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E.C.B. hints at providing helping hand to euro zone

FRANKFURT

More forceful response would require states to prove spending discipline

BY JACK EWING AND DAVID JOLLY

Mario Draghi, the president of the European Central Bank, laid the groundwork Thursday for a more aggressive response to the euro zone debt crisis, suggesting that the bank could increase its support for the European economy if political leaders took more radical steps to enforce spending discipline among members.

Mr. Draghi stopped well short of offering a European version of the huge securities purchases that the Federal Reserve has used to try to stimulate the U.S. economy.

But he seemed to be saying that the E.C.B. would use its virtually unlimited financial resources to keep financial markets at bay, if government leaders did their part by addressing the structural flaws that allowed the debt problems of Greece to mutate into a threat to the global economy.

"What I believe our economic and monetary union needs is a new fiscal compact," Mr. Draghi told the European Parliament in Brussels. "It is time to adapt the euro area design with a set of institutions, rules and processes that is commensurate with the requirements of monetary union."

After government leaders take steps to improve the way the euro area is managed, "other elements might follow," Mr. Draghi said.

European leaders will hold a summit meeting next Friday. European finance ministers said this week that they were counting on an agreement on stronger fiscal union to persuade the E.C.B. or the International Monetary Fund to intervene more forcefully to calm markets.

As is the way of central bankers, Mr. Draghi made no explicit promises, and the quid pro quo he offered governments was indirect. But his remarks illuminated how the central bank could answer increasingly desperate calls for it to escalate its intervention in bond markets, without violating its own mandate or alienating Germany, where opposition to an E.C.B. bailout of Greece or Italy runs deep.

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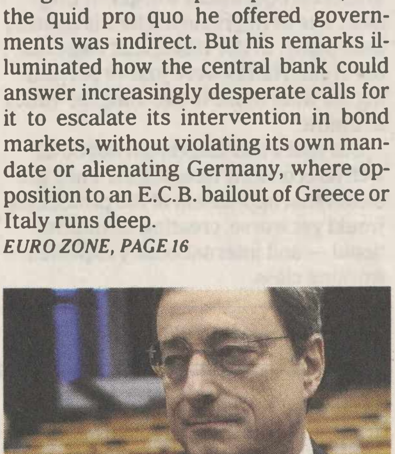

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Mario Draghi, the E.C.B. chief, at the European Parliament in Brussels on Thursday.

FACTORIES EASE UP IN CHINA AND EUROPE

A slump in Asian and European manufacturing bolsters fears that debt issues will lead to recession. *PAGE 15*

E.C.B. offers to help if states do their part

EURO ZONE, FROM PAGE 1

By insisting that greater action would depend on rules to enforce spending discipline among euro members, Mr. Draghi might at least partly address German concerns that greater E.C.B. action would reward countries that have mismanaged their finances and violate a prohibition against financing governments.

"Mr. Draghi appeared to be holding up the possibility of a greater degree of E.C.B. intervention if euro area governments were to commit, at next week's key E.U. summit, to a tougher set of fiscal rules," analysts at Barclays Capital wrote in a note.

In addition, Mr. Draghi noted on Thursday that the E.C.B.'s mandate required it to ensure price stability "in either direction." In other words, if inflation fell below the official target of about 2 percent, the bank would be required to take action to prevent deflation. That would be justification for the bank to buy bonds on the open market in greater amounts, effectively printing money.

In fact, Mr. Draghi gave a gloomy assessment of the economy Thursday and said pressure on prices was easing. The E.C.B. released a survey Thursday showing that small and midsize business were having more trouble getting bank loans. "This autumn, tensions in financial markets have intensified again with very adverse effects on financing conditions and confidence," he said.

Mr. Draghi might still face an outcry from Germany if the E.C.B. appeared to be printing money. Reflecting Germany's deep aversion to inflation, its chancellor, Angela Merkel, and Jens Weidmann, the president of the Bundesbank, have rejected any big increase in the E.C.B.'s relatively modest purchases of government bonds.

Germans account for just two of the 23 members of the governing council, which makes most decisions by majority vote. But though they could easily be overruled, other members of the council would be taking a huge political risk if they alienated the largest country in the euro zone.

As a first step, many analysts expect the E.C.B. governing council to cut interest rates when it meets Thursday, a day before the summit meeting. In addition, there is speculation that the E.C.B. might expand its emergency lending to commercial banks, which are having trouble raising money through usual channels.

Mr. Draghi made it clear that any action after that would depend on commitments from governments.

"The sequencing matters," he said. "And it is first and foremost important to get a commonly shared fiscal compact right. Confidence works backwards: If there is an anchor in the long term, it is easier to maintain trust in the short term."

He also said, though, that E.C.B. market interventions were limited and temporary, suggesting that the bank was still unlikely to buy securities on the same scale as the Federal Reserve, which has amassed more than $2 trillion in government debt and mortgage-backed securities. Bond purchases by the E.C.B. so far amount to about €200 billion, or $269 billion.

"The E.C.B. will continue to resist calls for it to fire a silver bullet into the heart of the debt crisis by printing money to buy up huge quantities of highly indebted governments' bonds," Jennifer McKeown, an economist with Capital Economics in London, wrote in a note.

Mr. Draghi's remarks in Brussels coincided with relatively strong debt auctions by France and Spain. As a result, financial markets were relatively calm Thursday.

His remarks also came a day after the world's major central banks announced a coordinated action to increase liquidity to the troubled financial system, sending stock markets soaring Wednesday.

The rally continued in Asia on Thursday, while major European stock indexes closed down less than 1 percent. U.S. stock indexes were little changed in afternoon trading.

France, with the second-largest economy in the euro zone, after Germany's, sold €4.4 billion of debt, including 10-year bonds priced to yield an average 3.18 percent. That was slightly down from the 3.22 percent at which it sold similar debt on Nov. 3.

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Spain met with solid demand at its auction Thursday, selling all of the €3.8 billion of bonds it was offering, the Bank of Spain said.

But Spain's borrowing costs continued to climb markedly. It sold five-year bonds priced to yield 5.544 percent, up from the 4.848 percent it paid at a similar auction on Nov. 3. Bonds maturing in April 2015 bond were priced to yield an average 5.187 percent, up from the 3.639 percent it paid two months ago.

Earlier this week, it cost Italy 7.89 percent to sell three-year bonds, the most it has paid since the creation of the euro.

There were more signs of a broad slowdown in the euro area, as sentiment among factory managers fell to its lowest in more than two years. The survey by Markit Economics of purchasing managers in manufacturing industries showed a slowdown in all eight countries covered.

The European competition commissioner, Joaquín Almunia, said Thursday that the European Union would extend rules that give member governments flexibility to bail out troubled banks.

The "exacerbation of tensions in sovereign debt markets has put banks in the Union under renewed pressure, justifying the extension of the crisis rules," he said.

The measures are necessary "to restore confidence and to continue the necessary restructuring of the sector," he added.

David Jolly reported from Paris. James Kanter and Stephen Castle contributed reporting from Brussels.