THE WALL STREET JOURNAL.

Data: 31/12/2011

Testata giornalistica: The wall street journal

Wall Street Journal reconstruction - Angela Merkel placed a confidential call to Rome to help save the euro

BERLIN—On a chilly October evening in her austere chancellery, Angela Merkel placed a confidential call to Rome to help save the euro.

Two years after the European debt crisis erupted in little Greece, the unthinkable had happened: Investors were fleeing the government debt of Italy—one of the world's biggest economies. If the selloff couldn't be stopped, Italy would go down, taking with it Europe's shared currency.

Her phone call that night to the 16th-century Quirinale Palace, once a residence of popes, now home to Italy's octogenarian head of state, President Giorgio Napolitano, trod on delicate ground for a German chancellor. Europe's leaders have an unwritten rule not to intervene in one another's domestic politics. But Ms. Merkel was gently prodding Italy to change its prime minister, if the incumbent—Silvio Berlusconi—couldn't change Italy.
[DisUnionLogo]

The Journal is examining how the euro-zone debt crisis is upending Europe's decades-long push toward deeper economic and political integration. See more in the series.

- Dithering at the Top Turned EU Crisis to Global Threat (Dec. 28, 2011)
- On the Secret Committee to Save the Euro, a Dangerous Divide (Sept. 24, 2010)
- Currency Union Teetering, 'Mr. Euro' Is Forced to Act (Sept. 27, 2010)
- As Ireland Flails, Europe Lurches Across the Rubicon (Dec. 27, 2010)
- In Euro's Hour of Need, Aide Gets 'Madame Non' to Say Yes (April 14, 2011)
- Doubts Arise in Euro's Birthplace (12/21/2011)

Details of Ms. Merkel's diplomatic channel to Rome haven't previously been reported.

Her impatience shows the extent to which Italy's woes undid Europe's strategy to fight the crisis. Until then, Europe had followed a simple formula to preserve the euro: The financially strong would save the weak. But Italy, with nearly €2 trillion, or about $2.6 trillion, in national debt, was simply too big to save.

This Wall Street Journal reconstruction, based on interviews with more than two dozen policy makers, including many leading actors, as well as examinations of key documents, reveals how Germany responded to the dangers in Italy by imposing its power on a divided euro zone. Ms. Merkel, widely criticized for not dealing forcefully with the crisis in its early phase, was at the center of the action, grappling with personal tensions and Byzantine politics among the 17 euro nations.

As well as nudging Mr. Berlusconi off the stage, Ms. Merkel had to smooth out her volatile relationship with France's president, Nicolas Sarkozy. The Franco-German couple eventually overcame many of their differences—and Mr. Berlusconi—only to be blindsided by fresh political chaos in Greece.

Europe's crisis is rooted in deep worries about government debt and economic imbalances inside the euro zone. Those concerns have scared bond investors away from Europe's weaker states, leaving some, like

Greece, without access to money with which to refinance or repay their debts. The great danger is that Italy might join them.

Greece and others were small enough to rescue with international bailouts. But an Italian default could severely hurt Europe's, and the world's, financial system, perhaps triggering a worse global slump than the 2008 failure of Lehman Brothers did.
Life in the Euro Zone

Hear six families -- from Greece, Spain, France, Germany, Italy and the Netherlands -- tell their stories.

View Interactive
Euro Zone Crisis Tracker

See economic, political and markets news from across Europe as governments and financial institutions deal with the continuing debt crisis.

View Interactive

- Charting the Euro Zone Crisis
- Timeline: Debt, Doubt and the Euro Zone
- Key Players in the Euro Crisis: Bios, Quotes
- More photos and interactive graphics

The scramble to shore up investor confidence in Italy led to simmering arguments over how to pay for a financial safety net. Europe's leaders were reluctantly realizing that living with a common currency meant surrendering more of their national independence than they had bargained for.

France and others urged drawing on the virtually unlimited firepower of the European Central Bank. But German strictures and the central bank's own reluctance to bail out governments—for fear of igniting inflation or rewarding profligacy—frustrated that idea.

And while German pressure helped bring about a new, reform-minded government in Italy, today Europe is still fighting to save the euro. The battle ahead looks daunting.

The euro zone, which accounts for nearly 20% of global economic activity, is sliding into recession. France and other countries are struggling to save their credit ratings. And Italy must borrow some €400 billion in 2012.

It's far from clear whether investors are willing to loan such amounts. On Thursday, Italy sold €7 billion in bonds, less than the full amount it had targeted. Investors demanded a yield of nearly 7% on 10-year lending, a painfully high rate.

From the dawn of the crisis in late 2009, Europe's leaders knew they had to avoid a bond-market run on Italy, given its big economy and towering pile of debt. But it was their own handling of Greece that helped spur just such a run. A July 21 decision to restructure Greece's bond debt, which saddled private investors with losses, set a precedent that made many investors wary of lending to any indebted euro members.

Italian politics unnerved the market further. Mr. Berlusconi fell out with his finance minister, Giulio Tremonti, considered a steady hand on Italy's tiller.

"Tremonti thinks he's a genius and everyone else is a cretin," Mr. Berlusconi said in his office, adding that his finance chief was "not a team player," according to a person familiar with the matter. Rumors swirled that Mr. Tremonti might resign, pushing Italy's borrowing costs to a euro-era high. That made it ever tougher for Italy to climb out of its financial hole.

When the market rout worsened on Aug. 3, Mr. Berlusconi gave a defiant speech before parliament declaring that his policies "have been judged adequate by Europe."

Two days later, the ECB contradicted him in a secret letter. Italy's deficit-cutting plan was "not sufficient," ECB President Jean-Claude Trichet and his anointed successor, Mario Draghi, wrote to Mr. Berlusconi. The letter said Italy needed extensive economic overhaul to boost growth, and it set out detailed demands including greater competition, labor-market deregulation, reduced pension largess, a slimmer bureaucracy and deeper public spending cuts.

The implicit message: These reforms were the conditions for ECB intervention in the bond market.

Rome was furious. Mr. Tremonti would later privately tell a group of European finance ministers that his government had received two threatening letters in August: one from a terrorist group, the other from the ECB. "The one from the ECB was worse," he quipped.

Mr. Berlusconi gave in. On Sunday, Aug. 7, he faxed a letter to the ECB pledging far-reaching reforms and deeper budget cuts.

FILT CGIL
TE
PE
AQ
CH

Mr. Trichet deemed Rome's reply satisfactory, and the next day, the ECB for the first time began buying Italian bonds, calming investors and giving them renewed confidence to buy Italian debt themselves. Rome's borrowing costs declined.

Enlarge Image
Brink_cast
Brink_cast

But at home in Italy, Mr. Berlusconi's reforms faced political resistance. He wavered.

Messrs. Trichet and Draghi phoned to press Mr. Berlusconi to honor his promises. European Union President Herman Van Rompuy also called and asked him to take the crisis more seriously. "Otherwise," Mr. Van Rompuy told him, "we are all in trouble."

On Aug. 31, Italian media reported that Mr. Berlusconi had told his advisers he was giving up on pension reform, a key ECB demand.

Investors resumed their flight from Italy. The ECB let Italian bond yields rise again. The episode appeared to confirm the fears of the German faction at the ECB: Politicians would revert to bad behavior if given a reprieve from market pressures.

The crisis had reached a scale that menaced the global economy. The ECB wasn't going to save Italy. Europe's other governments didn't know where else to turn.

The rest of the world was running out of patience. The euro-zone bailout fund—already committed to financing Greece, Ireland and Portugal—had only about €250 billion to spare. If Italy lost the ability to borrow in financial markets, it would burn through that amount in just a few months.

At September's annual meeting of the International Monetary Fund in Washington, D.C., Europe faced intense pressure to act. China and Brazil joined the U.S. in berating Europe for its too-small war chest. Europe was told to "leverage" its bailout fund by borrowing hundreds of billions of euros from the ECB.

Jens Weidmann of Germany's central bank quashed that idea. The bailout fund was an arm of the governments, he said, and lending to governments was against the ECB's charter.

Enlarge Image
Brink_Rifts
Brink_Rifts

The only options remaining were complicated schemes to offer investors in Italian bonds partial protection through guarantees or a "special-purpose investment vehicle." The problem, officials privately admitted, was that this amounted to financial gymnastics of the kind that banks had indulged in before the 2007 mortgage crash.

On Oct. 19, Mr. Sarkozy sought to break the deadlock. Leaving his wife, the singer and former supermodel Carla Bruni-Sarkozy, in labor at a Paris clinic, he flew to Frankfurt to confront Mr. Trichet over the ECB's reluctance to take bolder action.

Official Europe was gathering at Frankfurt's stately Alte Oper concert hall for a party to honor Mr. Trichet's retirement as ECB head. Mr. Sarkozy hadn't come to celebrate. While the orchestra played Rossini and Mozart, a clique of Europe's most powerful leaders huddled in a side room.

Mr. Sarkozy insisted that only decisive ECB help in government bond markets could save the euro zone. "Everything else is too small," Mr. Sarkozy said. Strains of the "Barber of Seville" overture reached the brown-paneled meeting room.

Mr. Trichet said it isn't the ECB's job to finance governments. His farewell party began turning into a shouting match in French.

Already, he said, the central bank's limited bond-buying had caused a political backlash in Germany, the euro's most powerful nation. "I did a bit, and I was massively criticized in Germany," Mr. Trichet said.

Ms. Merkel, also present, was irritated at the French pressure on the ECB. She thought Mr. Sarkozy, with whom she had a sometimes prickly relationship, was well aware that Germany opposed using the central bank's money-printing press to tackle the crisis.

Ms. Merkel came to Mr. Trichet's defense. "You're a friend of Germany," she said.

News came from Paris that Mr. Sarkozy's wife had given birth to a girl. Ms. Merkel offered restrained congratulations to France's president. The meeting ended without agreement.

A day later, Ms. Merkel made her confidential phone call to Rome. Behind the move was a growing belief in Berlin that euro-zone nations could no longer afford to live however they pleased. Italy's premier, Mr. Berlusconi, mired in legal and sexual scandals and unabashed about his reputation as a libertine, was the temperamental opposite of the sober Ms. Merkel, the daughter of a Lutheran pastor.

Mr. Berlusconi's failure to reanimate Italy's economy endangered Europe. So Ms. Merkel phoned Mr. Napolitano—as Italy's president, the man with authority to name a new prime minister if the incumbent were to lose parliament's support.

Ms. Merkel told the 86-year-old president that Italy's deficit-cutting efforts were "appreciated," but that Europe really wanted to see more aggressive reforms to boost economic growth. She said she was worried Mr. Berlusconi wasn't strong enough to deliver.

Mr. Napolitano said it was "not reassuring" that Mr. Berlusconi had recently survived a parliamentary vote of confidence by just one vote.

Ms. Merkel thanked the president in advance for doing what is "within your powers" to promote reform.

Mr. Napolitano got the message. Days later, he quietly began sounding out Italy's political parties to test the support for a new government if Mr. Berlusconi couldn't satisfy Europe and the markets.

Europe had promised the world it would fix its problems by late October. But Italy was only one of its headaches. While Rome struggled, Greece defied attempts at repair. The Greek bailout deal signed in July now looked far too small. Greece's economy was coming apart.

On Oct. 21, inspectors from the EU and IMF said Greece would now need more than €140 billion in extra euro-zone taxpayer aid through 2020, unless private-sector bondholders forgave 60% of what Greece owed them.

Germany pressed for a deep restructuring of Greek debt. France, fearful that rising bailout costs could jeopardize its own triple-A credit rating, dropped its objections.

Ms. Merkel repaired relations with Mr. Sarkozy at an EU summit on Oct. 23. She gave him a German teddy bear for his baby daughter. The president phoned his wife, Ms. Bruni-Sarkozy, and passed the cellphone to Ms. Merkel, who congratulated France's first lady.

The debate over Greece deepened. The Institute for International Finance, a banking lobby representing many of Greece's biggest creditors, resisted large-scale debt forgiveness for Athens. The banks wanted to make a smaller sacrifice.

Enlarge Image
CT_BRINK2
CT_BRINK2
Reuters

A Wall Street Journal reconstruction reveals how Germany responded to the dangers in Italy by imposing its power on the euro zone—including working to nudge Silvio Berlusconi from power. Above, Berlusconi and Angela Merkel in November.

Ms. Merkel, on the other hand, wanted banks to forgo 50% of their Greek bond repayments, up from an average 10% under the July accord. Governments would guarantee part of what remained.

Early in Brussels on Oct. 27, at a meeting past midnight, Ms. Merkel and Mr. Sarkozy summoned IIF head Charles Dallara into a room at EU headquarters. "This is the last offer," Ms. Merkel said, handing Mr. Dallara a draft agreement that included the 50% demand.

Her unspoken threat: Banks might get nothing if they spurned it.

Mr. Dallara left the room to phone top bankers. The IIF accepted the deal, and investors expressed relief that Greece wasn't pushed into a full default. Italian bond yields paused their upward march.

But the calm didn't last. Late on Oct. 31, Greek Prime Minister George Papandreou threw a wrench into the works by saying he would call a referendum on the bailout.

Europe was horrified. A "no" vote would sink the bailout and push Greece into the biggest sovereign bankruptcy in history.

Bond markets tanked. Euro-zone leaders summoned Mr. Papandreou to Cannes, France, on Nov. 2, ahead of the Group of 20 summit of world leaders.

Penetrating rain dulled the Riviera resort, which in fairer months welcomes movie stars and oligarchs with a palette of sparkling azure. "The real question" for the referendum, Ms. Merkel told Mr. Papandreou there, "is 'Do you want to be in the euro, or not?'"

A taboo had been broken. For the first time, Europe's leaders were openly suggesting that the euro's weakest members could be cast out.
Related Video

Outlook 2012: Ritholtz on What's Next for Europe (12/21/2011)
Is a European Union Worth the Trouble? (12/20/2011)
Spanish Auction Bolsters European Sentiment (12/20/2011)
Eurozone Struggles For Funds to Save Italy, Spain (12/19/2011)
Europe Continues to Dig Out (11/15/2011)

In Cannes, Spanish Finance Minister Elena Salgado made a bet with her German counterpart, Wolfgang Schäuble, that there would be no Greek referendum. She won the wager, and a bottle of fine wine.

In the end, Mr. Papandreou's own party colleagues rebelled against his idea for a plebiscite. He was forced out of office. The Greek bailout remained in place.

The Cannes conclave turned to Mr. Berlusconi. Italy, Europe's leaders told him, was close to being shut

FILT CGIL

out of bond markets. During lengthy discussions, Mr. Berlusconi fell asleep until aides nudged him awake.

Just days earlier, Mr. Napolitano had released a cryptic statement. He considered it his duty, he said, "to verify the conditions" of Italy's "social and political forces." It was code for speaking more openly with parliament's main groups about forming a new Italian government.

On Nov. 8, Mr. Berlusconi, a dominant figure in Italian politics for 17 years, lost his parliamentary majority. Soon he resigned. Mr. Napolitano, with broad assent in parliament, named the respected economist Mario Monti as Italy's new premier.

As 2011 drew to a close, Ms. Merkel's pressure had helped to install the reform-oriented leaders in southern Europe that she wanted, albeit ones that voters hadn't elected. She and Mr. Sarkozy have also steered the euro zone as a whole toward German-style fiscal rigor aimed at balancing budgets and cutting public debt.

But while Germany touts pan-European austerity as the key to stabilizing the region, investors remain doubtful. Italy's bond yields are still at a worryingly high level. And Europe is still looking for money.