

Economics

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Euro Area

EU Council: Strong Words But Few Deeds

- The EU Council of heads of State and Government declared its readiness to do *"whatever is required to ensure the stability of the euro area as a whole"*. Furthermore, the leaders of the euro area countries agreed on the wording to ensure *"adequate financial support through the EFSF pending the entry into force of the permanent mechanism"*. By arguing that *"only a very limited amount has been drawn from the EFSF to support the Irish programme"* the leaders – probably led by a German initiative – did not agree to increase the existing facilities, EFSF and EFSM, immediately. The Council decisions were in line with our expectations. The Council update is a powerful reminder that without additional severe market pressure, the European decision makers are not willing to act.
- The leaders of the euro area countries announced that they *"are strongly committed to achieve budget deficits lower than 3 percent of GDP by 2013 at the latest"* (noting Greece and Ireland have until 2014 and 2015, respectively). This announcement is probably targeted to convince the ECB about the earnestness of the budget consolidation of the member states, hoping that this will pave the way for additional support from the ECB.

The EU leaders also announced that they would conduct new stress tests for banks, which will be fully transparent. They also announced they would *"implement swift and decisive measures to strengthen and reform financial institutions"*. These are strong words, but we believe it requires action in terms of installing an area-wide Special Resolution Regime for banks and also to provide a European facility for bank recapitalization. And it will probably be very difficult to agree on these measures.

The EU Council also approved a limited change of the Lisbon Treaty, which in the view of the EU Council President Herman van Rompuy does not require approval by ratification in the member states. Article 136 of the TFEU will be extended by two sentences: *"The member states whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro as a whole. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality."* By adding *"if indispensable"* this version is somewhat tougher than the version mentioned in the press last week. The full decision on the Treaty change will be made by the EU Council in March 2011 at the latest. The plan is that the member countries will start to ratify the Treaty changes in 2011. Once enacted, this change would probably make the planned European Stabilization Mechanism (ESM) waterproof in the view of the German Constitutional Court. According to the timetable, the ESM will come into force in January 2013 and will be active from mid-2013. As expected, the Council did not release extra details on the ESM in addition to the statement of the Eurogroup from the end of November.

[See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.](#)

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Comment: In contrast to the earlier wording that the existing facilities are sufficient, the wording of today's statement is a clear commitment that the EU and euro area countries are willing to take additional measures when and if required. However, as we have seen several times before in the development of the sovereign debt crisis, the European leaders seem to overestimate the power of their words. Without clear action at the level of the member countries and at the area-wide level – including a sufficiently large support facility for fiscally strained euro area member countries – periphery bond markets are likely to come under severe pressure again at the beginning of the new year at the latest – when market activity will accelerate after the low year-end business. In our view, the Council decisions only managed not to disappoint markets. But, by only agreeing on strong words and not on deeds, the heads of State and Government most likely will not be able to calm the markets permanently.

Appendix A-1

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