Draghi Says ECB Agreed to Unlimited Bond-Purchase Program (1)

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(Updates with Draghi comments from second paragraph.)

By Matthew Brockett

Sept. 6 (Bloomberg) -- European Central Bank President Mario Draghi said policy makers agreed to an unlimited bond-purchase program to regain control of interest rates in the euro area and fight speculation of a currency breakup.

The program "will enable us to address severe distortions in government bond markets which originate from, in particular, unfounded fears on the part of investors of the reversibility of the euro," Draghi said at a press conference in Frankfurt after the ECB held its benchmark rate at a record low of 0.75 percent. "Under appropriate conditions, we will have a fully effective backstop to avoid destructive scenarios with potentially severe challenges for price stability in the euro area."

Draghi has staked his credibility on the bond plan, telling lawmakers in Brussels this week that the ECB needs to wrest back control of rates in a fragmented economy and save the single currency. Now it's up to governments such as Spain and Italy to trigger ECB bond purchases by requesting aid from Europe's rescue fund and signing up to conditions.

"Governments must stand ready to activate the EFSF/ESM in the bond market when exceptional financial-market circumstances and risks to financial stability exist -- with strict and effective conditionality," Draghi said. The ECB reserves the right to terminate bond purchases if governments don't fulfil their part of the bargain, he added.

ECB Purchases

The ECB will target government bonds with maturities of one to three years, including longer-dated debt that has a residual maturity of that length, Draghi said. Purchases will be fully sterilized, meaning that the overall impact on the money supply will be neutral, and the ECB will not have seniority, he said.

The euro fell as Draghi spoke, easing to $1.2586 from $1.2644 beforehand. The yield on Spain's two-year government bond fell to 3.05 percent at 2:12 p.m. London time, after earlier rising by as much as 22 basis points. Italy's two-year rate was eight basis points lower at 2.36 percent.

The ECB has been at the forefront of fighting the debt crisis, which has so far pushed five countries into bailouts and driven the 17-nation euro economy to the brink of recession.

The central bank today forecast a deeper economic contraction for 2012 than it did three months ago. Euro-area gross domestic product will drop 0.4 percent this year instead of 0.1 percent, it said.

In 2013, the economy will expand 0.5 percent rather than the 1 percent forecast in June. At the same time, the ECB raised its projection for inflation next year to 1.9 percent from 1.6

percent.

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