pro-European, anti-federalist and committed to enlargement of the Community".

It is clear from his curriculum vitae that he has an historic commitment to Europe, and few would dare to pigeonhole him as a Eurosceptic. Yet he has come to the reluctant conclusion that there is something wrong at the heart of the European project.

Starting with the Maastricht treaty in 1992 and continuing with Lisbon, he is concerned that Europe, led by Germany, is moving inexorably in a more federalist direction. He worries that the gulf between the European Union and its citizens is growing ever larger, demanding budget rises at times of domestic austerity, for instance.

> 'He wants to ask the British public rather than politicians to make a decision'

Lord Owen has spoken out in the past. As a founder of "New Europe", he was integral to the campaign to keep Britain out of the euro.

His intervention is still significant. In public, Germany's rescue plan — with Britain hovering on the sidelines of the EU — seems to be the only option that is available. But Lord Owen wants to ask the British public, rather than political establishment, to decide whether that is wise.

In private, senior figures from the Conservative Party and the Labour Party agree that Germany's plan for greater political integration poses dangers for Britain. Cabinet members and figures close to Ed Miliband, the Labour leader, both question whether Britain can maintain its influence on the single market in a Europe dominated by a eurozone government in all but name.

But to have that argument in private, for fear of irritating other European countries, does the British people a disservice. Perhaps Lord Owen's intervention will encourage others to ask more questions about whether Germany's post-crisis plan for Europe is really in the British interest.