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Italy gives EU a post-party hangover

By FT reporters

Italy's borrowing costs have climbed to euro-era highs just a day after European leaders agreed on a new plan to reverse the region's spiralling debt crisis, a worrying sign they have failed to regain the confidence of key financial markets.

As striking Italian civil servants massed in central Rome to protest against possible forced redundancies, Italy was forced to pay a record 6.06 per cent at an auction of its benchmark 10-year bonds, up from 5.86 per cent a month ago, despite intervention by the European Central Bank on the open market.

The move comes as European officials have turned to China and Japan for possible funding of the eurozone's bail-out fund. In Tokyo, Japan's prime minister, Yoshihiko Noda, told the Financial Times he would like to see "even greater efforts" in Europe to "ease crisis worries by creating a stronger and more detailed approach".

The world's third-largest economy remained concerned about possible contagion. "This fire is not on the other side of the river," Mr Noda said. "Currently, the most important thing is to ensure it does not spread to Asia or the global economy."

Markets increasingly see Italy as the decisive country for how the eurozone debt crisis plays out.

Economic reform plans presented by Silvio Berlusconi, prime minister, received a cautious welcome at the Brussels summit but have been criticised by investors as both inadequate and beyond the capacity of his weakened centre-right coalition government to put into action.

Brussels blog

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"Clearly this does not look like a strong vote of confidence in the package," said Nicola Marinelli, fund manager for Glendevon King Asset Management, commenting on the bond auction. "I think that after the euphoria of Thursday the market is looking for more hard details from Europe."

With Italy needing to roll over nearly €300bn of its €1,900bn debt mountain next year, Mr Berlusconi is under intense pressure from the EU and ECB to push ahead quickly with measures to lift the stagnating economy and avoid following Greece, Ireland and

Portugal in seeking a full-scale bail-out that would be beyond the eurozone's current firepower.

Efforts to bolster that firepower have prompted Europe to look to Beijing and Tokyo for funding. Klaus Regling, the head of the European financial stability fund, travelled to Beijing on Friday in the hope of persuading China to step up support for the beefed-up fund and is expected to also visit Japan.

This fire is not on the other side of the river

- Yoshihiko Noda, Japanese PM

Japan currently holds just over 20 per cent of the €10bn in bonds issued by the EFSF, and Mr Noda, who was finance minister until becoming premier last month, signalled that Tokyo would continue to back the expanded fund.

In Italy, Mr Berlusconi insisted there was "no credible alternative" to his government, but called the euro a "strange" currency that "has not convinced anyone". Mr Berlusconi later issued a statement to clarify his support for the euro which he said was vulnerable to speculative attacks because it was a currency without a government, a state or a central bank of last resort.

The markets' vote of no-confidence was also felt in Spain where benchmark yields jumped 18 basis points to 5.51 per cent. Italian banks also suffered as European equities lost their post-summit exuberance of Thursday. UniCredit fell by more than 4 per cent while French shares and the euro also declined.

Senior Italian officials at the central bank and Treasury, as well as leading bankers, are also warning Brussels that plans to recapitalise banks have not been properly thought out and risk pushing Italy, and other economies, into recession, by forcing banks to withhold funding from businesses and consumers.

"This situation has not been fully considered and there is a severe risk that half of Europe ends up in recession," one senior official said.

Further doubts over the eurozone's proposed rescue fund were raised in Berlin when Germany's powerful constitutional court issued an injunction that would require the full German Bundestag to approve any urgent bond-buying operations by the European financial stability facility.

The surprise move is not a final decision by the court, but it means that the parliament cannot use a special nine-member subcommittee to take emergency decisions in secret, until the court gives its full ruling – possibly in December.

Eurozone finance ministers have yet to negotiate the final details of ways to "leverage" the €440bn in the EFSF, to give the fund greater financial capacity to enable it to buy bonds in the secondary market. The eurozone summit set a deadline of the end of November to reach agreement, making it unlikely that the fund will be ready to take such action in the near future.

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