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Portugal Aid, Buybacks, Debt Rules Feature in EU Crisis Plan
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By James G. Neuger

Jan. 12 (Bloomberg) -- European governments are considering aid for Portugal, debt buybacks, lower interest rates on rescue loans and guarantees against excessive debt as part of a package to quell the financial crisis, according to two people with direct knowledge of the talks.

The plan, which may include a loan to Portugal of about 60 billion euros ($78 billion) and purchases of outstanding Greek debt, would mark an attempt to contain the crisis that has frustrated unprecedented efforts by policy makers to calm markets and raised questions about the health of the 17-nation euro economy.

Euro-area finance ministers will discuss elements of the package next week, though the debate is so sensitive in Germany that decisions may wait until a scheduled summit of political leaders on Feb. 4, said the people, who declined to be named because the deliberations are private.

"We need to review all options for the size and scope of our financial backstops," European Union Economic and Monetary Commissioner Olli Rehn told a conference in Brussels today.
Failure to clean up the fiscal mess would put Europe "at the mercy of market forces."

The cost of insuring European sovereign debt has climbed to a record as the crisis that last year led to 178 billion euros in EU and International Monetary Fund aid for Greece and Ireland threatened to claim Portugal as its next victim.

Portugal today raised 599 million euros in the sale of 10- year bonds at an average yield of 6.72 percent, down from a yield of 6.81 percent at a sale on Nov. 10. Portugal also sold 650 million euros of notes due in 2014 at 5.40 percent.

'Not Necessary'

Portugal has brushed aside suggestions that it will have to fall back on EU help. Noting that last year's deficit was less than forecast, Prime Minister Jose Socrates said yesterday that "Portugal will not request financial aid for the simple reason that it's not necessary."

Tomorrow, Spain will auction as much as 3 billion euros of five-year bonds, while Italy will market 6 billion euros of securities maturing in 2026 and 2015.

Rehn said "several alternatives" are under consideration for the European Financial Stability Facility, the 440 billion- euro key weapon in the euro area's anti-crisis arsenal. The need to set aside collateral to maintain a AAA credit rating limits what it can actually lend to about 250 billion euros.

While Rehn didn't name the options, the people familiar with the discussions said the focus is on amending the collateral rules to boost

the EFSF's effective lending ceiling, on offering the aid at lower interest rates and allowing it to be used to retire debt.

Some EU leaders have suggested the EU's fund could be used to buy government bonds or to offer shorter-term credits. Asked whether leaders are weighing those ideas, Luxembourg Prime Minister Jean-Claude Juncker said last month that measures under consideration are "exactly those that you mentioned."

Germany, Europe's largest economy and the biggest contributor to the aid packages, is tying the more flexible approach to an agreement by EU governments to anchor debt- limitation rules in their constitutions, the people said.

"The policy debate might be evolving toward a more forceful euro-wide response to the crisis," Jacques Cailloux, a strategist at Royal Bank of Scotland Group Plc in London, wrote in a research note. "European policy makers might be finally starting to grasp the seriousness of the situation as Italy, Belgium and Spain show increasing signs of strains."

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