

## Unpropitious weekend for EMU

Setbacks in France, Germany and the Netherlands

by David Marsh

Mon 23 Apr 2012

It's been a weekend where any long-term supporters of economic and monetary union (EMU) must put their head in their hands. The first round of the French presidential elections has produced a giant setback to German chancellor Angela Merkel's strategy for guiding cash-strapped EMU members out of trouble.

Given the strong vote for the anti-euro candidate, National Front leader Marine Le Pen, the only way that Merkel's ally President Nicolas Sarkozy can win the run-off on 6 May is if he moves still further to the nationalistic right. This would kill any pretence that Europe is moving to some form of fiscal union to solve the euro's problems.

Taking into account the front-runner, François Hollande, still favourite to become the next president, as well as the far-left candidate Jean-Luc Mélenchon, well over 80% of the electorate (in an unexpectedly high 80% turnout) voted yesterday for candidates hostile to German-style policies on EMU.

As if that was not enough, further EMU fault-lines emerged over the weekend:

- The euro area's No. 2 creditor country after Germany, the Netherlands, is without a functioning administration after Mark Rutte's government fell on Saturday in another row over shoring up the single currency's faltering framework.
- Germany's Bundesbank president, Jens Weidmann, again criticised excessive provision of liquidity by the European Central Bank, saying (correctly) it's up to governments, not the ECB, to alleviate the strains in EMU.
- The Bundesbank's board is being sued by a southern German lawyer, backed by some of the country's best-heeled private family companies, claiming that the German central bank is taking liberties with taxpayers' funds through the ECB's Target-2 payments system.

True, the IMF at its spring meeting in Washington lined up \$430bn in extra resources to help bail-out financing for hard-up euro members. But the money will be tied to conditions from the emerging market economies for further European reforms and for fresh (and highly overdue) moves to lower the west's hold on world economic governance.

Not a propitious time for Merkel. She must be thankful that doubts by Sarkozy allowed her to cancel the ill-thought out plan (announced three months ago) to campaign for the French president. No bad thing that the German chancellor was able to stay well away from Paris yesterday, opening the Hanover industrial fair with Chinese prime minister Wen Jiabao and proclaiming that China and Germany together held responsibility for economic stability. It is interesting to note that Germany's exports and imports with China last year amounted to €141bn, creeping up gradually on €169bn with France (well ahead of €125bn with the US, although still behind €159bn with the Netherlands and a surprisingly-resilient €147bn with the UK).

In the remaining two weeks of the election campaign, watch for further French attacks on the tough 'fiscal pact' Merkel wishes to enshrine as EMU's guiding framework. Hollande has already pledged to renegotiate it, and will now have the wind in his sails.

Capital flight from the problem-hit south of EMU towards the relatively healthy north of Europe is almost certain to intensify. One indicator of stress, the imbalances built up through Bundesbank lending to weaker national central banks via the ECB, shows that the Bundesbank's net Target-2 assets ballooned to €615bn in March from €547bn in February. Liabilities owed by the Banco de España and Banca d'Italia rose during the period to €252bn from €197bn and to €270bn from €194bn respectively.

These imbalances have attracted attention from litigious German conservatives who believe that default or euro exit by one or more peripheral states could open up the Bundesbank (and the German taxpayers behind it) to large losses. In such an eventuality, any losses would be shared out among EMU central banks, with the Bundesbank (given Germany's capital share of 27%) bearing the brunt. The Bundesbank board has been uneasily aware for more than two years that lawsuits may be in the offing. This goes some

way towards explaining some of the Bundesbank's recent actions and statements. Following the legal action against the Bundesbank board by Bernd Schünemann, backed by the Munich-based Foundation of Family Enterprises, Weidmann and his colleagues will become ever more cautious over support for weaker states.