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E.U. officials try to head off growing euro threats

LONDON

Meeting set for Monday expected to discuss fears that Italy could be next

BY STEPHEN CASTLE

With fears growing that Italy could become the latest victim of the euro zone's sovereign debt crisis, and with plans for a second Greek bailout deadlocked, top European officials are to meet on Monday to wrestle with the mounting threats to the currency union.

Euro zone finance ministers had previously scheduled two days of talks to begin on Monday afternoon in Brussels. Over the weekend, a meeting of more senior officials was also set for Monday morning.

A spokesman for Herman Van Rompuy, the president of the European Council, denied that the senior officials would discuss the market's fears about the precarious state of Italy's finances. But another official, who requested anonymity because he was not authorized to speak publicly, said Italy would most likely be on the agenda.

On Friday, the spread of 10-year Italian government bond yields over their German equivalents widened to 236 basis points, the most since the introduction of the euro, and the country's blue-chip stock market index, the FTSE MIB, fell by 3.5 percent. Investors were unnerved by evidence of a growing divide between the Italian prime minister, Silvio Berlusconi, and the finance minister, Giulio Tremonti.

Meanwhile, the impasse over plans to involve the private sector in a second Greek bailout seemed certain to dominate the broader meeting of finance ministers later Monday.

Some officials of euro zone governments now believe that any bailout plan calling for a substantial but voluntary contribution from private investors in Greek debt would still be declared a selective default by the bond rating agencies Moody's, Standard & Poor's and Fitch. If even voluntary contributions would trigger such an event, these officials believe, then more radical options may as well be considered — including forcing banks and other private investors to take part.

Speaking Sunday at a conference in Aix-en-Provence, France, the president of the European Central Bank, Jean-Claude Trichet, said Europe was at the "epicenter" of a debt crisis that concerns the entire developed world. He urged euro zone officials to do the "maximum" in terms of governance reforms, Bloomberg News reported.

The special session of top European officials was to start around 8:30 a.m. Monday, when a scheduled meeting between Mr. Van Rompuy and the president of the European Commission, José Manuel Barroso, would be extended to include Mr.Trichet as well as the European commissioner for economic and monetary affairs, Olli Rehn, and Jean-Claude Juncker, the finance minister for Luxembourg, who presides over Eurogroup, the meetings of finance ministers from

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the 17 countries using the euro.

Vittorio Grilli, the director general of the Italian treasury, was also scheduled to attend. But Dirk De Backer, a spokesman for Mr. Van Rompuy, said Mr. Grilli would be there in his capacity as head of the euro zone's Economic and Financial Committee and not to discuss his country's economic situation.

"There is absolutely no crisis meeting," Mr. De Backer said. "This is a coordination meeting to prepare for the Eurogroup. It is not the aim or purpose to talk about Italy."

Some officials downplayed the significance of the meeting, pointing out that Germany - the biggest economy in the European Union — will not be represented and that Mr. Van Rompuy and Mr. Barroso will not take part in the later gathering of euro zone finance ministers.

Italy has a debt equal to 120 percent of annual gross domestic product, one of the highest in the euro zone. The market selloff last week was sparked by tensions between Mr. Berlusconi and Mr. Tremonti. Mr. Tremonti, the country's long-serving finance minister, has been praised for his handling of the economy during the financial crisis and, in particular, for keeping control of the budget deficit — one reason why Italy has, up to now, escaped the significant market pressures that have been brought to bear on Greece, Ireland and Portugal.

His reluctance to endorse the tax cuts Mr. Berlusconi desires has put an acute strain on relations between the two men.

Last winter, investors drove Italy's borrowing costs higher amid concerns over its heavy debt load, but the attack was short-lived. Now, as the government stumbles in approving a new austerity plan and economic growth shows few signs of accelerating, investors have turned a laser-like focus back toward the country.

The euro zone has already been shaken by the fiscal troubles of Greece, Portugal and Ireland, which account for a relatively small portion of the euro zone's G.D.P. The Italian economy is more than twice as large as those of the three countries combined. If investors drove Italy's borrowing costs to unsustainable levels, it would imperil the entire European monetary union.

Few think that is something that will happen overnight. But if Mr. Berlusconi continues to fuel an uncertain political environment, and if Mr. Tremonti winds up a political victim, Italy would be hard-pressed to escape the contagion.

Financial markets are alarmed at European officials' continuing failure to come to grips with the crisis in Greece which, though it represents only around 2 percent of the euro zone economy, still poses a potent risk of contagion.

A second Greek rescue, worth an estimated €85 billion, has been held up by a dispute over the extent of private sector involvement. Negotiations over a complex French proposal to roll over debt have been derailed by a declaration from Standard & Poor's that this would probably constitute a selective default.

European officials are increasingly coming to the view that their objectives — of achieving a private sector contribution that is voluntary and substantial, but which is not judged a selective default — are irreconcilable.

While some see this as evidence that the E.C.B is correct to be skeptical about private sector involvement, several countries remain insistent that the banks and insurers that hold Greek debt should pick up part of the tab for a second bailout.

Liz Alderman contributed reporting from Paris.