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WRAPUP 5-Euro zone agrees to boost rescue capacity

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* Euro zone ready to provide 500 bln euros of new money till mid-2013

* IMF's Lagarde, G20 chair Mexico say will help raise IMF resources

* ECB board appointment deferred to April

* Spain unveils austerity budget after strike, protests

By Jan Strupczewski and Robin Emmott

COPENHAGEN, March 30 (Reuters) - Euro zone finance ministers agreed o n F riday to increase their financial firewall to 700 billion euros to ward off a new flare-up of Europe's sovereign debt crisis, drawing a positive initial reaction from G20 partners and markets.

The 17-nation currency area agreed to combine two rescue funds to make 500 billion euros of new funds available in case of emergency until mid-2013, on top of 200 billion euros already committed to bailouts for Greece, Ireland and Portugal.

The executive European Commission had proposed raising the total to 940 billion euros, with 740 billion in new money, but EU paymaster Germany resisted a bigger increase.

"The euro area has responded to calls from our global partners, the G20 and the BRIC countries. I trust today's decision will pave the way for an IMF decision at the Spring meetings," EU Economic and Monetary Affairs Olli Rehn said.

The United States and International Monetary Fund chief Christine Lagarde both welcomed the decision. Lagarde said it would help the global lender raise more resources to fight contagion from the European crisis if needed.

Washington, which has been pressing European leaders to tackle the problem aggressively, praised their efforts to strengthen confidence in the currency union.

The euro rose and Spanish and Italian bond yields fell slightly after the firewall boost and a draconian Spanish austerity budget.

Spain unveiled savings worth 27 billion euros ($35.85 billion) this year, roughly half from spending cuts and half from revenue increases, in a bid to convince European partners and investors it can rein in its budget deficit.

"Today's decision is a classic European compromise. It was as far as the German government was willing to go and it was the minimum most other euro zone countries were expecting," said Carsten Brzeski, economist at ING bank in Brussels.

A bigger boost would have been more convincing, he said: "With today's increase, the role of the European Central Bank as euro zone fire brigade is likely to continue."

In December, the ECB averted a looming credit crunch by flooding euro zone banks with cheap three-year loans, calming bond markets temporarily. But ECB Executive Board member Joerg Asmussen said there was no room for complacency.

The central bank was satisfied with Friday's decision but a bigger firewall was a substitute for pressing ahead with economic reforms, he said.

An official statement said the ministers had lifted the combined lending ceiling of the temporary European Financial Stability Facility (EFSF) and the permanent European Stability Mechanism (ESM) to 700 billion euros from 500 billion.

"All together, the euro area is mobilising an overall firewall of approximately 800 billion euros, more than 1 trillion dollars," the Eurogroup statement said.

The higher number was arrived at by adding in bilateral loans that euro zone countries granted to Greece under a first bailout, money disbursed by the EFSF and from a smaller third fund controlled by the European Commission.

The ESM will have only 200 billion euros in its first year from July since capital is due to be paid in over three years. Friday's decision means 240 billion of uncommitted EFSF funds could be tapped if necessary until the ESM becomes bigger.

IMF BOOST

French Finance Minister Francois Baroin said the decision put the euro zone in a strong position to persuade other major economies next month to increase IMF resources. The United States, China, Brazil and Britain had all said the euro zone should first do more to help itself.

Mexico, chairing the G20 major economies, said the European agreement was an important step towards boosting IMF funding.

"It's a major effort on the part of Europe, in line with what was discussed during the last meeting of G20 ministers," Mexican Deputy Finance Minister Gerardo Rodriguez told Reuters.

"Now we have to work within the G20 for additional resources for the IMF. That was the agreement."

There was no official comment from the United States. But Eswar Prasad, a former IMF official and senior fellow at the Washington-based Brookings Institution, said the euro zone move was likely to unlock extra funds for the IMF.

"Today's decision is an important step towards strengthening the fortifications around the euro zone," he said. "This step may not be adequate to convince markets that the fortifications are impregnable. But it is likely to elicit a positive response from the international community in terms of supporting an increase in IMF resources as a secondary backstop."

Some bond market players questioned whether the compromise would provide sufficient money to help Spain, the euro zone's number four economy, if it needs a bailout to overcome a banking crisis due to the collapse of a real estate bubble.

Gizem Kara, European economist at BNP Paribas, said euro zone governments had opted for the minimum amount that would be needed to cover the funding needs of Spain and Italy for the rest of this year and next if they were shut out of markets.

But Spanish Economy Minister Luis de Guindos said the idea of Spain seeking emergency funds was "absurd".

Tempers flared when Eurogroup Chairman Jean-Claude Juncker scrapped a scheduled news conference, blaming Austrian Finance Minister Maria Fekter for announcing the decision prematurely. She later apologised.

Juncker said the appointment of a new European Central Bank executive board member had been postponed until mid-April. He had earlier said fellow Luxemburger Yves Mersch was the strongest candidate for the ECB job.

France's Baroin said more time was needed to agree on what he called "a carousel of positions", including a successor to Juncker as Eurogroup chairman, expected to be German Finance Minister Wolfgang Schaeuble. The package also involves the heads of the ESM and the London-based European Bank for Reconstruction and Development, for which Paris has a candidate.

A decision would only be taken in June after France's presidential election, Baroin said.

SPANISH AUSTERITY

Countries sharing the euro have already agreed to adopt more strictly enforced balanced-budget rules in an effort to convince markets that their public finances will be sustainable.

They also agreed to impose fines on countries that run excessive budget deficits or have large imbalances in their economies.

Spain outlined a budget designed to cut the deficit to 5.3 percent of gross domestic product this year from 8.5 percent in 2011, despite a recession. Details will go to parliament on Tuesday but the government said public sector pay would be frozen, ministries' spending would be cut by 16.9 percent and corporate tax revenue increased by 17.8 percent.

"Spain considers that the budget shows the commitment to austerity and will implement it as soon as possible," de Guindos said.

He played down a general strike and mass street protests on Thursday that highlighted the scale of opposition to a new labour law making it easier to fire workers and dismantling collective wage bargaining. Hundreds of thousands of Spaniards marched in protest, with violence flaring in Barcelona.