Il Sole 24 ORE

Prolonging the summer calm

by Alessandro Leipold

28 August 2012

Thank you, Mario. A sense of gratitude prevails in international financial circles toward ECB President Mario Draghi for having bestowed a relatively quiet month of August upon the markets. His end-July commitment, to do "whatever it takes to preserve the euro" – along with his firm reassurance ("and believe me, it will be enough") – calmed frantic spirits.

True enough, the August calm benefitted also from the absence of key policy meetings during the summer doldrums. Indeed, as soon as such meetings – centered last week on Greece – resumed in Europe, the relative tranquility began to fade. And this despite the fact that the inconclusiveness of the talks between the Greek Prime Minister and his European partners was to be expected. It was in fact naïve to hope in any breakthrough at this stage: everyone is rightly awaiting the troika's new report, due in about a month, to determine the next steps. In the interim, the various players reaffirm established positions, which should come as no surprise. Market nerves must be already very frayed if it takes so little for them to snap.

Such skin-deep anxiety bodes ill for an event-filled, high-voltage month of September. Particularly given that the month begins with spreads that, while below their peaks, are still far too high for the sustainability of public finances. In such a setting, it will be essential that each of September's events be marked by clear steps forward.

The first key appointment is the ECB Governing Council meeting in Frankfurt on September 6. The expectation was that this meeting would define the modalities of the ECB's interventions on government securities markets. Unfortunately, according at least to a recent Bloomberg report, we might need to wait until after the German Constitutional Court's ruling on the ESM, on September 12, for any such details. The logic of such sequencing is unclear, and it will hopefully not be confirmed.

One thing for certain: the next ECB meeting will need to yield substance. Faced with a deepening recession and the absence of inflationary pressures, a further reduction of ECB interest rates would be desirable. As would the definition of at least the outline and the timing of the securities intervention program under consideration. The technical committees charged with studying the issue must have moved forward over the past month, and it would be good to hear a progress report. Actions must be shown to follow words, and within a short time span. The September 6 ECB meeting cannot be one of further deferment, of simply passing the buck from Frankfurt to Karlsruhe. Or else Draghi's reassurance – "believe me, it will be enough" – will lose the very credibility it invoked.

Less than a week later the German Constitutional Court is due to pronounce its fateful decision on the ESM. As noted by most, a positive ruling is expected on the constitutionality of the fund, but this in itself is unfortunately insufficient. It is also important that the Court avoid subjecting the fund's activation to such a maze of political controls by the Bundestag as to render its mobilization prolonged and demanding, if not downright impossible. The Court should bear in mind what German law already allows for the workings of the International Monetary Fund, where the weight of Germany's vote stands at only 5.81% (against 27.15% in the ESM). To recognize the EMS's constitutionality, while at the same time undermining its functionality and effectiveness, would be not only hypocritical and futile, but also fatal to the future of the eurozone. On the same day, general elections will be held in the Netherlands. Should a markedly anti-European result join an unsatisfactory ruling by the Court in Karlsruhe, September 12, 2012 will go down as a calamitous day for Europe. In the hope of prevailing unscathed over these key events of the first half of September, others are on tap for later. Among them, the Eurogroup and Ecofin meeting which should, inter alia, advance toward unified banking supervision, necessary to unlock support for Spanish banks, and the issuance of the troika's report on Greece. Work on a single supervisor is reportedly progressing, even amid difficulties on its scope, while Greek Prime Minister Antonis Samaras is demonstrating greater pragmatism than expected, supported by new Finance Minister Yannis Stournaras, who has so far worked with tenacity and in commendable silence.

There is no shortage of obstacles (Bundesbank and others) on the path toward this year's autumn. But they are not insurmountable. With even slight progress at each of the September's rendezvous, and with an early start of the new ECB securities program, one can aspire to extending this summer's calm. It will not be easy, but a full-fledged effort has to be made, beginning with Prime Minister Mario Monti's European meetings this week.