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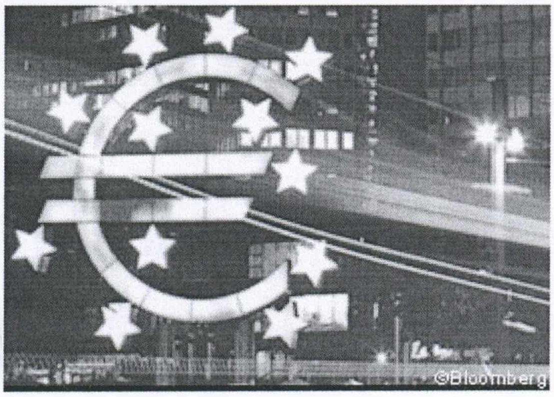
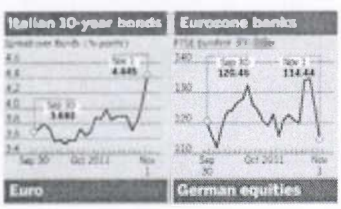
Papandreou wins backing for referendum

By Richard Milne in London, Quentin Peel in Berlin and Kerin Hope in Athens



George Papandreou, Greece's prime minister, has won the backing for a referendum on the second bail-out package for his heavily indebted country after a gruelling cabinet meeting.

The Greek cabinet met for seven hours before giving the Greek prime minister approval to hold the vote on a yet to be determined date.



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"The referendum will be a clear mandate and a clear message in and outside Greece on our European course and participation in the euro," Mr Papandreou told the meeting, according to a statement released by his office.

The prime minister is preparing to fly to Cannes to meet Angela Merkel, Germany's chancellor, and Nicolas Sarkozy, France's president, who summoned Mr Papandreou for emergency talks in with Christine Lagarde, managing director of the International Monetary Fund, and the heads of the leading European institutions, following his shock decision to hold a referendum on Monday.

The announcement spread panic in financial markets on Tuesday and raised fears that it could result in a disorderly default by Athens.

In a joint communiqué, the French and German leaders said they were "determined to ensure the implementation without delay of the decisions adopted at the eurozone summit", saying they were "more necessary than ever today".

The political upheaval came as investors fretted that last week's agreement was unravelling. Bank shares plummeted with France's Société Générale recording its biggest one-day fall since its privatisation in 1987.

Bond markets showed even more alarm as the premium Italy pays over Germany to borrow hit a fresh euro-era record of 455 basis points. Greece, Ireland and Portugal were all forced to accept international bail-outs after their borrowing costs reached that level. The rise in Italy's bond yields came in spite of heavy purchases by the European Central Bank on the first day in office of new president Mario Draghi, former head of the Bank of Italy.

On Wednesday markets across Europe were a little calmer following Tuesday's turmoil which resulted in the gains following the announcement of last week's three pronged deal being wiped out in the first two sessions of this week.

"What is especially frightening is that if the ECB really has been buying Italian bonds then it is the first time they have stepped into the market and failed to lower yields. We may have reached the tipping point," said Gary Jenkins, head of fixed income at Evolution Securities.

In Athens, the Greek prime minister faced a barrage of criticism ahead of a three-day confidence debate in parliament. His wafer-thin majority was crumbling, as two Socialist members announced they would vote as independents and a third called on the Greek president to form a government of national unity.

Mr Sarkozy said after an emergency meeting of his key ministers that the eurozone plan was "the only way possible to resolve the problem of the Greek debt".

"Consulting the people is always legitimate but there can be no solidarity of all the eurozone countries without each agreeing to make the necessary efforts."

In Berlin, officials confirmed that there had been no advance warning of Mr Papandreou's announcement about the referendum, and insisted that the rescue package for Greece was the best offer available from their 16 eurozone partners.

French officials made clear that Mr Papandreou would come under strong pressure to push on with parliamentary approval for the rescue plan. The rest of the eurozone could not be expected "to wait three or four months" for Greece to approve the deal.

"[Eurozone members] have put a lot of money on the table and used a lot of capital for Greece – that comes with commitments," said one official.

Greek and Italian stock markets both fell by 7 per cent while German and French equities dropped 5 per cent. The euro was off 0.8 per cent against the US dollar. German 10-year yields fell 25bp to 1.77 per cent, close to their all-time lows and a bigger one-day fall than after the collapse of Lehman Brothers.

The view in Germany is that rejection of the rescue plan would risk an outright Greek default on its debts, and be far more damaging to the Greek economy.

The Greek move severely disrupted final French preparations for the G20, which Mr Sarkozy had intended would give a ringing endorsement to the eurozone plan. Philippe Juvin, national secretary of Mr Sarkozy's ruling UMP party, said Mr Papandreou was out to "save his skin at any cost" and risked "ruining the efforts made by France and Germany" to reach the eurozone deal.