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Expect nothing and avoid disappointment

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"BLESSED is he who expecteth nothing," said D.H. Lawrence, "for he shall not be disappointed." Lawrence must have had the euro in mind. After four summits in 12 months, a solution to its problems remains elusive.

That is unsurprising given the problems' severity. They form a trifecta: solvency, as concerns continue mounting about the Club Med's ability to repay its debts; liquidity, as default risks undermine confidence in eurozone banks; and competitiveness, as the roots of southern Europe's crisis lie in low productivity and high labour costs compared with Germany and Europe's stronger economies.

To address these issues, eurozone leaders are likely to increase funding for bailouts.

That may mean bringing forward the European Stabilisation Mechanism, intended to replace the European Financial Stability Fund in 2013, and defining an increased role in bailouts for the European Central Bank and the International Monetary Fund.

The enhanced IMF role, funded partly by the stronger euro countries, would bring greater assurance that bailout funds would ultimately be recovered, as the IMF has absolute priority over other claimants. The IMF also has a proven record in imposing tough conditions on borrowers.

At the same time, leaders will endorse more stringent rules for the European economies. As far as German Chancellor Angela Merkel is concerned, those rules must include credible sanctions against countries that fail to comply.

Finally, there are pressures to strengthen the European Banking Authority, and associate to it some means of restructuring weak banks. The ECB's loosening, last Thursday, of collateral requirements for banks seeking access to liquidity would complement that.

Yet these measures are unlikely to be sufficient. There simply isn't the will in the stronger eurozone economies to bear the fiscal pain bailing out the Club Med would involve. Moreover, the IMF has said it will not carry more than one-third of any bailout's overall costs. The chasm between demands and resources therefore remains.

As a result, European banks will remain highly exposed to Club Med debt, weakening balance sheets and crippling their lending. But governments in southern Europe, where banks are most exposed, do not have the funds to recapitalise their banks, while in the north there is still a reluctance to fully recognise losses and restructure banks accordingly.

As for new fiscal rules, even if given treaty status, experience in 2002-05, when Germany and France led in weakening existing rules, casts doubt on their effectiveness.

Two further factors add to the problems. First, domestic political constraints are becoming ever more binding. France has presidential elections in April, and President Nicolas Sarkozy, who the Socialists accuse of caving in to Germany, is trailing badly in the polls. As for Germany, the bailout is straining the governing coalition, with the junior partner, the Free Democrats, increasingly uncomfortable with risks to German taxpayers. And, in the Club Med countries, domestic politics is impeding progress with desperately needed structural reforms.

This is especially true in Italy, where Prime Minister Mario Monti's fiscal "manoeuvre", released on Monday, egregiously fails to tackle structural impediments to Italy's economic growth.

Second, relations between the eurozone and the rest of the European Union are increasingly fraught. Sarkozy would be happy to see Britain sidelined. But Germany needs Britain to counter French interventionism, and worries about marginalising the EU's eastern fringe. Yet any EU-wide solution would be even more complex and uncertain than one involving solely the eurozone, forcing a eurozone-only solution that further fractures the EU. So only those expecting nothing are likely to be satisfied this Christmas.