Comment

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Has Europe been rescued?

Now the leaders need to bring their people to the party

Tony Barber

Midway through Thursday's save-the-euro summit in Brussels, European officials distributed a draft communiqué that spoke of a "European Marshall Plan" for Greece. When the summit ended, this grandiloquent phrase had been quietly dropped from the final text. It was a prudent decision. Just as the 17-nation eurozone is not instantly establishing a full-blown fiscal union to complement its common currency, so Greece's European Union partners are not putting a recovery programme comparable to the 1948-51 Marshall Plan for western Europe.

Eurozone leaders nevertheless have pulled off quite a feat. For the first time since May 2010, they delivered a positive surprise by striking a deal that went further than many financial market participants had anticipated. For this Angela Merkel, Germany's chancellor, deserves credit. On Tuesday she lowered expectations, saying the summit would not produce a "spectacular event". As it emerged the leaders had achieved rather a lot, the markets celebrated: share prices

It may only be just months before Europe's financial firefighters reach for their hoses again. But that is not the point

soared, up went the euro and down went Italian and Spanish government bond yields.

Of course, this will not end Europe's sovereign debt and banking crises. It may only be a matter of months before Europe's financial firefighters reach for their hoses again. But that is not the point.

Europe moves forward incrementally – sometimes a stumble, sometimes a step, sometimes a stride. It cannot be otherwise in a union of democracies that have pooled some sovereignty but have retained the features of nation-states. The complicated structures of European decision-making do not help. In trying to ward off the mortal threat to European monetary union, the eurozone's leaders still look a little off balance but, on Thursday, they gave every impression of heading towards fiscal union.

It is worth remembering how far the Europeans have travelled since Greece confessed in late 2009 that its public finances were a morass of swollen debt and falsified statistics. Germany and its allies set strict terms for rescues of debt-ridden countries: loans would be granted only as a last resort and with interest rates set at punitive levels.

At the summit, however, Germany conceded the all-important principle of debt relief for Greece. Eurozone leaders roughly doubled the emergency funds available to Greece between 2010 and 2014 to €180bn. They also slashed the interest rates on loans to Greece, Ireland and Portugal. This amounts to a significant transfer of resources from rich countries to their struggling neighbours. It goes beyond anything foreseen at the euro's launch in 1999.

More important are changes to the European financial stability facility, the EU's main rescue mechanism. Europe will not yet have a common debt management agency but the EFSF will be allowed to buy bonds on the secondary market, finance the recapitalisation of banks and provide pre-emptive credit lines to countries under pressure in debt markets. As Nicolas Sarkozy neatly phrased it, this represents "the beginnings of a European monetary fund".

The French president went on to note that eurozone leaders wanted "to seize the Greek crisis to make a quantum leap in eurozone governance". What he has in mind will no doubt become clear after the August holidays, a period of European rest and play that is impervious to all crises. Still, certain gaps in economic governance cry out for attention. Most of all, the eurozone needs credible enforcement mechanisms to ensure governments do not break agreed fiscal rules.

In short, the crisis is compelling eurozone leaders to assemble the building blocks of a common fiscal policy and economic government. They will surely have to go further. By not increasing the EFSF's lending capacity beyond €440bn, the leaders failed to eliminate the danger that Italian and Spanish bonds will come under intense market pressure, as they did just before the summit. Another wave of attacks on Italy and Spain might be the trigger for a joint eurozone guarantee of all the region's outstanding debt. Common eurozone bonds, once unmentionable in polite policymaking circles, would be the logical next step.

All the same, the path to a closer economic union contains a potential pitfall – public opinion. Politicians in Germany and rich countries such as Austria, Finland and the Netherlands have never asked voters if they want a union that channels part of their wealth to other countries. According to a poll for ZDF public television, only 47 per cent of Germans want Greece to stay in the eurozone; just as many want Greece to get out.

Similar tensions extend across the 27-nation EU. The rise of far-right and anti-euro parties is a reminder that the EU stirs disenchantment among millions, who see it as an elitist project incapable of tackling issues such as youth unemployment and illegal immigration. Pan-European institutions bore voters: turnout has fallen in every election for the European parliament since the first in 1979.

Sooner rather than later, politicians must address the problem of legitimacy. The paradox is that the debt crisis is driving Europe's leaders towards closer integration while simultaneously sapping the public's faith in that same goal.

The writer is the FT's Europe editor

Matt Kenyon

Trichet must mine lessons from the Fed to stop the eurozone caving in

Sebastian Mallaby

Half a century ago, when the European project was bright-eyed and young, a youthful Jean-Claude Trichet worked for a stint as a coal miner. Years later he described going "several hundred metres under ground, sometimes in extremely narrow coal veins, a metre or 90 centimetres wide, crawling between the stanchions with a pickaxe". The experience drove the 18-year-old student to embrace the politics of the French left. In an interview with Anne Sinclair, aka Madame Strauss-Kahn, Mr Trichet recalled the claustrophobic peril of the mine as "a very, very strong experience".

Now, Mr Trichet is nearing the end of his tenure as president of the European Central Bank. His office near the top of the Eurotower in Frankfurt is a world away from the dark mine of his youth; he has grown sleek and urbane; his politics have drifted rightward. And yet he surely is reliving the subterranean terror of his youth, as the eurozone threatens to cave in on top of him.

The difference this time is that Mr Trichet's reaction to the danger is not just personal. The future of Europe could depend on it – as his fellow European leaders understood this week, breathing a sigh of relief as he dropped his previously stiff resistance to a deal that effectively allows Greece to default.

The deal yielded a new bail-out for Greece but no credible plan to staunch contagion to the rest of the eurozone. To give the Greeks some breathing room, private lenders are being asked to choose among a variety of unappealing options, some of which involve waiting decades before their money is returned. Despite much chest-beating to the contrary, lenders to other European governments now know they may be treated the same way.

Despite Mr Trichet's earlier doubts about this deal, there is no mystery about what needs to be done in the medium term. Italy and Spain, whose economies dwarf Greece, Ireland and Portugal, must at all costs remain solvent. They can only do that if investors choose to lend to them at reasonable rates; but now that Greece's creditors have been hit, rates must surely rise to reflect the risk of similar restructurings. To prevent Italy and Spain from succumbing to a self-fulfilling loss of confidence, both have to be "ringfenced".

Europe's leaders now seem to understand what they must do; but they lack the political space to deliver. On Thursday they promised to allow the European financial stability fund to lend pre-emptively to countries not yet in crisis, presumably Italy and Spain. But the summit communiqué refers ominously to "conditions" that borrowers must meet, while there is no plan to make the EFSF bigger. In short, the deal is almost certainly too little, too late.

The machinery of Brussels will now grind away at its own pace, while market sentiment could shift instantly. All of this brings us back to Mr Trichet. Even before he took the helm of the ECB, he used his perch as head of the French central bank to press for a stronger fiscal union. He has pointed out the asymmetry between the ambition of the single currency and the lack of a single budgetary authority, suggesting that Europe's immature federation is partly to blame for the crisis. The implied comparison with the strong central government of the US is clear. And yet the real lesson from America is, paradoxically, the one that Mr Trichet is resisting.

The truth is that, even in America, crisis lending is mostly done by the central bank. In the dark days after the Lehman bust, Hank Paulson, Treasury secretary, begged Congress for $700bn of bail-out funds. He got it – but not before panicking the markets by being rejected the first time. Even then, the Treasury's intervention was massively surpassed by the Federal Reserve, which pumped $3,300bn into distressed markets. It turns out that the best

If Mr Trichet's ECB really did emulate the Fed, the ringfence for Italy and Spain could be established instantly

lenders of last resort are, in fact, the traditional lenders of last resort: central banks that do not have to deal with sluggish parliaments, but can print money. Their responsibility for financial stability is arguably equal to their responsibility for fighting inflation. Indeed, Europeans who gaze enviously at the US should recall that, when the Fed was established in 1913, its central purpose was crisis lending.

If Mr Trichet's ECB really did emulate the Fed, the ring fence for Italy and Spain could be established instantly. He could simply declare that he stands ready to buy sovereign bonds issued by both. The combined net sovereign debt of Italy and Spain comes to around €2,200bn. Mr. Trichet could plausibly promise to buy the whole lot – which would guarantee he would never have to.

Of course, central banks, especially young central banks, do not like to take these risks. Purchases of bonds would let irresponsible governments off the hook and might stoke inflation fears, however unfounded. Mr Trichet has so far resisted riding to the rescue. But the lesson from the political dithering in Europe is that he may soon have no choice. Sometimes moments of dark danger can force changes of ideas – to socialism, or this time to something more constructive.

The writer is an FT contributing editor and Paul A. Volcker senior fellow for International Economics at the Council on Foreign Relations

The FT's A-List

Joseph Stiglitz

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Europe may have taken an historic step on Thursday – it seems, for once, to have done more than "just kick the can down the road". Its leaders recognised that it is not just Greece that faces a problem; it is a European problem, which requires a European solution. The euro was, at birth, an unfinished project. It took away two key instruments of adjustment – interest and exchange rates – and put nothing in their place. This week's agreement is a big step towards correcting this deficiency, and creating a European monetary fund.

Europe's leaders finally recognised that Greece's problems require a focus on debt sustainability. Not only are maturities being extended, but interest rates are being cut. Even more crucial is the commitment to investments that will stimulate the Greek economy, create jobs and increase tax revenues.

Any rational calculation showed that the benefits of doing what it has done vastly outweighed the costs. The question was not one of economics but of politics. The politics finally came together. There is more to be done, but these were critical steps.

Mohamed El-Erian

Only skilful execution will now ensure that Thursday's debt deal translates into restored growth and financial stability for the eurozone's troubled peripheral economies. Contagion risk – especially for Italy, Spain and the Europe-wide financial system – is now lower due to a new, flexible and fast-disbursing credit facility. But, as it stands, the package still lacks sufficient upfront debt relief for the most troubled economies, Greece in particular. There is still much to do for this to be the beginning of the end of Europe's painful debt crisis.

Keep the faith in folk wisdom and say no to online lotteries

Christopher Caldwell

There is a push in Massachusetts and other US states to start selling lottery tickets online. It is the worst idea the states have had since they decided to sell lottery tickets in the first place.

It was New Hampshire that had the brainstorm, in 1964, of making compulsive gamblers responsible for an extra percentage of the state's revenue. Today, 43 states have lotteries and all but Hawaii and Utah raise part of their budgets from gambling. This dependence is the classic contemporary example of a "prisoners' dilemma". Several dozen actors have responded in a self-interested way to a collective action problem, and it has left them all worse off. Gambling is the opposite of productive economic activity. It shuffles money around, generally from the poor to the rich, while creating problems – particularly bankruptcy and crime – that divert resources from more productive uses. States benefit from gambling only to the extent that they can siphon money out of other states. The main argument made for internet gambling is that, since several states already have it, your state will haemorrhage money as long as it does not.

There is another, odder, rationale for dragging the states into online gambling. It is that state lotteries offer the only alternative to *unauthorised* online gambling. In Massachusetts, there has been a big problem with "internet cafés" that are actually casinos. You pay the management to rent a certain number of units of internet time. You access a jazzy website where you can wager those units to win more of them, which can in turn be redeemed for money.

Last week's push for online state lottery tickets followed a move by attorney-general Martha Coakley against companies trying to "skirt our laws by disguising gambling as something else". Officials in Virginia, where you can buy lottery tickets online, have targeted companies using various "measurable units" – tokens, chips, chits – that can be bartered on websites based elsewhere. In the UK, John Penrose, minister for tourism, wisely urged requiring a Gambling Commission licence for any company, no matter where located or incorporated, that takes British customers' wagers.

Nowadays, whenever an interested party wants an excuse to deregulate a harmful industry, he raises what Albert O. Hirschman, the economist, called the futility thesis: "In an age when the world-wide web connects us all, it is simply impossible to . . . " and so on. Almost always, this argument is false. The federal Unlawful Internet Gambling Enforcement Act of 2006 has been effective. Several online gambling operations – PokerStars, Full Tilt Poker and Absolute Poker – were indicted under the measure in April. The law forbids banks (including those that

States benefit from gambling only so far as they can siphon money from other states

sponsor credit cards) and non-bank institutions from paying punters' bets and prizes. This makes it dangerous for big banks to co-operate with online gambling sites. But even if fly-by-night banks can be found offshore, no court will enforce the debts owed them. Controlling online gambling does not require states to provide online gambling themselves.

The internet café scam that Massachusetts hopes to unravel does not differ much from the way states envisage raising money with their own lotteries. In the District of Columbia, the first virtual casinos were set to be introduced this month. Punters would be able to take their laptops into "secure zones" and play a variety of games. The plan was surreptitiously written into a budget bill eight months ago by city council member Michael Brown, an ally of the gambling industry. The budget for next fiscal year, which begins two and a half months from now, already includes revenues from it. Community organisations were among the last to get wind of the new games, but when they did, they were able to shut them down, pending further study. The plan envisioned a period of free play over this summer, which critics say was designed to "hook" Washington's residents.

One of the reasons gambling has not caused more damage is that folk wisdom tells people that gambling is wrong. Most are inhibited by concerned relatives, friends and colleagues. In the solitary world of cyberspace, those inhibitions are removed. That is why gambling moguls love online gambling. Over time, under assault from the state, the folk wisdom erodes, with dire consequences. A people that does not believe gambling is wrong has no moral reason to object to, for example, a wide open market in credit default swaps.

The legitimacy of a state is measured in part by how justly the tax burden is shared. A lottery is a tax. Defenders of the lottery often describe it, in fact, as a stupidity tax. But when government induces a people abandon common sense, the case that people ought to know better collapses. At that point, it is harder to figure out who the stupid ones are.

The writer is a senior editor at The Weekly Standard

Empty baskets
The end of Borders highlights shrinking consumer choice
Page 10

Calm descends
Bold eurozone plans curb contagion fears – for now
Page 12

Struggling consumers lift McDonald's shares to record

Expanded menu helps second-quarter profits top Wall Street expectations

GENERAL RETAILERS

By Alan Rappeport in New York

Struggling consumers are still flocking to McDonald's, the US fast-food restaurant chain, which has benefited from the lingering effects of the economic downturn.

McDonald's shares touched a record high on Friday, after the company said its frozen drinks and breakfast offerings helped its second-quarter earnings exceed Wall Street expectations.

With an expanded menu offering, it is stealing market share from competitors such as Starbucks and Yum! Brands and luring consumers away from their breakfast tables with oatmeal and smoothies.

Jim Skinner, chief executive, said McDonald's was succeeding by offering more "relevant" food and beverage choices and because of its move to modernise its restaurants.

Drinks sales at McCafe, which Mr Skinner introduced in the US in 2009, increased by 29 per cent year-on-year in the second quarter.

McDonald's raised prices in March and May this year to keep up with soaring commodity costs.

But the company said that although consumer sentiment remains "volatile" and unemployment is high in the US and across Europe, customers have not shied away or changed their eating habits.

"We aren't seeing any dramatic spike in the usage of our dollar menus," Peter Bensen, chief financial officer, said in a call with analysts. "We'll continue to be judicious as we move forward."

Mr Bensen said that because grocery prices are rising faster than restaurant menu prices, McDonald's has more room to raise prices this year.

He expects commodity prices to "top out" in the third quarter and ease during the past three months of the year.

McDonald's plans to import some of its premium hamburgers that have been popular in Europe to the US, as it looks to fend off competition from increasingly popular "better burger" chains in the US.

The company would like to begin exporting its strawberry lemonade beverages, which are popular in the US, but said it was assessing global fruit supplies.

Meanwhile, McDonald's is looking to use its scale to capitalise on weak spots in the economy and to edge out competition.

Net income at McDonald's rose by 19 per cent to $1.41bn, or $1.35 a share, from $1.23bn, or $1.13, in the same period a year ago.

The results sent the company's shares up 3 per cent to $89.14 in midday trading on Friday.

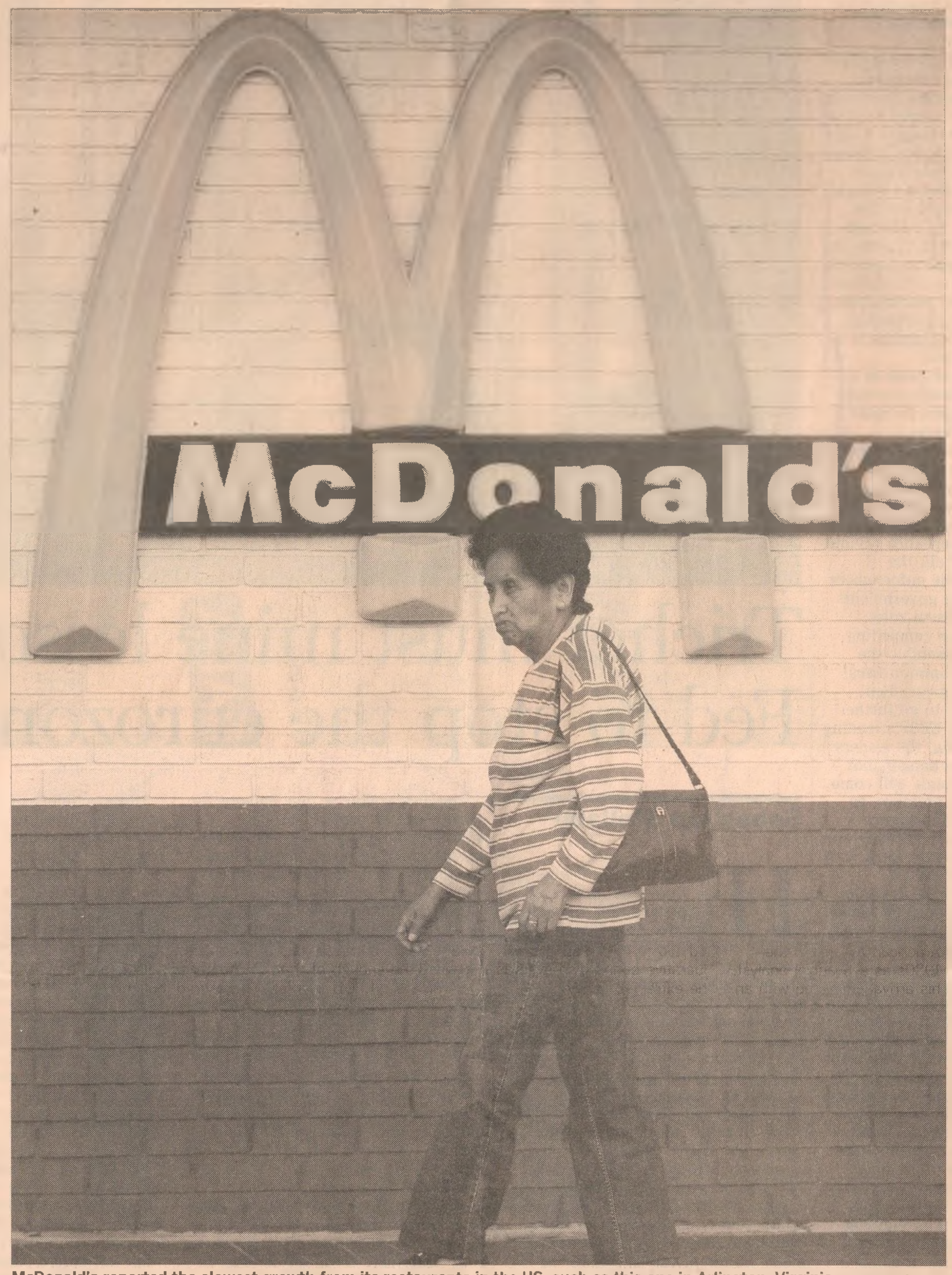
Total revenues at McDonald's rose by 16 per cent to $6.9bn.

The US was the slowest growing region of the world, with total revenues increasing by just 4 per cent.

The pace of growth picked up in Europe, where total revenues increased by 21 per cent, and in Asia and the Middle East, where they jumped by 25 per cent. McDonald's said it expects global comparable store sales to rise by 4-5 per cent in July.

McDonald's
Share price ($)

Source: Thomson Reuters Datastream



McDonald's reported the slowest growth from its restaurants in the US, such as this one in Arlington, Virginia Reuters

Foxtel's bid to buy rival questioned

MEDIA

By Peter Smith in Sydney

News Corp suffered another blow on Friday after Australia's antitrust regulator said a proposal by its local pay-TV affiliate to buy rival Austar for A$1.9bn ($2bn) would hurt competition.

The Australian Competition & Consumer Commission's preliminary ruling said Foxtel's proposed purchase of Austar was likely to result in a "substantial lessening of competition".

The ruling triggered a 20 per cent fall in the share price of Austar, which is majority-owned by US billionaire John Malone's Liberty Global. It comes amid heightened scrutiny of News Corp around the globe as the UK phone-hacking scandal deepens.

Graeme Samuel, outgoing ACCC chairman, said the concerns were not linked to the escalating crisis over phone hacking by the News of the World, the now-defunct UK Sunday tabloid.

"There is not even the slightest scintilla of connection," Mr Samuel told the Financial Times, adding that Foxtel's proposed acquisition raised genuine and significant competition concerns.

After earlier dropping to A$1.03, Austar shares closed 21 cents lower at A$1.08½, a large discount to Foxtel's A$1.52 offer price, and suggesting the market believes the takeover is doomed.

The setback follows Mr Murdoch was forced to withdraw News Corp's planned bid to take full control of British Sky Broadcasting, after admitting the public outcry over phone hacking had made the climate "too difficult".

The ACCC's statement capped another punishing week for Mr Murdoch's media group.

Fresh allegations have emerged on a daily basis in the UK about the role played by News Corp executives and journalists at its UK newspaper subsidiary and the scandal is threatening to spread further into Mr Murdoch's US and Australian operations.

Julia Gillard, Australia's prime minister, this week called on Mr Murdoch's Australian subsidiary to answer "hard questions" about the UK phone hacking scandal. She is also considering a review of the country's media industry.

Foxtel is half-owned by Australian telecoms group Telstra, with 25 per cent stakes held by both News Corp and gaming tycoon James Packer's Consolidated Media. It has been courting Austar for the best part of a decade.

Foxtel said it was confident the deal would "not substantially lessen competition in any market," and that pay-TV operators in Australia faced vigorous competition from commercial and state broadcasters, their digital channels and online operators.

Austar stressed that the ACCC had not made a "final decision" and that the two pay-TV groups were committed to the deal.

The ACCC is expected to make its final ruling by September 8.

VTB snaps up billboard unit

News Corp has sold its News Outdoor billboard businesses in Russia and Romania to a group of Russian investors led by VTB Capital, the state investment bank, at a steep discount to that which it had hoped to raise, **writes Catherine Belton in Moscow.**

People familiar with the matter said the deal was valued at units that had been sold at a value of only $350m, excluding debts, against the $1bn-$1.5bn cash-and-shares deal it had sought from JCDecaux, the advertising group based in France only three years ago.

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www.ft.com/media

Hedge fund founder jailed for 10 years

FINANCIAL SERVICES

K1 manager Kiener ran Ponzi scheme

By James Wilson in Frankfurt

A former hedge fund manager who defrauded investors out of €345m ($496m) has been sentenced to more than 10 years imprisonment after one of Germany's most spectacular cases of financial crime to be revealed by the global economic crisis.

Helmut Kiener founded and ran the K1 hedge fund, attracting banks including UK-based Barclays Capital and French lender BNP Paribas into investing hundreds of millions of euros. Barclays was defrauded of €147m and BNP of €42m, a statement from a court in the German city of Würzburg said on Friday.

In addition, Mr Kiener was proved to have defrauded almost 5,000 private investors out of €121m between 2006 and July 2009, the court said. He was sentenced on Friday to 10 years and 8 months in prison, with the court saying the case was "extraordinary because of its size and the number of cheated investors".

Mr Kiener, who had originally fought the allegations, in April admitted that he had set up a complex Ponzi scheme. The former hedge fund manager had said he lacked the courage to shut the fund after it racked up losses and said he had hoped for a recovery by bringing in new investments. Money from the funds was used to invest in aircraft and property in Florida. Most of the money at one stage managed by the funds is believed to have disappeared.

An accomplice of Mr Kiener, identified in court only as Claus Z, was also jailed on Friday for three years and nine months.

€345m
Total amount defrauded by Kiener

€121m
Amount 5,000 private investors lost to the fraud

Another person linked to K1, Dieter Frerichs, a former managing director of two funds in the group, killed himself in Spain a year ago as police attempted to detain him to carry out an extradition order.

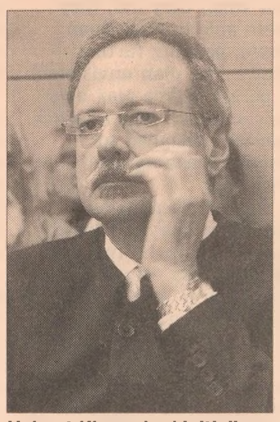
The details of the Ponzi scheme that became known after Mr Kiener's arrest in October 2009 – months after the arrest of Bernard Madoff, the disgraced financier, in the US – appeared to shed light on the trusting nature of investors during the last years of the financial boom, and the lack of scrutiny applied to those in charge of investment funds.

Mr Kiener, a former advertising salesman who was based in the small Bavarian town of Aschaffenburg, boasted of an average 17 per cent annual return from his "K1 Allocation System" since its inception in 1996. After his arrest he tried to claim immunity on the grounds that he was registered as a diplomat by Guinea-Bissau.

BaFin, the German financial regulator, had barred Mr Kiener from portfolio management in 2001 for failing to register his fund, after which he registered two funds from the British Virgin Islands.

Mr Kiener's arrest came after suspicions were raised at US bank JPMorgan about transactions involving Bear Stearns, which it took over, and K1.

BNP declined to comment on Mr Kiener's conviction, while Barclays Capital could not be reached for comment.



Helmut Kiener had initially fought the allegations

Durex condoms suffer global supply shortage

CONSUMER GOODS

Legal dispute over distribution rights

By James Fontanella-Khan in Mumbai

A legal spat between Durex owner Reckitt Benckiser and its Indian joint venture TTK Lig has led to a severe disruption to the UK-based consumer group's condom supplies.

The dispute between the two companies over Indian distribution rights and pricing strategy is having a serious impact on the global condom market, as TTK produces more than 50 per cent of Durex's condoms, according to Citigroup.

With Durex accounting for more than 40 per cent of the $3.9bn global market for condoms, and TTK, which produces about 1.3bn condoms annually for Durex, halting its supplies of the latex contraceptives to Reckitt from the beginning of May, consumers are having to turn to other brands.

"Industry sources suggest the Indian supply disruption is beginning to result in supply shortages of Durex condoms at the retailer level," Citi said in a note to investors.

The UK's National Health Service had to issue a statement on its website to inform customers of Durex's supply chain disruptions with a link to alternative brands.

"NHS Supply Chain regrets to inform customers that Reckitt Benckiser are experiencing manufacturing problems on a number of Durex Branded Condoms," the NHS said. "NHS Supply Chain procurement has listed suitable alternative products to ensure disruption to your services is kept to a minimum."

Citi said it expected Australia's Ansell, the second-largest condom maker by revenues, to pick up the majority of Durex's lost sales. "Ansell's Surat Thani plant [in Thailand] will likely have spare capacity from August and Ansell may choose to contract manufacture for Durex if terms are sufficiently lucrative," the bank said.

Reckitt, in Slough where the UK company is based, said that the group had "a legal case against TTK because they have stopped supply."

According to local media reports, a parent company of TTK was accused of allegedly charging double the market rate to distribute condoms in India. To settle the matter amicably, Reckitt, which has a strong presence in India having acquired the domestic pharmaceutical group Paras last year, offered to outsource the distribution of the condoms they produced locally to a third party. TTK denied the allegation and Reckitt declined to comment.

In June, the clash escalated to the High Court in London, where Reckitt requested an emergency injunction to force TTK to resume the production and supply of condoms.

Justice George Mann rejected the UK group's claim on June 29 and ruled that the dispute should be tried in an Indian court. TTK "has the claimants, for the time being, over a barrel and it knows it", Justice Mann said in his ruling.

Reckitt said the case is pending review at India's Company Law Board.

Volvo steers clear of investment for now

CARS

Truckmaker stalls even as profits soar

By Andrew Ward in Stockholm

Volvo, the world's second biggest truckmaker by sales, said there was so far no sign of the debt crises in Europe and the US triggering a renewed economic downturn but the group had put big investment decisions on hold until the outlook became clearer.

Leif Johansson, chief executive, said business conditions were continuing to improve in spite of the fiscal challenges facing the western world.

"We read the newspapers and look at the stock market like everyone else but, if you listen to what our customers are telling us, we do not see any crisis," he told the Financial Times.

Volvo suffered the worst downturn in its 84-year history in 2009 but sales have now returned to the same level as before the crisis, after a 34 per cent increase in orders during the past year, while second-quarter profits hit a record high.

Truck orders more than doubled in the US from a year ago. Mr Johansson said strong demand in northern and central Europe was offsetting weakness in the south.

However, he admitted that financial turmoil in the eurozone and uncertainty over the US recovery was making Volvo cautious on committing to big new investments.

He said "bottleneck investments" would be made where capacity utilisation was highest, but the group would wait for greater economic clarity before deciding on longer-term capital expenditure.

In the US, he said demand was being supported by the need for hauliers to modernise the country's ageing truck fleet. "There comes a point where old trucks are not economical to drive when there is liquidity in the market . . . [to finance] new trucks that increase their productivity," he said.

Mr Johansson welcomed signs of a slowdown in the Chinese economy, arguing that a lower growth rate would prove more sustainable. Asian truck orders declined 1 per cent compared with the first quarter – in part because of the Japanese earthquake – and rose just 3 per cent year-on-year. This marked a sharp decline from the rapid growth enjoyed by Volvo in Asia in recent years.

European orders were up 29 per cent year on year and in North America they more than doubled.

For the three months to June, Volvo Group – which owns the Volvo, Renault and Mack truck brands – said that net earnings rose 62 per cent from the same period last year to SKr5.12bn ($808m), beating analysts' consensus expectations. Sales rose 15 per cent to SKr79bn.

FINANCIAL TIMES

Saturday July 23 / Sunday July 24 2011

The Lex Column

Greece rightening

Vodafone

The task for Vodafone is simple – it just has to do two things at once. In its first-quarter results on Friday, the UK-based mobile operator confirmed the complete dichotomy it faces in its markets. On one hand, its emerging markets are racing along. Revenues in Turkey increased 32 per cent and India were up by 17 per cent (although intense competition there limits profitability). On the flip side, the mature European business – which contributes about 70 per cent of revenues – barely grew as it nursed revenue falls of 10 per cent in Spain and 16 per cent in Greece. Cautious but confident investors pushed the share price up 2 per cent.

Despite the trouble in Europe, many shareholders are encouraged by the hints that Verizon Wireless, Vodafone's US joint venture with Verizon, will start paying dividends again next year. Vodafone generated £7bn of free cash flow in its last financial year. Dividends from Verizon Wireless could increase this by 45 per cent, according to analysts Sanford Bernstein.

But this embarrassment of riches could prove a problem. Vodafone is already underleveraged. At the end of June, its net debt of £23bn was only 1.6 times the company's expected earnings before interest, tax, depreciation and amortisation next year. A £4bn share buy-back programme now under way will increase that figure to 1.8 times – which would remain about 10 per cent below the company's target.

Figuring out a use for all the extra cash from the dividends could be a pain. Vodafone's own history includes several large acquisitions that proved hard to integrate. While chief executive Vittorio Colao could merely expand the share buy-back programme, investors might interpret that as a sign that he has run out of ideas. As with investors in many technology companies, Vodafone shareholders may have to grow used to being heavily invested in cash.

Didn't they do well? Shares in European banks exposed to the eurozone's periphery rebounded sharply once the outcome of the emergency eurozone summit became clear. Investors assumed that Greek bail-out 2.0 and a debt restructuring for banks would stop contagion swamping Italy and Spain, for now.

The effects on individual banks of swallowing the proposed package of debt swaps and rollovers are as yet unknown but a 21 per cent haircut is hardly likely to destabilise them. As an exercise in shielding Europe's banks from Greek fallout – which is what it was – Thursday's package looks to have worked. But investors should keep things in perspective.

European bank shares still have a mountain to climb.

Even after Friday's rebound, the FTSE-Eurofirst 300 banks index is 20 per cent below its February peak – and that is 66 per cent below its pre-crisis high. Looked at differently, Datastream's German banks index trades at only 0.4 times book value (lower than Greek banks) from a lame 0.65 times book in the summer of 2009, just after the worst of the financial crisis. France's banks have stayed flat, trading at 0.64 times. While they are so cheap, it is tempting to treat them as options on a positive outcome to the Greek crisis.

But this would be wrong. Greek contagion is not the only thing keeping investors on the sidelines. Also weighing on European bank ratings are worries about increased regulation, higher capital buffers (and, therefore, lower returns) and inconsistencies among banks' risk weightings. For some, the grim outlook for investment banking revenues is a further concern.

One risk has been reduced. For investors who really believe that the latest bail-out has stopped the rot, European banks may look a steal.

But they should not let the Greek drama distract them from banking's dark backdrop.

European bank indices
Price-to-book ratios

Source: Thomson Reuters Datastream

General Electric

Not too long ago, unkind critics of Jeff Immelt, Jack Welch's successor at General Electric, might have remarked that his company's financial results were a reflection of its motto: "Imagination at work." Whether it was its streak of "beating by a penny" for so many quarters in a row or later accusations during the financial crisis that the company's finance unit swept problems under the rug, those days seem to be over, and not just because it beat analyst expectations by two pennies on Friday.

Mr Immelt, about to begin his second decade at the helm of the conglomerate, started his job with the equivalent of one hand, and perhaps a foot, tied behind his back. His legendary predecessor's retirement was impeccably timed, coming a few days before the September 11 2001 atrocities and with the stock sporting an overhyped 50 price-to-earnings ratio – the sort of number that, even with the pumped-up financial units Mr Immelt would have liked to trim back, could not be sustained. The total shareholder return during his tenure has been negative 35 per cent, with the trailing p/e ratio now below 16.

When finance was driving the "e", the "p" did not co-operate. The financial crisis gave Mr Immelt the excuse to shift emphasis to the industrial units that grow more slowly during good times but have far better earnings visibility. Industrial revenue rose by a so-so 10 per cent (3 per cent organically) over a year ago but the order backlog has swollen to $189bn. Energy infrastructure and aerospace look particularly promising and recent acquisitions (mainly energy) and disposals (NBC Universal) appear well-timed. Given the more stable profit engines and an undemanding valuation, investors hoping Mr Immelt's next decade will be more rewarding do not have to be very imaginative at all.

Celebrity endorsement

Celebrity product endorsement has long been marketing gold. But it is expensive. It cost a reported $14m to have James Bond drive a franchise-insulting Ford in *Casino Royale*. For much of his career, Michael Jordan made more from endorsements, such as Nike Air Jordan shoes, than from playing basketball. The sums can only grow; Chinese products litter the new *Transformers* film.

Now, England footballer David Beckham has given his services for free. He and pop star wife Victoria have named their daughter Harper, after Harper Lee, author of *To Kill a Mockingbird*, one of Mrs Beckham's favourite books. The novel's sales have doubled on Amazon.com. Given that people already accept $15,000 to have brand names tattooed on their faces, how long before they name children after the highest bidder?

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Markets

Eurozone can put moral hazard on the sidelines

John Authers
THE LONG VIEW

Betting on bail-outs is generally a good idea. When a government steps in to rescue a financial institution, it has usually decided to do what it takes to keep that institution alive. It will it behoves investors, with no monetary printing presses at their disposal, to bet against them.

Investors understand this. Hence, the extraordinary snap back in the prices of European bank shares, and of the sovereign debt of peripheral European countries, ever since the details of the latest deal "to save the euro" began to emerge. Traders were following a well-established template. Whatever their doubts about the longer-term feasibility of this package, the only sensible short-term response is to buy.

Government bail-outs are sometimes necessary. It is dangerous to be too much of a purist over market discipline when real and avoidable human pain is at stake. But they carry a penalty in terms of moral hazard. This term refers to people's extra propensity to take risks when they know they have some insurance.

By the time Lehman Brothers hit the wall in 2008, everyone now knows that the western financial system was riddled with moral hazard. After a string of bail-outs, financiers cosily assumed that whatever went wrong, there would be a bail-out for them.

For the longer term, the critical question is whether European politicians have injected too much moral hazard into the eurozone. For the shorter term, the question is whether they have done enough. These two issues directly conflict.

It is helpful to put this week's incident on a continuum from Long-Term Capital Management to Fannie Mae. LTCM was the biggest hedge fund of its day and melted down in the wake of the Russian default of August 1998, prompting a bail-out.

Fannie Mae, the biggest US mortgage bank, needed to be rescued by the US government a decade later, in July 2008.

Both prompted market reactions very similar to the sudden drive to buy European bank shares that happened this week. But there were important differences.

Bail-outs are sometimes necessary. But they carry a penalty in terms of moral hazard

While LTCM was stricken, credit markets came to a standstill. There were fears of a generalised collapse if it defaulted on its loans to a range of Wall Street's biggest banks.

The government's response was to bang the big banks' heads together to force them to help LTCM out. Then, when markets remained frozen, the Federal Reserve obliged with a cut in interest rates. At that point, risky assets set off like so many rockets. It turned out to be a great buying opportunity. By the beginning of 2001, the S&P Financials index was up 75 per cent, and by May 2007, at the very top of the credit bubble, it had gained 120 per cent.

With hindsight, LTCM was the moment when the US financial system began to take leave of its senses. Emboldened by the notion that both government aid and easier monetary policy were there to help them, banks took ever bigger risks. This delivered them ever greater earnings. Before LTCM, financial companies accounted for 20 per cent of earnings by S&P 500 companies. By the middle of the next decade, this had risen to 30 per cent. Then came the crash.

The Fannie Mae rescue came in July 2008, two months before Lehman. Disaster was imminent, and could not be thwarted even by full nationalisation two months later. But the immediate response saw US bank shares gain 37 per cent in a week.

In both incidents, the correct response was to buy bank stocks. In the case of Fannie Mae, however, it was necessary to get out quick.

How does the European incident compare? At one level, the precedents are dangerous. This is a blatant exercise in helping out banks. They took the risk of lending to Greece, and yet their total "haircut", or reduction in payments that they are due to receive, is only about 21 per cent. The private sector will pay only a third of the total bail-out. Politicians could easily have made them bear a far greater share. By trying this hard to spare the banks some pain, European authorities run the risk of sparking the kind of risk-taking that the Fed triggered in 1998.

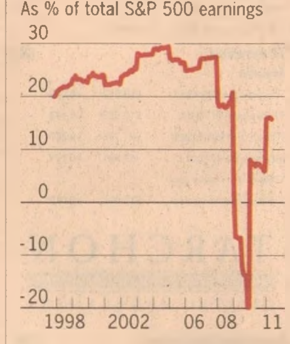
However, the moral hazard involved in this deal does not approach the scale of LTCM. The debt being propped up is that of a sovereign, which is part of the European Union. The remedy involves a ratcheting up in the strength of the eurozone's institutions.

If – and it is a big if, as politicians can still get in the way – this crisis leads to the creation of a true European monetary fund, then eurozone government debt will be safer, and the initial surge of enthusiasm may come to be seen as the beginning of a re-rating.

Like the establishment of the Fed after the Panic of 1907, the crisis will have forced the creation of an important new institution that makes finance safer.

Many risks remain, within the eurozone and without. But investors would be safest not fighting moral hazard for now.

S&P 500 financial sector earnings
As % of total S&P 500 earnings



Source: Thomson Reuters Datastream

The Week in Numbers

48.9

China contracts
The HSBC/Markit "flash" purchasing managers' index for China fell from 50.1 in June to 48.9 this month, the first time it has dipped below the 50 threshold that separates expansion from contraction in 12 months. Economists attributed the decline to policy tightening measures that started last October

$1,600

Gold
The price of gold finally broke above the $1,600 an ounce level to reach a record high of $1,609.51 as sovereign debt concerns in the US and the peripheral eurozone prompted investors to seek safety in the precious metal. Silver breached the $40 an ounce mark for the first time since early May

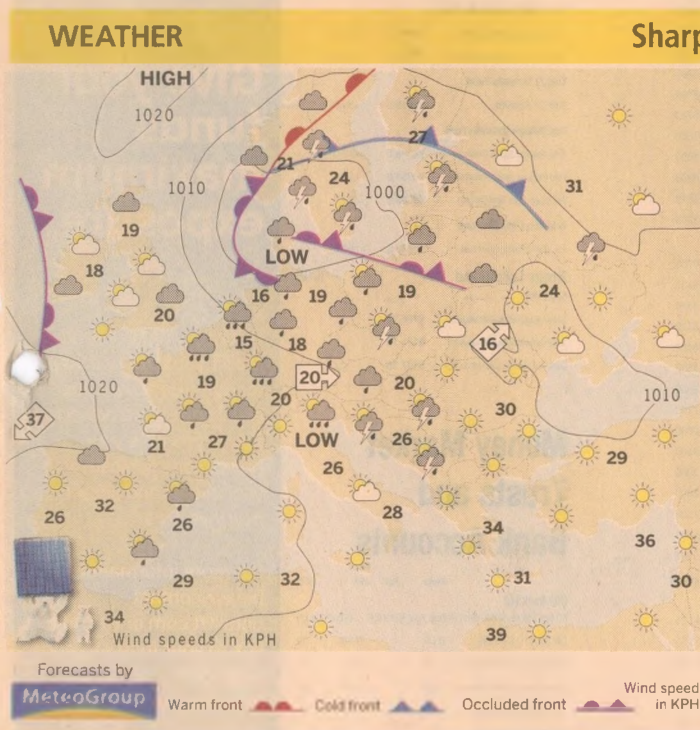
40%

Greek debt
The yield on Greece's two-year government bonds briefly broke above 40 per cent before retreating sharply as European leaders agreed a new bail-out plan for the country, which will involve private holders of Greek debt. The deal also included a commitment to support Athens until it can return to the financial markets

Greek government bonds
Two-year yield (%)

Source: Thomson Reuters Datastream

WEATHER



Today's temperatures — Maximum for day °C

Abu Dhabi	Sun	40	Malta	Sun	33
Amsterdam	Shower	16	Manila	Thunder	31
Ankara	Sun	29	Miami	Fair	33
Athens	Sun	34	Milan	Sun	27
Bahrain	Sun	40	Montreal	Sun	31
Barcelona	Sun	27	Moscow	Fair	31
Beijing	Fair	34	Mumbai	Shower	29
Belfast	Sun	17	Munich	Rain	17
Belgrade	Shower	28	Naples	Fair	28
Berlin	Cloudy	19	New York	Fair	37
Brussels	Shower	16	Nice	Sun	24
Budapest	Thunder	20	Nicosia	Sun	36
Cairo	Sun	35	Oslo	Thunder	21
Cardiff	Fair	18	Paris	Shower	19
Chicago	Thunder	33	Prague	Fair	19
Cologne	Shower	16	Reykjavik	Drizzle	16
Copenhagen	Rain	18	Riga	Rain	23
Delhi	Cloudy	34	Rio	Cloudy	22
Dubai	Sun	39	Rome	Sun	26
Dublin	Fair	18	San Francisco	Sun	23
Edinburgh	Fair	18	Singapore	Fair	31
Frankfurt	Cloudy	18	Stockholm	Thunder	24
Geneva	Fair	20	Strasbourg	Cloudy	18
Hamburg	Rain	16	Sydney	Shower	15
Helsinki	Thunder	27	Tokyo	Fair	28
Hong Kong	Sun	32	Toronto	Fair	33
Istanbul	Sun	32	Vancouver	Sun	21
Lisbon	Sun	26	Vienna	Shower	18
London	Cloudy	20	Warsaw	Fair	19
Los Angeles	Sun	26	Washington	Thunder	34
Luxembourg	Shower	15	Zagreb	Thunder	21
Madrid	Sun	32	Zurich	Shower	18

Forecasts by MeteoGroup — Warm front — Cold front — Occluded front — Wind speed in KPH