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2nd UPDATE: IMF: Could Intervene In Europe's Secondary Bond Markets

--The IMF would have to create a special new financing tool to buy bonds in the private market

--However, the IMF isn't currently considering a European request for additional financing, senior fund official says

--Emerging markets say they are open to pooling new resources through the IMF

(Adds economist comment, background information and details throughout.)

By Riva Froymovich and Ian Talley
Of DOW JONES NEWSWIRES

BRUSSELS (Dow Jones)--The International Monetary Fund could create a special financing tool to buy bonds in private markets as a way to help stem the euro zone's debt crisis, a senior IMF official said Wednesday.

However, Antonio Borges, head of the IMF's Europe Department, said the idea hadn't yet been vetted by the fund's membership and there have been no formal requests from euro-zone members for additional financing.

Such a plan could aid countries such as Spain and Italy, which face rising costs for financing in capital markets. Borges said these countries have a problem of market confidence rather than solvency. IMF bond-buying interventions could help solve that problem, he said. The IMF's involvement in euro-zone secondary bond market purchases would give an "additional element of credibility because of the conditionality the IMF requires," he said.

Borges said the idea is for the fund to create a special-purpose vehicle to buy bonds under stress in secondary and primary markets.

IMF headquarters in Washington issued a clarification from Borges shortly after the IMF's top Europe official made the comments at a press conference in Brussels. "We do not have any additional requests for support from European members and we are not contemplating any market involvement with the EFSF," he said in a statement. The European Financial Stability Facility, or EFSF, is the euro zone's EUR440 billion bailout fund.

IMF officials couldn't immediately say whether there had been a request from Europe as a region for financing help. Also, it is unclear whether the IMF buying bonds in private markets either directly or through a regional facility such as the EFSF would require changes to the IMF's bylaws. If not, such a facility could be quickly established with consensus among board members.

Economists and market participants have said Europe's bailout fund may not be powerful enough to tackle the massive debt requirements of Italy and Spain, two of the euro zone's biggest economies.

Earlier this year, euro-zone leaders agreed to expand the bailout fund's financing capacity and to allow it to buy bonds in private markets. All national parliaments have agreed except Slovakia and the Netherlands; those two countries are expected to approve the terms later this month. Currently, only the European Central Bank can intervene in secondary bond markets.

According to officials familiar with the matter, some members of the Group of 20 industrialized and developing nations are drafting a "Plan B" to backstop European efforts. Some G-20 officials fear that Europe won't be able to move fast enough to prevent a global financial crisis and are drafting proposals to boost IMF resources and create new short-term financing tools. One option could make permanent a cash pool originally meant to be temporary, potentially giving the IMF a total firepower of at least $1.3 trillion. Other options also under consideration include issuing IMF bonds in the private market or to emerging markets, or direct cash loans from those countries.

"It is being discussed quite extensively within the IMF because there's a strong sense the fund will need more resources to be a key player in the European debt crisis," said Eswar Prasad, a Cornell University economist and former senior IMF official.

Last month, IMF Managing Director Christine Lagarde said the fund needed to boost its resource pool in response to the euro crisis. She said one possibility was for short-term financing to regions, rather than just countries.

There may be political challenges to expanding IMF resources and lending tools, however.

The U.S. Treasury, the IMF's biggest shareholder, has repeatedly said that Europe has enough resources to handle its own crisis and that there is no need for additional IMF funding. Given that advanced economies are still struggling to recover from the 2008 crisis and to cut their budgets, any new funding for the IMF would likely have to come from major emerging economies such as China. Some members of U.S. Congress are trying to defund a portion of Washington's existing commitments to the fund, An indication of the political hurdles facing an expansion of fund resources.

Key emerging-market nations have said they are open to making additional lending resources available through the IMF. The fund estimated that China and other emerging markets hold between $1 trillion to $2.3 trillion in excess foreign-exchange reserves that could be put to use elsewhere in the world.

Prasad said emerging markets could buy IMF-issued bonds and count them as foreign-exchange reserves. "That would mean they don't have to pony up additional resources," he said. Those IMF bonds could then be traded among central banks.

Fund watchers said emerging economies see financing an expanded IMF resource pool as an opportunity to gain more power at the IMF.

-By Riva Froymovich, Dow Jones Newswires; riva.froymovich@dowjones.com

-By Ian Talley, Dow Jones Newswires; ian.talley@dowjones.com

--Matina Stevis in Brussels contributed to this article.

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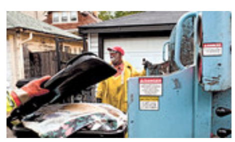

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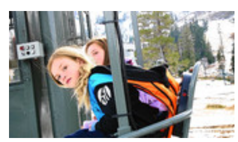

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