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Cameron in eurozone contingency talks

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David Cameron on Monday summoned top policy makers to discuss contingency plans for an implosion of the eurozone, as Spanish bond yields neared the danger zone.

Against the backdrop of a banking crisis in Spain and uncertainty in Greece, Mr Cameron and his senior ministers met Sir Mervyn King, Bank of England governor, and Lord Turner, the City's top regulator, to discuss the worsening outlook.

Although Downing St said the meeting was long-planned, its purpose was "to ensure the UK is properly placed to deal with the eurozone situation and the issues arising from it".

The discussions came as investors recoiled at a €19bn rescue of Bankia, the Spanish lender, sending the country's borrowing costs over Germany's to the highest level since the start of the euro even as Spain's prime minister insisted his country will not need an international rescue for its banks.

The yield on Spain's 10-year government bonds spiked above 6.50 per cent, closer to the 7 per cent level that prompted bailouts for Greece, Portugal and Ireland, while spreads on Spanish 10-year bonds over German Bunds hit new euro-era highs, climbing to 511 basis points.

In the City, banks have been told to work out the legal and financial implications of various scenarios – ranging from a Greek exit from the eurozone to larger government defaults – and to explain to supervisors how they would deal with them.

Across Whitehall ministers are drawing up their own contingency plans; the Foreign Office is considering how it would help British tourists in Greece if the cashpoints ran dry and if disruption to ferry services left them stranded on Greek islands.

Theresa May, home secretary, has not ruled out some kind of suspension of the EU's free movement rules if a crisis spreads across the eurozone triggering large-scale migration, according to her aides.

The sense of danger was amplified by Mariano Rajoy, Spain's prime minister, who warned that Bankia, Spain's second-biggest bank by local deposits, would have collapsed if Madrid had not agreed to the rescue last week. Mr Rajoy added that this would have risked bringing down Spain itself.

"We are not going to let any regional government fall, or any bank fall, because they can't ... if that happens the country will fall," Mr Rajoy said at an unscheduled news conference, calling again on Brussels to restore confidence in the currency union.

Bankia shares fell by 13 per cent in its first trading session since the rescue was announced on Friday, while Banco Popular dropped by 7.5 per cent, and Banco Santander, the country's largest, lost 3.2 per cent.

Over the weekend Spain had suggested it could sidestep the rising cost of borrowing in the bond markets by swapping €19bn in government bonds directly for equity in BFA, Bankia's parent. The bank could then deposit the bonds with the European Central Bank in exchange for cash – a suggestion that unsettled investors.

"Telling people you're worried about raising €19bn in the market is idiotic," said one senior financier in Madrid. "Basically it's saying: 'we're going to need a €400bn bailout from the IMF'."

Spanish officials said on Monday that its plan to raise money for the Bankia rescue was still based on borrowing in the bond markets, to which Spain still had access. Madrid had not contacted the ECB about the Bankia situation, Mr Rajoy said.

European officials are torn over the merits of the Spanish proposal, which would set an important crisis-fighting precedent in the eurozone that would underline the acute concerns over the fallout from a big bailout for the euro area's fourth-biggest economy.

Madrid has been left battling to convince international investors that it can contain the mounting problems in a banking sector saddled with €180bn of bad property loans, and which some analysts now fear needs more money than Madrid can realistically provide.

"It creates a lot of uncertainty around the way Spain feels about its ability to raise debt in the markets," said Daragh Quinn, analyst at Nomura in Madrid, pointing out that Spain has about €400bn of sovereign debt that falls due over the coming few years.

So far there has been little sympathy and plenty of scepticism over Madrid's insistence that it will rescue its faltering banking sector without outside support. Some senior officials and EU ministers see Spain's reluctance to tap EU funds as mainly a political obstacle, generated by the Rajoy government unnecessarily staking its reputation on avoiding a bailout.

The board of BFA, Bankia's parent group, met on Monday night to prepare to announce what is expected to be the largest loss in Spanish banking history, exceeding the previous record of a €3.5bn loss reported by Banesto in 1993.

Bankia on Friday restated its accounts for last year, turning what was a €309m net profit in February into a €2.97bn loss, which prompted some analysts to suggest that other losses could be hidden in the country's banking system.

"We do not believe that Bankia is unique in the extent of new losses identified," analysts at Rabobank said. "We assume that all Spanish banks would have to report further writedowns and fresh capital needs, should their books be scrutinised by third parties."

Additional reporting by Brooke Masters in London and Alex Barker in Brussels