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Draghi hints at eurozone aid plan

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By Ralph Atkins in Frankfurt and Hugh Carnegy in Paris

A last-ditch rescue plan for the eurozone has started to take shape after Mario Draghi hinted that a "fiscal compact" could pave the way for a more aggressive European Central Bank response to the region's escalating debt crisis.

An agreement binding governments to strong rules on public finances would be "the most important element to start restoring credibility" with financial markets, the ECB president told the European parliament on Thursday. "Other elements might follow, but the sequencing matters," he added.

His comments on Thursday indicated that the ECB could ramp up its bond buying programme after a European summit on December 9.

Mr Draghi argued a fiscal compact could act as "long-term" anchor for confidence, while also boosting investor trust in the short term. Underlining the need for immediate action, he urged eurozone leaders to keep their options open on how European economic integration could be implemented. While "far-reaching" changes to European Union treaties "should not be discarded", he argued that "faster processes are also conceivable".

Eurozone politicians have this week urged the ECB to take a stronger role in defending the eurozone, with options including more aggressive bond buying and limits on the differential – or spread – between German and other governments' debt. The Bundesbank, however, remains opposed to such measures.

Adding to the pressure on Mr Draghi, French president Nicolas Sarkozy said on Thursday that the ECB had a "decisive role to play".

"I am convinced that faced with the risk of deflation threatening Europe, the [ECB] will act," Mr Sarkozy said. "It is up to it to decide when and with what means. It is its responsibility. Nobody doubts that it will assume its responsibility ... I am pleased that it has started to do so."

Mr Sarkozy also signalled his willingness to accept stronger European control over national budgets as demanded by Berlin. But he also made it clear there were limits to how much

sovereignty France was prepared to concede. "It is not by going down the path of more supranationality that Europe will be relaunched."

While warning that the ECB's current intervention in the bond markets was "not eternal and it is not infinite", Mr Draghi also signalled further ECB steps were likely at its governing council meeting next week to shore up the eurozone's weakened banking system. Use of the ECB's overnight deposit facility hit €304bn on Wednesday evening – the highest since June 2010.

"We have observed serious credit tightening ... which, combined with a weakening in the business cycle, does not bode at all well for the months to come," Mr Draghi warned. "The most important thing for the ECB is to repair the credit channel."

Options include three-year ECB loans to banks and broadening the pool of assets that can be provided as collateral. Financial markets expect the ECB to cut its main interest rate for a second consecutive month, from the current 1.25 per cent.

Bond markets in Spain, France and Italy rallied sharply on Thursday after successful auctions and co-ordinated central bank action earlier this week cut the global cost of dollar liquidity. Spanish borrowing costs saw their third sharpest daily fall since data were first recorded in 1993, while the fall in French 10-year yields was one of the biggest since 1990.

A meeting of a private sector group that monitors potential systemic risk across the global financial system called for resolute and urgent action to address the eurozone debt crisis.

"The crucial role of the European Central Bank in ensuring normal liquidity conditions in the Euro Area sovereign and financial debt markets cannot be overstated," said the Institute of International Finance's Market Montoring Group said in a statement after a meeting on Thursday. "Decisive steps towards closer Euro Area economic and fiscal integration need to be taken now, with a clear roadmap for implementation."

Additional reporting by David Oakley in London and Michael Mackenzie in New York