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Markets find eurozone deal short on detail

By Richard Milne, Capital Markets Editor

The sugar-rush reaction of markets to European summits kicked in early on Thursday, as investors welcomed the news that leaders had reached broad agreement on measures to ease the region's sovereign debt crisis.

Bank shares sky-rocketed, the euro surged, while German and French equities saw some of their biggest gains in years and the borrowing costs for peripheral eurozone countries fell.

However, if markets follow the pattern of any of the previous big European meetings since the first Greek bail-out in May 2010, the coming days are likely to bring a return to pessimism.

On Thursday, the biggest reason for doubt was the word every analyst and investor focused on: details, or rather the lack of them. "It remains a deal long on intentions and short on details," said Jens Larsen of Royal Bank of Canada.

Guillaume Menuet of Citi agreed that a reversal of Thursday's rally is "a strong possibility".

"In terms of details, we have a few more weeks of uncertainty to digest," he added.

But the strength of the rebound led some to wonder whether the gains could be more sustainable this time. "[The plan] certainly seems to have gone a long way to meeting market desire for something more comprehensive than the piecemeal approach we have encountered over the last couple of years," said Mike Turner of Aberdeen Asset Management.

The main share indices in Germany, France, Italy and Spain all rose by about 5 per cent while the euro gained more than 2 per cent against the dollar to $1.417. Mr Menuet argued that many investors were behind their benchmarks as the end of the year approached, so were hoping for a continued rally.

The reaction was perhaps most striking in the bond markets, where investors had been more pessimistic than equities traders in the run-up to the summit. Spanish benchmark 10-year government bond yields fell 16 basis points to 5.33 per cent, helped by European Central Bank purchases.

But the biggest hint of investors turning wary again was seen in the bond yields of Italy. The country is viewed by many in the market as the key to the entire eurozone debt crisis, as it has the region's biggest bond market and third-largest economy. Yields initially fell by more than

20bp to 5.7 per cent. But in late trade they had climbed back up to 5.89 per cent, only 3bp down on the day.

Investors are worried about the prospect of an imminent recession in Europe. "Europe needs a substantial growth package for 2012... [which is] needed to bring debt-to-GDP ratios back on a sustainable path," said Andrew Milligan of Standard Life Investments.

Among US analysts and investors there was more scepticism. Carl Weinberg of High Frequency Economics probably went further than most in asking where the money would come from for the bank recapitalisations, the increase in the firepower of the bail-out fund and the second Greek rescue.

"Funding all of this will, in our opinion, break the economy and cause a depression the likes of which euroland has never seen before. No one seems to be thinking about this," he said.