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Germany: Preparing for worse?

ECB frictions to the fore

The surprise resignation of ECB Board member Stark on Friday has very much accentuated financial market worries, it being yet another reminder of the policy disagreements that have typified the Eurozone debt crisis: Stark is seen as leaving in protest to the continued purchasing of government bonds by the ECB. It is being suggested, particularly from the conservative economic wing in Germany, that the resignation of Stark, on top of the resignation of Bundesbank chief Weber earlier in the year, marks the end of strict German monetary principles as the foundation of ECB policy making. This is unlikely as current Bundesbank President Weidman and the likely person Germany will offer to replace Stark (current German finance ministry secretary Asmussen) are very much in the mould of Weber.

Has the ECB a freer hand?

Regardless, it could be argued that it would be better if the German influence on ECB policy making were to be diluted. After all, it has almost certainly been this Germanic influence that not only was responsible for ECB rate hikes in April and July that not only increasingly look to have been misjudged, but which were partly justified by the ECB with very-stretched monetary logic that surely has damaged its credibility. In addition, the ECB may now be in a better position to continue with its bond buying role (a clearer picture will emerge later today when weekly figures updating the size of recent purchases are released). Indeed, the deeper banking sector fragility as evident in increasing deposits at the ECB alongside rising spreads (eg the Euribor/OIS), surely justify the need for any action that the ECB feels its needs to carry out in order to ensure that the transmission mechanism for monetary policy does not become even more impaired.

Germany getting more resistant

However, the Stark resignation has further and more perturbing reverberations, all very much questioning both the appetite and willingness of Germany to remain the effective lender of last resort to the fiscally troubled parts of the Eurozone. Indeed, recent events in Germany, including the only-guarded manner in which the constitutional court upheld the enlargement of the EFSF, underscore that German politicians will be restrained and/or made more reluctant to contemplate the likes of a Eurobond or fresh bail-outs, without which the current Eurozone sovereign debt situation may only get worse given the bleak economic backdrop.

Planning for a Greek default?

Indeed, possibly realizing this, Germany already may be planning for, or at least preparing for, worse to come, especially in regard to Greece: over the week-end German politicians started to talk more openly about a Greek default while the press is today alive with suggestions that the German Government is making plans to shore up its banks should such a default take place.

As far as Greece is concerned, such a default looks increasingly inevitable, with the July 21 deal for a fresh and less costly bail-out increasingly looking to have come far too late. Such a default could very possibly occur in the near-term, especially after the latest quarterly audit of Greek public finances by the troika of the ECB, EU and IMF broke up just over a week ago, evidently after it seemed Greece was falling back on meeting deficit targets. However, with markets fearing that a default may have been on the cards over the week-end, more time may have been bought after the Greek government announced on Sunday that it would impose a new two-year property tax to raise € 2 bln this year, closing a supposed budget gap that the troika said must be resolved or further bail-out payments (from the existing scheme) would be stopped. To what extent such measures will have to get potentially difficult parliamentary approval in Greece is unclear. Regardless, even if Greece therefore does get the next tranche of its existing bail-out it needs by end-month (a Eurozone finance minister meeting this coming week-end may be the ultimate arbiter), the likelihood is that more bad economic news and political resistance will see the next audit of Greece in December demand more budget cuts that will be untenable.