FINANCIAL TIMES

Last updated: November 7, 2011 9:56 pm

Italy's bonds dragged into danger zone

By Guy Dinmore in Rome, David Oakley in London and Peter Spiegel and Josh Chaffin in Brussels

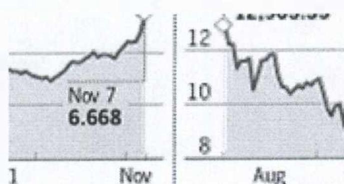
Silvio Berlusconi pledged on Monday to fight on in spite of a growing revolt within his centre-right party and a further erosion of Italy's credibility on bond markets that forced the European Central Bank to intervene to steady nerves.

Italian 10-year bond yields rose to euro-era highs of 6.68 per cent at one point, well into territory considered unsustainable by the markets. Traders warned that without ECB intervention, the Italian bond markets would have seen leaps in yields that forced Ireland and Portugal to accept emergency bail-outs.

Comments by two editors close to the Italian prime minister that predicted his imminent resignation led to sharp gains for stocks on the Milan bourse, until Mr Berlusconi stepped in to deny them.

"Reports of my resignation are without foundation," Mr Berlusconi said on Facebook as his ministers rallied around him, calling on opposition parties to back the reform programme that Rome agreed with the EU last month.

Mr Berlusconi is hanging on as the last surviving prime minister on the crisis-stricken periphery of the eurozone, following changes of governments in Ireland and Portugal, the decision by Spain's José Luis Rodríguez Zapatero not to seek re-election this month and the latest declaration by George Papandreou that he would not lead a new coalition government in Greece.



Click to enlarge

The Italian government faces a key test of its strength in parliament with a vote to ratify the 2010 state accounts on Tuesday. Mr Berlusconi's already thin majority has been eroded further by the defection of several MPs, but the opposition has indicated it would abstain on that motion. Instead, it plans to call for a vote of no confidence in an effort to force Mr Berlusconi to accept an interim emergency government.

Eurozone finance ministers met in Brussels on Monday night to address both the Italian and Greek upheaval. Greece's lenders sought to forestall any possibility that the

new government in Athens might seek to amend or wriggle out of the strictures of a €130bn rescue package agreed late last month.

Olli Rehn, the commissioner for economic and monetary affairs, said that Greece could receive a badly needed €8bn loan payment this month only if the government and the country's two main political parties reaffirmed their support for the rescue programme in writing.

"It is essential that the new government – once ... set up – will express a clear commitment on paper, in writing, to the EU-IMF programme, and its related elements," Mr Rehn said, calling an aborted move last week to hold a referendum on the plan "a breach of confidence."

Mr Rehn said he also expected Italy to produce answers by the end of the week to an extensive questionnaire he had sent the government, seeking to determine how it would implement economic and budget reforms.

Wolfgang Schäuble, the German finance minister, had said as he headed into the meeting: "In Greece, the developments are cataclysmic ... Every day it's a new situation." But he insisted Italy, while too big to be rescued by the existing EU bail-out fund, was not comparable with Greece. "The real numbers from Italy do not justify the nervousness in the markets," he said.

The ECB announced that it had spent €9.52bn on eurozone bonds last week, Mario Draghi's first as president. It was the highest since mid-September and more than double the previous week's figure.

Traders noted the big rise in Italian yield spreads, which leapt to 491 basis points over German Bunds at one stage. They were also trading about 420bp over a basket of triple A rated countries. Markets consider that this is close to the area that will trigger additional margin payments on the trading of Italian bonds. Olli Rehn, EU economic and monetary affairs commissioner, urged Italy to stick to its target of implementing its budget deficit by 2013 and to carry out long delayed reforms to boost growth and job creation. EU experts are to visit Rome this week to monitor its progress, followed by an IMF delegation next week.

Additional reporting by Ralph Atkins in Frankfurt

Printed from: http://www.ft.com/cms/s/0/7293db80-0925-11e1-8e86-00144feabdc0.html

Print a single copy of this article for personal use. Contact us if you wish to print more to distribute to others.

© **THE FINANCIAL TIMES LTD 2011** FT and 'Financial Times' are trademarks of The Financial Times Ltd.