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Merkel Seeks EU Rules After German Short-Selling Ban (Update2)

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By Tony Czuczka

May 19 (Bloomberg) -- German Chancellor **Angela Merkel** laid out proposals to gain control over "destructive" financial markets, after she imposed a unilateral ban on naked short- selling that sent stocks sliding.

Merkel, opening a parliamentary debate on Germany's contribution to a $1 trillion bailout to backstop the euro, said faster budget cuts, tougher penalties for countries that flout the rules and the orderly insolvency of euro-region states are among the measures Germany will put to European Union partners on May 21.

"The lack of rules and limits can make behavior in financial markets driven purely by the profit motive destructive and lead to an existential threat to financial stability in Europe and even the world," Merkel told lawmakers in Berlin today. "The market alone won't correct these mistakes."

Merkel's coalition is seeking to build momentum on market regulation amid public opposition to Germany's share of the Greek and euro-region bailouts. The coalition parties, reeling from a regional election loss on May 9 that cost Merkel her control of the federal upper house, fell to their lowest combined support in 10 years in a Forsa poll today.

'Political Desperation'

Merkel's move looks like "political desperation," sending "the totally wrong signals to European partners and also to the markets," **Carsten Brzeski**, an economist at ING Group in Brussels, said in a phone interview. "It's mainly driven by the domestic political agenda."

Germany brought in a ban today on naked short-selling and speculation on European government bonds with credit-default swaps, sparking investor anxiety about increasing regulation.

The euro reached the weakest level in more than four years, falling as much as 0.5 percent to $1.2144, before rebounding. **The Stoxx Europe 600 Index** dropped 1.9 percent to 246.46 at 1:54 p.m. in London. Standard & Poor's 500 futures sank 0.5 percent to 1,113.4 at 8:27 a.m. in New York after tumbling as much as 1.2 percent.

Short sellers borrow assets and sell them, betting the price will fall and they'll be able to buy them later, return them to the lender and pocket the difference. In naked short- selling, traders never borrow the assets so betting is unlimited.

'Strong Pressure'

"There is strong pressure to take action against speculative attacks," European Union Economic and Monetary Affairs Commissioner **Olli Rehn** said in an interview today in Strasbourg, France. "Therefore, I can see the reasons for this decision" in Germany. "It's important that we now accelerate the regulatory reform of the financial markets."

Merkel, who will host international talks in Berlin tomorrow on financial regulation ahead of the Group of 20 summit in Canada in June, said Germany will act alone where necessary.

"All of this will stay in effect until another solution has been found at the European level," she said, citing the short-selling ban by financial regulator BaFin.

A Europe-wide ban on the practices is "doubtful," **Eddy Wymeersch**, Europe's top market regulator, said in a telephone interview. The Netherlands and Finland said they have no plans to implement similar measures.

France, which lined up with Germany on market regulation before the last two G-20 summits, doesn't plan follow Germany in banning the use of contracts to speculate on European sovereign debt, Finance Minister **Christine Lagarde** said.

"We haven't envisioned doing it," Lagarde told reporters in Paris. France has banned "naked short sales" on equity markets since September 2008.

Germany will lobby governments to introduce a tax on financial markets, and for ratings companies to come under European supervision so governments regain "primacy" over markets, Merkel said.

The euro is at risk and Europe may be facing its greatest challenge since the founding of the European Union, she said. The consequences are "incalculable" if leaders fail to act.

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