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Bini Smaghi, Greece and fairytales

May 30, 2011 10:38 am by Ralph Atkins

Lorenzo Bini Smaghi, European Central Bank executive board member, used an interview in today's Financial Times to explain in detail just why the ECB is so opposed to any kind of Greek debt restructuring. In doing so, he took on directly those such as Nouriel Roubini and Deutsche Bank's Thomas Mayer, who have called for an "orderly" restructuring, drawing on lessons learnt from the Latin American experience in the 1980s.

His messages, based on extensive scenario analysis by ECB economists, were that an "orderly" restructuring was a "fairytale," there was no such thing as a "soft" restructuring, and the consequences of default would be catastrophic.

There were other highlights of from the interview -

First, Mr Bini Smaghi hinted that the ECB was not yet ready to take the next step towards unwinding its emergency financial market support mechanisms. At its June meeting, it has to decide whether to continue providing unlimited liquidity to eurozone banks. A logical step would be to reintroduce auctions for three month loans. But the pace of the "exit strategy" depends on progress in strengthening the banking systems in Greece, Portugal and Ireland. Mr Bini Smaghi said: "I am not sure if we will have sufficient data to take a decision in June."

Second, he suggested the ECB was still on track to raise its main interest rate in July – as hinted at by Jean-Claude Trichet, ECB president, after the May meeting. Immediate eurozone inflation pressures might have abated a bit. "But if you look over the medium term, keeping in mind the recovery in the economy, the very low level of interest rates that we have does not seem fully justified. A process of adjustment is required if the economy continues to grow."

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