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Draghi Retreats Vs. Germany, Now Says ECB 'May' Act

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The European Central Bank looks less like the eurozone's savior and more like a junior partner, after ECB President Mario Draghi retreated Thursday from last week's pledge to do "whatever it takes" to preserve the euro.

Instead of announcing a bond buying program, which Draghi had strongly hinted at, he indicated the central bank "may" purchase sovereign debt only after Europe's leaders deploy their bailout money with strings attached. The ECB also kept the benchmark interest rate at 0.75%.

"The adherence of governments to their commitments and the fulfillment by the (rescue funds) of their role are necessary conditions," Draghi said after an ECB policy meeting.

But his failure to back up his bold words, at least for now, undermined his credibility and crushed hopes Spain and Italy will see quick relief. Spain's 10-year yield, which had fallen sharply on Draghi's prior vow, shot up 49 basis points on Thursday to top 7% again. Italy's leapt 41 ticks; now back far above 6%.

U.S. stocks sold off, and Treasury yields fell. The euro also weakened vs. the dollar.

Draghi's stance appears to leave elected officials in the lead on the debt crisis, rather than letting them off the hook from resolving their differences.

Progress on promised fixes has been limited by disagreements between richer eurozone states and more indebted ones, especially over austerity measures required to secure bailouts.

"The ECB is withholding market support until elected political leaders take ownership of enforcing debt reduction and other terms of new bailouts,"

analysts at PNC Financial said in a note.
Those bailouts also will rely strictly on government coffers — and their overseers. An ECB legal opinion ruled out giving the funds a bank license, which would let them draw on ECB money to boost their firepower.

Lack of specifics on possible action, such as the scope of any intervention or whether bond buys would be "sterilized" with equivalent selling, was seen by PNC as discouraging evidence of disagreement.

"These are among the first decisions needed before this policy can be implemented, suggesting that the Governing Council's consensus only extends to broad principles," it said.

The Berlin Wall

Draghi acknowledged Germany remains opposed to direct bond purchases, which could be seen as a violation of ECB rules against financing governments.

But how much sway Europe's top economy will hold over any ECB bond buys came into question when he added that policymakers "will take a final decision and the votes will be counted."

He also said the ECB will evaluate other policies, like further loosening collateral rules for banks to borrow from the ECB and providing another round of cheap, long-term ECB loans.

Failing to answer whether debt purchases would be sterilized is a sign that Draghi is mulling aggressive action, says **Bernard Baumohl, chief global economist at the Economic Outlook Group**. It suggests the central bank might adopt something akin to quantitative easing.

But such a move would meet fierce German opposition.

Despite market disappointment with Thursday's statement, **Baumohl** considers it the ECB's most forceful of the debt crisis. "That tells me Mario Draghi has decided to attack any notion that the eurozone's days are numbered," **Baumohl** said.