Germany unmoved by anti-austerity votes in Europe

By Noah Barkin and Stephen Brown

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(Reuters) - Germany is ruling out any substantive shift in its approach to Europe's debt crisis despite a rising chorus of opposition to Berlin's austerity policies that reached a crescendo in Sunday's elections in Greece and France.

Chancellor Angela Merkel, speaking in Berlin on Monday, rejected the notion that Europe was on the brink of a major policy shift after Socialist Francois Hollande defeated her fellow conservative Nicolas Sarkozy and Greek voters punished ruling parties who slashed spending to secure a foreign bailout.

Shunned by Merkel, who publicly backed Sarkozy's campaign, Hollande repeatedly criticised Germany's focus on budget cuts and labour law reforms as the solution to Europe's debt crisis. Many saw his victory and the outcome in Greece as heralding a shift in Europe toward higher-spending growth-oriented policies.

But close Merkel allies made clear within hours that the expectation in Berlin was that it would be Hollande who would be making the lion's share of the concessions, and rowing back on policy promises made during the French campaign which the Germans view as dangerous for the entire single-currency bloc.

"The position of the German government is clear. We will continue on our savings path," said Volker Kauder, parliamentary leader of Merkel's conservatives and one of her closest allies.

After another bad night for her Christian Democrats (CDU) in a state election on Sunday, Merkel knows that if she is to win a third term next year she can ill afford to ignore German voters' demands that she give no more of their cash away to foreigners.

"Germans could end up paying for the Socialist victory in France with more guarantees, more money. And that is not acceptable," her ally Kauder said. "Germany is not here to finance French election promises."

FRENCH PROMISES

Those promises appear potentially costly.

Hollande has pledged to balance the French budget in five years, but he also wants to hire tens of thousands of new teachers, introduce a 75-percent tax on million-euro annual incomes and raise the minimum wage.

He favours the introduction of joint euro zone bonds and a more active role for the European Central Bank in fostering growth - both taboos in Germany.

Andreas Schockenhoff, a leading CDU lawmaker who heads a Franco-German parliamentary group, told Reuters he expected Hollande to commit "very quickly" to "stability policies".

Pressed repeatedly at a news conference on whether the French and Greek votes might change the policy debate in Europe, Merkel's spokesman Steffen Seibert insisted the only way forward was growth through structural reform - such as of tax and labour rules aimed at improving trade - not debt-funded stimulus plans.

Merkel herself made clear that, while there was scope to discuss tactics, the overall strategy EU leaders committed to by agreeing a compact on fiscal consolidation was "not negotiable".

"We are in the middle of a debate to which France, of course, under its new president will bring its own emphasis," she said. "But we are talking about two sides of the same coin - progress is only achievable via solid finances plus growth."

"OPEN ARMS"

The German leader telephoned Hollande, whom she has never met, on Sunday night after his victory and the two spoke, with the help of interpreters, for nearly a quarter of an hour.

Sources told Reuters the conversation was friendly and that Hollande assured Merkel he wanted very close ties. The president is expected to visit Berlin next week, most likely on May 16, the day after he takes office, on his first foreign trip. Merkel said Hollande would be welcomed with "open arms".

Germany has already signalled it is ready to negotiate a "growth pact" with the new French leader. Though its terms may well be vague, that would allow Hollande to claim victory in his push for a more balanced approach to the crisis.

But bold new initiatives that might give ailing economies like Greece and Spain a substantial boost are unlikely.

"Boosting growth is fine, but the question is how," CDU budget expert Norbert Barthle told Reuters. "Our focus remains firmly on structural reforms."

German officials have indicated they are prepared to explore a more flexible use of EU structural funds, bolster the capital of the European Investment Bank (EIB) and allow the issuance of so-called "project bonds" to fund investment in infrastructure.

These steps would not require substantial new funds from Berlin and this is why they are acceptable. But launching new government stimulus programmes, allowing euro members more time to cut deficits they have pledged to get down, or giving the ECB new powers to bolster growth remain anathema to Germany.

"There will be no loosening of the deficit targets," one high-level German source said, pointing to Hollande's victory speech in Tulle as a sign of his readiness to work with Germany.

"He mentioned cutting back the deficit as his second priority. That was significant and a signal."

Hollande's chief economic adviser, former finance minister Michel Sapin, also said on Monday: "Nobody expects that we simply arrive in power and hand out money."

HARD LINE ON GREECE

On Greece, officials in Berlin and Brussels are also taking a hard line, making clear they see no room for the country to renege on or renegotiate the terms set out in its multi-billion euro rescues by the bloc and the IMF.

The failure of the big parties that have dominated Greek politics for decades to secure a majority, and a surge in support for extreme parties from the left and right, has raised questions about whether Athens will stick to its commitments and sparked speculation it could be forced out of the euro zone.

"Either they stick to the programme and receive the financing from member states - or they will have to default," said a senior euro zone source before the pro-EU Greek Socialist party leader called explicitly for a renegotiated bailout deal.

"What the default would lead to, I don't know," the source said. "But certainly to even more hardship for Greek citizens."

At the core of the European project, formed around France and Germany to end a succession of wars, Hollande can look to the euro zone's third economy, Italy, for support. Sapped by a moribund business climate and budget cuts meant to appease wary creditors, Prime Minister Mario Monti's technocratic government endorsed the new French president's pro-growth agenda.

An indication of whether Hollande is ready for confrontation with France's key partner, Germany, or will seek reconciliation will come when he names his government later this month.

A leading candidate for the post of prime minister is Jean-Marc Ayrault, a German-speaker who knows the country well and who has sent conciliatory messages to Berlin in recent weeks.

Choosing him over Martine Aubry, a more traditional Socialist who was responsible for introducing France's 35-hour workweek, would signal that Hollande is ready for compromise.

"I will be very interested to see whether or not Hollande kicks off his presidency with a battle with Merkel," said Louis Gargour, chief investment officer of hedge fund LNG Capital.

"This is a contest of Keynesian economics and a focus on growth versus an extended phase of austerity that electorates are fast becoming tired of."

(Reporting by Noah Barkin, Stephen Brown and Andreas Rinke in Berlin, Jan Strupczewski in Brussels and Sinead Cruise in London; Editing by Alastair Macdonald)