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Italy pays dearly to issue one-year debt

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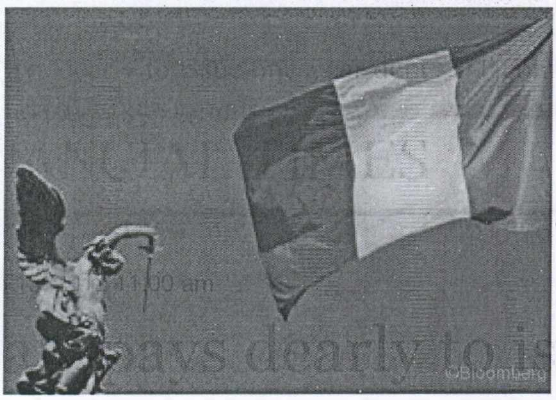

Italy sold €6.5bn of one-year debt at the highest cost since December, underscoring how one of the world's biggest bond markets has been dragged back into Europe's debt crisis.

The 364-day bills were priced to yield 3.972 per cent, but the bid-to-cover ratio fell to 1.73 from 1.79. At the last auction of similarly dated debt Rome's Treasury only paid 2.34 per cent, according to Bloomberg.

Despite the rising cost of borrowing even short-term debt, Italian bond yields fell across the curve on Wednesday. The composite two-year bond yield edged down 2 basis points to 4.51 per cent, while the composite 10-year yield fell 7bp to 6.1 per cent.

Mario Monti, Italy's prime minister, has forcefully denied it would be next in line after Spain to seek a eurozone bailout, and said comments by Austria's finance minister that Italy was at risk of needing a rescue were "inappropriate". Corrado Passera, the Italian industry minister, also dismissed the idea that Rome might need external help.

Italy's ability to tap capital markets will face a bigger test on Thursday, when it will sell as much as €4.5bn of longer-dated bonds.

The European crisis has been deepening in recent weeks, as a €100bn eurozone bail-out of Spain's banks agreed over the weekend failed to assuage investor concerns.

The fears are centred on whether Greece could exit the euro if elections on Sunday lead to gains for political parties that oppose the eurozone-enforced austerity, and Spain's deteriorating economic and fiscal health. Spanish 10-year borrowing costs hit a euro-era high on Tuesday.

Many strategists and investors believe the eurozone is now approaching the point where only two outcomes are possible – decisive policy action or a break-up of the euro.

Fears over these two tail-risks have sent bond yields markedly higher in both the struggling periphery and the previously resilient "core" European countries, like Germany.

"The politicians better get their act together soon as if this week's trend in Spanish and Italian bond yields continues then it might be too late to restore confidence without a move towards a full fiscal union, which clearly is not on everyone's agenda," Gary Jenkins of Swordfish Research said in a note.

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