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Greece Aid Request May Be Clouded by Strauss-Kahn Arrest (3)
2011-05-16 10:37:25.951 GMT

(Adds comments from Kauder in third paragraph.)

By Tony Czuczka and James G. Neuger

May 16 (Bloomberg) -- Greece today will plead for a boost in its 110 billion-euro (\$155 billion) bailout from European governments and the International Monetary Fund in talks clouded by the arrest of IMF Managing Director Dominique Strauss-Kahn.

Europe's donor countries, led by Germany, are demanding deeper budget cuts in exchange for granting Greece extra aid or giving it more time to pay back official loans, and are weighing whether to make bondholders share the costs.

"No help without something in return," Volker Kauder, the parliamentary leader of German Chancellor Angela Merkel's Christian Democratic bloc, said on ZDF television today. He wouldn't rule out a "soft restructuring" involving an extension of Greek bond maturities.

Greek bonds fell after Germany put up hurdles to an expanded aid package, with public discontent simmering in northern Europe over the costs of propping up high-deficit countries on the continent's periphery. Adding to the challenge is the absence of Strauss-Kahn, a former French finance minister, in the talks starting at 3 p.m. in Brussels.

"Greece is going to have to be bailed out and there's going to be a restructuring of their debt," Eswar Prasad, a senior fellow at the Brookings Institution in Washington, said in a Bloomberg Television interview. "The presumption was that with Strauss-Kahn at the helm the IMF would not turn its back on Europe, that the IMF would continue to support Europe. Now, with Strauss-Kahn gone, that proposition becomes a little dubious."

Strauss-Kahn Future

Prasad, who previously worked at the IMF, predicted Strauss-Kahn's "imminent" departure as head of the fund. Strauss-Kahn, who as French finance chief in the 1990s played a role in setting up the euro, piloted the IMF through the financial crisis and negotiated its one-third contribution to aid for Greece, Ireland and Portugal.

Nemat Shafik, a deputy managing director, will represent the Washington-based lender at the Brussels meetings after Strauss-Kahn's May 14 arrest on sexual-assault charges in New York. Strauss-Kahn, 62, denied the charges and will plead not guilty, his lawyer, Benjamin Brafman, said in an e-mailed statement. He is scheduled to appear today at 11 a.m. for arraignment in Manhattan Criminal Court.

Greek 10-year yields rose 14 basis points to 15.58 percent as of 11:55 a.m. in London. Two-year note yields gained 9 basis points to 24.98 percent. The extra yield that investors demand for holding 10-year Greek debt instead of the benchmark German bunds increased 14 basis points to 12.50 percentage points.

Central Bank

The euro rose to \$1.4108 as of 10:50 a.m. in London after earlier touching \$1.4048, the lowest since March 29.

Also on the agenda for the European finance ministers are approval of 78 billion euros in aid for Portugal and the nomination of Bank of Italy Governor Mario Draghi to be the next president of the European Central Bank.

Greece needs to slice more out of the budget, the European Commission said on May 13 after forecasting a deficit of 9.5 percent of gross domestic product in 2011, above the 7.4 percent target set when Greece tapped aid last year.

Greece's debt will balloon to 157.7 percent of GDP in 2011 while the economy slumps for the third year, the forecasts showed, fueling doubts whether the country will generate enough growth to pay its bills.

Eighty-five percent of international investors surveyed by Bloomberg last week said Greece will probably default on its debt, with majorities predicting the same fate for Ireland and Portugal.

Spending Cuts

Greek Prime Minister George Papandreou's government will propose a 76 billion-euro package of spending cuts and asset sales by May 19, spokesman George Petalotis said on May 13.

There will be "corrective measures" in public employee benefits and no across-the-board salary or pension cuts.

Plans to offload 50 billion euros of state assets "have top spot on the agenda," Papandreou told Italian newspaper Corriere Della Sera on May 14. "We will show that we're in a position to keep our obligations on the debt."

The yield on Greece's 10-year bond has more than doubled since last year's bailout, complicating a return to markets to cover 27 billion euros of financing needs in 2012. Papandreou said in the newspaper interview that he hoped Greece would be able to tap bond markets next year.

Officially Taboo

A debt restructuring -- with options ranging from an extension of maturities to a writeoff of principal -- remains officially taboo, with the most vocal opposition coming from the ECB. Bending its mandate to focus on fighting inflation, the Frankfurt-based central bank has bought 76 billion euros of bonds of fiscally struggling countries in the past year and would suffer along with private investors in a restructuring.

Default is "just a nightmare," ECB council member Christian Noyer said in Tokyo today. "It's the absolutely wrong solution. It would be a catastrophe."

Greece's chances of escaping a restructuring hinge on the fickle public mood in Germany, which crafted the euro's low-deficit rules and as Europe's largest economy is the biggest guarantor of the unprecedented loan packages.

Forty-one percent of Germans oppose further financial aid for Greece, with 48 percent in favor, according to an Emnid survey published in Bild am Sonntag yesterday. Some 58 percent voiced "very

low" or "quite low" trust in the 12-year-old euro, up from 54 percent in December.

Free Democrats

German Chancellor Angela Merkel dodged a political bullet on May 14 when delegates at a convention of the Free Democrats, the junior partner in her coalition, defeated a motion to toss aid recipients that miss debt-reduction targets out of the euro zone.

Once in Germany's pro-European vanguard, the Free Democrats have tilted against Merkel's bailout policies to boost polling numbers that have plummeted since the party won a 14.6 percent in the September 2009 federal election.

FDP lawmaker Frank Schaeffler, who last year called for Greece to sell its islands to cut debt, said as many as 50 coalition lawmakers will join his revolt against a permanent euro rescue fund due to be set up in 2013. Such a swing would force Merkel to rely on opposition support in a vote planned after the summer recess.

"A year ago I was isolated in the party, but that's no longer the case," Schaeffler said in an interview at the FDP meeting in Rostock, Germany. "A good many Free Democrats share the view in private that something is going badly wrong in solving this crisis."

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--With assistance from Brian Parkin in Rostock, Sandrine Rastello in Washington, Susan Li in Hong Kong, Aki Ito in Tokyo and Anchalee Worrachate in London. Editors: Jones Hayden, Chris Anstey

To contact the reporters on this story:

Tony Czuczka in Berlin at +49-30-70010-6227 or aczuczka@bloomberg.net;

James G. Neuger in Brussels at +32-2-285-4300 or jneuger@bloomberg.net.

To contact the editor responsible for this story:

James Hertling at +33-1-5365-5075 or jhertling@bloomberg.net