

FINANCIAL TIMES

EUROPE Wednesday December 1 2010



The big and the dead
The race to standardise on a global car. Analysis, Page 11

The eurozone's political glue may be about to melt
Martin Wolf, Comment, Page 13



News Briefing

Er-Deletto partner on insider trading charge
A former Deletto partner and his wife face US civil charges for insider trading that alleges they tipped off her London-based relatives to seven mergers obtained by his clients.

IMF bail-out concerns
The International Monetary Fund has played the role in the Irish bailout that has led some experts to worry about the threat to its reputation if the programme is off track.

Turkey dismisses claims
Turkey has dismissed claims against a writer of diplomatic cables released by WikiLeaks that question its cooperation with the west and its domestic policies.

Ukraine dispute settled
Russia and Ukraine have settled a natural gas dispute, bringing a controversial gas trader back into the centre of the supply route to Europe.

Tax rate freeze mooted
The Obama administration is debating whether to freeze the rates which determine the taxation of American investors and companies about the tax of non-US tax cuts.

Italy's debt market: year
Italy's debt market: year-end review shows how the market fared over the year, with a focus on the new data showing unemployment rising and protecting students.

Shell in deep from top
Shell has formed an alliance with Royal Dutch, the world's biggest gas producer, to develop cooperation in the US.

Will-Links on China
Chinese officials have told their international counterparts that Beijing could accept a Kosovo precedent on the issue of Taiwan.

US house price falls
US house prices fell for the third month running in September as the residential real estate market continued to suffer from unemployment and high rates of foreclosure.

India rates pressure
India's economy grew close to 9 per cent in the three months to September, putting pressure on the central bank to continue its campaign of raising interest rates.

Beijing food price curbs
The Chinese government has introduced measures to bring down the soaring cost of staple food prices.

England bidders unite
Former England football captain David Beckham joined forces with UK prime minister David Cameron and Prince William to use their persuasive skills to bring the 2016 World Cup to England.

Separate section
Combating AIDS
Aminah's story: a leading Malaysian human rights activist.

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Trichet hints at ECB bond rethink

Purchase programme could be expanded
Move aimed at driving down borrowing costs
By Ralph Atkins in Frankfurt and Richard Miles and David Oakley in London

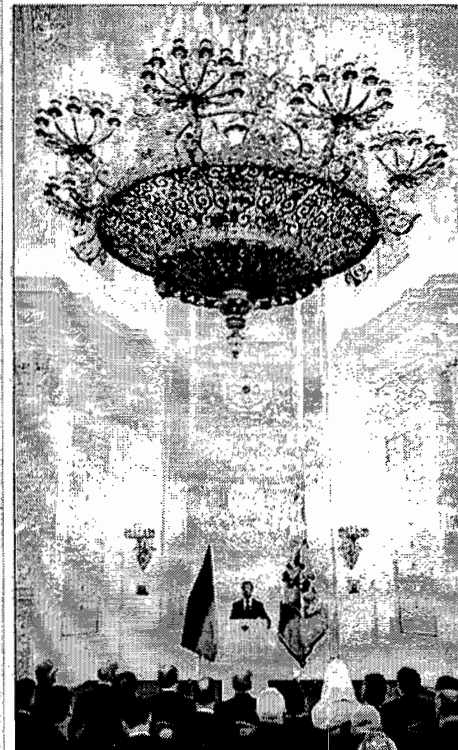
Barroso almost undoubtedly Europe's determination to resolve the escalating eurozone crisis. Jose Manuel Trichet, European Central Bank president, has warned he is left open to the possibility of the bank significantly expanding its government bond purchases to drive down borrowing costs.

The hint that the ECB could renege on its promise to limit the amount of Italian and Spanish government bonds it would buy has sent German benchmark interest rates to a fresh high, despite the fact of the ECB's intervention.

The ECB's bond purchase programme has been controversial within its governing council since its launch in May, with Axel Weber, president of Germany's Bundesbank, voicing his opposition publicly. But the pace at which the crisis has spread has altered the debate in the ECB, which could justify stepping up its intervention by arguing that governments' borrowing costs were far out of line with fundamentals, signalling deteriorating creditworthiness.

Speaking in the European parliament on Tuesday, Mr Trichet said the ECB was "in this stage" on the bond programme "in the light of the current situation".

Delivery Medvedev's state of the nation



Russian president Dmitry Medvedev gives his state of the nation address in the Kremlin on Tuesday. He used the address to announce for a second term in 2012. Report, Page 3

MEPs seek action on misspent regional funding

By Stanley Pignat in Brussels

European parliamentarians have called on the EU executive arm to cut off hundreds of millions of euros in funding given to regions that regularly misspent the money.

Attending lessons on the European Union's 50th anniversary, MEPs also demanded that EU commissioners who allocate structural funds under the bloc's CAP be held directly responsible for misspent money. They also urged the commission to start off accounts early next year to give political weight to Brussels' assurances that the money is spent properly.

Luisa Andor and Johannes Hahn, commissioners who oversee the funds, faced pointed questions from the European parliament's budgetary control committee on Tuesday, including some related to the publication of the 2010 audit investigation with the Bureau of Investigative Journalism into how the funds are spent.

Jörgo Chantziaridis, a German liberal MEP, demanded to know why the Commission kept on financing schemes in regions where spending was stopped by error and fraud over and over.

The commissioners said that they were already using temporary cuts in payments, where they had insufficient assurances the money would be spent effectively.

The annual report of the independent watchdog of EU funds, the European Court of Auditors, found that 60 per cent of errors identified in 2008 could not have been due to error or fraud. The outstanding was down sharply on previous years but remains problematic.

"We have to continue to further reduce the rate of error," Mr Hahn said.

Royal breaks ranks



Dorcasian Sirinukunwong is under growing pressure to decide whether to sell up to join an emerging strategy of the International Monetary Fund and run for the French presidency after one of his leading rivals broke ranks and endorsed the race to the Socialist party nomination.

Royal (above), who lost to Nicolas Sarkozy in 2007, said on Tuesday she would seek the Socialist nomination for the presidential election in 2012. Report, Page 3

EU launches formal probe into Google's dominant position

Chims of abuse on web search rankings

By Matt Tate in Brussels, Mary Hackett in London and Richard Waters in San Francisco

Google will come under intense scrutiny from antitrust authorities in Brussels who announced a full probe into allegations that it had abused its dominant position in the online search market and breached European competition rules.

The investigation, which follows eight months of more informal inquiries by competition officials, will centre on claims that the US search company gave preferential treatment to its own services when ranking search results, and otherwise acted against competitors.

It will also probe the contractual relationships which Google has with advertisers. In particular, it will explore allegations that Google imposed onerous obligations and restrictive conditions from buying their data to competing platforms.

There is no time limit for European Commission inquiries of this type, but they typically take many months, if not years. Google said it had "worked hard to do the right thing by our users and our industry". It said it had tried to ensure that advertisers were "always clearly ranked, making it easy for users and advertisers to take their data with them when they switched services and leaving heavily in operation products".

The US company also challenged the claim that it was dominant in the online search market in spite of its very high market share, pointing out that users do go to more specialised search sites directly.

Lawyers believe that allegations related to Google's search system are potentially the most damaging.

This strikes at the heart of how internet search is conducted, Google's natural search results are based on its proprietary algorithms, said Kenneth Stanten, technology specialist at the Withers law firm. "These are Google's crown jewels and how its search ranking works is still largely a secret."

The commission's initial inquiries followed complaints from three internet services - one owned by archrival Microsoft and another a member of a trade group in which Microsoft has a strong hand.

If Google was found to have breached competition rules, it could be forced to change business practices and face heavy fines. In theory, fines could amount to up to 10 per cent of global annual turnover, or about \$1.2 billion on current levels.

Complex issues, Page 18 www.ft.com/google

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EU opens Google antitrust probe after complaints from rivals

Vodafone's Indian foray turns into a nightmare

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THE WALL STREET JOURNAL

VOL. XXVIII NO. 214

EUROPE

Wednesday, December 1, 2010

DOUGHNUTS

europe.WSJ.com

Doubts over new 'stress tests'

By DAVID EWING and STEPHEN FOLBERG

LONDON—As market sentiment toward the euro zone continues to sharply deteriorate, European plans for another round of bank "stress tests" next year are already beset by squabbling and the possibility that the test results won't become public.

European officials are planning a new round of bank "stress tests" that they say will be more rigorous than the widely discredited exams conducted earlier this year.

But the tests are already subject to bickering between countries. While some European leaders are pushing for next year's tests to be broader and more transparent than last summer's exercise, the agency that will oversee the tests says it might opt to not publicly disclose the results.

The planned European Union stress tests are a follow-up to last summer's exams of 91 European lenders, whose results were published in an attempt to restore confidence in the health of the continent's banks.

The exercise temporarily eased fears about European banks' vulnerabilities to the burgeoning sovereign-debt crisis. But those jitters have been steadily building since late July. The tests were largely discredited by revelations that they lacked rigor,

including a Wall Street Journal report in September that the tests understated some banks' holdings of potentially risky sovereign bonds.

The eroding confidence is now accelerating, thanks to events like the international bailout of Ireland. Two big Irish banks that passed the tests have encountered trouble and are likely to end up majority-owned by the Irish government. This week, the stress tests' effectiveness—or lack thereof—was back in the spotlight as fears mount that

Europe's banks, holding tens of billions of euros worth of bonds issued by troubled governments, are caught in the crossfire. Investors are dumping the banks' shares, and the banks are growing nervous about lending to each other. It is precisely the situation the stress tests were meant to avert.

On Tuesday, a top European Union official for the first time publicly acknowledged problems with last summer's tests. "There was some variety in terms of rigor and application of these tests," European Economic and Monetary Affairs Commissioner Olli Rehn said in Brussels.

Mr. Rehn said the European Banking Authority, a newly created agency that is set to officially open its doors in early 2011, will have the power to conduct next year's tests in a more "rigorous" manner than last summer's exams. People familiar with the matter say the EBA's new tests may examine banks' access to funding—a major weakness for some European banks—in addition to the previous tests' focus on the banks' cushions to absorb losses.

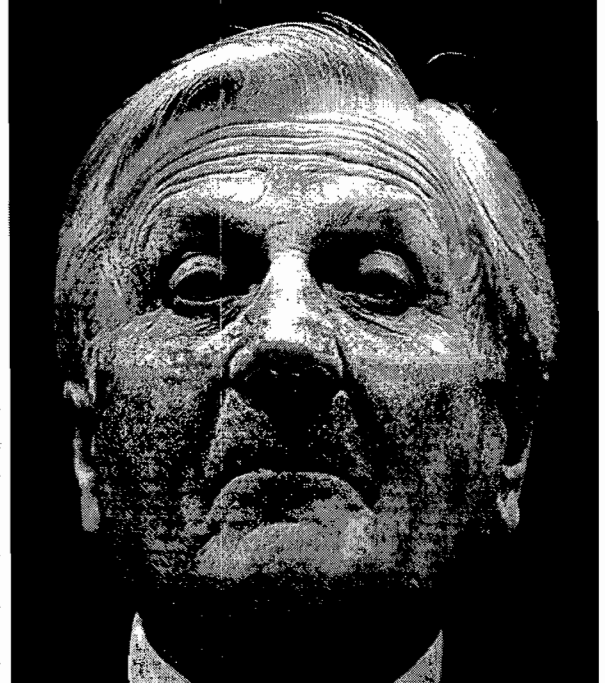
The European Union's second stab at the stress tests will take place next year. The EBA is already working on the methodology and scope for

Euro-zone crisis

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- Ripples from Ireland are becoming waves 5
- Portugal's central bank issues a warning 6

financially shaky countries such as Portugal, Spain and Italy may follow in Ireland and Greece's footsteps and require foreign bailouts.

Yields on Spanish, Italian and Belgian bonds rose sharply Tuesday and the euro tumbled to a two-month low against the dollar. Also Tuesday, European Central Bank President Jean-Claude Trichet sought to allay financial market concerns over the procedure for dealing with possible sovereign defaults.



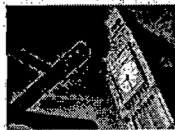
ECB President Jean-Claude Trichet sought to allay financial market concerns on Tuesday.

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The Quirk



UK lawmakers weigh a leap into the future—if only by an hour. Page 33

World Watch

A comprehensive rundown of news from around the world. Pages 34-35

Editorial & Opinion

Edward Luttwac: The Secret of North Korea's survival. Page 15

Deloitte partner faces insider-trading charges

By JESSICA HOLZER

WASHINGTON—The Securities and Exchange Commission on Tuesday charged a Deloitte Tax LLP partner and his wife with passing nonpublic information about pending corporate deals to relatives in London.

The SEC, in a civil complaint filed in federal district court in Northern California, alleged that San Francisco residents Arnold McClellan and his wife Annabel alerted her sister and brother-in-law Mirandos and James Sanders about at least seven pending transactions from 2006 to 2008.

The McClellans allegedly learned about the deals

through Mr. McClellan's work leading one of Deloitte's regional mergers and acquisitions teams, the SEC said.

James Sanders, who co-founded a derivatives-trading firm in London, allegedly took financial positions in the acquisition targets based on the tips and shared the insider information with his colleagues at the firm, Blue Index Ltd.

The SEC said the Sanderses netted \$3 million from transactions based on the tips, half of which they shared with the McClellans. Mr. Sanders's colleagues and clients made \$20 million in profits from the tips, according to the SEC.

The U.K. Financial Services Authority last week an-

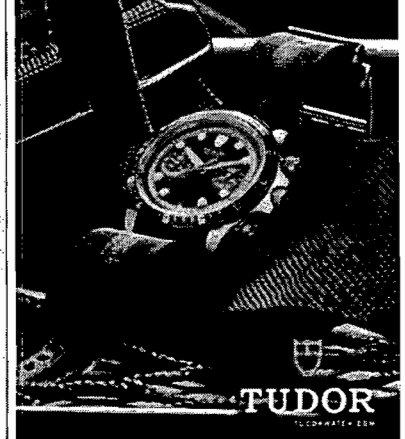
nounced charges against the Sanderses and three of James Sanders's colleagues. The SEC decided not to charge the Sanderses to avoid duplicating efforts already being made by the U.K. authorities, the official said.

Lawyers for the three colleagues couldn't be reached when the charges were filed last week.

A lawyer for Arnold McClellan said he denies the charges. A lawyer for the Sanderses couldn't immediately be reached, while a lawyer for Annabel McClellan didn't immediately respond to a request for comment.

A Deloitte spokesman said the firm is cooperating with the SEC's investigation.

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Eurozone tempest heads towards Italy

Rome's fate is increasingly linked to that of Madrid

The European debt crisis took an ominous turn for the worse on Tuesday, sucking Italy closer to the whirlpool that has swallowed Greece and Ireland and is threatening to engulf Portugal and Spain. Yields on Italian 10-year government bonds are approaching 5 per cent. For the first time since the euro's launch in 1999, the interest rate premium that investors demand to hold these bonds instead of similar German debt has risen above 2 percentage points. With Italy due to redeem almost €300bn of public debt over the next year, these market movements are fraught with peril for the future of Europe's monetary union.

With good reason policymakers in Rome complain that the markets are ignoring Italy's strengths. Italy's public debt is very high - it will hit 118.5 per cent of gross domestic product this year - but it is funded mainly by the domestic market, and it has been kept skillfully under control for many years by the finance ministry's debt managers. Moreover, Italy's private sector debt is low, and its banks have survived the financial crisis virtually unscathed thanks to cautious lending policies.

Above all, Giulio Tremonti, Italy's experienced finance minister, has played a difficult hand well since he returned to office

after the April 2008 national election. Now enjoying his fourth spell in the post, Mr Tremonti immediately grasped that, at a time of acute market tensions, the condition of the public finances would be Italy's Achilles heel. He therefore made it his priority to keep Italy's budget deficit within reasonable limits. Even though this came at the cost of a severe recession in 2009, the economy is growing modestly again.

Mr Tremonti's personality and policies are vital stabilising factors amid the political tensions that will culminate on December 14 in two parliamentary confidence votes that may topple Silvio Berlusconi's government. For whether or not the scandal-plagued prime minister loses his job, Mr Tremonti seems certain to remain in control of Italy's finances - whether in his present position or, just conceivably, as Mr Berlusconi's successor.

But the harsh reality is that Italy's fate appears increasingly tied to that of Spain. For if Spain, like Greece and Ireland, required an emergency eurozone rescue, Italy's portion of the bill would put its own finances under great strain. Italy, however blameless, would then itself be at risk. For the sake of the eurozone as a whole, the defence of Italy must start with the defence of Spain.

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LEGATO
A SPAGNA

BRAVO
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Italy admits to concerns on debt market contagion risk

Jobless rate rises and students protest

By Guy Dinmore in Rome

Italy's centre-right government on Tuesday expressed worries over turmoil on international debt markets, as new data showed unemployment rising and thousands of protesting students paralysed central Rome.

Silvio Berlusconi, prime minister, told cabinet colleagues the spread between Italian 10-year bonds and the German equivalent had risen to a record 210 percentage points.

Gianni Letta, cabinet undersecretary, said he was worried that markets were trying to "spread the contagion from Ireland to more solid countries like Spain and Portugal, and maybe even Italy". He did not know how much longer the government, facing a confidence vote in parliament on December 14, would last.

The comments from Mr

Letta - sometimes named in the media as a possible caretaker successor to Mr Berlusconi - amounted to the first official admission in public that Italy was at risk of contagion.

It was the first time the cost of Italian borrowing had risen more than 2 percentage points over Germany's since 1997.

The **ABI** banking group blamed market speculation, arguing the public finances and banks were solid. Luigi Casero, Treasury undersecretary, also sought to calm markets, saying Italy did not need further austerity measures to meet budget deficit targets.

His comments followed a European Commission forecast that Italy's budget deficit would fall to 4.3 per cent in 2011 against a government target of 3.9 per cent in 2011 and 5 per cent at end-2010.

In spite of government assurances that Italy is emerging from its worst postwar recession, figures

released on Tuesday show that the jobless rate rose to 8.6 per cent from 8.3 per cent a month earlier.

Giorgio Squinzi of the Confindustria business group said the fall of the government would not have a significant impact on Italy's finances.

Oliviero Roggi, professor of corporate finance at the University of Florence, believes markets have discounted political instability, but fears that market speculation will intensify, driving up Italy's borrowing costs.

The opposition has promised to see the 2011 budget through parliament before the confidence vote.

Adding to the sense of disarray, thousands of students protesting at planned education cuts brought central Rome to a standstill, throwing eggs and flour at riot police at parliament.

Mr Berlusconi was quoted as telling the students to go and study but they went on to block Rome's main railway station instead.

ABI ?



THE LEX COLUMN

Italy

US diplomats say Silvio Berlusconi's "frequent late nights and penchant for partying hard mean he does not get sufficient rest", the WikiLeaks documents show. If anything should keep Italy's prime minister up at night, though, it is his country's defences against contagion from the eurozone crisis. Credit default swaps on Italian debt and the spread between Italian and German 10-year paper have suddenly ballooned to euro-era highs. After Greece, Ireland, Portugal and Spain, Italy must be next, surely?

For sure, there are cracks in Italy's edifice. Its economy is in the doldrums. Investors hate Italian assets: stocks are heading for their worst year since 1995 and their sixth year in a row of negative returns. Debt to gross domestic product will be about 118 per cent this year. It faces more than €300bn of financing (sovereign plus bank) in 2011, a third of it in the first three months. Italian banks are undercapitalised relative to peers and have little capacity to generate internal capital.

But it has key strengths. Italy is one of the few large economies with a stable debt level. State finances are relatively robust, with a budget deficit of 5 per cent (lower than the eurozone as a whole), relatively low private sector indebtedness and high domestic ownership of Italian bonds. Its public finances are well managed and the treasury has resisted pressure to pump up spending.

Italy should, therefore, be a bulwark against eurozone contagion, not a victim of it. Its defences could be tested if the spring refinancing coincides with an election, which would hamper Italy's ability to react nimbly to financial instability. But on the upside, it could see the end of Mr Berlusconi, who could then spend more time in the bedroom, where arguably he can do less damage.

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Italy sees Mafia's hand in 'lobbyists of fraud'

By Giulia Segreti in Rome and Federico Gatti in Catanzaro, Calabria

It took two years to prepare but when plainclothes officers from Italy's finance police launched pre-dawn raids around the country in August they struck relative gold.

Arrested on suspicion of defrauding the European Union of public funds were a group of businessmen. Police seized assets worth €40m, including a site with a swimming pool, wedding reception area, warehouses and hedges trimmed in the shape of Disney characters.

Italy's finance police have tackled thousands of cases of suspected fraud involving EU structural funds totalling hundreds of millions of euros. Though it concerns a small proportion of the total disbursed, their work has uncovered sophisticated networks and sometimes Mafia involvement.

"In this field, consultants and professionals specialise in the submission of fake fund applications and act as real lobbyists of fraud," says Colonel Fabrizio Martinelli at Italy's Guardia di Finanza.

In the first 10 months of 2010, Italy's finance police closed 769 cases of suspected fraud totalling €320m in structural funds.

According to Col Martinelli, the majority of irregularities concern the European fund for regional development and aid co-financed by Italy through law 488, a piece of legislation politicians now admit was seriously flawed.

Passed in 1992, law 488 established the mechanisms for allocating direct grants to businesses in less developed areas of Italy and put regional authorities in charge of disbursing funds.

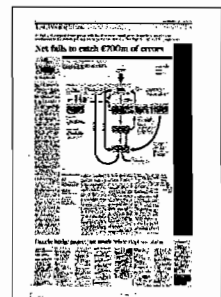
Pierluigi Bersani, leader of the opposition Democratic party, was a critic of the law while serving as development minister. It was replaced in February 2008 with a system based on providing fiscal incentives for industrial investments.

But the questions over alleged fraud associated with law 488 illustrate bigger EU worries over irregularities. A European parliament report in March expressed concern that "Italy, Poland, the United Kingdom and Spain have the highest level of irregularities", though it also commended their collaboration in combating fraud.

Rossana Boldi, head of the Italian Senate's EU policy commission, notes that 30 per cent of fraud cases in the south occur in Calabria, known for its high level of infiltration into business and public affairs by the 'Ndrangheta Mafia.

"A new Mafia-related bourgeoisie, made of lawyers, notaries, accountants and entrepreneurs, [is] the connection between criminal organisations and the economic and political reality," says Beppe Pisanu, president of parliament's anti-Mafia commission.

Federico Gatti is a reporter for the Bureau of Investigative Journalism

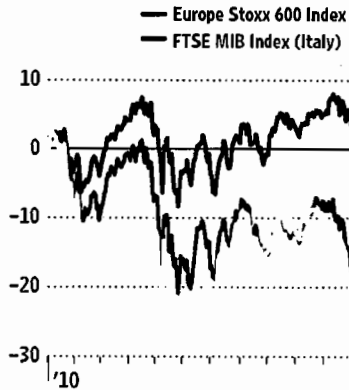


MARKETS

Grim month for Italy, Spain

Left behind

Year-to-date performance



Source: Thomson Reuters

By TOBY ANDERSON
AND SIMON KENNEDY

Stock markets in Italy and Portugal fell more than 1%, leading a day of red ink in European markets as investors fretted that more countries may need a bailout.

While financial stocks fell across the board, hurt in part by falling bond markets, losses were modest in the biggest national markets, and the Stoxx Europe 600 index edged down 0.1% to 261.83, part of a 1.6% loss for the month.

The euro fell below \$1.30 as the details of Ireland's rescue package failed to ease fears that other debt-laden countries in the 16-nation bloc would need financial help. The risks of contagion helped push down Italy's FTSE MIB 1.1% to 19105.71, part of an 11% slide in November, and even dented the Dow Jones Industrial Average.

Spain's IBEX 35, while posting a more modest loss on Tuesday, plunged 14% in November amid persistent worries about its finances and the health of its savings banks.

Bond markets focused on Belgium as well as Italy and Spain. Yields on government debt in all three countries rose sharply, and the gap over German debt, the euro-

zone benchmark, jumped to the highest levels in the euro era.

"Concern about the euro is still playing havoc with the markets as the Irish bailout has done little to stabilize the euro zone," said Barry O'Neill, head of foreign-exchange sales at Clear Currency, a foreign-exchange brokerage. "It looks as if concerns about the euro are unlikely to dissipate any time soon and the euro is in for a rough ride short term."

Philip Shaw, chief economist at Investec Securities, said a vicious circle has developed, where debt worries have pushed up bond yields, which has prompted some investors to pull out, driving up yields yet more.

"Bailing out individual economies is not sufficient to quell the nerves in euro-zone bond markets," he said.

The yield premium demanded by investors to hold Spanish 10-year bonds over the benchmark German bund rose more than 0.3 percentage point to top three percentage points at one point, before easing back to 2.90 percentage points, according to Tradeweb. The premium for Italian bonds rose more than 0.2 percentage point to 2.15 percentage points

and later eased to 2.04 percentage points. The yield gap for Belgian debt climbed more than 0.20 percentage point to 1.40 percentage points.

Investors seeking a haven turned to U.S. Treasuries, where prices rose and yields fell. The benchmark 10-year note firmed 7/32 to 98 17/32 to yield 2.795%. Others turned to gold. Comex gold for December delivery gained \$19, or 1.4%, to \$1,385.

The dollar also benefited. The euro traded as low as \$1.2969 before recovering some losses. Late Tuesday in New York, it was at \$1.3007, down from \$1.3123 late Monday.

Among national stock markets, the U.K.'s FTSE 100 fell 0.4% to 5528.27 and France's CAC-40 shed 0.7% to 3610.44, part of a 5.8% slide for November. Germany's DAX lost 0.1% to 6688.49 but ended the month up 1.3%, its third consecutive monthly gain.

Lisbon's PSI General Index fell 1.1% to 2591.84, and Spain's IBEX 35 shed 0.6% to 9267.20.

Spain, Europe's fourth-largest economy, is suffering from a hous-

Un mese negativo per Italia e Spagna (ca)

data
stampa

ing bust and unemployment of around 20%. The Bank of Portugal, meanwhile, warned in its semiannual Financial Stability Report that the country's banks face severe challenges in the coming years, including finding new sources of funding and tackling slow economic growth at home that will hit their profits.

The Dow Jones Industrial Average recovered most of its early losses and ended down 46.47 points, or 0.4%, at 11006.02. The blue-chip measure lost ground for all of November, its first down month since August.

Banks and insurers, which are big holders of government debt were among the biggest decliners. **Standard Life** fell 3.7% in London, **Société Générale** lost 3.6% in Paris, **UniCredit** fell 3.4% in Milan and **ING Groep** lost 2.9% in Amsterdam. **BBVA** shed 2.1% in Madrid.

Banks also suffered in the U.S. **Bank of America** fell 34 cents in late-afternoon trade.

Eurozone banks hit by return of the credit crunch

News analysis

The sovereign debt crisis is affecting corporate credit markets, write Victor Mallet and Peter Wise

The fear is spreading. Worries over sovereign credit-worthiness are now affecting the private sector.

In Spain, and other "peripheral" eurozone nations, banks and non-financial companies face a painful credit squeeze as borrowing costs soar.

Far from making life easier for banks and businesses that need to tap the debt markets, the €85bn rescue package for Ireland risks having the opposite effect as government bond yields spike higher.

"The bond and credit markets are completely closed," says one Spanish banker after days of sharply rising yields.

Spanish and Portuguese banks, and through them the two domestic economies, are highly vulnerable to any shutdown of international debt markets - such as those that followed the collapse of Lehman Brothers in 2008 and the bail-out of Greece in May this year - because of their dependence on foreign credit.

Spain's treasury, the country's regional governments and its banks need to finance a total of €253bn of maturing debt next year, with the public sector expected to issue a further €61.3bn in new debt, calcu-

lates Analistas Financieros Internacionales (AFI), the Madrid research group.

"The particular characteristic of the Spanish economy is its savings deficit, which translates into a current account deficit and a concentration of maturing debt in foreign hands," says Emilio Ontiveros, AFI chairman. Portugal is in a similar position and, unlike Spain, has failed to reduce its current account deficit.

Big international companies such as Iberdrola in energy and Telefónica in telecoms can now raise money directly through bond issues more cheaply than the unloved sovereign, according to the latest market prices.

But credit for small companies and for household mortgages is largely mediated through the banks and unlisted savings banks, which for years have tapped the international markets. Another financing drought would further damp Spain's chances of economic recovery. Mr Ontiveros compared the solvency problems at Irish banks with the liquidity problems for Spanish lenders and noted that the liquidity "has to be obtained primarily outside Spain". He said: "A liquidity problem for the banks could turn into a solvency problem for companies."

Only a few months ago, as the Greek scare faded into the past, Spanish banks had begun to reduce their dependence on liquidity from the European Central Bank.

From late July, big lenders such as Santander and La Caixa flocked back into

the wholesale finance markets with a series of medium-term bond issues. They also found it easier to access short-term liquidity through "repo" transactions using Spanish government debt as security.

Spanish bankers say the repo market remains open, but they fear a shutdown or prohibitive cost increase there too - as happened in June and as has occurred again in recent days for banks using Irish sovereign debt as collateral.

In Portugal, Spain's smaller neighbour, the credit crunch has been squeezing banks and the rest of the private sector for months. In a report published on Tuesday, the central bank said that the country's sovereign debt difficulties had forced banks into "permanent and large-scale" dependence on ECB funding that was "not sustainable".

Like Spain, Portugal has held up its "resilient and well-capitalised" banking sector as an asset that demarcates the country from Ireland, where huge banking losses have been blamed for its sovereign debt crisis.

But since a downgrading of Portugal's sovereign debt rating in April, its banks have been virtually frozen out of international capital markets, making them almost wholly reliant on ECB funding.

The central bank said no Portuguese bank had succeeded in making an international debt issue since April, while net bond issues by banks in the first nine months of 2010 were negative - that is, insufficient to

offset bonds maturing in the same period.

Portuguese and Irish banks are, like those of Greece, in effect shut out of the short-term lending markets for everything except overnight deals, brokers say. Spanish banks still have access to these markets, particularly since they started using LCH.Clearnet, one of Europe's biggest clearing houses, as an intermediary in the deals.

In the bond markets, the last corporate deal from a Spanish, Portuguese or Irish company came from Iberdrola, the Spanish utility, on October 6.

Across Europe, there has been just one issue by a bank or company this week, says Dealogic, as the crisis has deepened and fears have grown it is spreading to Spain and Italy.

Analysts and investors remain more worried about banks than non-financial companies in the short-term. Hans Lorenzen, credit strategist at Citi, says most companies, including those in the periphery, have a strong funding position. "I don't think these corporates have immediate funding needs. But it probably wouldn't be the right time to try to get funding," he says.

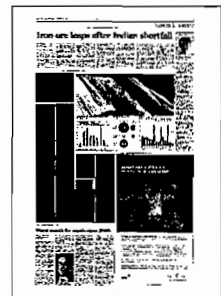
The head of one large financial group in Europe agrees, saying that non-financial companies' refinancing needs in the short-term are relatively modest.

With investors apparently growing more wary of "peripheral" eurozone debt as each day passes, some analysts believe the only way to avoid further panic is a dramatic move by the ECB to flood the markets with liquidity. "You can't live through days like this for ever," says Mr Ontiveros. "It can't last long. You have to break the cycle."

Additional reporting by Richard Milne and David Oakley in London

€253bn

Amount of Spanish debt that matures next year



Le banche dell'Europa colpite dal ritorno della crisi del credito (pds)

Trichet hints at ECB bond rethink

Purchase programme could be expanded

Move aimed at driving down borrowing costs

By Ralph Atkins in Frankfurt, and Richard Milne and David Oakley in London

Markets should not underestimate Europe's determination to resolve the escalating eurozone crisis, Jean-Claude Trichet, European Central Bank president, has warned as he left open the possibility of the bank significantly expanding its government bond purchases to drive down surging borrowing costs.

The hint that the ECB could recalibrate its response to the unfolding crisis came as the premiums that Italy and Spain paid over German benchmark interest rates hit fresh highs since the launch of the euro. The currency's monetary guardian had already stepped up purchases of Portuguese bonds, traders said.

The ECB's bond purchase programme has been controversial within its governing council since its launch in May, with Axel Weber, president of Germany's Bundesbank, voicing his opposition publicly. But the pace at which the crisis has spread has altered the debate in the ECB, which could justify stepping up its intervention by arguing that governments' borrowing costs were far out of line with fundamentals, signalling dysfunctioning markets.

Speaking in the European parliament on Tuesday, Mr Trichet would not comment "at this stage" on the bond programme "in the light of the current situ-

ation". But the programme was "ongoing" and decisions on its future would be taken by the 22-strong governing council, which next meets on Thursday. He refused to rule out the possibility of eurozone governments issuing joint bonds, although the ECB was not endorsing this.

Since May, the ECB has spent just €67bn under its bond purchase programme. Financial markets, however, increasingly see the bank as the only institution with pockets deep enough to ease the crisis.

The ECB thinks financial markets are badly mispricing risk; eurozone growth was proving surprisingly strong, and Ireland's bail-out had shown the EU was capable of responding to crisis. "I don't think that financial stability in the eurozone, given what I know, could really be called into question," Mr Trichet said.

Willem Buiter, chief economist at Citigroup, said: "The involvement of the ECB is likely to rise, despite its statements - and probably wishes - to the contrary." He said recently that the ECB backed by governments could give the European bail-out fund a €2,000bn loan.

Gary Jenkins, head of fixed income at Evolution Securities, argued that the ECB could try "real quantitative easing" through purchases of €1,000bn-€2,000bn of bonds. "It would be an immediate way of creating a firebreak," he said.



Trichet accenna a un ripensamento sui bond della Bce (pds)

EUROPE

Doubts over new 'stress tests'

By DAVID ENRICH AND STEPHEN FIDLER

LONDON—As market sentiment toward the euro zone continues to sharply deteriorate, European plans for another round of bank "stress tests" next year are already beset by squabbling and the possibility that the test results won't become public.

European officials are planning a new round of bank "stress tests" that they say will be more rigorous than the widely discredited exams conducted earlier this year.

But the tests are already subject to bickering between countries. While some European leaders are pushing for next year's tests to be broader and more transparent than last summer's exercise, the agency that will oversee the tests says it might opt to not publicly disclose the results.

The planned European Union stress tests are a follow-up to last summer's exams of 91 European lenders, whose results were published in an attempt to restore confidence in the health of the continent's banks.

The exercise temporarily eased fears about European banks' vulnerabilities to the burgeoning sovereign-debt crisis. But those jitters have been steadily building since late July. The tests were largely discredited by revelations that they lacked rigor, including a Wall Street Journal report in September that the tests understated some banks' holdings of potentially risky sovereign bonds.

The eroding confidence is now accelerating, thanks to

events like the international bailout of Ireland. Two big Irish banks that passed the tests have encountered trouble and are likely to end up majority-owned by the Irish government. This week, the stress tests' effectiveness—or lack thereof—was back in the spotlight as fears mount that financially shaky countries such as Portugal, Spain and Italy may follow in Ireland and Greece's footsteps and require foreign bailouts.

Yields on Spanish, Italian and Belgian bonds rose sharply Tuesday and the euro tumbled to a two-month low against the dollar. Also Tuesday, European Central Bank President Jean-Claude Trichet sought to allay financial market concerns over the procedure for dealing with possible sovereign defaults.

Europe's banks, holding tens of billions of euros worth of bonds issued by troubled governments, are caught in the crossfire. Investors are dumping the banks' shares, and the banks are growing nervous about lending to each other. It is precisely the situation the stress tests were meant to avert.

On Tuesday, a top European Union official for the first time publicly acknowledged problems with last summer's tests. "There was some variety in terms of rigor and application of these tests," European Economic and Monetary Affairs Commissioner Olli Rehn said in Brussels.

Mr. Rehn said the European Banking Authority, a newly created agency that is

set to officially open its doors in early 2011, will have the power to conduct next year's tests in a more "rigorous" manner than last summer's exams. People familiar with the matter say the EBA's new tests may examine banks' access to funding—a major weakness for some European banks—in addition to the previous tests' focus on the banks' cushions to absorb losses.

The European Union's second stab at the stress tests will take place next year. The EBA is already working on the methodology and scope for the next batch of tests, said Arnoud Vossen, secretary general of the banking agency's predecessor organization and a likely senior official at the EBA.

Until now, the assumption has been that those test results will be publicly revealed. But that is not necessarily the case.

"This is an open question. We are now looking at the pros and cons," Mr. Vossen said in a recent interview at the agency's headquarters in the 18th floor of a London skyscraper.

Mr. Vossen said the plan was for the tests to get under way next spring, after banks have finalized their year-end numbers, and to wrap up by July 2011.

But some European officials are pressing to accelerate the tests by a few months, arguing that the Irish bailout undermined whatever credibility remained of this year's exercise. These officials said the issue was raised at a meeting of EU finance ministers in Brussels on Sunday that finalized the Irish bailout plan.

Meanwhile, at a meeting of Euro-

Emergono dei dubbi sui nuovi "stress test" (ca)

