STRASBOURG, France—The leaders of the euro zone’s three largest economies agreed on Thursday to pursue closer political and economic integration as the European Central Bank considered measures to shore up the region’s banks and keep the protracted debt crisis from freezing new lending.

The European Commission, the European Union’s executive arm, this week presented proposals that would give Brussels increased powers to monitor the budgets of member states. The commission also pushed for the creation of euro-zone bonds that would aim to pool the debt of euro-zone countries.

The push to renegotiate EU treaties adds yet another layer of complexity and tension to a crisis that has already stretched the euro zone’s leadership to a breaking point.

The crisis has toppled seven euro-zone governments in less than a year, including those in Spain, Italy and Portugal.

Proposals for treaty changes that would subject countries to stricter oversight of their budgets and spending signal the bloc’s leaders—in particular German Chancellor Angela Merkel—continue to favor long-term solutions that do little to satisfy calls for urgent action to solve the deepening crisis.

Those jitters were on stark display on Wednesday, with a lackluster auction of German government bonds, the region’s benchmark, and again on Thursday when the yield on the benchmark 10-year U.K. government bond came perilously close to falling below that of its German counterpart for the first time.
since 2009. The yield on the five-year government bond of the U.K.—which isn’t in the euro zone and runs a fiscal deficit well wider than Germany’s—slipped below its German counterpart for the second successive day.

Meeting in this eastern French city on Thursday, French President Nicolas Sarkozy, German Chancellor Angela Merkel and Italy’s Prime Minister Mario Monti said they will present a plan ahead of the next meeting of European leaders on Dec. 9, including proposals to grant Brussels oversight and disciplinary powers over national budgets that exceed euro-treaty restrictions on public debt and deficits.

The leaders appeared to reject pressure from financial markets for a quick-fix solution, stressing that lost faith in Europe’s ability to resolve the crisis could be regained only through closer alignment of European policies.

"Trust has been lost," said Ms. Merkel. "That is why it is important that we demonstrate that we trust each other and trust that each of us individually is doing his homework back home."

Investors and economists have long decried the euro zone’s response as too sluggish to cope with the fast-shifting debt storm and they expressed their disappointment again on Thursday.

European stocks fell, the euro hit a seven-week low and yields on government bonds rose after Ms. Merkel poured cold water on hopes she was warming to the idea of commonly backed euro-zone bonds as a means to ease the crisis.

The market moves suggest widespread fear that the crisis could be entering a new and more dangerous phase that the bloc’s leaders seem unable or unwilling to ward off.

"It’s doubtful whether the intrusive fiscal and economic regime proposed by Germany and the European Commission is a price which Italy, and many other euro-zone countries for that matter, is willing to pay to rescue the bloc," said Nicholas Spiro, a London-based sovereign debt consultant. U.S. markets were closed for the Thanksgiving Day holiday.

Banking stocks got a lift after people familiar with the matter said the ECB was considering offering longer-term loans to commercial banks that are having trouble securing funding in private markets, which would mark an escalation of its role as the lender of last resort.

Officials may extend loans to banks at maturities of two or three years, said people familiar with the matter. The longest maturity at present is 13 months.

The ECB will make that 13-month loan available next month, meaning banks that need it will have secure funding through 2012.

If implemented, the new loans would mark an escalation in the ECB’s role as lender of last resort to Europe’s banks.

Despite warnings in 2009 and 2010 that banks could become “addicted” to central bank credit, the ECB has recently embraced its defense of the banking system, repeatedly making funds available on an unlimited basis.

By creating a larger euro-zone bond market, some economists believe, investors would regain confidence to invest in the region’s debt, making it easier for countries now shunned by the markets to finance their budgets.

Germany vehemently opposes the idea before a natural alignment of euro-zone economies is achieved through sound economic policies.
introduction of euro-zone bonds would create artificial convergence of interest rates and not address the root cause of the crisis, she said.

"It would be a completely wrong signal to ignore these divergent interest rates, because they are an indication of where more work is needed," said Ms. Merkel. "If we all work responsibly, convergence will take place all on its own. But to impose convergence on everyone would weaken us all."

There was no sign of a shift from the German chancellor either on a more ambitious mission for the ECB in addressing the crisis.

Germany and France have often been at odds over the central bank's policies, with French officials pressing for a greater role for the ECB in supporting the euro zone, including by taking on more sovereign debt. The ECB currently buys limited amounts of government bonds on the open market to stem the rise in borrowing costs.

Mrs. Merkel, along with many in Germany, has remained a defender of the bank's traditional role.

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