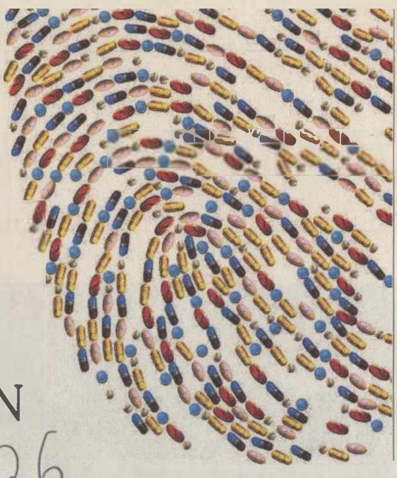

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SATURDAY-SUNDAY, MAY 15-16, 2010

Markets challenge Europe's resolve

PARIS

E... hits 18-month low as doubts spread about currency bloc's future

BY DAVID JOLLY AND JACK EWING

Despite a strong effort last weekend by European policy makers to contain the sovereign debt crisis, global stock markets skidded Friday and the euro fell to its lowest level in more than 18 months as investors voiced anxiety about the future of the common currency.

"We're on the cusp of a crisis of confidence," said Derek Halpenny, currency economist at Bank of Tokyo-Mitsubishi UFJ in London. "We've had rumors of countries threatening to depart from the euro and comments from officials that sound like people at the heart of Europe are concerned about a possible collapse."

Some of the fears expressed in the markets were distortions of what officials said. But Mr. Halpenny noted that Paul A. Volcker, the former chairman of the U.S. Federal Reserve and now an adviser to the administration of President Barack Obama, warned Thursday about a "potential disintegration" of the common currency and that Jean-Claude Trichet, the European Central Bank president, had called for "fundamental change" in the euro zone.

Over the weekend and into Monday, the European Union and the International Monetary Fund worked out nearly $1 trillion in aid to help struggling euro-zone countries, prompting a broad market rally. But investors have remained unsettled, turning their attention to the larger questions of how the tightening fiscal policies being imposed in countries like Greece, Spain, Portugal and Ireland are likely to affect Europe's overall economic prospects.

The euro, which had risen above $1.31 Monday after the rescue was announced, fell to $1.2388 from $1.2534 late Thursday in New York.

On Friday, finance officials from the Group of 7 nations, including the U.S. Treasury secretary, Timothy F. Geithner, held a conference call to discuss the continuing market turmoil. They did not comment publicly afterward.

Business executives have generally applauded the huge commitment to stabilizing the euro area, which also included a decision by the E.C.B. to buy corporate and government bonds.

Jörg Krämer, chief economist at Commerzbank in Frankfurt, described the rescue package as, in effect, "a transfer of debt from the peripheral countries to the whole euro zone."

"The measures were designed to help the peripheral countries and to preserve the stability of the currency union," Mr. Krämer said. "In that they've succeeded," he said, as evidenced by the decline of borrowing costs to smaller member states, like Greece.

"But that's not the same thing as preserving the euro-dollar exchange rate," he added.

In fact, a weaker euro is welcome by many European business leaders — but a rout is not.

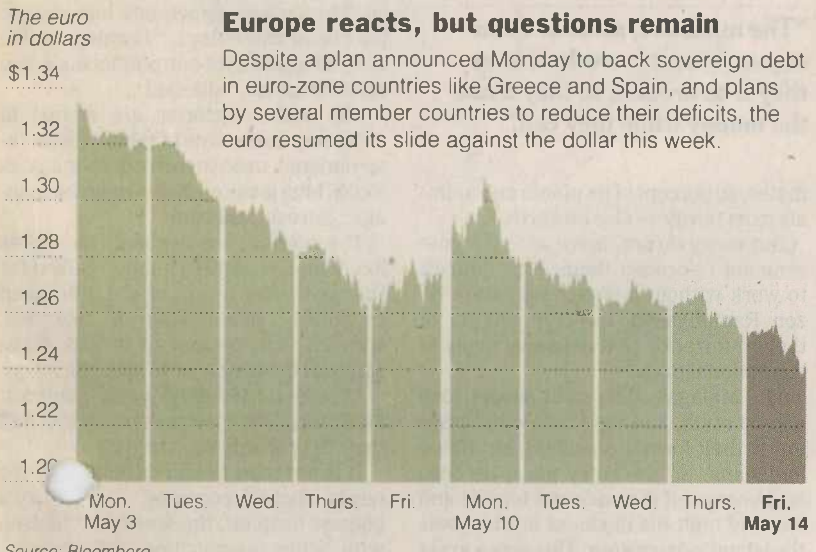
Meanwhile, doubts remain about the ability of Greece, Spain, Portugal and other countries to solve their fiscal problems, and the E.C.B.'s relentless focus on price stability is now in question, analysts said. Weaker growth and a rise in inflation are likely to push the euro even lower against other currencies.

There are also indications that the rescue deal has exacerbated tensions

EURO, PAGE 16

Europe reacts, but questions remain

Despite a plan announced Monday to back sovereign debt in euro-zone countries like Greece and Spain, and plans by several member countries to reduce their deficits, the euro resumed its slide against the dollar this week.



Source: Bloomberg

A MEASUREMENT THAT FALLS SHORT
Many economists hope to replace the G.D.P. index as the predominating metric of well-being. *PAGE 11*

AN UNEVEN INCREASE IN TRADE
Trade is rising rapidly around the world, but some European countries are lagging behind. *PAGE 13*

WORLD NEWS

Obama vows to end 'cozy' ties

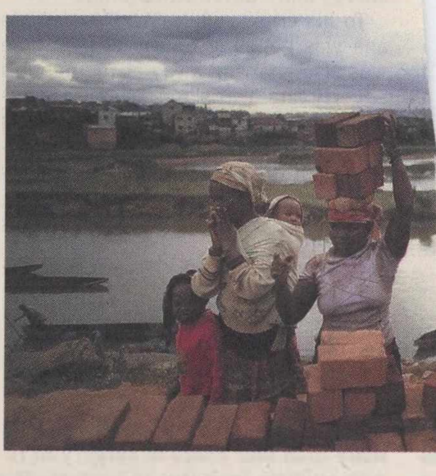
President Barack Obama vowed on Friday to end what he described as a "cozy relationship" between government regulators and the oil industry and denounced finger pointing by oil industry executives. Mr. Obama ordered a review of regulatory and licensing practices. *PAGE 4*

Visa error puts German in jail

Kars... Sander, a dual British and German citizen, was taken away in handcuffs from his wife, an American, and locked up in an immigration detention center in New Jersey because he ran afoul of the U.S. visa waiver program. *PAGE 3*

Online twist to assisted suicide

Hard detective work by a British woman helped track down a man accused of luring people over the Internet to commit suicide. The issue raises thorny questions because the case involves people in different countries exchanging just words over the Web. *PAGE 4*



PAGE TWO

A lush but troubled land

Workers sta... Antananarivo, Madagascar. The island is a ne...

BUSINESS

What's next for Hello Kitty?

The Japanese icon, at age 36, may be running out of lives as its global pop-culture appeal wanes. *PAGE 11*

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Euro's slump is testing Europeans' resolve

EURO, FROM PAGE 1

between capitals.

El País, the Spanish newspaper, reported Friday that President Nicolas Sarkozy of France had pressured Angela Merkel, the German chancellor, to back the rescue effort, pounding his fist on the table and saying France would leave the common currency without Germany's support.

At a press conference in Zagreb, the French finance minister, Christine Lagarde, dismissed the El País report as "rubbish." But with rumors like that swirling through markets, investors were unsure of what is going on, a sure prescription for selling.

Financial shares led markets lower. The Euro Stoxx 50 index, a barometer of euro-zone blue chips, fell 4.7 percent, while the FTSE 100 index in London fell 3.1 percent. The main Spanish market index fell 6.6 percent and Italy's benchmark fell 5.3 percent. The overall European market was still up about 4.7 percent for the week.

In New York afternoon trading, the Dow Jones industrial average fell 1.7 percent and the Standard & Poor's 500 index fell 2.1 percent.

As for the euro, Daimler, the German carmaker, illustrates the quandary facing European companies. U.S. sales of its Mercedes-Benz cars surged 22 percent in the first four months of the year, to 66,900 vehicles. The company's factory in Sindelfingen, outside Stuttgart, is running full bore to produce E-Class passenger cars, one of the most popular models in the United States.

On the positive side, those dollar sales are worth 15 percent more when converted to euros than they were at the beginning of the year.

But the speed of the euro's decline — it is down more than 9 percent in the past month — is making managers nervous not only at Daimler headquarters in Stuttgart but at factories around the euro area. More than anything, European business people long for stability. And they worry that the euro sell-off reflects a broader loss of faith in the common currency's integrity.

"The volatility can really create a lot of problems," said Olaf Wortmann, a business-cycle specialist at the German Engineering Federation, a manufacturers' association. Sharp currency swings complicate deals with foreign suppliers and scramble investment plans, he said.

"A cheaper euro helps us in certain markets," agreed Christoph Liedtke, a spokesman for SAP, a maker of business software based in Walldorf, Germany. But, "we have a strong interest in a stable currency," he added. "The stronger the currency fluctuations, the more difficult it is for all companies."

And with growth stronger in the United States, most analysts expect the Fed to move faster than the E.C.B. to raise interest rates. "That will draw investors toward the dollar," Mr. Krämer said.

He predicts that inflation in the euro zone will rise to an annual rate of 3 or 4 percent in coming years, rather than the 2 percent that the E.C.B. has aimed for.

The euro, which was trading around $1.24 on Friday, is still above so-called purchasing power parity, the point at which the currencies are aligned with how much they actually buy in the real world. The fair value of the euro is about $1.20, analysts say.

The questions about Europe have weighed on credit markets. On Friday, the cost of insuring against corporate loan defaults with credit default swaps rose and three-month dollar lending rates on the London interbank market rose for a fourth consecutive day.

A big decline of the euro would be good for some of the countries that have the most serious problems. Besides alarming debt levels, countries like Greece, Spain and Portugal have let wages rise faster than productivity, and now have trouble competing on world markets.

A depressed euro would make their products less expensive in foreign markets, and help restore competitiveness. A stronger dollar would also help increase tourism, which is an important industry in all the Mediterranean countries.

But a weaker euro brings problems as well as advantages. Oil and raw materials, which are often priced in dollars, become more expensive. Currency hedging, like any other kind of insurance, becomes more expensive when the risk rises, as it does during big exchange rate moves.

Many international companies have set up manufacturing abroad, in part to cushion themselves against currency fluctuations.

SMA Solar Technology, a maker of inverters for solar plants in Niestetal, Germany, is in the process of setting up a factory in Denver that will employ 700 people, partly to serve the U.S. market but also to guard against a gyrating euro.

"SMA will be able to reduce transportation and interim storage costs as well as currency exchange risks," Günther Cramer, the company's chief executive, said in a statement.

Jack Ewing reported from Frankfurt.