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Europe agrees crisis-fighting measures

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By Peter Spiegel and Joshua Chaffin in Brussels

Eurozone leaders agreed to radically restructure Spain's €100bn bank recapitalisation plan during all-night talks at an EU summit that ended in the early hours of Friday.

The agreement will result in EU bailout funds eventually being injected directly into teetering Spanish financial institutions, meaning Madrid can sweep the burden of the bailouts off its sovereign books.

However, the rescue for Spain's banks will only come after the creation of a single banking supervisor to be run by the European Central Bank.

The current hotchpotch of 17 different bank supervisors will be replaced by one regulator for all eurozone banks, an important step towards a so-called banking union that is arguably the most significant change to the single currency area since it was created, observers said.

The summit agreement also contained some concessions for Italy, though less than for Spain, setting the stage for Rome to become the sixth eurozone country to request EU assistance as part of the eurozone debt crisis.

Ireland, which suffered a bank meltdown like that in Spain, would also be considered for similar treatment, the summit agreed.

The agreement came after Italy and Spain forced leaders to remain at the summit overnight, blocking progress on all other agenda items before getting a deal on short-term rescue measures.

Investors welcomed the breakthrough, sending the euro 1.2 per cent higher against the dollar to $1.2590, its biggest daily gain in eight months.

Strains in the European government bond market also eased, with yields on Italian and Spanish bonds falling sharply. At noon in London, yields on Spanish 10-year bonds were trading down 34 basis points at 6.61 per cent. Comparable Italian yields were down 25bp at 5.94 per cent

At the same time, European equity markets were significantly higher. The composite Euro Stoxx index was up 2.89 per cent, with Spain's Ibex and the MIB index in Milan up 2.96 per cent and 3.2 per cent respectively. There was slightly less ebullience in Frankfurt, where the Dax was up

2.49 per cent and London, which saw the FTSE 100 up only 1.41 per cent, while the CAC 40 in Paris occupied the middle ground, rising 2.79 per cent.

Banks were among the biggest gainers among European equities as investors reacted to the decision by European leaders to allow the rescue funds to invest directly in the continent's biggest lenders.

But analysts and financial commentators were beginning to question the strength of the underlying political agreements and the detail of what the EU leaders had signed up to, particularly over timing and the sequence of events.

"It is imperative to break the vicious circle between banks and sovereigns," eurozone heads of state said in a post-summit statement.

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Under the revised rules – demanded by Italy – countries that want the eurozone bailout fund to purchase their bonds – an essential way of lowering their borrowing costs – will no longer be subject to Greek-style monitoring programmes. Instead, they would simply have to maintain their EU debt and deficit commitments, though EU authorities could mandate tighter deadlines and timetables.

Italy is expected to make use of the new bond purchase plan. "It is a double satisfaction for Italy," said Mario Monti, the Italian prime minister. For Angela Merkel, the German chancellor who had for months insisted she would agree no new short-term rescue measures, the deal was a significant concession.

The change in the Spanish programme is likely to have the most immediate effect on the financial markets, particularly since leaders also agreed bailout loans to Spain would no longer be granted seniority status, a structure that had spooked the bond market because of the prospect of official lenders jumping the repayment queue.

Leaders tasked the European Commission to come up with plans for the shift to a single supervisor for the banks "as a matter of urgency" and before the end of the year.

Thomas Wieser, head of the euro working group, said that while Spain's bank bailout would probably begin under current rules, the loans could quickly be moved off Madrid's sovereign books once the new bank supervisor was in place.

In exchange for the concessions, a German-led group of northern creditor countries will gain more control over all of the eurozone banks through the new single supervisor.

In addition to the ability to break the occasionally cosy relationship between national supervisors and their banks, eurozone authorities will now be able to force struggling institutions to recapitalise, something the US was able to do quickly and forcefully in 2008, stopping the Lehman Brothers crisis before it spread any further.

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