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Future of ageing
James Crabtree takes you inside MIT's Agelab and reports on how we will cope with living longer
Life & Arts

Private bondholders to take hit ● First eurozone debt default looms ● Victory for Merkel

Deal agreed on Greece bail-out

Summit: from left Nicolas Sarkozy, Christine Lagarde and Angela Merkel ahead of the Brussels meeting where they joined other eurozone leaders to thrash out a deal Reuters

By Peter Spiegel and Quentin Peel in Brussels, and Patrick Jenkins and Richard Milne in London

European leaders agreed a further bail-out for Greece worth €109bn, a third of which will come in the form of debt swaps or rollovers by private sector bondholders.

The agreement to involve private sector creditors is a political victory for Angela Merkel, Germany's chancellor, but one that will almost certainly lead to the first default on eurozone bonds since the creation of the single currency.

At a momentous summit in Brussels anxiously awaited by investors, eurozone heads of government quickly reached agreement to lower interest rates on rescue loans to all three countries in bail-out programmes. Greece, Ireland and Portugal would pay about 3.5 per cent – 100-200 basis points lower than at present. They also agreed to extend the repayment schedules from 7 ½ years to 15-30 years.

In addition, they gave the bloc's €440bn bail-out fund, the European financial stability facility, new powers to help countries not currently in bail-outs, including precautionary lines of credit and the ability to recapitalise any struggling bank in the eurozone. The EFSF will also be able to buy bonds on secondary markets in "exceptional" circumstances and subject to the approval of the European Central Bank.

President Nicolas Sarkozy of France said the changes were tantamount to the creation of a European monetary fund.

In addition, eurozone leaders agreed to a smaller scale bond buy-back plan worth €12.6bn.

Private holders of Greek bonds will provide €37bn to Greece's second international bail-out. They will be given four options – three forms of debt exchange and one rollover plan – with different durations and coupons. On average, investors would take a 21 per cent hit in the net present value of their current bondholdings.

The notionally voluntary scheme is likely to trigger a selective default rating, albeit temporary.

Jean-Claude Trichet, European Central Bank president, has fiercely resisted allowing a selective default. But officials said he relented after it was made clear that such bondholder plans would be limited to Greece and no other countries struggling with debt loads would be asked to do the same.

Herman Van Rompuy, the EU's president, said: "Today we reached three important decisions fully supported by all of us. We improved Greek debt sustainability, we took measures to stop the risk of contagion and finally we committed to improve the eurozone's crisis management." Mr Sarkozy said the deal would cut Greece's debt to gross domestic product ratio by 24 percentage points.

The last-minute deal was reached after Mr Sarkozy earlier agreed to shelve a proposal for a €50bn tax on eurozone banks.

Stock markets and the euro rebounded as news of a draft deal circulated, while the borrowing costs of Italy, Spain and other peripheral eurozone countries fell. Italian and Spanish benchmark interest rates, measured by 10-year bond yields, fell 0.27 percentage points to their lowest level in two weeks.

Euro bounces back

Against the dollar ($ per €)

Source: Thomson Reuters   Times are GMT

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Blog: www.ft.com/brusselsblog

Markets rally despite scepticism

Markets rallied in relief ahead of a new Greek bail-out on Thursday but some investors remained sceptical that the eurozone crisis had reached a definitive turning point, **writes Richard Milne.**

Stock markets and the euro rebounded as news of a draft deal circulated, while the borrowing costs of Italy, Spain and other peripheral eurozone countries fell.

The biggest gainers were European banks, many of which have been hit hard in recent weeks. National Bank of Greece rose 11 per cent, UniCredit 10 per cent and Barclays 8 per cent. The euro rose almost 2 per cent from its low on Thursday to $1.437 against the dollar.

Italian and Spanish benchmark interest rates, measured by 10-year bond yields, both fell 0.27 percentage points to their lowest level in two weeks. The premium over Germany that Italy and Spain pay to borrow has fallen by a quarter for both countries since Monday, relieving some of the pressure building on the respective third- and fourth-largest economies in the eurozone.

But some investors said the proposed deal seemed to fall short of the action they thought would be needed.

"I am a little nervous that markets have got ahead of themselves," said Dan Morris, market strategist at JPMorgan Asset Management. "It really seems that the big bold measures are beyond Europe's grasp. They are still playing around the edges."

A fund manager at a large hedge fund said: "There is still a good chance that we have to have another summit to avoid catastrophe sometime in the future."

The S&P 500 in New York rose 1.5 per cent to 1,345, just 1 per cent below its post-crisis peak. **Markets, Page 28**

News Briefing

UK 'able to ringfence banks' under EU rules
The UK would still be able to ringfence its retail banks and put extra capital requirements on them under the proposals that seek to harmonise capital rules across the EU, said Michel Barnier, internal market commissioner. **Page 15**

Hope for US debt deal
Some elements of proposals by a bipartisan group of US senators may well make their way into a narrower deficit cut deal that would be sufficient to increase the US debt ceiling. **Page 4; Philip Stephens, Page 11**

Pepsi chief faces heat
The pressure on Indra Nooyi, PepsiCo's chief executive, to revive the group's ailing US beverage arm intensified after disappointing quarterly results and a cut to its full-year earnings guidance. **Page 15**

Peru attracts interest
Glencore, Telefónica and America Movil are riding a wave of optimism over Peru after the incoming president there named a business-friendly cabinet. **Page 4**

Xinjiang tensions
Tension in the restive Western Chinese region of Xinjiang has again surfaced in a remote oasis town after an attack on a police station there left at least 20 people dead. **Page 5; Online video www.ft.com/xinjiangprotests**

US healthcare takeover
Express Scripts will buy Medco in a $29.1bn deal that will create the largest pharmacy benefits manager in the US, fuelling the debate about competition and costs. **Page 15**

Syrian banks pressed
Protests are putting pressure on Syria's economy, as data show nearly 10 per cent of deposits in the country's banks were withdrawn in the first four months of 2011. **Page 5**

US jobless data gloom
More Americans filed for unemployment insurance last week as the US labour market continued to struggle amid widespread uncertainty over the stalling economy. **Page 4**

Scientists warn over apeing humans

By Clive Cookson in London

Experiments to make animals look, sound or even think like people could soon be on the research agenda, according to a UK scientific body that has warned politicians and the public to start considering the implications.

The Academy of Medical Sciences has spent the past 18 months investigating present and future research into "animals containing human material".

So far humanisation of animals has been limited to the insertion of relatively small numbers of human genes or cells into laboratory animals, mainly mice. This has led to many advances in grasping the causes of diseases and devising treatments for them, without triggering regulatory or ethical concerns beyond those already associated with animal research.

The academy's review is based on what might happen in the near future, given the rapid pace of biological research.

"We are not aware of any work going on now that is likely to cause anxiety, but we wanted to take a proactive look at an area of science that has not received much public attention," said Martin Bobrow, a medical genetics professor at Cambridge university who chaired the inquiry.

The review identified three types of experiments that might soon become possible and would cause particular concern: modifying animal brains to mirror human "cerebral function"; fertilising human eggs or sperm in an animal; or endowing animals with characteristics perceived as uniquely human such as facial shape, skin texture or speech.

Mice with human livers are already used in toxicology research. US scientists have also created mice in which one-quarter of the brain cells are human neurons, and they have discussed – but not gone ahead with – making a mouse in which all neurons are derived from human stem cells.

"If you replaced an entire mouse brain with human neurons, it would almost certainly still be a mouse, though with some interesting changes," Prof Bobrow said. "But for something with a bigger and more complex brain, such as a primate, it is hard to guess what the result would be."

Another controversial move would be to make animals sound like humans. A gene associated with human language has been transferred to mice.

"These animals vocalise slightly differently from ordinary mice – but they don't speak," said Robin Lovell-Badge, head of stem cell biology at the National Institute for Medical Research.

"If you come home and your pet parrot says, 'Who's a pretty boy then?', that's one thing," said Christopher Shaw, neurology professor at King's College London. "If your pet monkey says it, that's another."

'If your pet parrot says "Who's a pretty boy then?", that's one thing. If your pet monkey says it, that's another'

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World Markets

STOCK MARKETS

	Jul 21	prev	%chg
S&P 500	1344.87	1325.84	+1.44
Nasdaq Comp	2834.09	2814.23	+0.71
Dow Jones Ind	12734.44	12571.91	+1.29
FTSEurofirst 300	1103.12	1091.11	+1.10
Euro Stoxx 50	2763.34	2705.75	+2.13
FTSE 100	5899.89	5853.82	+0.79
FTSE All-Share UK	3068.36	3048.05	+0.67
CAC 40	3816.75	3754.6	+1.66
Xetra Dax	7290.14	7221.36	+0.95
Nikkei	10010.39	10005.9	+0.04
Hang Seng	21987.29	22003.69	-0.07
FTSE All World $	(u)	223.67	

CURRENCIES

	Jul 21	prev		Jul 21	prev
$ per €	1.438	1.420	€ per $	0.695	0.704
$ per £	1.630	1.614	£ per $	0.614	0.620
£ per €	0.882	0.880	€ per £	1.134	1.137
¥ per $	78.5	78.9	¥ per €	112.9	112.0
¥ per £	128.0	127.3	£ index	79.1	79.0
$ index	75.9	76.5	€ index	96.12	95.50
SFr per €	1.177	1.164	SFr per £	1.334	1.323

COMMODITIES

	Jul 21	prev	chg
Oil WTI $ Sep	99.13	98.40	0.73
Oil Brent $ Sep	117.51	118.15	-0.64
Gold $	1,602.10	1,588.35	13.75

INTEREST RATES

	price	yield	chg
US Gov 10 yr	100.97	3.01	0.08
UK Gov 10 yr	104.55	3.17	0.09
Ger Gov 10 yr	103.17	2.88	0.11
Jpn Gov 10 yr	100.92	1.10	0.02
US Gov 30 yr	101.03	4.31	0.05
Ger Gov 2 yr	100.57	1.44	0.13

	Jul 21	prev	chg
Fed Funds Eff	0.06	0.06	-
US 3m Bills	0.04	0.03	0.01
Euro Libor 3m	1.55	1.55	0.00
UK 3m	0.72	0.72	-

Prices are latest for edition

Cover Price

Albania	Lek410	Macedonia	€3.30
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Bulgaria	Lev7.00	Netherlands	€3.30
Croatia	Kn27	Nigeria	Naira715
Cyprus	€3.30	Norway	NKr28
Czech Rep	Kc115	Oman	OR1.50
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Italy	€3.30	Spain	€3.30
Jordan	JD3.25	Sweden	SKr32
Kazakhstan	[illegible]	Switzerland	SFr5.40
Kenya	Kshs300	Syria	US$4.74
Kuwait	KWD1.50	Tunisia	Din6.00
Latvia	Lats3.40	Turkey	YTL6.25
Lebanon	LBP7000	UAE	Dh15.00
Lithuania	Litas14	Ukraine	€5.00
Luxembourg	€3.30		

Eurozone debt woes

Greek bond swap plan to be limited

Rescue proposal

Other EU countries cannot rely on private creditors to bail them out, write Quentin Peel and Patrick Jenkins

Private creditor participation in Greece's latest rescue programme will be very strictly limited to the Greek crisis, and will be specifically excluded as a model for any other eurozone country in financial difficulties, according to officials closely involved in the eurozone negotiations in Brussels.

A proposal for bond swaps for all Greek government debt falling due for repayment up to the end of 2019 has emerged as the central element in the scheme, although the eurozone governments now accept that such a plan would almost inevitably trigger a "selective default" declaration by credit-rating agencies.

Agreement on a very strict definition limiting the bondholder participation to Greece was reached by France and Germany on Wednesday night in order to reassure Jean-Claude Trichet, president of the European Central Bank, to relax his outright hostility to any scheme that might prompt such a selective default.

According to the officials, any declaration of default would be triggered only when the bonds are actually exchanged, and could be limited to "a very few days". If the declaration were then rescinded, the ECB would be able to resume accepting Greek debt as collateral for providing liquidity to the Greek banks that are the principal private creditors.

A variety of options will be on offer for private creditors to contribute to a relief of the Greek debt burden, according to the proposals under discussion in Brussels, ranging from four variants of bond swaps, to a debt rollover, and a bond buy-back scheme.

The four variants of swaps would be designed to cater for the differing requirements of financial institutions, but their common effect on net present value would be "around 20 per cent", according to those familiar with the negotiations between the eurozone governments and the biggest banks.

Although the schemes will be voluntary, the eurozone governments are hoping for a high response from bondholders, with up to 90 per cent participating. A variety of "credit enhancements" to provide an incentive for participation are under discussion, including forms of providing other collateral than a Greek government guarantee to ensure repayment.

Europe's biggest banks and insurance companies – the main holders of Greek sovereign debt – have spent the past month trying to find consensus among themselves over how best to take a degree of private-sector responsibility for Greece's woes. The banks, co-ordinated by the Institute of International Finance, set up a series of meetings – most of them in Rome and Paris – to reconcile their differences, and by early this week they had a compromise plan.

> 'Without something convincing we will see bond spreads for Spain and Italy widen sharply again'

It began with a proposal from France's banks, led by BNP Paribas, to roll over Greek debt maturing between now and 2014 into new 30-year paper. Germany preferred a shorter-term rollover but a one-off seven-year maturity transformation.

But both ideas appeared excessively soft on the banks and, with a proposed interest rate of up to 8 per cent on the new debt, excessively tough on the Greeks.

The new proposal would extend the original three-year time frame for the rollover to as much as eight years, with the interest rate on the bonds potentially cut to as little as 4 per cent, in line with the rate planned under the revised terms of the core EU-International Monetary Fund bail-out, at least for an initial period. The rate would have a ceiling of 5.25 per cent.

It would give debtholders the choice between the French rollover idea, under which debt as it matures over the coming years could be rolled over for another 30 years, and the German idea, allowing debtholders to flip it immediately into 30-year debt.

Bankers say that because of the idiosyncrasies of national accounting and regulatory requirements, one option may appeal more to some banks in some countries. Banks believe the rollover programme would work well with a Greek debt buy-back idea, which could be focused on longer maturities.

They argued vehemently against the alternative idea of a tax, but are highly nervous that a failure by European leaders to agree a detailed plan for Greece would leave investors feeling increasingly bearish about larger southern countries. "[Without] something convincing articulated," said one senior banker, "we will see bond spreads for Spain and Italy widen sharply again."

The idea of a bank tax, also favoured by Paris, was abandoned by president Nicolas Sarkozy after his talks with Angela Merkel, German chancellor, in Berlin on Wednesday evening. The German government argued that it would require months of detailed negotiations between the institutions of the European Union, and that anyway Germany has already introduced a national bank levy.

Banks braced to take hits on their bonds

Writedowns

By Patrick Jenkins and Megan Murphy in London

Banks across Europe are braced to take as much as €16bn of writedowns on their holdings of Greek sovereign debt within a matter of days.

Even before politicians sat down on Thursday to thrash out the terms of the second Greek bail-out, auditors had been warning bank finance directors that they would have to make provision for losses on their bonds with their second-quarter results, beginning next week.

Auditors have argued that the banks must take the hits now, given that almost any scenario for dealing with Greek sovereign restructuring will impair the value of their bondholdings.

After the Greek banks, French and German banks and insurers are the biggest holders of Greek sovereign debt. Deutsche Bank and UBS kick off the mid-year reporting season in Europe next Tuesday, with the French institutions due the following week.

Up until now, most banks have not written down the value of the bulk of their Greek sovereign bonds. Bonds can be held in two buckets on banks' balance sheets: trading books, which routinely mark the value of bonds to market, only hold a fraction of banks' sovereign bond investments; the balance is in so-called banking books, which are routinely held to maturity and are therefore not traditionally marked to market, ignoring plunges in bond values as a result.

Of the €82.7bn in aggregate net exposure to Greek sovereign debt revealed in last week's European stress tests, just €3.9bn – or less than 5 per cent – is held in banks' trading books, according to an analysis by the Financial Times.

Nearly €79bn, however, is held in institutions' banking book assets, which are not adjusted for swings in market value. A 20 per cent writedown or "haircut" on Greek sovereign debt held in those portfolios would trigger losses of nearly €16bn across the 90 banks surveyed in this year's widely discredited tests. A 15 per cent haircut would cost €12bn. European officials have discussed de facto haircuts of 15-20 per cent on average as part of the bail-out plan.

Greek banks, which hold about €47bn of Greek sovereign debt in their banking books, would be hit the hardest, suffering losses of more than €9bn.

BNP Paribas, the French bank that holds more than €4.5bn worth of Greek debt in its banking book, would have to write off €900m. Other banks with significant exposure to Greece include Belgium's Dexia.

Summit measures

Bail-out fund bolstered

The €440bn temporary bail-out fund that eurozone governments cobbled together more than a year ago to confront the debt crisis will be given a range of new tools to help ease the pressures on Greece and other stricken members of the currency union, **writes Joshua Chaffin in Brussels**.

The changes to the fund, known as the European financial stability facility, were agreed by the 17 eurozone leaders at an emergency summit meeting in Brussels.

Taken together, they represent a dramatic departure from the fund's limited applicability – and tough lending terms – that two of its chief underwriters, Germany and the Netherlands, have long insisted on in order to limit their taxpayers' exposure.

> 3.5%
>
> **Proposed interest rate for EFSF loans**

That shift has been driven by an acknowledgement that lenders must do more to alleviate the crushing debt loads born by Greece and other bail-out recipients if they are to return to health.

"It is an example of Europe progressing from initial mistakes and doing the right thing after exhausting all other options," said Alessandro Leipold, chief economist at the Lisbon Council, a Brussels think-tank.

Chief among the new tools would be the ability for the EFSF to buy back bonds of struggling governments on the open market. An early draft of the summit conclusions made clear, however, that such powers could only be exercised in "exceptional financial market conditions", and that all eurozone countries would have to agree.

Assuming the bonds were trading at a steep enough discount, a buyback programme would allow Greece cheaply to erase some of its €350bn in outstanding debt, which economists increasingly believe is unsustainable.

In another effort to lessen that burden, the maturities of EFSF loans would be extended from 7.5 years to at least 15 years. Interest rates would also be reduced to about 3.5 per cent – a possible boost for Ireland, which is paying 100 basis points more than Greece or Portugal on its EFSF loans.

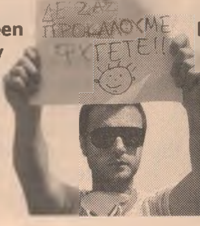
Seeking to address a criticism that the EFSF only steps in too late, the fund has been given new flexibility to extend short-term loans to countries that have not signed up to full rescue programmes from the EU and International Monetary Fund. EFSF funds may also be used directly to inject capital into teetering banks – even in nations outside bail-out programmes.

Both measures could help to shield other vulnerable governments, such as Spain or Italy, from the shockwaves of a possible Greek default.

Picture: AP

How a deal might look

	Preventing eurozone contagion	Cutting Greece's debt mountain	Being more generous
What's in the deal	**The European financial stability facility, the EU's €440bn ($633bn) bail-out fund, will gain new powers to make short-term loans, provide funds to recapitalise banks and in "exceptional" circumstances even buy back bonds of debt-laden governments**	**Eurozone governments are looking to cut the net present value of Greece's debt mountain by 20 per cent through a variety of options including a debt swap and a small-scale bond buy-back. The details were the big sticking point on Thursday**	**Interest rates on EFSF loans to Greece, Ireland and Portugal will be cut by 100-200 basis points. Loan maturities will be doubled to 15 years. Interest rates on private sector debt swaps for Greece would also be lowered**
Why it's there	The bail-out fund will be able to act pre-emptively. It will be able to help countries that are not already subject to full international rescue programmes that are facing temporary difficulty in raising debt on the markets	Germany and the Netherlands are insisting on private bondholders sharing the burden of a second rescue for Greece. Other countries also came to the view that Greece's debt mountain was unsustainable and needed to be cut	Greece, Ireland and Portugal were paying punitive rates on their bail-out loans, raising serious questions about whether their austerity programmes were politically and economically sustainable
FT verdict	**The European Commission, many governments and most analysts have been arguing for these new powers for months, but Berlin resisted. The EFSF would be able to intervene to help Spain and Italy if rapid help is needed**	**The problem has always been how to assuage markets by cutting Greece's debt burden without roiling them by pushing Greece into default. The problem is unresolved and the impact unknown**	**More favourable terms and longer maturities will provide much-needed relief, but these countries still face a struggle to regain competitiveness and manage their debt burdens**



Athens' ability to stay course in doubt

Debt burden

By Alan Beattie in Washington

Early details of the financing package for Greece that were emerging on Thursday may have given some comfort to the financial markets.

In particular, the reductions in interest rates on official loans from the European financial stability facility may have convinced some investors that Ireland and Portugal could escape a big debt restructuring.

But whether the measures likely to be announced are enough to restore Greece to sustainability will depend heavily on the writedown achieved in the private sector holdings of Greek debt. And here, economists stressed, the uncertainty about what investors might accept and the limited reductions that seemed to be on offer were less convincing.

Proposals based on the plan from the Institute of International Finance involve swapping about €135bn of privately held debt into much longer-dated bonds, which would relieve the funding pressure on Greece by increasing the average maturity of its bonds from less than seven years to nearly 20.

But estimates suggested that operation would write down in the net present value of debt by only about 20 per cent, much lower than most calculations of the necessary reduction.

Economists said that meant Greece would struggle to achieve sustainability even with cheaper official lending.

Jacob Funk Kierkegaard at the Peterson Institute of International Economics in Washington said that, based on the sketchy early details circulating in the summit, Greece was still likely to end up with a debt burden comfortably above 100 per cent of gross domestic product.

"This package establishes some useful principles including cheaper loans from the EFSF and the idea that debt restructuring will happen only in insolvent countries like Greece, not illiquid governments like Italy's," he said. "But, by and of itself, it is not going to put Greece on a sustainable path."

The forecasts in the eurozone and International Monetary Fund programme involved optimistic assumptions about growth and tax revenue, Mr Kierkegaard said.

"Absent a dramatic improvement in the business climate or Greece raising money by selling off its islands, I still think it is going to be a struggle to get investors to have confidence in Greece with such a high debt burden," he said.

"This package may put Ireland and Portugal on sustainable paths, but it is unlikely to be the end of the story for Greece."

Fears Cyprus may be next

The prospect of a selective default for Greece has raised fears that Cyprus could be next in line for a bail-out, **writes Kerin Hope in Athens**.

Athanasios Orphanides, central bank governor, has warned that "broader and more drastic" reforms were needed to avoid a worse outcome.

Mr Orphanides criticised foot-dragging by the government over shoring-up the public finances, even after an explosion at a Greek Cypriot naval base last week caused damage that could cost €1.5bn-€2bn ($2.8bn). The accident, which knocked out the island's biggest power plant, is expected to push growth into negative territory.

This year's budget deficit projection was raised last month from 4 per cent to 5 per cent of gross domestic product, while yields on Cypriot debt have jumped this week.

Cyprus also has to refinance €1.4bn of debt maturing over the next six months.

Full story at www.ft.com/europe
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LETTERS TO THE EDITOR: Fax: +44 20 7873 5938, letters.editor@ft.com

Losses mean all roads lead to default

Options

Debt exchanges, rollovers and buy-backs will all be treated similarly by rating agencies, says **David Oakley**

One thing is likely after this week's negotiations in Brussels: Greece will become the first western, developed-world country to default in more than 60 years.

Strategists expect all three main rating agencies to determine that Greece has defaulted, because bond holders will suffer losses whatever plan policymakers decide to adopt involving private creditors. The options are debt exchanges, rollovers or buy-backs.

Although all three rating agencies were not commenting on Thursday, strategists say Standard & Poor's is likely to put Greece on selective default, while Fitch will follow a similar route and put the country on restricted default, which is the same thing.

Strategists assume Moody's will announce that Athens is in default, even though the agency does not have a specific default rating.

The terms "selective" and "restrictive" default mean Greece as an issuer will default, but only some of its bonds will be downgraded. Bonds that are not affected by whatever private creditor plan is used will not be defaulted.

An issuer default would normally mean that the European Central Bank would not be able to accept Greek bonds as collateral for loans. That would bring the entire Greek banking system, which relies on the ECB to fund itself, to a standstill, presenting a serious threat of contagion to other banks and bond markets across the eurozone. That is why Jean-Claude Trichet, the ECB president, has for weeks rejected the idea of a short-term or selective default.

A cleaner works at the Athens stock exchange as eurozone leaders talk in Brussels Reuters

For this reason, with the default scenario likely, the ECB is expected to make Greece a special case and waive its rules that do not allow it to accept defaulted bonds as collateral.

Many strategists say a default may not have a big effect on the market, as Greece would only default on a temporary basis. Both Standard & Poor's and Fitch are likely to upgrade the country's rating back to triple C, a low junk-grade status, once the debt exchange, rollover or buy-back has been initiated to reflect a forward-looking view of Athens, with its reduced debt burden.

> The ECB is likely to waive rules that do not allow it to accept defaulted bonds as collateral

However, the euro fell sharply on Thursday after Jean-Claude Juncker, the head of the group of eurozone finance ministers, said Greece would suffer a selective default.

Underlining the difficulty in making predictions on market moves, Greek bonds rallied because of relief that policymakers appeared ready to take decisive action.

The other key point is that default is not the same thing as a credit event or a pay-out in credit default swaps, which insure investors against bond defaults. A credit event is not likely to be triggered, say most strategists.

This is because the International Swaps and Derivatives Association (Isda) is expected to rule that the action on Greece is voluntary and does not obligate all investors to take part. Even if a credit event were triggered, Isda says the overall pay-out would only be $5bn, which it says would have little effect on the market or the balance sheets of the banks.

EBRD warns

Escalation of the eurozone crisis would pose "serious risks" to the economic recovery in eastern Europe and could push parts of the region into a new downturn, the European Bank for Reconstruction and Development has warned, **writes Neil Buckley in London**.

On Friday the bank published growth forecasts for its 29-country region, prepared before Thursday's eurozone summit. The EBRD stuck to a base scenario that assumes an orderly resolution of the Greek debt crisis, and slightly raised its regional growth estimate to 4.8 per cent for this year, from the 4.6 per cent it forecast in May.

But the bank toughened its language on the impact of a failure to resolve the Greek crisis in an orderly way, compared with its previous forecasts.

The EBRD, International Monetary Fund and local authorities have been trying to build a "firewall" between "emerging" Europe and problems at the Greek banks.

Full story at www.ft.com/europe

Necessity of the political imperative weighs on ECB

Bank policy

By James Wilson in Frankfurt

With near certainty that the rescue package being agreed for Athens will involve some kind of selective default on Greek sovereign bonds, the apparent concession made by the European Central Bank – which had seemed to be steadfastly resisting such a move – deserves scrutiny.

In an interview only days ago, Jean-Claude Trichet, ECB president, was reminding Europe's political leaders that the bank was "warning . . . loud and clear" against taking a decision that could lead to a selective default.

That followed a string of demands that politicians should take the lead in solving the crisis and not expect the central bank to compromise its central mandate of price stability with further firefighting.

> 'The ECB wanted something that did not quickly turn into a restructuring for Greece'

But Mr Trichet also accepted this week that while the ECB had not changed its position, "we are in a domain where governments are responsible".

As at other times during the financial crisis when the ECB has broken with orthodoxy – such as when it started buying sovereign bonds on the grounds of avoiding disruption in secondary markets – Mr Trichet may again have accepted the political imperative of the move to help Greece. Gilles Moec, co-head of European economics at Deutsche Bank, said: "It seems the solutions put forward are going to mean selective default, but I think this is a solution that Trichet thinks he can sign up to."

The central bank's stance over selective default always seemed like a "bargaining chip", Mr Moec said.

"They didn't want to get into the situation they were put into after May 2010 [in the first Greek bail-out] when the money they started putting on the table made national governments complacent.

"The kind of deal that we seem to have today makes sense in terms of commitments from core countries, and it is a good deal for the ECB, probably better than we expected," he added.

Jörg Krämer, chief economist at Commerzbank, said he expected finance ministers to fulfil a key ECB demand by providing Greece with extra collateral for its banks.

"Mr Trichet was careful to build a bridge in the recent interview by in effect telling politicians they would have to make sure, in a case of default, that the Greek banks were given adequate collateral," Mr Kramer said.

"The argument at the ECB is not about selective default or not, it is about the bank not getting into a position where it has to do a job that should be done by fiscal policy. It wants to maintain a clear division of labour and avoid . . . supporting fiscal policy by in effect printing money, which is what financing Greek banks without adequate collateral would be."

Analysts at UniCredit agreed the ECB appeared to have back-pedalled on its "no selective default" threat on condition that any potential loss on Greek collateral would be borne by governments. "This seems a reasonable compromise," they said.

According to Mr Moec, "The ECB wanted something that did not quickly turn into a big restructuring for Greece and that gave some visibility as to how the other peripheral countries would be treated. This ticks a lot of boxes, whatever the deal is that is struck on collateral.

"Trichet is a statesmen and will do what it takes. If that means a U-turn, so be it."

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US looks to debt menu options

Congressional pay freeze considered

Repeal of new benefit likely

By James Politi in Washington

When the "Gang of Six" – a bipartisan group of senators – this week reached unexpected agreement on a $3,700bn package of fiscal reforms, it galvanised hopes that Congress and the White House could still strike a budget deal in time to avoid a default.

It also served as a reminder of the sweeping changes to government practices and programmes – from the way federal officials calculate inflation to the criteria they use to dole out unemployment benefits – that are being contemplated by lawmakers and the Obama administration as they seek to slash costs over the next decade.

Most in Washington do not think there is enough time – or sufficient political consensus – for the group's full plan to pass both chambers of Congress and be signed into law by August 2, the deadline set by the Treasury beyond which it will not be able to pay its bills.

But some elements of the group's proposals may well make their way into a narrower deficit reduction agreement that would be sufficient to increase the country's borrowing limit.

The most likely items that could quickly be included in a debt ceiling deal are $500bn in cuts identified for immediate implementation by the group. In that category are a freeze in congressional pay, the sale of unused federal property, and the repeal of a benefit included in last year's US healthcare reform that offered insurance for long-term medical care.

Also on the menu in the first round of cuts – suggesting there is relatively broad political backing for the move – is a transformation in the way the US government measures inflation, which some economists believe is currently overly generous. Starting next year, the US would move from basing its inflation estimates on the ordinary consumer price index to the chained CPI, which would slow cost of living adjustments on a range of government outlays by about 0.25 percentage points a year.

The regular CPI assumes that consumers buy the same things every month, so if the price of pork goes up then so does the cost of their shopping. But in reality, if the price of pork goes up but the price of beef does not, then some consumers will switch. The chained CPI tries to take account of that switching – and it tends to rise by less on average as a result.

The switch will not apply right away to recipients of social security – the US pension scheme – who would be exempt from the change for five years, meaning the bulk of the savings to the government would be accrued later in the decade.

Also on the list of immediate measures proposed by the group is a requirement that the Department of Labor and the Government Accountability Office, a federal watchdog, submit a report to Congress on ways to establish a more "effective" trigger for unemployment insurance.

At the moment, the states and the federal government share responsibility for paying out jobless benefits, according to a formula that allows recipients to receive more than 26 weeks of payments in states with high unemployment rates. Beyond the $500bn in initial savings, the Gang of Six plan offers a framework for the US to achieve the bulk of its deficit reduction target. Individual congressional committees would have six months to achieve savings from all corners of the federal budget, including reductions in Medicare, the health scheme for elderly US citizens. And the Senate finance committee would have to shepherd through an overhaul of the US tax code. This would reduce income tax rates, with the top bracket coming down from 35 per cent to 23-29 per cent.

Additional reporting by Robin Harding

Fortunes of growing middle classes hold the key to stability

GLOBAL INSIGHT

John Paul Rathbone in London

Where lies the world's biggest source of instability? For many, it is the "clash of civilisations", an idea popularised by Samuel Huntington, whereby people's cultural and religious identities will remain the main source of conflict in the post-cold war world. "The clash of civilisations will dominate global politics. The faultlines between civilisations will be the battle lines of the future," the political scientist wrote in 1993.

Certainly, al-Qaeda's terrorist attacks, the rise of China, and wars in Afghanistan and Iraq seem to confirm this vision. Yet, as Moisés Naím, the former editor of Foreign Policy Magazine, points out in a recent article, most recent conflicts have been *within* civilisations, rather than between them.

Islamist terrorists have killed more Muslims than non-Muslims. The same is true of the fight between Shia and Sunni. Likewise the homegrown revolutions that made up the Arab spring. Rather, the main source of future global conflict, Mr Naim suggests, will stem from a different source – the changing fortunes of the world's middle classes.

The observation rings true. In the developed world, the middle classes of Europe and the US are getting poorer and feeling cross about it. Result? In the US, the rise of the Tea Party – and the real possibility of a sovereign default; in Europe, angry protests in Spain, Greece and France over austerity measures – and the possible collapse of the eurozone.

In the developing world similar frustrations spring from a very different source, but with similar results. There, a new middle class has emerged in recent years in numbers that are quite mind-boggling. Taking the definition of middle class as anyone with an annual income over $6,000 but under $30,000, Goldman Sachs estimates that Brazil, Russia, India and China alone added 500m people to the global middle class during the past decade, and will add a further 800m by 2020. That is as much as the entire global population grew during the first decade of this century.

These new consumers do not yet enjoy the same standards of living as their richer world counterparts. Yet they are eating foods and buying clothes, medicines, electronic goods and new housing like they have never done before. Inevitably, that prosperity brings other aspirations too, especially better political representation and all manner of better public services. If the new middle classes of India, China and Brazil become frustrated, it will not be because they want more but because they want better.

Brazilians, for example, pay high, developed world tax rates but get lousy, developing world public services in return. The first shoots of the Arab spring arose from the frustrations that Tunisians felt about the regime of Zein al-Abidine Ben Ali – although Tunisia was the best managed economy in the region. Even Chileans have been getting upset.

Their country is often held up as one of the most economically successful, best managed and politically stable countries in the world. It also has a middle class that has continued to grow and prosper. And yet huge middle class street protests have become a recurring problem for the centre-right government of President Sebastián Piñera.

'Our leadership [is] being tested by citizens who are . . . demanding greater equality'

In June, as many as 100,000 students took to the streets to demand changes to the education system. It may not have been an Arab spring moment, yet it was still the largest street protest since Chile's transition to democracy in 1990 after the dictatorship of Augusto Pinochet.

In response, Mr Piñera set aside $4bn to improve education and reshuffled his cabinet. "Our institutions, our leadership, are being tested by citizens who are more empowered, who are demanding greater participation and, above all, greater equality," he said.

It is sometimes said that Mr Piñera, a billionaire former businessman, has a tin ear when it comes to politics. But here he was quite right. And it is increasingly true elsewhere in the world, too.

For the FT series The Squeezed Middle, go to www.ft.com/squeezed

Jobless claims rise to 418,000

By Shannon Bond in New York

More Americans filed for unemployment insurance last week as the US labour market continued to struggle amid widespread uncertainty over the stalling economy.

Initial claims for jobless benefits rose by 10,000 to 418,000 in the week ending July 16, the labour department said, higher than the 410,000 economists had expected. The tally included 1,750 jobs lost in Minnesota because of the state government shutdown. The four-week moving average of initial claims fell by 2,750 to 421,250.

"We are still waiting for this series to break 400,000 and make meaningful strides downward before we can truly say that the labour market is back on track," said David Semmens, US economist at Standard Chartered. "The most worrying thing is that it's showing an uninspiring start to hiring in the third quarter."

While many US companies are reporting strong second-quarter earnings this week, hiring is not likely to pick up until the productivity of existing workers begins to decline, Mr Semmens said.

In addition, "the distortions caused by the annual auto shutdowns at this time of year make it very hard to work out exactly what is happening", noted Ian Shepherdson, of High Frequency Economics. "The auto effect will fade over the next couple of weeks but, in the meantime, the claims numbers need to be viewed with scepticism."

Thursday's labour department report showed continuing claims for benefits fell 50,000 to 3.75m in the week ending July 9.

Final touchdown Shuttle programme comes to an end

The space shuttle Atlantis lands at the end of its final mission just before sunrise yesterday at the Kennedy Space Center, bringing to a close the 30-year US shuttle programme. The craft had been on a 13-day mission taking supplies to the International Space Station AP

Corporate investors revive backing for Peru

New appointments calm market fears

By Naomi Mapstone in Lima

Glencore, Telefónica and America Movil are riding a wave of renewed optimism over Peru's investment climate after the incoming president named a business-friendly cabinet.

Ollanta Humala, a nationalist former soldier, exceeded market expectations on Wednesday night when he appointed Luis Miguel Castilla, who was educated in the US, finance minister and Salomon Lerner, a millionaire businessman, prime minister.

Lima's general index opened strongly on the news, up 1.27 per cent, consolidating Monday's gains, when investors applauded Mr Humala's decision to retain Julio Velarde as chief of the central bank. The rally suggested equity investors had joined foreign exchange and bond markets in giving Mr Humala the benefit of the doubt.

"Let me work. This is a movie you haven't seen before," Mr Humala told the *Primera Noticias* television programme on Thursday. He stressed he wanted a calm monetary policy, greater transparency and social inclusion.

Peru's $153bn mining-heavy economy, one of the fastest-growing in the world, contracted sharply when Mr Humala won office last month.

The candidate shrugged off his associations with Hugo Chavez, the Venezuelan president, throughout the campaign and claimed to find his inspiration in the centre-left model of Luiz Inacio Lula da Silva, the former Brazilian leader.

Private investors remained sceptical of his transformation, however, with a business-confidence survey by Apoyo, a Lima pollster, showing 60 per cent of respondents thought Mr Humala was only pretending to be moderate.

Ismael Benavides, Peru's finance minister, estimates that $9bn, or 5-6 per cent of gross domestic product, of private investment, stalled when Mr Humala was elected. "We are talking about large mining, petroleum and petrochemicals that are waiting. But there is also stagnation in construction," he said.

'Let me work. This is a movie you have not seen before'
Ollanta Humala Incoming president

The economy, Mr Benavides said, is forecast to grow at 5.5 per cent to 6 per cent rather than the 7.5 per cent to 8 per cent forecast before Mr Humala was elected.

On Wednesday, Telefónica, already a market leader in Peru, announced it would invest $1.5bn over the next two years. "We are confident in the new government and we support economic growth with social inclusion," said Javier Manzanares, Peru president of the Spanish telecoms company.

The spending more than matches rival Claro's $1bn spending commitment, announced in June, before Mr Humala had named his cabinet. Claro is a unit of America Movil, the Mexican telecoms behemoth.

Glencore also announced this week it would spend $475m on a 70 per cent stake in Peru's Mina Justa copper project. The miner's investment is significant, as Mr Humala has said one of his priorities is to restructure mining taxes and royalties and secure a bigger cut of profits for the state.

The top zinc, copper, silver and gold producer has $42bn in mining investments in the pipeline, and Mr Humala said he wants a Chilean- or Australian-style tax regime that would not deter investment.

Blog: www.ft.com/bb

We need to talk about Kevin

Nigel Andrews
FILM

Horrible Bosses is a one-man show that other actors have been allowed, lucklessly for them, to crash. Crash they do. Like a Prospero luring uninvited guests to their doom, Kevin Spacey, in a supporting role he turns into a star turn, is the evil boss exercising smooth magic, rough justice and the gravity of some deadly planet drawing alien ships to catastrophe.

First question up: why isn't it funnier, this tale – pre-hyped as one of the Hollywood comedies of the season – of three ill-starred friends (Jason Bateman, Charlie Day, Jason Sudeikis) planning crossover murders of their bosses? A will kill B's employer; B C's; and so on. Think of *Strangers on a Train*: only don't think of it too hard, comparisons are odious. It isn't very funny, never mind thrilling, to watch Sudeikis glare daggers at his new company director, played by a barely recognisable Colin Farrell (three-second giggle for his balding wig plus comb-over). And a little goes a long way with the O-level comic chemistry between dental assistant Day and his sexually harassing boss Jennifer Aniston. How often can you laugh, before you start screaming, at repeated scenes of a female orthodontist trying to have sex with, on, around or under, a gassed-unconscious patient?

There is nothing for it but to "watch this Spacey". He swaggers on as a Mr Cool Master of the Universe, crisply horrible, supererogatorily smug and barely even needing to move his lips as he sculpts his nastinesses. "We've got to trim the fat. Fire all the fat people." Spacey does more with an eyebrow than Bateman-Day-Sudeikis can do with their combined physiognomies. He does more with a cadence than Aniston can do with a cataract of would-be comical *bel canto*. And he doesn't even need a Farrell comb-over. He just is Hollywood's lord of timing. He is playing *Richard III* on stage now in London, I am told. Hold my hat, I'm off.

In the silly season the first casualties are film critics. They lose their hold on reality. Their intelligences drift off into hyperspace accompanied by theremin music. Colleagues who voiced praise of **Beginners** had to be taken aside by me, after the screening, and told gently, as I rubbed their foreheads with an eau-de-cologne-impregnated towel: "This is not a good film. It just *seems* good, amid all the louder rubbish around, because it is quiet, whimsical and full of politically correct thinking."

Whimsical it remorselessly is. Ewan McGregor conducts a fey, irritating, meant-to-be-adorable romance with Mélanie *Inglourious Basterds* Laurent, in some fantasist's Los Angeles where the French New Wave has belatedly tsunami'd, leaving a debris of handheld camerawork and improvised-sounding dialogue. Christopher Plummer is McGregor's aged dad, a late gay comer-out living with an implausibly young Ganymede (*ER*'s Goran Visnjic). The latter tries to explain his father fixation with some fixer-upper sub-Freudian dialogue. The whole film is ghastly beyond words, while using words, unstoppably, to try to save itself. I didn't catch Mike Mills's first film, the praised-by-some *Thumbsucker*. But it has now dropped to the bottom of my desert island downloads wish list.

The advantage of a week such as this is that we can bury all the bad news at once. Even Pixar, the fantabulous Pixar (*Toy Story*, *Finding Nemo*, *The Incredibles*, *Up*), finally has – let's come out with it – a flop.

When will American movie sequels learn? The secret to extending the charm of a successful home-raised original such as the digimation feature *Cars* is not, repeat not, to take the characters around the world. *Sex and the City* went to Dubai and died. *Mission: Impossible 3* crashed in Australia. Long before either, the *National Lampoon* series lead-ballooned in Europe. But "Go east, young franchise" is still Hollywood's Horace Greeleyism.

Hence **Cars 2**: a mishmash of intercontinental tourist clichés and international intrigue as our funky car heroes, led by Tow Mater the tow truck and the Owen Wilson-voiced race car Lightning McQueen, chase a global Grand Prix season. Picture-postcard Paris: check. Picture-postcard Italy: check. The climax takes place in and around London's Big Ben and Buckingham Palace, with Vanessa Redgrave voicing a vehicular version of HM the Queen.

As a spin-off, the film spins off early and straight into the crowd. Writer-director John Lasseter, *Cars* saga creator, compounds catastrophe by adding a spy story. Michael Caine, as chief agent, voicemails in a performance of flat, jaded Caine-isms. Eddie Izzard does his doomed best as the automotive baddy, a sort of Bernie-Ecclestone-gone-Svengali.

The French thriller **The Big Picture** (*L'Homme qui voulait vivre sa vie*) also goes around the world. The story, from a Douglas Kennedy novel, offers itself as a kind of new-generation *The Talented Mr Ripley*. But Ripley creator Patricia Highsmith knew her Europe: she revelled with dark, caustic expertise in its un-Americanness. This movie guides crime-of-passion killer Romain Duris, fleeing family and justice, to Italy preceded by Montenegro, spinning behind him the Ariadne thread of a plot that comes unravelled like a sweater snagged on barbed wire.

Catherine Deneuve performs the Michael *Cars 2* Caine function, barely phoning in her performance as Duris's dying work boss, a character with no discernible plot utility. Niels Arestrup, late of *Un Prophète*, contributes a slyly rumbustious late cameo that almost saves the day. But by then, in plot terms, it's already dusk.

Never mind. Next week promises better. And the good thing about a silly season is that it only lasts a season.

Horrible Bosses
★★★☆☆
Seth Gordon

Beginner
★☆☆☆☆
Mike Mills

Cars 2
★☆☆☆☆
John Lasseter, Brad Lewis

The Big Picture
★★☆☆☆
Eric Lartigau

Nasty business: Kevin Spacey in 'Horrible Bosses'; below, the line-up in 'Cars 2'
John P. Johnson Disney/Pixar

WEEKEND ARTS
Ahead of his first ever appearance at the Edinburgh Festival, composer Philip Glass talks about the movie that changed his life in tomorrow's Life & Arts section

THEATRE
Loyalty
Hampstead Theatre, London
★★★☆☆
Sarah Hemming

Centre stage for Edward Hall's production of Sarah Helm's new play is a double bed. And on that double bed is a pile of ministerial red boxes. It is a telling image: symbolic of the conflicting loyalties in the play. Helm is married to Jonathan Powell, who was Tony Blair's chief of staff during the Iraq war. Her debut play is a fictionalised account of that period and its impact on their personal life. The closer the war gets, the more red boxes pile up on the bed.

Here the couple at the centre become Laura and Nick, though the other characters – Tony, George, Kofi, Alastair – retain their real names. Laura tells us that when Tony became prime minister "he just arrived in our lives": that was strain enough. But we watch the tensions mount as the war rolls over the horizon, Laura passionately opposed and aghast at the increasingly frantic justifications for invasion.

It is a fascinating subject and yet here it makes curiously stiff drama. Here we are, eavesdropping on the build-up to one of the most controversial episodes in recent British history, and yet it is not that gripping and several conversations feel surprisingly stilted. It is not helped by the fact that we are never quite sure what is true and what isn't. And though Laura is right about the elusive weapons of mass destruction, this has the unhelpful effect of making her seem rather smug as a character, despite being played with vivid intelligence by the superb Maxine Peake.

But the play does give a witty impression of how it feels when crucial affairs of state crash into your bedroom. Helm has a great eye for detail and the minutiae of domestic chaos: Nick struggling with a broken washer in the bathroom as Bush comes on the line; the au pair covering the attorney-general's report in icing sugar. The play is peppered too with nuggets of information: Tony will only play tennis with his coach, for example. And it raises questions about the strained loyalties in any relationship in which one partner has an all-absorbing job.

Peake holds the stage with her warmth and Lloyd Owen makes an attractive, conflicted Nick. Patrick Baladi, meanwhile, is hugely enjoyable as Tony. But, for all its intrigue and promise, the play never quite catches fire.

www.hampsteadtheatre.co.uk

Journey to the city of the future

Against the odds, Foster & Partners has created a zero-carbon metropolis in the Abu Dhabi desert, writes **Edwin Heathcote**

There is a creaky old joke about a driver who stops a farmer to ask directions to Balbriggan. The farmer thinks about it and says: "If I was going to Balbriggan, I wouldn't start from here." I couldn't help thinking about that punchline when I first visited the site of Masdar, the new zero-carbon eco-city in Abu Dhabi. The sun shines fiercely, the desert continuously fights to take every site back into its sandy clutches and there is no access to the site other than by car (or aircraft – it is right next to the international airport).

I wasn't alone with my doubts. Masdar faced a whispering wall of sniping. Its loudly trumpeted personal transit system of 1,300 vehicles has only reached 10 so far, the podium on which the city was to sit (and which was to house the transport system) was severely reduced in size and progress has been slowed hugely by the credit crunch, by the collapse in confidence and by an oversupply of commercial property.

But, on my return to the site, now built up as a strange new metropolis in the middle of the harsh, sandy hinterland of the industrial edge of the city, I couldn't help but revise my opinion. The architects, Foster & Partners, have, against the odds, created a small piece of real city. The streets are tight and shady, students sit languidly outside a café despite the fierce midday sun, the architecture is delicate and diverse, adopting local archetypes, pierced screens and timber gates, while water trickles away in the background. It is, unlike most of the rest of the city's outdoor space, pleasant.

The completed section of Masdar sits on a podium, a bit like a child's toy wooden fort, surrounded by sandy scrub. That lower layer was to have housed all the city's services as well as its "Personal Rapid Transport" vehicles, little electric cars that whizz silently about underground to the destination you have tapped into a touchscreen. It all feels very space age. Cars – the gas-guzzlers you have no option but to take on the 17km journey from the city centre – are left outside the city. Once deposited by your oddly symmetrical vehicle you are confronted with a spiral staircase – possibly the first set of stairs you will have seen in the whole of this country where escalators and elevators are ubiquitous. It is part of an attempt to reintroduce the tropes of traditional city movement to a culture that is barely urban in the terms we in the old world expect. It is an exquisitely sculptural stair, a piece of pure early modernist iconography, and it sits in a grand, shady subterranean hall lit by bright shafts of sunlight from porthole-shaped openings above. Half-Kubrick, half-Washington DC Metro, it is a vision of a semi-sci-fi future that never quite arrived.

> The streets are tight and shady, students sit languidly outside a café, the architecture is delicate and diverse

The stairs deposit you at an interior node that reveals glimpses of the heart of the city, the Masdar Institute, a joint venture with the US university to establish a centre for radical research into alternative energy and a post-oil future. Beyond are the undulating, terracotta facades of the student accommodation, segregated by sex and made intimate by intricately pierced walls inspired by traditional Arab mashrabiya screens. At street level, there are a few small shops, planting and the constant, welcome shade. The pavements are exquisite, a tessellation of Islamic motifs cast in concrete that create a seemingly endless variety of pattern – stars, octagons, diamonds. A more extravagant structure beyond, with a characteristically shell-like roof, is less successful, an unwelcome intrusion of iconism to a scheme that had avoided it so well. The city's central monument, a cooling tower that draws hot air up from the square below while sprinkling a mist of cooling water at ground level, suffers from the same angst about creating icons and markers.

Work may have slowed but it is continuing. Masdar certainly seems a long way from the home to the planned 50,000 residents but it is smoothly efficient and genuinely impressive.

It has been condemned as a gated city, though in fact it is accessible to all 24 hours a day. "Walled city" is closer to the mark, in part to defend against the encroaching desert, the abrasive sand and wind. But you can only get there by car, which, until the light rail arrives (20 years is the current estimate), is obviously a profound failure.

It has also been criticised on social grounds as the plaything of a wealthy international elite. Certainly it has no "labour camps" for the inevitable subcontinental workers, but housing here is intended to be mixed. Whether it turns into a diverse city has yet to be seen. It does, however, have an undeniable problem of context: if this development had been attempted in the heart of Abu Dhabi, proximity to business and infrastructure would have made it more commercially viable.

It is also jarring to see that the wider context for a sustainable city experiment is the nearby Ferrari World and the new Yas F1 race circuit. There is a gas-guzzling, aircon-blasting mainstream that can make these experiments look laughably insignificant. But that does not mean we should not take this seriously.

Masdar could represent a pivotal moment in architecture, in energy, academia and urbanism. It is an extraordinary beginning. Even if it is starting from the wrong place.

Endless variety: intricate walls and solar panels at Masdar Institute Bloomberg

THE LEX COLUMN

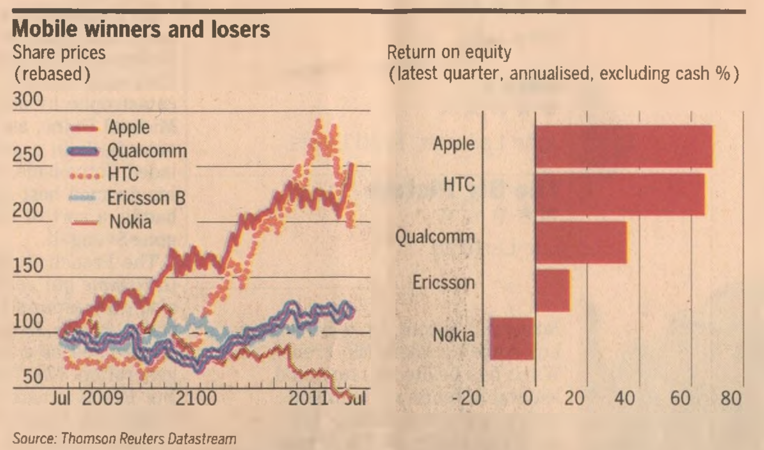
Friday July 22 2011

Phone for help

The mobile phone business is still very healthy. As a crude indicator, imagine a combination of five big players: smartphone leaders Apple, HTC and Nokia, along with chipmaker Qualcomm and Ericsson, the infrastructure leader. The revenues of this hypothetical giant were 60 per cent higher in the most recent quarter than a year earlier, and the return on equity from operations – excluding the effect of the remarkable $58bn net cash position – was a hearty 40 per cent.

Such numbers fit with the industry's characteristics. It has rapid growth: handset sales increased 32 per cent globally in 2010 and Ericsson projects 40 per cent annual growth in the number of mobile broadband users over the next four years. It also has compelling innovation: smartphones cost at least three times as much as the units they replace.

Still, the high tide is not lifting all ships. On the contrary, it has an undertow that threatens to pull Nokia down. The Finnish company reported a loss in the second quarter and sold 31 per cent fewer smartphones than in the previous one. The share price has been cut in half in two years. Ericsson is far



Source: Thomson Reuters Datastream

from drowning but its second-quarter results looked like they had come from a fairly mature industrial in a cyclical upturn: revenues up 14 per cent, a 9 per cent operating profit margin and an annualised cash-adjusted ROE of 14 per cent. The struggle is not new: the share price, which dropped 10 per cent on Thursday on the results, is up only 6 per cent in two years.

Why do corporate fortunes vary so greatly? With technology changing so fast, a leading position can quickly become a drag. And when price competition is lively, as it is in Ericsson's hardware and services businesses, it is hard to earn a tremendous return on the big investments required in research and development.

Eventually the mobile industry will settle down. But not for a while yet. The next few years are likely to be much like the last few, just a little more so.

Eurozone

So that is what markets going into reverse sound like. A draft eurozone communiqué circulating ahead of the conclusion of the "summit to save the euro" prompted yields on Italian and Spanish debt to snap back, while German Bund yields widened. The draft text may have been all about Greece, Ireland and Portugal but the message was for Italy and Spain. The euro survives, until the next summit.

The summiteers appear to realise that a solution to the sovereign debt crisis has been staring them in the face all along: the European financial stability facility. The draft suggests that this body's scope and financial firepower are to be greatly expanded. As a start, the cost of its lending to Greece, Ireland and Portugal would be cut to 3.5 per cent, and maturities doubled to 15 years. That concrete act would have immediate benefits for those three countries – and have lasting effects on the eurozone's fiscal cohesion.

All of this would be positive if confirmed. Yet the market reaction still looks a little extreme. The FTSE-Eurofirst 300 eurozone banks index has risen by 14 per cent in three days. Yields on Greek two-year bonds were 6.3 percentage points tighter at the close on Thursday than at the open. The Italian 10-year yield has fallen to below 5.4 per cent, from 6 per cent (still uncomfortably above the 5 per cent level). But then, the communiqué is an invitation to buy Italian and Spanish bonds. Talk about moral hazard.

The sticking point is private sector involvement, which remains vague to the point of distraction. The "financial sector" (all of it?) has shown its "willingness to support Greece on a voluntary basis" at rates "comparable to public support with credit enhancement". That sounds like bribery, or even quantitative easing. But, as governments are now committed to keeping the euro alive, it would be perilous for investors to bet against them.

Nestlé and Syngenta

Commodity and food price inflation sits on top of many a chief executive's agenda – both hedging against it and, ideally, profiting from it. For companies on the scale of Nestlé, one of the world's largest buyers of agricultural products, risk might also be limited by acquisitions. Buying farms goes far beyond the expertise of food makers but acquiring companies that sell to farmers might be worth considering.

One interesting target might be Syngenta, the Swiss provider of seeds and crop-protection products, which will publish results on Friday. Both companies deal with farmers. Syngenta sells them chemicals and seeds; Nestlé buys their produce. A corporate combination would give Nestlé greater influence over the quality and types of crops produced. And, as food prices rise, Syngenta would provide a hedge as demand for its yield-enhancing products would grow in turn – the company expects sales related to its seven key crops to double by 2015.

Nestlé could finance such a deal. Syngenta's SFr26bn market value plus a 20 per cent takeover premium gives an acquisition price of about SFr31bn. To fund this, Nestlé could, in 2014, sell its superfluous 30 per cent stake in L'Oréal, the French beauty product maker – currently worth about SFr18bn. Additionally, Nestlé, which has almost no net debt (Syngenta has SFr3.1bn). has plans to increase its borrowings by perhaps SFr15bn over the next few years. Taken together, it has room to spare.

As both are based in Switzerland, there would be no nationalistic opposition. And, as they do not compete, antitrust hurdles should be low. There is no reason to believe that any such deal is in the pipeline. But the thought experiment shows that, properly executed,such "value chain" acquisitions could help chief executives look outside their company, as well as within, to deal with commodity market shocks.

Unnaturally disastrous

It is disastrous but not yet tragic. The global insurance industry remains resilient after enduring a half-year that was costlier than its worst full year. Led by the Japanese earthquake and tsunami and supplemented by tornadoes in the US and New Zealand's quake, economic and insured losses so far are estimated by Munich Re to have been $265bn and $60bn, respectively.

Unfortunately, the second half carries more risk due to the Atlantic hurricane season, which runs from June until November and peaks in about seven weeks' time. The widely watched annual forecast from Colorado State University sees 16 named Atlantic storms this year, down from 19 last year, though still above average. Of course, the key variable is how many of these make landfall. Last year saw the second highest number of hurricanes on record but a piddling $500m in losses after all the major storms died at sea. This year, CSU says the odds of at least one major storm making landfall are a disconcerting 72 per cent, well above average.

Fitch Ratings reported in May that a hurricane causing big losses could strain some companies' capital positions. US insurers might be particularly exposed after the freakish weather in the spring. Travelers, which stayed in the black even through the year hurricane Katrina hit, just registered its first quarterly loss in seven years. Allstate said it lost more in April and May than in all of 2010.

But, believe it or not, many in the industry are upbeat. Capital strains could transform the current "soft" market into a "hard" one, allowing anaemic premiums to rise. That is something that natural disasters since the annus horribilis of 2005 and even man-made ones, such as the financial crisis, have failed to do.

It seems that every cloud, even those that are funnel-shaped, has a silver lining.

AstraZeneca and Roche

Defying the accepted logic of the market is fraught with danger but sometimes it can pay off. Take AstraZeneca and Roche, two of Europe's largest healthcare companies. Both focus on developing drugs – a strategy at odds with healthcare investors, who generally pay a premium for shares in companies that diversify into other areas. Yet both companies can justify their one-track strategy.

AstraZeneca's big bet has come off. On Wednesday, the US Food and Drug Administration's approval of its blood-thinning drug Brilinta allowed the drug to be classed as superior to one current medication, Plavix, for several applications. In the acute coronary syndrome market, which Brilinta will now target, Plavix currently generates about $4bn in the US, says UBS. Although some type of approval was expected, the news sent AstraZeneca's shares up 3 per cent and added £1.2bn to the company's market capitalisation.

Roche, meanwhile, has been on the other end of an FDA decision – which, with currency movements, contributed to Thursday's 4 per cent drop in first-half earnings per share. Its cancer treatment Avastin was Roche's top-selling drug last year, generating SFr6.5bn – almost 15 per cent of the company's sales. An FDA review this year caused an 8 per cent sales drop, compared with 14 per cent growth last year. Now that the drug's usage has been officially curtailed, second-half revenues will almost certainly fall further.

But Roche's pipeline of new drugs has convinced investors to continue to value the company at about 11 times next year's earnings – much the same as GlaxoSmithKline and Novartis, which are more diversified. Roche claims that all seven of its drugs in late-stage trials during the first half had positive results. Specialisation can be an all-or-nothing bet but, for those brave enough, the rewards are plenty.

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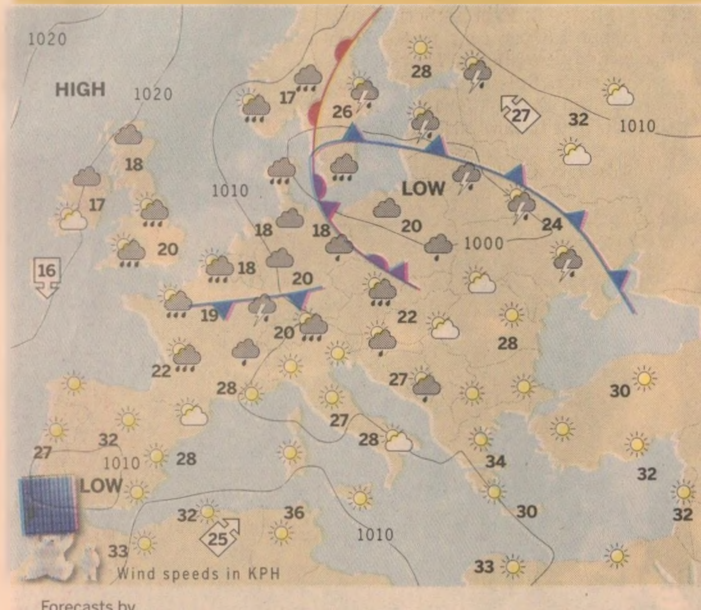
WEATHER



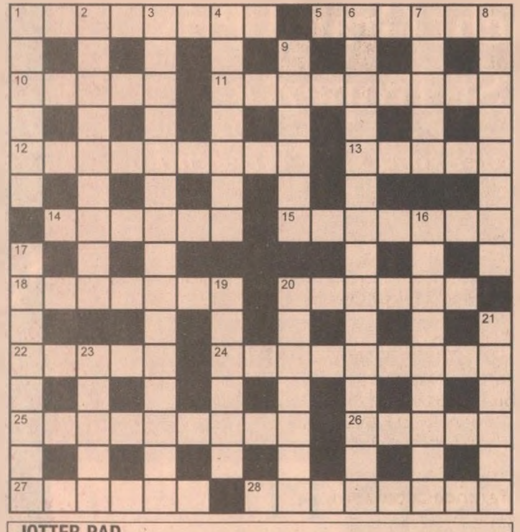
Forecasts by MeteoGroup · Warm front · Cold front · Occluded front · Wind speed in KPH

Today's temperatures — Maximum for day °C

City	Weather	°C	City	Weather	°C
Abu Dhabi	Sun	43	Malta	Sun	31
Amsterdam	Fair	18	Manila	Shower	31
Ankara	Sun	30	Miami	Cloudy	32
Athens	Sun	34	Milan	Sun	29
Bahrain	Sun	40	Montreal	Sun	32
Barcelona	Fair	25	Moscow	Cloudy	32
Beijing	Cloudy	31	Mumbai	Thunder	30
Belfast	Fair	16	Munich	Shower	18
Belgrade	Fair	25	Naples	Fair	28
Berlin	Rain	18	New York	Sun	40
Brussels	Drizzle	18	Nice	Sun	25
Budapest	Fair	22	Nicosia	Sun	35
Cairo	Sun	35	Oslo	Rain	17
Cardiff	Shower	18	Paris	Shower	19
Chicago	Thunder	32	Prague	Fair	19
Cologne	Cloudy	18	Reykjavik	Drizzle	15
Copenhagen	Rain	19	Riga	Shower	28
Delhi	Rain	34	Rio	Cloudy	24
Dubai	Sun	40	Rome	Sun	27
Dublin	Cloudy	17	San Francisco	Sun	23
Edinburgh	Fair	17	Singapore	Thunder	31
Frankfurt	Cloudy	20	Stockholm	Thunder	26
Geneva	Cloudy	21	Strasbourg	Shower	19
Hamburg	Cloudy	17	Sydney	Rain	15
Helsinki	Sun	28	Tokyo	Sun	25
Hong Kong	Fair	31	Toronto	Sun	34
Istanbul	Sun	31	Vancouver	Fair	19
Lisbon	Sun	27	Vienna	Shower	21
London	Fair	20	Warsaw	Cloudy	20
Los Angeles	Fair	24	Washington	Fair	37
Luxembourg	Rain	17	Zagreb	Sun	25
Madrid	Sun	32	Zurich	Shower	20

CROSSWORD

No. 13,752 Set by LOROSO

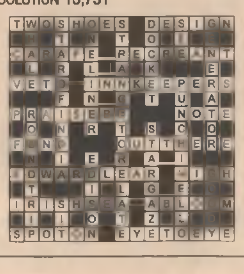


JOTTER PAD

ACROSS
1 Private place, in time, is moderate (8)
5 Mineral paste to stop spot returning (6)
10 Coaster from Australia brought back some bread (5)
11 Moving up, our star over the moon (9)
12 Funny tingles in all ears (9)
13 They appear regularly excited (5)
14 Roman statesman's restricted by new printer (6)
15 Bird has to visit a business (7)
18 Heads off old-timers confused in heat of battle? (3,4)
20 Military bosses against one of the latest gadgets (3,3)
22 Complaint from group at university (5)
24 Divide then bind together an element (9)
25 Bullied man kissed tip of proboscis (9)
26 Information from bible is old (5)
27 Indiscreetly loses every other shade? (6)
28 Worked to hold 8 in? (8)

DOWN
1 Storage unit's opened correctly, but not intelligently (6)
2 Strong breeze around that's turbulent weather (9)
3 Claim of 17 28 yet this worried us (8,2,5)
4 Act against what monarch has heard (7)
6 19 3? (3,8,4)
7 Exclusive small grocery store (5)
8 Mouth's capacity to expand (8)
9 Energy contained by double plug (6)
16 A sport's significance for defender (9)
17 Love to support immodest socialist (8)
19 Actor officially getting recognition? (6)
20 Male rock band not quite game for musical (7)
21 Better than that which fills sack (6)
23 Sort of boom that's very good if base is removed (5)

SOLUTION 13,751



Investors eye US Treasuries amid downgrade threat

News analysis

But any move by agencies would hit lower-rated assets and other countries hard, say **Michael Mackenzie** and **Richard Milne**

The US stands apart as having both the world's reserve currency and the paramount government bond market that serves as the "risk-free" rate for global assets.

But this coveted status is under intense scrutiny, with Standard & Poor's warning that there is "at least" a one-in-two chance it could downgrade the US's triple A credit rating, even if the $14,300bn debt ceiling is raised before next month's deadline.

A downgrade would be momentous. It would mean the global risk-free rate, used to price billions of dollars of assets worldwide from government to corporate debt, would no longer look quite so risk-free.

But while some investors fear a downgrade of the US to, say, a double A rating, could spark turmoil for US equities and bonds, they argue that a default, due to the debt ceiling not being raised next month, would be technical in nature and the effects most probably temporary.

Over the past week, dollar assets such as equities, Treasury bonds and corporate and mortgage securities have sold off and rallied as the prospects of a grand fiscal plan in Washington that would significantly address long-term spending as a part of a deal to raise the debt ceiling, has ebbed and flowed.

The real danger, however, is that lower-rated assets and other countries would be hit harder as markets will still require a benchmark, and, even after a downgrade, this is likely to remain US Treasuries and the dollar.

"They are so embedded in the fabric of the capital markets that even if there is one downgrade, it wouldn't matter," says Gary Jenkins, head of fixed income at Evolution Securities.

With the eurozone engulfed in a debt crisis and emerging market economies, such as China, years away from becoming legitimate global financial entities, investors insist there is really no alternative to the US at the present time.

"A downgrade for the US would mean the new triple A is double A," says Jim Paulsen, chief investment strategist at Wells Capital Management. "The US is the benchmark for other assets, and a downgrade would hurt other countries more than the US, in my view."

Market watchers predict attention would initially focus on the dollar and the Treasury market, before switching to riskier assets such as lower rated bonds and equities.

So far this week, the yield on the 30-year bond, which is the barometer of the long-term fiscal outlook, has made a round trip from 4.34 per cent down to 4.18 per cent, and back at 4.32 per cent on Thursday.

"The price action of the past few days indicates that the long end of the Treasury market will get hit on a downgrade," says Richard Tang, head of fixed income, equity and FX sales at RBS Securities.

"All dollar assets would perform poorly after a sovereign downgrade, but there is a circuit breaker in the form of the US Treasury market," says Mr Tang. "Although risk assets would get hit, money ultimately would flow back to US Treasuries as they are a very liquid asset."

Japan may be a prescient example. Between 1998 and 2002, for example, Japan was downgraded as its debt load mounted, only for its sovereign yields to fall as investors sought havens as the economy faltered.

"Ultimately the performance of the economy and outlook for inflation and monetary policy has a greater bearing on the Treasury market," says Mr Tang.

A main difference between Japan and the US, however, is that much of Japan's debt is held domestically, whereas just under half of outstanding Treasury debt is held by foreign investors.

"If US lawmakers fail to get a grip on the public finances, the US is comparatively more vulnerable than Japan to a shift in the risk appetite of overseas investors," says John Higgins, senior markets economist at Capital Economics. "Nonetheless, it is not in the interests of the biggest of those investors, China, to liquidate her holdings."

Fidelio Tata, head of US interest rate strategy at Société Générale, says: "There is no immediate prospect of an alternative, and China will keep buying Treasuries. Big central banks are price insensitive buyers."

Ultimately, however, few are willing to assert with any certainty what will happen. Investors have learnt from the rolling series of crises in the past four years that there is a strong law of unintended consequences.

"These remain unique and dangerous times," says Jim Reid, credit strategist at Deutsche Bank. "If all financial assets are a pyramid, the most risky assets are a small part at the top supported by the huge base at the bottom that is the world's major government bond markets. Without the base, the financial system runs the risk of collapsing."

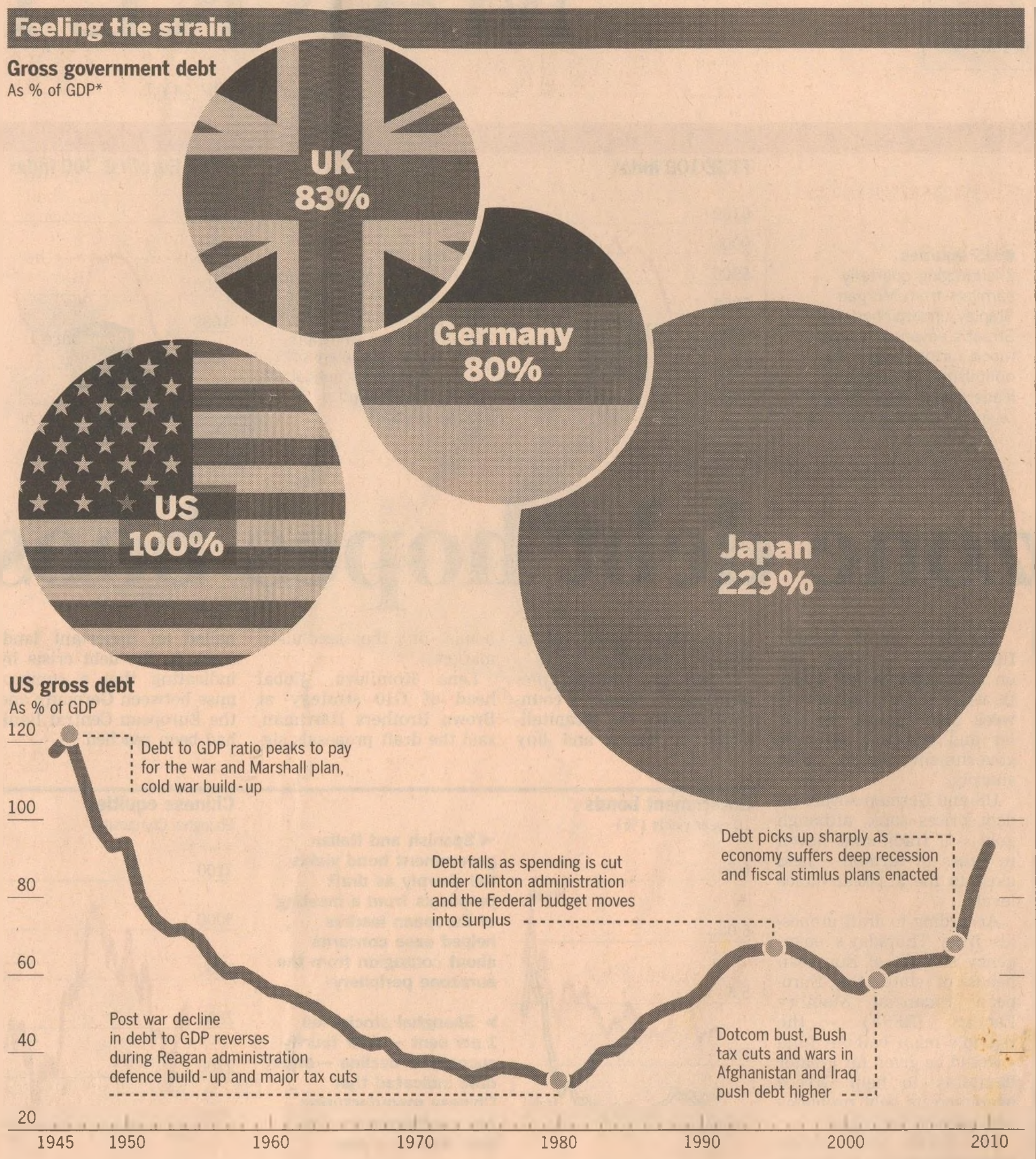
> Markets require a benchmark, and this is likely to remain Treasuries and the dollar

Ripple effect

A downgrade of the US would ripple through the financial system.

Standard & Poor's on Thursday said it would downgrade Fannie Mae, Freddie Mac, the Federal Home Loan Banks, and the Federal Farm Credit System Banks to correspond with the US sovereign rating. S&P would also lower the ratings on triple A rated US insurance groups.

Moody's has placed 7,000 ratings, or $130bn of municipal bonds, and the triple A rating of five states on review for downgrade.



Sources: IMF; Haver Analytics

* 2011 forecasts

Trading post
Jamie Chisholm

As China's economy develops and becomes an ever greater force in determining global activity, traders may be tempted to extrapolate from the country's stock market performance for investment ideas elsewhere.

Good luck with that! The Shanghai Composite seems to revel in its determinedly maverick bent.

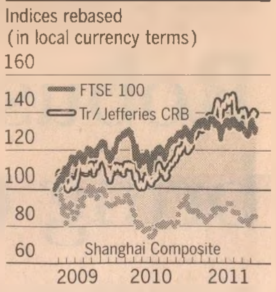
Thursday's 1 per cent fall following a softer-than-expected manufacturing survey was one of those fairly rare occasions when the benchmark tracked the broader mood.

Even then it is just as likely Chinese punters were reacting to reports of further restrictions on the property market as Beijing continues to try to damp speculative investment to cool inflation.

No, if traders want a play on the market's view of the Chinese economy, they may be better off plumping for the FTSE 100 in London, replete as it is with global miners and energy groups.

The UK's benchmark is famously not a very good gauge of the UK economy (the second-tier FTSE 250 is better for that) but it closely follows the Reuters/Jefferies CRB basket of commodities, which in turn is a slave to investors' views of Chinese raw material demand.

jamie.chisholm@ft.com
Rolling global overview at: www.ft.com/markets



Source: Thomson Reuters Datastream

Spain hit by punitive borrowing costs in €2.6bn bond auction

By Miles Johnson

Spain has again been forced to pay punitive borrowing costs in a €2.6bn long-term debt auction that led to the eurozone's fourth-largest economy selling debt at interest rates not seen since 1997.

An auction of 10- and 15-year bonds seen as a delicate test of investor sentiment amid negotiations over the fate of Greece was met with solid investor demand, in spite of the Spanish government paying a higher rate to borrow than the last equivalent auction in May.

Spain sold €1.8bn of benchmark 10-year bonds at an average yield of 5.90 per cent, up from 5.40 per cent at the last sale. The rise was a reflection of the amplified anxiety seen over the past month after Italy became the largest indebted European country so far to be dragged into the market's spotlight.

The €814m of 15-year bonds also sold at a costlier yield of 6.19 per cent against a previous rate of 6.03 per cent last month, with the total amount raised by both sales coming in just above an already low minimum target of €1.75bn set by the Spanish treasury.

But buoyed by market sentiment over a possible further bail-out for Greece, Spanish 10-year yields fell in the secondary market, hitting 5.74 per cent, their lowest in two weeks.

The premium paid by Spain over Germany fell to 2.9 percentage points.

Analysts also noted that although Spain's interest costs had been forced higher with every auction, the yield on its benchmark 10-year bonds remained below the 6 per cent level, seen by some as a threshold that has eventually forced other eurozone members into bail-outs.

The bid-to-cover ratio for 10-year debt, which weighs investor demand for bonds against the total amount being sold, came in at 1.9 times – higher than the 1.8 times subscription the last time similar debt was sold. For the 15-year maturity there was about double the demand for the amount on sale, down from a level of 2.6 last month

Thursday's debt sale followed an auction of shorter term Spanish debt on Tuesday, in which the country's borrowing costs surged by more than a percentage point in an auction for 12-month bills.

> A sale of 10- and 15-year notes seen as a delicate test of investor sentiment met solid demand

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Precious metals: can gold keep up the momentum?
Talking Point

Nervous investors have pushed gold to a record high above $1,600 this week as turmoil elsewhere in the markets triggered a flight to safety. But can the precious metal maintain its momentum – and if so, how high could it go?

Nick Moore, head of commodity strategy at RBS, says gold's dual nature, being perceived as both a haven and a hedge against inflation, has been instrumental in the recent price rally. "The former attribute has seen strong purchases emerge as mounting sovereign debt concerns have fuelled a rise in risk aversion," he says. "The latter attribute has meant that recent indications that further monetary easing in the US is possible have been positive for gold.

"These drivers are unlikely to evaporate in the near term, so further price gains from current levels cannot be ruled out.

"Nevertheless, we note that on a medium- to long-term horizon, both gold and silver look richly priced and are likely to underperform industrial commodities.

"Silver at $40 an ounce seems particularly expensive, given its troublesome supply-demand fundamentals and attractive margins enjoyed by primary silver producers at the moment."

Eugen Weinberg, head of commodity research at Commerzbank, says he is optimistic on a long-term basis but cautions that a boom is not a one-way street.

Noting the sharp decline in both silver and gold prices this week, shortly after gold hit its high, he says: "We think the recent optimism on gold and silver has been excessive.

"Nevertheless, we are heartened by the increasing popularity of silver exchange-traded funds. For example, the largest silver ETF, iShares Silver Trust, registered 191 tonnes of inflows on Tuesday alone. ETF holders often prove to be long-term oriented investors.

"In the medium to long term, support for gold and silver will come from production problems, which are currently curbing the expansion of supply, in addition to the persisting sovereign debt issue.

"In South Africa, for example, pay negotiations between the National Union of Mineworkers and gold mine operators have been interrupted without result."

Julian Jessop at Capital Economics makes the point that gold's lack of any income stream makes it notoriously hard to value.

"One approach," he says, "is to compare the price of gold to that of other assets.

"For example, the ratio of the price of an ounce of gold to a barrel of Brent oil is currently 13.5, below the average since 1970 of around 16. Applying that average now suggests a target for gold of $1,870. By contrast, gold is slightly expensive relative to its long-run average against equities.

"Our own long-standing forecast is that gold will climb to $2,000 by 2012 – although we would not be surprised to see prices reach this level sooner and then rise significantly further.

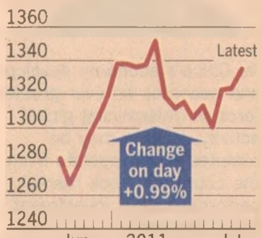
"A severe deterioration in the eurozone sovereign debt crisis – for example, if investors seriously thought that there was a good chance that the euro itself would not survive – could easily see prices surge well above $2,000."

MARKETS

Friday July 22 2011

Markets update

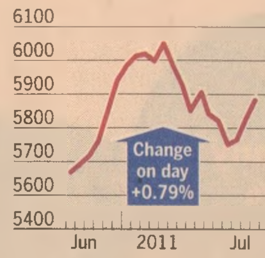
S&P 500 index



● **US equities** Encouraging quarterly earnings from Morgan Stanley underpinned Wall Street's advance, with the mood further helped by optimism that eurozone leaders were addressing the region's sovereign debt crisis

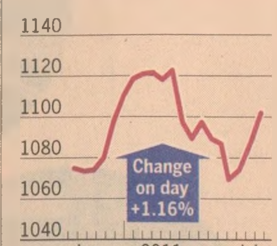
Source: Thomson Reuters Datastream

FTSE 100 index



● **UK equities** The FTSE 100 advanced for a third straight day as the banking sector continued to rebound from a two-year low struck at the start of the week. Pharmaceutical stocks also enjoyed a positive session

FTSE Eurofirst 300 index



● **European equities** Banks led the way higher as the sector climbed another 4 per cent as worries over the eurozone sovereign debt crisis eased. The gains helped drive the Eurofirst 300 to its best close for nearly two weeks

Nikkei 225 Average
'000

● **Asian equities** The Nikkei held steady as gains for banks were offset by losses for leading exporters as the yen stayed strong. Seoul fell 0.5 per cent as sentiment was undermined by weak shipbuilding stocks

Markets updated at www.ft.com/markets

Eurozone debt hopes boost risk appetite

GLOBAL OVERVIEW

Equities and euro enjoy big gains

Treasury and Bund yields climb

By Dave Shellock

Optimism that eurozone leaders were finally grasping the nettle with regard to the region's sovereign debt crisis helped send risk assets soaring and further encouraging results from the US banking sector added to the positive mood.

"Indications that EU leaders are coalescing around the private sector bail-in option for Greece could mark a turning point in the 15 month-old crisis," said Nicholas Spiro, of Spiro Sovereign Strategy.

Equities – most notably financials – shot up on both sides of the Atlantic while the euro hit a two-week high against the dollar and non-core eurozone government bonds rose sharply.

US and German sovereign debt prices sank, although gold – a traditional haven in times of turmoil – held close to the $1,600-an-ounce level.

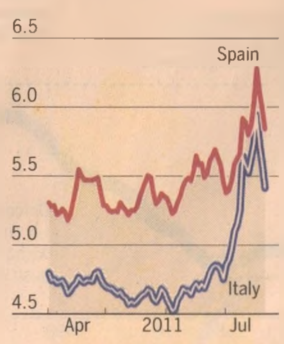
According to draft proposals from Thursday's emergency summit of European heads of state, the European Financial Stability Facility (EFSF) – the region's main bail-out fund – would be given far greater flexibility to help Greece overcome its debt problems and prevent contagion.

The EFSF will provide loans to Greece – as well as Ireland and Portugal – at lower interest rates and for longer maturities.

It will also provide "precautionary" loans to countries, finance the recapitalisation of banks and buy bonds on the secondary market.

Lena Komileva, global head of G10 strategy at Brown Brothers Harriman, said the draft proposals signalled an important landmark in the debt crisis by indicating that a compromise between Germany and the European Central Bank had been reached.

Government bonds
10-year yields (%)



Source: Thomson Reuters Datastream

◄ **Spanish and Italian government bond yields fell sharply as draft proposals from a meeting of European leaders helped ease concerns about contagion from the eurozone periphery**

► **Shanghai stocks fell 1 per cent – their fourth successive decline – after data indicated that Chinese manufacturing had contracted for the first time in a year**

Chinese equities
Shanghai Composite

"The ECB has agreed to a selective default for Greece that allows for a Greek debt restructuring with private sector involvement," she said. "Germany has agreed that the EFSF will be able to intervene in secondary government bond markets on a precautionary basis.

"The agreement not only makes a Greek deal possible but it enhances the EU safety net with respect to the rest of the periphery."

However, analysts also cautioned that any changes to the flexibility of the EFSF would still require ratification from individual member states.

"Given [German chancellor Angela] Merkel's problems at home with respect to voter disquiet about bail-outs, and splits in her party, [this] could be a significant obstacle," said Michael Hewson, of CMC Markets.

But there was little room for pessimism in the markets on Thursday.

Greek 10-year **government bond** yields fell 85 basis points to 16.49 per cent and similar-maturity yields for Spain and Italy – seen as the two countries most at risk from contagion – fell 25bp and 26bp respectively.

By contrast, the German Bund yield jumped 12bp to 2.88 per cent and the 10-year US Treasury yield climbed 7bp to regain the 3 per cent level.

The euro briefly pushed above $1.44 before easing back to stand 1.1 per cent higher at $1.4382.

The single **currency** also gained ground against the Swiss franc and the yen. The dollar fell against a basket of currencies – hitting a four-month low against the Japanese yen – amid the sharp improvement in risk appetite.

Equities pushed higher across the board. By midday in New York, the S&P 500 was up 1.1 per cent with financials leading the way.

The FTSE Eurofirst 300 index rose 1.1 per cent with the banking sector up another 4 per cent. Emerging market stocks rose 0.5 per cent.

The news from the EU summit largely overshadowed weak manufacturing data from China and the eurozone. The US market also shrugged off lacklustre labour market figures.

In **commodities**, gold held below $1,600 an ounce but came well off the day's low. Brent crude oil rose as high as $119.25 a barrel before easing slightly.

Robust results at Morgan Stanley bring cheer to financial sector

WALL STREET

By Johanna Kassel in New York

Better-than-expected results from **Morgan Stanley** boosted the US financial sector and erased the wider markets' Wednesday losses in midday trading on Thursday. The results closed out the mostly positive second-quarter reports from the big Wall Street banks.

Morgan Stanley's loss of $558m, or 38 cents a share, was smaller than the 61 cents the market had expected and sent shares 7.9 per cent higher to $23.44. The loss was the result of a charge related to the conversion of **Mitsubishi UFJ**'s preferred stake.

Analysts at Citigroup said Morgan Stanley results still left "considerable room for improvement," but targets remained intact.

The financial sector led all the S&P sectors and the KBW Capital Market index was up 2.1 per cent.

Bank of America led the Dow Jones Industrial average with a gain of 3.1 per cent, while **Citigroup** added 2.8 per cent.

American Express, which reported after the bell on Wednesday, gained 0.1 per cent on strong profits. Cardholders spent a record amount in the second quarter, helping the credit card group report a 31 per cent increase in net profit

In midday trading, the S&P 500 was up 1.1 per cent to 1,340.12, while the Nasdaq Composite added 0.5 per cent to 2,828.35. The Dow Jones Industrial Average added 1 per cent to 12,692.32.

E*Trade gained for the second straight session, adding 3.3 per cent to $15.20. The online broker gained nearly 14 per cent in Wednesday trading following news that Citadel, a fund that is shareholder, asked for two board members to step down.

"The hedge fund injected $2.55bn of cash into E*Trade back in November 2007 so that it could avoid bankruptcy, and that hasn't turned out to be a winning investment so far," noted Canaccord Genuity.

A $29bn pharmaceutical deal lifted the sector 1.2 per cent despite **Eli Lilly** reporting a drop in quarterly earnings.

Express Scripts agreed a $71.36-a-share offer in cash and stock to buy **Medco Health Solutions** in a deal that will make it the largest pharmacy benefits manager in the US. Medco shares soared 13 per cent to $63.04. Express Scripts also benefited, rising 4.2 per cent to $54.75.

Eli Lilly reported that sales beat forecasts and the drugmaker increased its full-year profit outlook. Shares rose 1.6 per cent to $38.77.

Weak jobs data did little to damp optimism in wider markets with weekly US jobless claims rising to 418,000.

Markets were watching progress of a possible European bail-out deal for Greece.

The technology sector was cheered by positive results released after the bell on Wednesday. The sector gained 0.1 per cent after finishing the previous session slightly down. It was dragged down by **Western Digital**, which fell 7.4 per cent ahead of earnings after the bell.

F5 Networks was down 10 per cent after losing 6 per cent over the past two sessions. The cloud computing software maker reported third-quarter profit climbed 54 per cent.

Ebay results exceeded expectations, registering a revenue gain of 25 per cent. The online auction company's shares increased 1.8 per cent to $33.78 and led the S&P technology sector.

US chipmakers **Intel** and **Qualcomm** also reported strong results and offered bullish forecasts for the second half of the year. Despite the results, shares in Intel fell 1.6 per cent, while Qualcomm lost 1.4 per cent.

Traders are looking ahead to **Microsoft** results after Thursday's close, which many expect will include warnings about sluggish PC growth.

In consumer results, **Safeway**, the US grocery chain, fell 7.7 per cent after reporting weak same-store sales and lowering forecasts for the same group.

Citigroup analysts were positive about Safeway's forecast that same-store sales would gradually increase, but said that investors were still "disappointed".

PepsiCo shares also suffered after the company's second-quarter results missed expectations. The beverages division was hardest hit and sent shares down 4.8 per cent to $65.24.

In its first report after activating its online paywall, the **New York Times** reported losses weighed down by print costs. Reports that more than 220,000 people subscribed to the digital model cheered investors sending shares 2.9 per cent higher to $9.23.

Biggest movers, Page 24

Morgan Stanley
Share price ($)

Source: Thomson Reuters Datastream

Key indicators

Indices	Close	Day's change
S&P 500	1343.21	+17.37
DJ Industrials	12713.02	+141.11
Nasdaq Comp	2833.94	+19.71
Russell 2000	840.06	+7.72
VIX	17.67	-1.42
US 10 yr Treas Bd	3.01	+0.08
US 2 yr Treas Bd	0.40	+0.03

Single currency moves higher

CURRENCIES

By Peter Garnham

The euro advanced after enduring a volatile session in expectation that EU leaders would strike an overnight deal on Greek debt.

After markets closed in Europe, Germany, France and the European Central Bank agreed a deal under which existing Greek debt would be exchanged for new 30-year bonds with a low interest rate.

Analysts said that according to rating agencies' standard rules, such a plan would be categorised as a "selective default".

They also warned that there remained a chance that the deal could be altered or rejected by the broader set of European leaders later in the session.

Greg Anderson, of Citigroup, said that a deal involving a selective default would certainly have some positives that could lift the euro.

He said the debt exchange, when accompanied by further loans from the International Monetary Fund and the European Financial Stability Fund, would solve all of Greece's liquidity problems, and that if the interest rate was low, as reported – sources suggested 3.5 per cent – then debt affordability would be addressed.

Mr Anderson warned that one apparent drawback of the deal was the moral hazard it created for other eurozone countries that already had a bail-out deal.

"Despite the drawbacks, presuming there is a deal that looks somewhat like the preliminary reports, we can expect the euro to rally somewhat against the dollar over the next couple of days on relief that the summit event and associated short-term uncertainty are behind us," he said.

The euro rose 1.1 per cent to $1.4382 against the dollar, 0.8 per cent to Y112.944 against the yen and 1 per cent to SFr1.1775 against the Swiss franc.

Relief over a potential deal boosted other European currencies and weighed on haven demand for the dollar.

The pound rose 0.9 per cent to $1.6300 against the dollar, while the Swedish krona gained 1.9 per cent to SKr6.3102. The dollar lost 0.3 per cent to Y78.55 against the yen and 0.9 per cent to $1.0835 against the Australian dollar.

Currency rates, Page 25
www.ft.com/currencies

Gains for Commerzbank and UniCredit as banks perk up

EUROPE

By Neil Dennis

Bank stocks jumped in later trading on hopes that measures to address the eurozone debt crisis would be put into action.

Germany and France appeared to have reached an accord on a new rescue package for Greece and investors were picking over details of a draft statement ahead of the official communiqué from Thursday's emergency summit.

Financials moved higher thanks in part to reports that a proposal by Nicolas Sarkozy, French president, to include a €50bn tax on eurozone banks had been dropped.

Italy's **UniCredit** jumped 10 per cent to €1.38 while domestic rival **Intesa Sanpaolo** climbed 9.5 per cent to €1.80. In France, **Société Générale** rose 6.2 per cent to €38.23 while Germany's **Commerzbank** gained 9.4 per cent to €2.75.

Meanwhile, the pan-European FTSE Eurofirst 300 index rose 1.1 per cent to 1,103.12.

The region's top mobile phone groups both reported tough conditions in the quarter.

Nokia reported a second-quarter operating loss associated with the costs of its strategic move this year to adopt Microsoft technology instead of its own Symbian system.

Net sales of €9.3bn in the period, however, matched expectations and the shares were up 2.5 per cent at €4.18.

Swedish mobile phone and networks group **Ericsson** was the worst-performing stock on the Eurofirst, down 9.7 per cent to SKr83 after its second-quarter net earnings missed market forecasts.

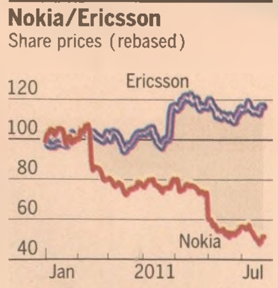
Although much of the underperformance was down to one-off restructuring costs, it warned of the impact of the rise in the Swedish currency versus the euro and the dollar.

Many companies outside the eurozone have been giving warnings about the impact of exchange rates on profit.

Roche, the Swiss drugmaker, reported a 4 per cent fall in first-half earnings as the strong franc took its toll. However, it lifted its full-year profitability targets, which it said would be achieved through cost cuts. Shares in Roche climbed 1.3 per cent to SFr141.50.

Swedish truckmaker **Scania** fell 4.5 per cent to SKr127.30 after reporting an unexpected drop in second-quarter earnings, which was put down to higher costs and the impact of the stronger krona.

Nokia/Ericsson
Share prices (rebased)



Source: Thomson Reuters Datastream

Aviva buoyed by deal speculation

LONDON

By Bryce Elder

Deal talk underpinned **Aviva** as financial stocks squeezed the London market to its third straight gain.

Aviva gained 4.2 per cent to 420p as bid theories did the rounds. However, analysts pinned the strength on comments from competitor Allianz, which was hosting an investor day for its US life assurance division.

In particular, Allianz flagged up a net profit margin on writing new business of between 2 per cent and 2.5 per cent.

The rest of the financial sector surged as eurozone leaders edged towards agreeing a bail-out plan. The FTSE 100 ended up 46.07, or 0.8 per cent, to 5,899.89.

A scramble to rebalance portfolios squeezed banks to the top of the leaderboard. **Barclays** led the way, up 7.8 per cent to 239¾p, while **Royal Bank of Scotland** rose 5.7 per cent to 36p and **Lloyds Banking Group** added 5.9 per cent to 47½p.

AstraZeneca took on 2 per cent to £30.92 after the US approved Brilinta, a blood-thinning treatment.

Capita led the blue-chip fallers, down 1.6 per cent to 686p.

Arm Holdings slipped 1.6 per cent to 601p, having risen by nearly 5 per cent on Wednesday.

Pace fell 2 per cent to 108p after Numis Securities said the set-top box maker's turnround plan might also need a cash call.

Colt slumped 13.5 per cent to 114p as heavy investment in network and data centres meant the telecommunications group's interim results disappointed.

Halfords lost 4.4 per cent to 341⅛p after a trading update showed retail sales and profit margins continuing to deteriorate.

Pubs group **Mitchells & Butlers'** shares ended 2.9 per cent weaker at 282½p.

Britvic lost 1.1 per cent to 363p on a trading update.

Bid target **Charter International** drifted 2.1 per cent to 779½p.