FINANCIAL TIMES

Last updated: June 29, 2012 1:16 am

Eurozone officials in all-night aid fight

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By Peter Spiegel and Quentin Peel in Brussels

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German officials gave their clearest indication to date that they were prepared to intervene to shore up Italian and Spanish borrowing costs, saying eurozone leaders should use existing powers with their €440bn rescue fund for short-term help.

After weeks of insisting they would not budge on short-term measures, the sudden German acquiescence led to a flurry of activity in Brussels, where EU leaders gathered for the latest in a series of high-stakes summits intended to solve the crisis.

Unexpectedly, senior officials from all 17 eurozone finance ministries met on the sidelines of the summit to weigh emergency plans for Rome and Madrid which focused on using the rescue fund to buy Italian and Spanish bonds to reverse the recent spike in yields.

Despite the German shift, it was not enough for Spain and Italy. The finance ministers' group, known as the "euro working group", was forced to continue deliberations into the early morning hours Friday after the Italian and Spanish prime ministers threatened to scupper agreement on the rest of the summit agenda without a deal on new aid.

François Hollande, the French president, said Spain's Mariano Rajoy was holding out for changes in his country's €100bn EU bank rescue plan so that bailout aid could be injected directly into teetering Spanish financial institutions. Under current rules, such funds must be funnelled through the Spanish state, adding greatly to Madrid's sovereign debt levels. Germany has insisted on such a structure to ensure repayment.

In addition, Mr Hollande said Mr Rajoy wanted to ensure the new bailout loans did not have seniority over current private deb holders; such seniority for government loans will be a requirement once a new eurozone rescue fund comes into effect next month.

Mario Monti, the Italian prime minister, continued to insist on an instrument that would automatically trigger the purchase of Italian bonds by the rescue fund if borrowing costs rise too high, Mr Hollande said. Such a mechanism does not currently exist and the German-led group of creditor countries have refused to create new tools for bond buying.

"There is a toolbox which is available," said a senior German official.

In a sign of how untenable things have become for Italy, Rome's borrowing costs shot up at a €5.24bn auction of five and 10-year notes to the highest levels since December. Italy sold the five-year bonds at an average yield of 5.84 per cent – up from 5.66 per cent in May – while the yield on 10-year paper increased to 6.19 per cent from 6.03 per cent.

The political stakes for Mr Monti also rose on Thursday. Giorgio Napolitano, the Italian president and a strong Monti backer, said that political support for his technocratic government was slipping – an implicit warning to European leaders that Mr Monti needed to return from Brussels with assistance.

"Conflicts and political polemics among the forces that support this government are increasing," Mr Napolitano said a written statement.

As an alternative to the Spanish and Italian plans, officials were debating whether the bailout fund, the European Financial Stability Facility, would buy bonds on the open market, one of the powers granted the EFSF last year.

Finland and other northern creditor countries were pushing for a programme that would be focused on purchasing bonds from both countries at auction – assistance that would come with intensive economic monitoring.

Alex Stubb, EU minister for Finland, one of the remaining triple-A rated countries in the eurozone and a close ally of Germany, said his government would only back a programme that purchased bonds at auction, adding that strong conditionality would ensure that Italian reforms would continue once Mr Monti leaves office next year.

"The sand in the time glass of Monti is going," said Mr Stubb. "It's very much part of our thinking ... That is a good incentive to get something done."

In order to ensure there were enough funds available to assist both Rome and Madrid, officials were also debating whether to revive the so-called "leveraging" plans created for the EFSF last year.

Under those plans, instead of the EFSF directly buying bonds at auction, it would incentivise private investors to buy by insuring against 10-20 per cent of potential losses. It could increase EFSF's firepower by several multiples, depending on how much loss the EFSF was willing to insure.

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