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Subject: ECB ready to accept Greek default in broad deal (Reuters)

FRANKFURT/BRUSSELS, July 21 (Reuters) - The European Central Bank's readiness to drop its opposition to a 'selective default' as part of a Greek rescue must have been secured with a concession from euro zone leaders, sources and analysts said.

ECB President Jean-Claude Trichet has for weeks repeatedly and implacably rejected the idea of a short-term or selective default, fearing the market contagion it could prompt.

Just two weeks ago he told the ECB's monthly policy meeting: "We say no to selective default, no to a credit event", although some of his colleagues have been more equivocal.

To fold on that position abruptly without cover from euro zone governments would have been tough to swallow as his term draws to a close, although last year he sharply switched tack on opposing the ECB buying peripheral government bonds.

Trichet joined German Chancellor Angela Merkel and French President Nicolas Sarkozy in Berlin at short notice late on Wednesday -- almost five hours after the two government leaders began their talks to prepare for Thursday's euro zone summit.

Merkel and Sarkozy reached a joint position and Trichet appears to have indicated he could accept a deal on the basis that it would be far-reaching and led by the EFSF rescue fund.

Dutch Finance Minister Jan Kees de Jager confirmed that selective default for Greece was now a possibility, telling the Dutch parliament on Thursday: "The demand to prevent a selective default has been removed."

COLLATERAL PROMISE?

A euro zone source said a proposal in the works centred on a bond swap under which new bonds issued for Greece could be accompanied with collateral provided by other euro zone states, or the EFSF, to ensure Greece can receive funds from the ECB after the ratings agencies declare a short-term default.

That may have been the price to get the ECB on board.

Draft summit conclusions seen by Reuters showed leaders were considering a sweeping expansion of the

EFSF's role to help states sooner, recapitalize banks and intervene in the bond market in a drive to halt contagion. [ID:nB5E7HN032]

The ECB would not comment on any proposals under discussion.

"It is definitely at the top end of expectations," Deutsche Bank economist Gilles Moec said of the draft conclusions.

"I really don't see how Trichet could spoil the party at this stage. He got what he wanted, which was massive participation from the governments."

The draft summit conclusions showed three options for a private sector role in the second Greek bailout remained on the table: a debt buyback, a rollover and a swap. Each of these would almost certainly trigger a selective default.

The ECB had insisted that it would not accept collateral that is in default, thereby threatening to starve Greek banks of liquidity on which they are utterly reliant.

This stance was aimed at making sure euro zone governments -- with or without the private sector -- assume the cost of dealing with the crisis, rather than pushing it over to the ECB, which feared its independence being compromised.

If the ECB is presented with collateral that is essentially underwritten by the euro zone's healthy economies and they -- rather than the central bank -- lead the bailout, then Trichet could be satisfied.

"I guess what matters to him is whether or not the deal was far-reaching, whether it would really address the issues, and then he would be ready to give his support to it," said Deutsche's Moec.
(Reporting by Andreas Rinke, Andreas Framke and Luke Baker; writing by Brian Rohan and Paul Carrel, editing by Mike Peacock)

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