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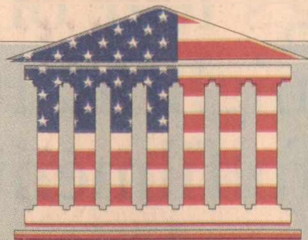


Regulatory fatigue

Dodd-Frank one year on. Analysis, Page 8

No laughing matter: lese majesty in Thailand

David Pilling, Page 11

World Business Newspaper

News Briefing

Blackstone in €700m Jack Wolfskin takeover

US buy-out group Blackstone is to take over German outdoor clothing company Jack Wolfskin in a €700m ($995m) deal that will mean a tenfold increase on the 2005 investment by Barclays Private Equity and Quadriga Capital. **Page 15**

China call on US deficit

Beijing has called on Washington to bolster international faith in its economic policies amid signs that China has cut purchases of US government debt. **Page 2; Pressure for compromise, Page 4; Editorial Comment, Page 10; Trading Post, Page 29**

Jitters hit BlackRock

Fund manager BlackRock reported 43 per cent higher second-quarter profit as market gains offset client redemptions but recent asset inflows slowed in uncertain markets. **Page 15; PNC seeks deals, Page 16**

Somalia famine plea

Aid agencies' calls for funds and access to Somalia to halt what they call the worst famine in 20 years has put a spotlight on a failed state held hostage by Islamist extremists, pirates and warlords. **Page 7**

Arrest clears EU block

Serbia's arrest the last fugitive war crimes suspect from the 1990s Balkan conflicts fulfils its main remaining obligation to the UN tribunal and clears an obstacle to European Union membership. **Page 2**

Danish bond dispute

A dispute has erupted over one of the finance world's oldest and safest assets after Moody's rating agency demanded Danish covered bond issuers ... up the debt ...

Eurozone crisis Sarkozy rushes to German capital ● Rescue plan includes €50bn bank tax

Paris and Berlin in last-ditch Greek talks

By Peter Spiegel in Brussels and Patrick Jenkins in Paris

Nicolas Sarkozy, French president, rushed to Berlin on Wednesday night in an attempt to hammer out a new Greek rescue plan that could include €71bn in bail-out funds from global lenders and a €50bn tax on eurozone banks, proceeds from which would be used to buy back 20 per cent of Greece's €350bn in outstanding debt.

The proposals, included in a rescue plan circulated by the European Commission ahead of an emergency summit today, also include a bond exchange programme under which private owners of Greek debt would be encouraged to swap their holdings for new 30-year bonds.

The swap plan could reduce the value of Greek debt by an estimated €90bn. It would be offered to owners of bonds coming due in the next eight years, with credit sweeteners to enc... participation.

... briefed on the plan ... likely ...

José Manuel Barroso, Commission president, warned: "Nobody should be under any illusion: the situation is very serous. It requires a response. Otherwise the negative consequences will be felt in all the corners of Europe and beyond."

Officials said Mr Barroso's plan would expand the powers of the eurozone's €440bn bail-out fund. It would be allowed to offer lines of credit to eurozone countries not receiving bail-outs and to recapitalise banks in those countries. In the past 14 months, the EU has bailed out Greece, Ireland and Portugal.

Berlin is particularly lukewarm towards the bank tax proposal. According to officials briefed on the plan, it would amount to a 0.0025 per cent levy on all assets held by eurozone banks and would raise €10bn per year for five years. The cash would go to the eurozone bail-out fund, which would ... the money to cond... b... buy-back.

George Osborne: 'We see the potential for a set of economic events that could be as damaging as 2008' Charlie Bibby

Osborne urges leaders to 'get a grip' on sovereign debt crisis

By Chris Giles and George Parker in London

... leaders must "get a ... it today, ...

debts but said this was only the first step towards a necessary fiscal union in the single currency area.

He acknowledged that his enthusiasm for greater eurozone ... turned British for... its head, since it ... government's ...

vulnerable and increasingly irritated by what they see as German foot-dragging.

Although Mr Osborne did not criticise Germany directly, he called for "serious consideration" of Eurobonds, which would force Germany to stand behind southern European de... while the periphery wo... Germ...

they are going to be able to produce [a comprehensive] plan ... but they have really got to show the world that they can get a grip," he said.

He said the private sector would have to take ... hit ... Greek debt ...

World news

China calls for ‘responsible’ US

Beijing urges move to boost confidence

Signs of slowing Treasury purchases

By Simon Rabinovitch in Beijing

China has called on Washington to bolster international faith in its economic policies amid signs that Beijing has cut its purchases of US government debt.

The State Administration of Foreign Exchange, which manages China's currency reserves, said it had noted warnings by rating agencies Standard & Poor's and Moody's of a possible sovereign rating downgrade for the US if lawmakers do not reach an agreement on the country's debt ceiling.

"We hope the US government will earnestly adopt responsible policies to strengthen international market confidence, and to respect and protect the interests of investors," it said in response to questions posted on its website.

The US appeared to be closer to a deal to avert a default after Barack Obama, president, on Tuesday backed a deficit-cutting agreement proposed by a group of Democratic and Republican senators.

About two-thirds of China's $3,197bn in currency reserves, the world's largest by a wide margin, is estimated to be invested in US dollar-denominated assets. China considers the composition of its reserves to be a state secret.

But by contrasting US and Chinese data, economists have come to the tentative conclusion that Beijing has greatly slowed the pace of its investment in US government debt this year.

In the first five months of the year, the Chinese central bank purchased $269bn in foreign exchange. However, combined inflows into US Treasuries from China, and from Hong Kong and London – Beijing's two preferred global financial centres – totalled about $63bn. This suggests that China has invested less than a quarter of its new currency reserves in US assets, far below its rate in previous years, economists say.

The Chinese foreign exchange body declined to say whether it was slowing its accumulation of US Treasuries, and said any move to increase or decrease holdings was normal investment behaviour.

In a research note this week, Capital Economics cautioned against reading too much into these numbers, saying that Beijing could be disguising its purchases of Treasuries through another country.

It added that Chinese investments in US debt could increase in the second half of the year because the wind-down of the Federal Reserve's quantitative easing programme means that it is no longer a competing buyer of government bonds.

The statement from China reiterated a pledge to diversify its foreign exchange reserves, but also repeated comments about the difficulty of investing in precious metals and industrial commodities.

Using official reserves to acquire such assets would push up their price, and so hurt the Chinese individuals and companies that are already buying large amounts of gold, oil and other commodities, it said.

Deficit concerns, Page 4
Editorial Comment, Page 10

Beijing's fear of social nightmare slows fulfilment of urban dream

GLOBAL INSIGHT

Jamil Anderlini in Beijing

China's economic development "suffers from a serious lack of balance, co-ordination and sustainability".

Those are not the words of an ultra-bearish hedge fund manager. They come from a speech delivered three weeks ago by Chinese President Hu Jintao and they show that the ruling Communist party understands better than anyone the momentous challenges it faces in managing the world's second-largest economy.

It is always strange to hear foreign analysts and fund managers who are far more bullish on China than the people who run it, but with developed markets engulfed in crises, the Chinese economy has become the great hope for much of the rest of the world.

Central to the bullish argument is an almost religious belief in the power of Chinese urbanisation.

When China bulls are asked who they think is going to buy all the shiny new apartments springing up across the country, the inevitable answer is all those newly urbanised peasant farmers.

On paper, China has experienced rapid urbanisation over the past two decades, with the portion of the population living in cities leaping from 26.4 per c[illegible] in 1990 to 49.7 per[illegible]

the new cities they have helped to build.

The hukou system has been a key ingredient in China's economic model, by creating an underclass to provide the cheap labour that fuels rapid growth.

Despite government talk of reforming and loosening the hukou system, it has actually been getting stricter in big overcrowded cities, which refuse to hand out hukou permits to all but the most desirable, well-educated and wealthy residents.

In China, the state officially owns all land, and in the countryside it is very difficult for peasant farmers to sell or trade the family plots they lease from the government or the local collective. This means that rural migrants retain strong links to the land and if they lose their jobs they are unlikely to hang around in the cities.

Chinese policymakers have nightmares about what would happen if they were to abolish the hukou

> Urbanisation relies heavily on policy decisions that [politicians are] not yet willing to make

system and privatise land in the countryside. They point out that the only reason China doesn't have huge populations of landless peasants flooding the cities and living in slums (as seen in most other large developing country such as India, Indonesia, Brazil, etc) is because they retain tight control over this two-tier social structure.

[illegible] ne time than[illegible]

Tale of two classes in Brazil as millions climb out of poverty

The squeezed MIDDLE

By Joe Leahy in São Paulo

Speaking to Melissa Beeby, you would not know that Brazil is enjoying its most prosperous period since the "economic miracle" of the late 1960s – as the country's last great boom is known.

As with other members of Brazil's so-called "traditional" middle class, Ms Beeby has found that things have become harder in recent years. The prices of meat and petrol have doubled, highway tolls have risen and eating out or buying property have become prohibitively expensive.

"The middle class basically is in debt. That's how people manage," says Ms Beeby, who runs the Bridge Restaurant at the British Centre in São Paulo. "People have more dinners at h[illegible] and when they do go [illegible]

[illegible] classes" or above. Today 105.5m Brazilians out of a total population of 190m are members of this group, who earn between R$1,200 and R$5,174 (US$3,315) per household each month. Also better off are the rich, who have profited from a stock market, commodities and consumption boom.

On the losing side, say sociologists, are the 20m or so people of the "traditional" middle classes who earn more than R$5,174 per household. Unlike in India, where the old middle class benefited from the creation of new industries, such as information technology outsourcing, many in the Brazilian middle class complain of rising prices, taxes, congested infrastructure and more competition for jobs.

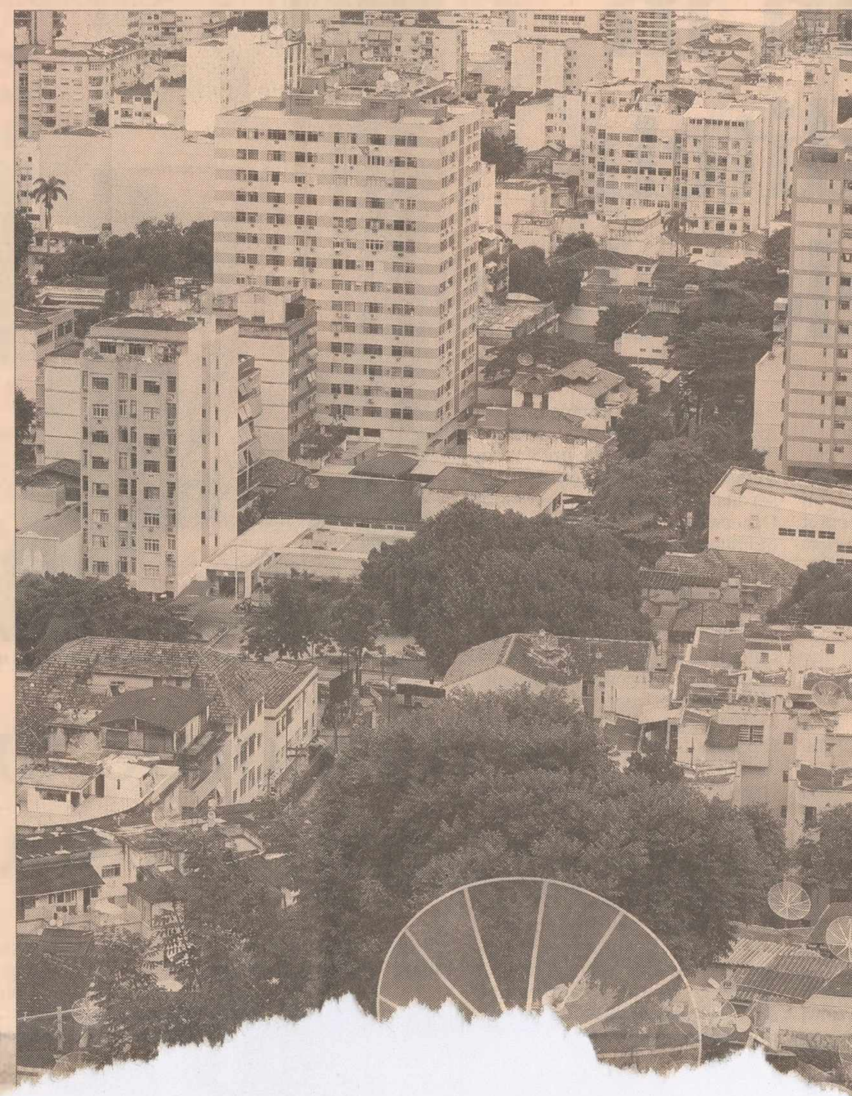
"In the past 10 years the income of the poorest 50 per cent of the population grew 68 per cent in real per capita terms, while the income of the richest 10 per cent grew 10 per cent," says Marcelo Neri of the Getúlio Vargas Foundation (FGV) [illegible] the co-ordinator of a [illegible] of Brazil's new [illegible] cent between 2003 and 2009, while that of a person with at least an incomplete university degree fell 17 per cent. "It's upside down," says Professor Neri.

The changes represent a rebalancing of wealth that has been pending since 1888, when Brazil became the last country in Europe and the Americas to abolish slavery, says Prof Neri.

"Incomes are growing more [quickly] in traditionally excluded groups of Brazilian society, such as non-whites, women, those living in the poor north-east, in *favelas* [slums] or in the outskirts of Brazilian cities," says the FGV study.

The process has been driven partly by increasing access to education. The new middle class has flocked to private universities and technical colleges and begun competing for jobs with the traditional middle class.

Conscious of her support among the poor, President Dilma Rousseff recently launched a social welfar[illegible] programme aimed [illegible] ing anoth[illegible]



Cameron dodges questions on BSkyB discussions

UK prime minister faces parliament

Regret expressed in appointment furore

By Elizabeth Rigby and Jim Pickard

David Cameron's attempt to distance himself from the hacking scandal was undermined on Wednesday as the UK prime minister repeatedly dodged questions over whether he had discussed Rupert Murdoch's BSkyB bid with executives from News International.

Mr Cameron, determined to "clear up" the phone-hacking "mess", expressed regret for hiring Andy Coulson – former News of the World editor – as his communications chief as he forced MPs to postpone their holidays to attend a one-day emergency debate.

"I am extremely sorry and deeply regret the whole furore this has caused," said Mr Cameron, amid a barrage of criticism from the opposition benches. "If it turns out I have been lied to [by Mr Coulson], that would be the moment for a profound apology," he said. "In that moment I would not fall short."

The heavily caveated apology was made to a packed chamber as the prime minister, fresh back from a curtailed trip to Africa, led the government's parliamentary response to the scandal of phone hacking by journalists and potential police corruption.

With MPs leaving Westminster for their summer break, the opposition Labour party sought to twist the knife one more time.

During a heated debate lasting over two hours, the prime minister fielded questions from 136 members of parliament in a gruelling interrogation over his links to Rupert Murdoch's media empire and claims that he turned a blind eye to Mr Coulson's past record.

In an attempt to take control of events, Mr Cameron published the terms of reference for the two inquiries launched to investigate the behaviour of the British press and the "extent of unlawful or improper conduct" within News International and other newspapers.

Tory MPs cheered on their prime minister as he offered an assured performance at the dispatch box and Ed Miliband, the Labour leader, failed to land a killer blow.

But Mr Cameron's effort to oversee the clean-up was overshadowed by his repeated refusal to say whether he had had conversations with News International executives about the now aborted BSkyB bid while prime minister.

"I have never had one inappropriate conversation," is all he would say on the matter, despite Labour politicians raising the issue eight times in the debate. News Corp was last week forced to walk away from its attempt to buy the 61 per cent of BSkyB it does not own in the face of fierce political resistance to the deal.

Mr Cameron told MPs his cabinet secretary had ruled "very clearly" that no ministerial code was broken in relation to the BSkyB merger and politicians' meetings with News International executives.

Mr Miliband accused the prime minister of building a "wall of silence" so he did not hear warnings about Mr Coulson.

He pointed to five opportunities the prime minister had had to learn about Mr Coulson's unsuitability to work in Downing Street but which he had failed to heed.

● MPs investigating the role of the police in the News of the World phone-hacking scandal have issued an emergency report highly critical of the Metropolitan Police (Scotland Yard), saying senior detectives had "no real will" to uncover the real depth of journalistic illegality.

The home affairs select committee rushed out its report damning a "catalogue of failures" by Scotland Yard early on Wednesday. It also launched an attack on News International, saying Rupert Murdoch's UK newspaper arm deliberately tried to obstruct the original inquiry in 2006.

Inside and online

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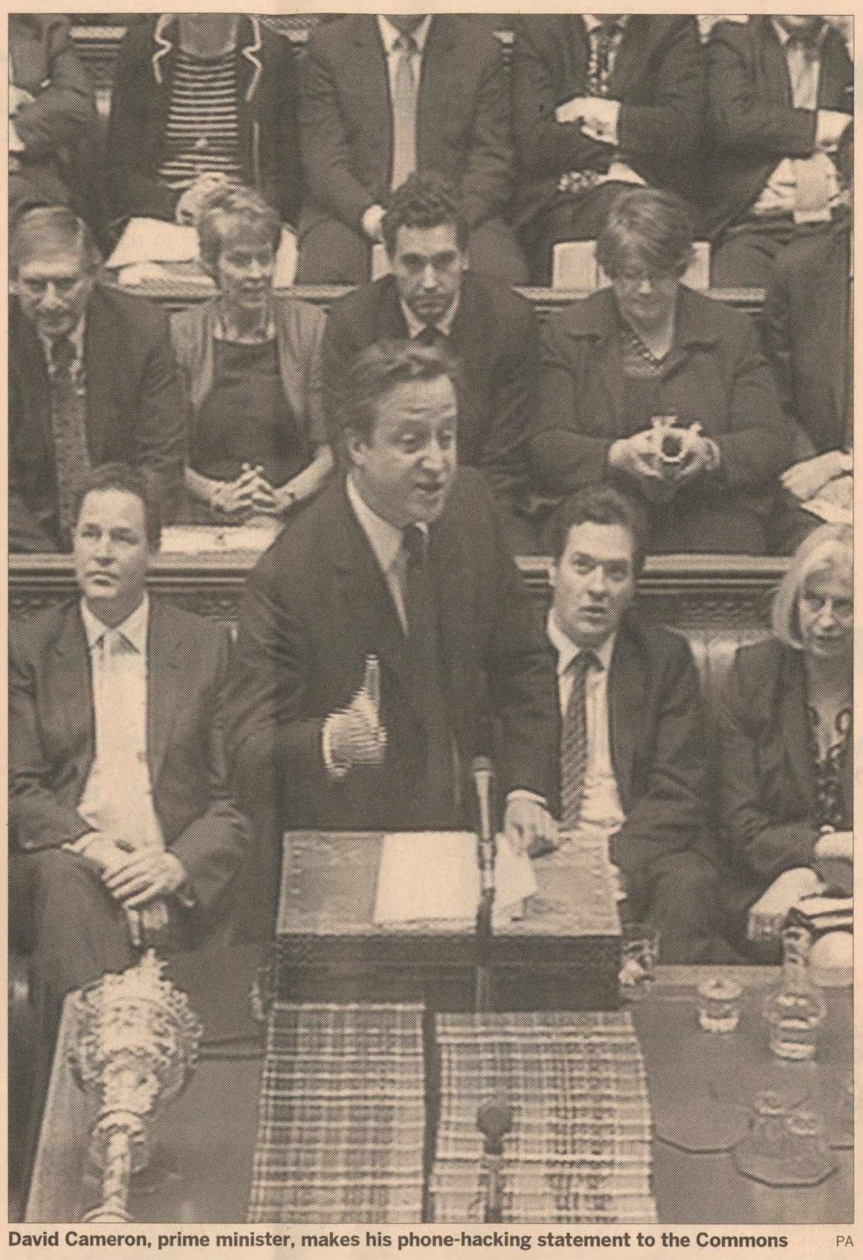
Video The US fallout from the phone-hacking scandal **www.ft.com/murdochfallout**

In-depth News, comment and analysis **www.ft.com/phonehacking**

Blogs The lessons of Wendi Murdoch **www.ft.com/mw**
Quotes of the week **www.ft.com/westminster**



David Cameron, prime minister, makes his phone-hacking statement to the Commons PA

Radical action urged on police leadership

The British prime minister has called for "radical proposals" to transform police leadership, steps that could include allowing top US police to take up senior posts in UK forces, following a spate of resignations at Scotland Yard in connection with the phone-hacking scandal, **writes Helen Warrel in London.**

David Cameron told members of parliament on Wednesday that the "extraordinary events" of the past few days – in which the Metropolitan Police commissioner and his counterterror chief quit over their links to News of the World – was an opportunity to "stand back and take another, broader look at the whole culture of policing in this country, including the way it is led".

Raising concerns that there were "too few – and arguably too similar" candidates for the most senior policing jobs, Mr Cameron said police officers who had been a proven success overseas could be flown in "to help turn around a force at home".

It is understood the prime minister has been impressed by US officers such as Bill Bratton – former New York police chief, known for his success in computer-assisted policing.

US fund attacks News Corp's share structure

By Dan McCrum and Andrew Edgecliffe-Johnson in New York, Kate Burgess in London and Leslie Hook in Beijing

The California Public Employees' Retirement System, the largest US public pension fund and an influential campaigner on corporate governance, has taken aim at the dual-class share structure that preserves Rupert Murdoch's family power at News Corp.

The two-tier structure that gives the Murdoch family almost 40 per cent of the voting rights in a global media company where it owns about 12 per cent of the equity was "a corruption of the governance system", said Anne Simpson, senior portfolio manager, of Calpers Global Equity and its corporate governance chief.

"Power should reflect capital at risk. Calpers sees the voting structure in a company as critical. The situation is very serious and we're considering our options. We don't intend to be spectators – we're owners," Ms Simpson said: "Dual-class voting is one way to pervert the alignment of ownership and control."

Calpers owns almost 7m shares in News Corp, worth about \$110m in a company with a market capitalisation of almost \$42bn. Although it has held one-share/one-vote as a core principle for several years it has not introduced any shareowner resolutions at corporate meetings on the issue to date.

News Corp shares levelled off on Wednesday after a partial rally on Tuesday, standing up 13 cents at \$15.92 in early afternoon trading in New York.

One large global fund manager with a holding in News Corp said that Mr Murdoch's performance at a parliamentary select committee on Tuesday highlighted a common flaw in US governance models where an octogenarian chairman and chief executive held, in effect, a controlling bloc of voting shares.

The dilemma for News Corp's board was how to establish its independence, the fund manager said. "Where the founder is still in control, as at News Corp, it is hard to see him running the board as a hands-off chairman or letting an independent chairman in to run strategy and the board. And the worst of all worlds would be to bring in a puppet chairman."

> 'Dual-class voting is one way to pervert the alignment of ownership and control'

Lord Rothschild, a former deputy chairman of BSkyB, told the Financial Times the hacking scandal was "an incredibly sad chapter in [Mr Murdoch's] extraordinary career".

"Whether you like him or not – I happen to like him – Rupert Murdoch was a one of the great figures of entrepreneurial life of the last 50 years. The empire got very big. Newspapers were a very small part of it. He lives in the United States. These things can happen," he said, adding that he remained an admirer of James Murdoch.

His comments came as Fitch said it saw little threat to News Corp's credit ratings, even if it closed all of its low-margin, capital-intensive newspapers.

EU leads pack on bank capital

Basel III

Implementing rules aimed at averting another financial crisis will not be a painless process, writes Nikki Tait

The European Union has become the first jurisdiction to begin implementing the so-called Basel III guidelines into law, in an attempt to ward off any repeat of the 2008 financial crisis.

Announcing in Brussels on Wednesday the implementation of the internationally agreed standards designed to make banks hold bigger and better levels of capital, Michel Barnier, EU internal market commissioner, said: "We cannot let such a crisis occur again."

Under the proposals, known as the Capital Requirements Directive 4, the highest quality capital which banks must hold – labelled common equity tier one, or CET1 – will increase from 2 to 4.5 per cent of risk-weighted assets. There will be 14 strict criteria to determine what can be counted as CET1.

In addition, there will be a "capital conservation buffer", amounting to 2.5 per cent of risk-weighted assets, also made up of the highest quality capital – in effect making the ratio 7 per cent. If banks breach this buffer, they face limits on the bonuses and dividends they can pay. There will be further requirements in terms of lower quality capital that they must hold.

On top of all this, national supervisors can introduce special "counter-cyclical buffers" if they fear that lending – to the property sector, for example – is getting out of hand. Again, this must consist of top quality capital and will generally be up to 2.5 per cent of risk-weighted assets.

The plan is to apply the new rules to more than 8,000 banks in the EU, phasing them in from 2013 to 2018. In addition, Brussels plans to introduce from 2015 new liquidity requirements – that is, cash assets to meet, for example, sudden demands from withdrawing depositors.

Brussels will also consider introducing a binding leverage ratio from 2018, although there will be further review and discussion on this..

Most of these requirements are contained in a draft "regulation", which will need the approval of member states and the European Parliament. Once this is secured, the rules will be binding across the Union.

However, the capital buffers and some less technical measures – dealing with the make-up of bank boards and penalties for institutions which step out of line – are in a separate "directive", which member states will have to transpose into their national laws.

At least six states – notably the UK – would like the new capital rules to be minimum standards only, and to have the flexibility to impose higher ratios if they wish.

But EU officials say the mandatory approach is necessary to establish a "single rulebook" for banks in Europe, which in turn will make the regulatory process more transparent and better able to adapt to changing market conditions. Brussels also argues that differing capital requirements in various countries would distort competition and encourage regulatory arbitrage.

This issue is certain to lead to fierce debate when diplomats consider the proposals. It will by no means be the only bone of contention. While the banks themselves generally favour the "single rulebook" approach, they claim the new rules could be dangerously onerous, putting Europe at a disadvantage if other jurisdictions, such as the US, were slow to follow.

The European Banking Federation said it was "concerned over the impact of the new requirements", especially with regard to liquidity.

The scale of that impact was fleshed out by Brussels on Wednesday. Assuming full implementation, banks will need an extra €84bn ($117bn) of CET1 capital by 2015 and €460bn by 2019, the end of the eight-year transition period. That is equivalent to just under 3 per cent of the sector's risk-weighted assets. The combined net profit of the 100 biggest EU banks in 2009 was about €33bn.

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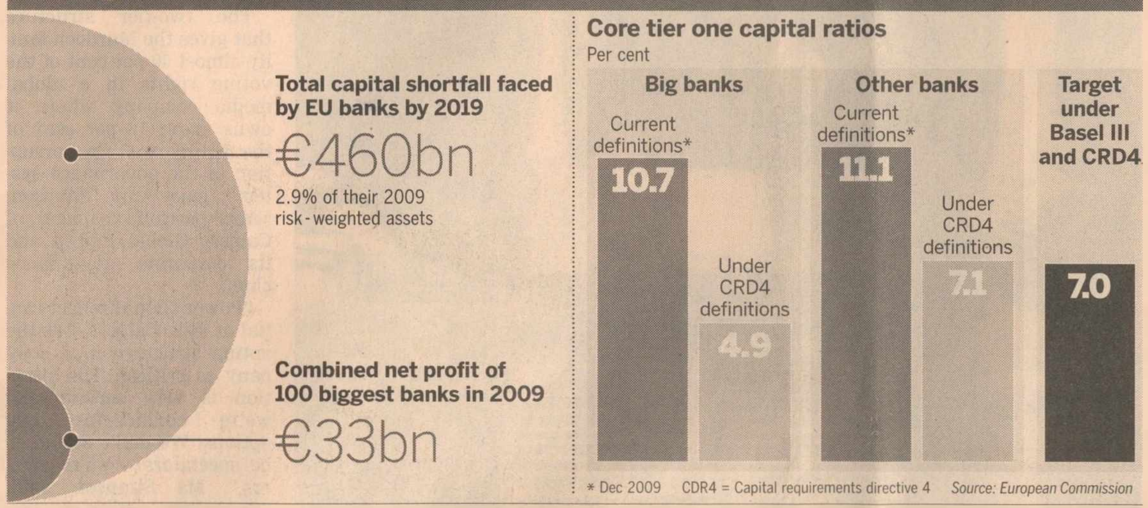
Raising the bar



* Dec 2009 CDR4 = Capital requirements directive 4 Source: European Commission

Republicans face pressure to make debt compromise

By Stephanie Kirchgaessner and James Politi in Washington and Michael Mackenzie in New York

Republican lawmakers in the House of Representatives are under increasing political and market pressure to compromise in US debt talks, but analysts on Wall Street and in Washington expressed new fears about the feasibility of a sweeping deficit deal.

President Barack Obama's support for a $3,700bn fiscal reform package agreed by the "Gang of Six", a bipartisan group of senators, and a receptive response by Republican leaders in the House, created a brief sense of optimism that wrangling over an increase in the US debt ceiling could be resolved. But on Wednesday, intense opposition to the plan by conservative pressure groups and some vocal Tea Party-backed lawmakers in the House underscored that the goal of winning the 218 votes needed to secure any increase in the borrowing authority was still elusive.

"Gangs meeting in back rooms generally doesn't lead to much good," was the tweet from Jason Chaffetz, a Tea Party-backed congressman from Utah.

The Gang of Six compromise was also panned by some conservative think-tanks, including the Heritage Foundation, which said it was full of "procedural gimmickry" and would not control spending.

In the Senate, passage of the Gang of Six deal seemed likely if it came up for a vote, but there was concern that the August 2 deadline, after which the US will be in default, would come too soon for legislation to be crafted.

Brian Gardner, a vice-president at Keefe, Bruyette & Woods, said: "We think the uncertainty of a large chunk of the plan along with the controversy over the tax portion is likely to doom the Gang of Six plan among conservatives, especially in the House."

The political question now is whether continued resistance to a deal by conservative Republicans can be shaken by shifting public sentiment.

Two public opinion polls released this week showed that Americans are increasingly pinning the blame for the budget impasse on congressional Republicans. According to a Washington Post-ABC survey, 79 per cent of independent voters, a crucial voting block, believe Republicans have been too intransigent. Even a majority of Republicans see their party as excessively hardline, with 58 per cent arguing they should be more conciliatory, up from 42 per cent in March.

"House Republicans have to be careful that they are not seen as the ones who kept a reasonable deal from happening because they will pay a price for that in 2012," said David Walker, former comptroller general and a fiscal activist.

After the markets' enthusiastic response to the Gang of Six on Tuesday, investors took a more circumspect view on Wednesday. The yield on the 30-year bond was up 6 basis points at 4.25 per cent, after falling as low as 4.18 per cent on Tuesday.

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Merkel and Sarkozy in late move to resolve Greece dispute

By Quentin Peel in Berlin and Peter Spiegel in Brussels

Angela Merkel, the German chancellor, and President Nicolas Sarkozy of France were locked in negotiations on Wednesday night in an 11th-hour bid to resolve their differences over a new rescue plan for Greece.

The two agreed on the emergency meeting at the chancellor's office in Berlin after a conference call on Tuesday failed to break their impasse over how to get private bondholders to shoulder some of the €115bn ($163bn) needed for the new bail-out, according to a senior European official.

Germany remains adamant that a substantial and quantifiable contribution from the private sector remains its "decisive demand" for the new programme being negotiated by the 17 eurozone countries, on the basis of recommendations from the European Commission, the European Central Bank, and the International Monetary Fund. The problem that has delayed agreement has been finding a way of getting private sector participation without triggering a Greek default. The ECB says such an event would in turn force it to stop supplying liquidity to the Greek banking sector against the collateral of Greek government bonds – forcing a virtual shutdown of the Greek economy.

France has always been closer to the position of the ECB, and now favours a bank levy as an alternative way of making the financial sector pay without triggering a default. But the idea of a bank tax – furiously opposed in the banking sector – is seen in Germany as unlikely to produce any contribution towards the Greek rescue for many months. It would have to be agreed by all European Union institutions, and by national parliaments.

Even as José Manuel Barroso, president of the European Commission, warned on Wednesday of the dire consequences of failure to reach an agreement at today's (Thursday's) emergency eurozone summit in Brussels, German officials expressed confidence that a deal could be done.

"We are confident that it will come to a good solution," said Steffen Seibert, Ms Merkel's spokesman, before Mr Sarkozy arrived for the talks. "Germany and France together feel the responsibility to use their strength to reach a good solution for Europe."

He said the aim of the talks was to consider all the options on the table, and "as far as possible agree on a common line". No final decisions on the bail-out plan could be taken before the summit in Brussels, he added.

The failure of the two leaders to resolve their differences over the phone on Tuesday forced senior European officials to rearrange the key negotiating meeting leading up to the summit, which was supposed to finalise the Greek programme. The joint meeting of the so-called "euro working group" of senior finance ministry officials, with the top aides of the 17 eurozone heads of state and government, scheduled for Wednesday evening, has now been reconvened for Thursday morning.

Ms Merkel and Mr Sarkozy met with only their closest advisers in the Berlin chancellery, for a first round of negotiations and then dinner. The French president was staying the night in Berlin before both leaders flew to Brussels together. The German chancellor has already sought to play down expectations of any "spectacular step" at the summit, in the face of calls from opposition politicians and economists in Germany for more radical thinking about how to cut the Greek debt burden.

Germany had opposed holding the emergency summit until a comprehensive deal had been done on private sector participation, and had feared that rushing the process would force the eurozone countries to bear the brunt of a rescue with taxpayers' money. The German plan has been for a bond swap scheme, with bondholders agreeing to extend maturities. The French alternative is for a bond rollover, which would require bondholders to maintain their holdings when they fall due.

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www.ft.com/euro-in-crisis

Pointing the way: Nicolas Sarkozy, French president, and Angela Merkel, German chancellor, meet in Berlin Reuters

Lenders unveil rollover plan

Europe's biggest banks and insurance companies – the main holders of Greek sovereign debt – have unveiled a compromise plan on how best to take a degree of private-sector responsibility for Greece's woes, **writes Patrick Jenkins in Paris.**

The proposal could 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. The banks believe the rollover programme would work well with a Greek debt buy-back idea, which could be focused on longer maturities. They say the alternative idea of a tax on European banks would be too open to national political implementation to give certainty to markets.

Accounting for day of reckoning

News analysis

Traders are starting to consider what would happen if the US debt ceiling were not lifted, says Robin Harding

The start of a debt-ceiling crisis would be marked with a phone call, not too late in the morning, from the Federal Reserve to the US Treasury.

Based on forecast incomings and outgoings, the caller would say, the Treasury's account at the Fed would be in overdraft at the end of the day. That would violate Section 14 of the Federal Reserve Act.

Then, like any bank manager calling a client about to go overdrawn, the Fed would ask the Treasury: do you want to pay funds in or cancel some of the payments going out?

Although almost everyone still expects Congress to raise the debt ceiling in time, nervous policymakers and traders are starting to consider what would happen if it did not. It would create a bizarre kind of financial crisis, one in which the asset the entire world normally flies to in times of trouble – US Treasury securities – was the asset in doubt.

The Treasury estimates that the day of reckoning is August 2. It has steadfastly refused to discuss its contingency plans but if Congress failed to raise the debt ceiling it would have to act promptly to avert a market panic.

A widespread assumption is the Treasury would avoid a default on US debt by prioritising interest payments. Markets wonder whether the Treasury might have more accounting tricks up its sleeves – such as borrowing from government-controlled Fannie Mae and Freddie Mac – to help it continue spending.

"I think they would work very hard to prioritise and they would work very hard on possible accounting devices," said Vincent Reinhart, resident scholar at the American Enterprise Institute and former director of the Fed's monetary affairs division. The rise of electronic payments would help the Treasury to select which bills to pay and bills to delay, he noted.

But the real focus in a crisis would be financial markets because Treasuries provide the reference interest rate for every asset in the world.

"Nobody has a clear idea on exactly how big the forced selling – if any – would be," said Ira Jersey, director of US interest rate strategy at Credit Suisse in New York. Much would depend on how investors interpreted their mandate or their fiduciary duty and whether it let them continue to hold Treasuries.

Even if most investors held on, however, any one of a host of technical and practical issues could send a shock through markets.

One source of danger would be money market funds, especially those that specialise in Treasuries, which regulators would monitor closely for any signs of a panic.

Serious issues could arise in the repurchase agreement, or repo, market where Treasury securities are heavily used as collateral for short-term loans. With that collateral in doubt, short-term investors might reduce their repo lending. Clearing houses and exchanges would also have to decide whether and on what terms to take Treasuries as collateral.

"That will have a ripple effect both in terms of volatility and cost throughout our markets," said Randy Snook, executive vice-president at Sifma, a trade body for the US financial markets. The worst case is that leveraged investors could be forced to sell securities, transmitting the shock to other markets, and creating a classic financial panic.

The risks are manifold, so heavily are Treasuries used: credit market trade might dry up because all other bonds are priced off Treasuries; US credit default spreads might widen, destroying confidence.

It is frightening to imagine, which is why investors find it so hard to believe Congress would ever put them through it.

Italy's business lobby leader demands structural reforms

Country faces 'relentless decline'

By Rachel Sanderson in Gazoldo degli Ippoliti

Emma Marcegaglia, head of Italy's influential business association Confindustria, has demanded Silvio Berlusconi's government immediately undertake sweeping structural reforms to avert the "relentless decline and impoverishment" of the country as it risks sovereign contagion from Greece.

Speaking before today's emergency meeting of eurozone heads of state in Brussels, Ms Marcegaglia said European leaders must "act decisively".

"With a crisis this serious, when there is talk of the break-up of the euro, the idea that we could get to September without a decision would be madness," she said at the headquarters of her family-run multinational, steelmaker Marcegaglia.

However, Ms Marcegaglia, in an apparent rebuttal of comments made by officials in Rome, also said Italy "could not simply blame others". Italy last week sought to stem the eurozone crisis by approving a three-year austerity package worth €45bn ($64bn) by 2013, but officials said the government had no contingency plan to deal with more market attacks and that it would now be up to Brussels.

"Italy is not Greece, Ireland, Portugal or even Spain. But we do need immediate and deep structural reforms now. This is not something that can wait until 2013 as the government is proposing," Ms Marcegaglia said.

In one of the most stark statements made by a public leader in Italy since the eurozone sovereign crisis began, Ms Marcegaglia said national cohesion was needed for reform.

"We must either start these reforms now or Italy risks continuous decline in its wealth and competitiveness. There will be no overnight collapse but we will keep on having to pass emergency austerity budgets to pay ever more interest, the banks' cost of funding will increase, families will suffer. We risk a relentless decline and impoverishment of the country."

Ms Marcegaglia, who at 45 is one of Italy's youngest public leaders, also hit out at politicians who amended the budget to protect their perks. "When you ask for sacrifices from the people but fail to cut the costs of government, this is unacceptable. People are very unhappy," she said.

Italy and Spain are braced for a further battering on bond markets in the absence of a breakthrough at Thursday's summit, amid nerves about Italy's debt of nearly 120 per cent of gross domestic product.

While apolitical, Confindustria traditionally serves as a counterweight to Italy's politicians. Giulio Tremonti, Italy's finance minister, "is to be congratulated" for pushing through the austerity cuts at record speed, Ms Marcegaglia said. Nonetheless, she said Italy's business community felt "abandoned by the government" owing to its failure to enact structural reforms.

"Italy needs to renew its political class. We are the only country to have had the same politicians – of all political parties – for the past 20 years. We just need to change," she said.

The A-List How to save the eurozone www.ft.com/thealist

Eurobonds are the only answer

Mario Monti and Sylvie Goulard

Eurozone leaders face a choice as they meet today. Either they declare, once again, that they stand ready to do whatever is necessary to solve the eurozone crisis, or they actually do it.

In the first case, markets are likely to target larger countries, such as Italy and Spain, making any solution ever more costly and ever less credible. Alternatively, eurozone leaders could show leadership.

Markets, so far, have been winning a game of divide and conquer. Eurozone governments have been seeking financial stability by committing ever larger amounts of their taxpayers' money. A more effective strategy would be to surprise the markets with a genuinely common policy.

For such a response to be agreed on, the government of the leading eurozone country, Germany, has to provide leadership both among the member states and at home. This means convincing the German people that they are benefiting from the European Union, its single market and the euro; that the German culture of stability is permeating the rest of the union; and that Germany would be the biggest loser if the eurozone were to break up.

A German government that promotes common policies focused on the long term would be better able to protect German taxpayers' interests than one which, in focusing on their shorter-term interests, convinces neither the markets nor its citizens. It is this lack of credibility that would eventually generate a disruptive transfer union.

Luckily for Chancellor Angela Merkel and for Europe, the two main opposition parties in Germany – the Social Democrats and the Greens – are pro-EU. This creates a fresh opportunity for Ms Merkel and Wolfgang Schäuble, finance minister, to support the use of Eurobonds – an initiative that would reinforce Germany's ties to the euro.

Commissioner Olli Rehn said last month that the European Commission will be ready to propose a system of common issuance of euro-denominated government bonds before the end of the year. The proposal is for the use of Eurobonds as an instrument of debt management, not as a financing instrument for new expenditures.

Many options are possible, including giving the European financial stability facility new powers. The new bonds would assert the euro in the global markets. It is not even obvious that there would be a higher financing cost for the most creditworthy member states, given the liquidity of the new Eurobond market and the existing turbulence of the sovereign debt markets. To liberate the European Central Bank from the role it has been obliged to play would also be in the general best interests and in line with the best German traditions.

It will be difficult to find a lasting solution to the eurozone crisis without the use of Eurobonds. Today's summit should give a clear political signal that it is considering the Eurobond proposal. A European vision, based on the creation of a European instrument, backed by a precise timetable, is now the best way to restore trust and stability.

Mario Monti is president of Bocconi University and former European commissioner. Sylvie Goulard is a member of the European Parliament and rapporteur on the economic governance package

Now the central bank must act

Joseph Stiglitz

Today, Europe is at a critical juncture that may determine not only whether the euro will survive, but whether the global economy will be once again plunged into turmoil.

The current strategy for dealing with Greece's debt difficulties is not working. The market has given its verdict: the speculators have been handed an opportunity, and they have seized it. Of this we can be certain: Europe's response so far has amplified uncertainty concerning the future of the euro. "Contagion" has now spread from the periphery to the centre, to Spain and Italy.

Yet the problem is not so much economic as political. Europe is lucky that in most of the countries in the periphery, there were responsible governments that did not take populist stands. What George Papandreou has done in the past 18 months has been truly impressive – one could hardly have expected more. But in at least one of the countries – and perhaps in the future, in others – there wait in the wings less responsible politicians who would take advantage of widespread, and sometimes justified, views that Europe has not done what it should and has imposed politically unpalatable conditions.

It is easy to see what should be done. If Europe issues European bonds – supported by the collective commitment of all governments – and passes on low interest rates to those in need, debts are manageable. Even if there were some subsidy, Europe could afford it – compared with what will be lost if it does not assist those countries facing trouble.

The other ingredient of a successful response is restoring growth. The current uncertainty has had an especially adverse effect on banks and bank lending. A solidarity fund for stabilisation could, together with the European Investment Bank, make needed investments in the countries in trouble. A revolving loan fund for small businesses could provide money to proven enterprises, to help restart the engines of growth.

Europe's problems are partly the result of a well-intentioned but imperfectly conceived monetary union. It was hoped that, in spite of the marked differences, if countries only managed their debts, all would work well. Spain and Ireland, which both had surpluses and low debt to GDP ratios before the crisis, showed the fallacy in this logic.

As Europe stands at the precipice, it is time to end brinkmanship and political squabbles. The European Central Bank should realise that a restructuring, even if some American rating agency deems it a "credit event", means Greek bonds are safer than they were before; if they were acceptable as collateral before, they should be more acceptable after. Put bluntly, to not accept Greek bonds is to end Greece's membership in the euro, with all the consequences. The ECB must recognise too that for citizens of many countries, a deal without shared sacrifice by the private sector is unacceptable. But those advocating private sector involvement need to realise that the private sector will be reluctant to take a haircut on old loans, and will refuse to accept less than a risk-adjusted interest rate on new.

Resolving this crisis is easily within Europe's grasp. It is not a matter of economics. It is only a matter of political will.

The writer is a recipient of the 2001 Nobel Memorial Prize in Economics and professor at Columbia University

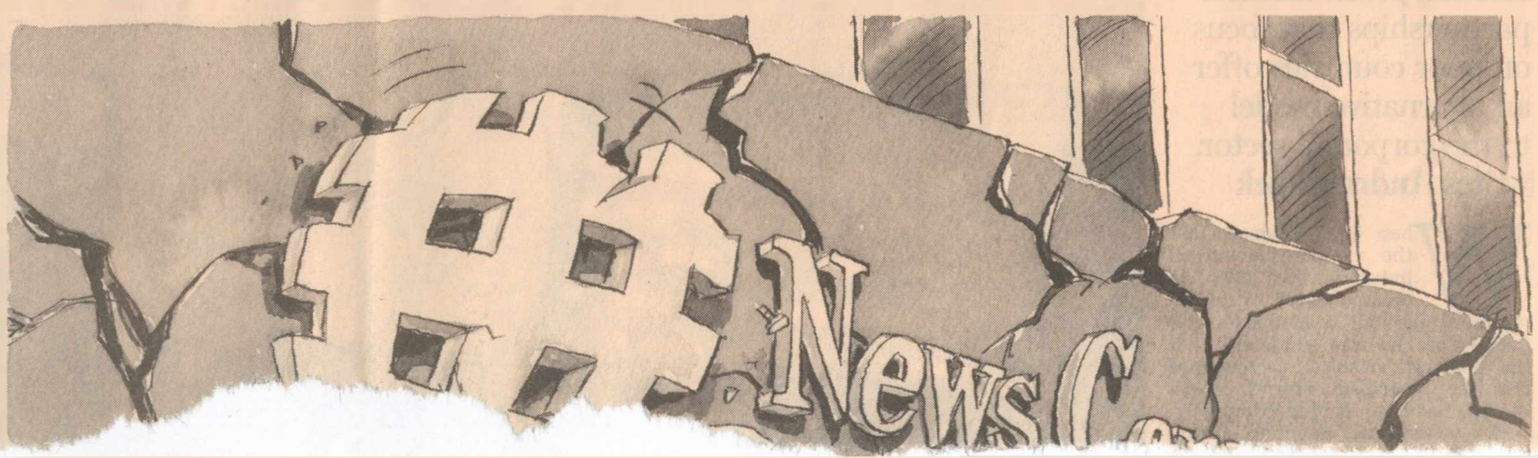
The best way for Rupert Murdoch to leave

John Gapper

There is no doubt which Murdoch family member emerged best from the phone-hacking hearing befor– a UK House of Commons sele–t committee this we– ... the room to la... idiotic foam... ass...

... and early 21st century, but he should not cling on to power in a way that tarnishes that record. Instead, he could pass it on gracefully while helping to reform Fleet Street.

No one can make him do so – he could behave like Sumner Redstone, the media mogul who remains executive chairman of both Viacom and CBS at the age of 88 despite plainly being past it, thanks to his 79 per cent voting stakes in both companies. Mr Murdoch could use the family's voting control of News ... to impose James, Elisabeth and ... three of his children, as the ... eds him. ... tention, as he ... ng. He spent ...



THE LEX COLUMN

Thursday July 21 2011

Cocos

It's no go for cocos. Contingent convertibles, bank debt that converts into loss-absorbing ordinary equity in a crisis, looked like the perfect post-crisis panacea. Swiss regulators backed them as an ordinary equity supplement. Credit Suisse sold $9bn of them in February. But the Basel Committee on Banking Supervision is not convinced: it wants the world's 30 too-big-to-fail lenders to use only ordinary equity to meet its proposed core equity tier one capital surcharge of between 1 and 3.5 per cent. Mario Draghi, chairman of the Financial Stability Board, has lent his support. In effect, that sounds the death knell for cocos.

Although they will survive in Switzerland and jurisdictions that want higher buffers than the Basel III minimum, the coco market is unlikely ever to reach the $1,000bn once forecast by Standard & Poor's. That is just as well because they are flawed in practice – mainly because of the difficulty of setting precise conversion triggers. Investors, aware of the likely criteria (such as the core tier one capital ratio falling below a certain level) and of the proximity to a trigger event, might dump the bank's shares to hedge against a looming conversion. That would fuel exactly the kind of "death spiral" that cocos were meant to avert. Moreover, cocos have little attraction as an equity substitute in the US, where interest payments on convertibles are not tax deductible.

Instead, banks will have to rely on retained earnings and share issues. Last month, Mediobanca Securities estimated that European banks would need to raise €62bn if a 2.5 per cent capital surcharge was applied in 2012.

This is tough for banks' shareholders but regulators are right: ordinary equity capital is the best absorber of losses, both in theory and in practice. No wonder European bank stocks are still a quarter below their post-crisis peak.

Eurodämmerung

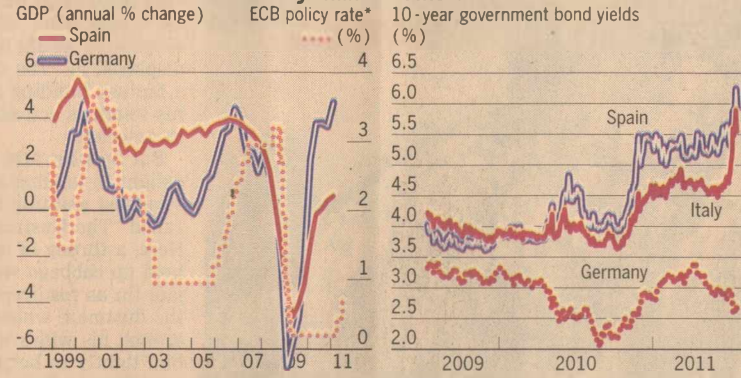
The hour of Europe is at hand. A European politician made that observation at the outbreak of the civil war in Yugoslavia two decades ago; Europe failed that particular test. It is proving equally inept at addressing an equally difficult but thankfully less bloody challenge – the eurozone debt crisis. As Italian and Spanish debt yields creep closer to the danger zone of 7 per cent, Thursday's emergency summit offers perhaps the last chance to rise to the occasion.

At a minimum, the summit must put forward a plan to offer Greece a second bail-out along with an emphatic restructuring of its debt; ringfence Ireland and Portugal by reducing the cost of their emergency funding and immunise Spain and Italy from the effects of contagion by offering financing guarantees. All of this requires acceptance that the eurozone's core must pay for the periphery's problems in an open-ended commitment. Failure until now to accept that inescapable fact explains why the crisis has become so severe and enduring.

That failure results from a lack of leadership, seen most blatantly in the aimless quest to avoid a Greek default. The eurozone has one functioning institution – its central bank. Ideally, it needs a second one, vested with fiscal powers: perhaps a European finance ministry or a type of International Monetary Fund.

In the shorter term, a successful summit will require political leadership, especially from Germany, which has gained most from the euro. European Central Bank interest rates have more closely tracked German economic growth since 1999 than, say, Spain's, indicating how favourable the eurozone has been for Germany. Yet Berlin's inattention in this crisis has put the burden of rescuing the euro on Europe's taxpayers – surely an unintended consequence. The summit offers an opportunity for eurozone leaders to get ahead of the markets and show that they finally know what they are doing. Without a credible crisis plan on Thursday, the hour of the euro may well have passed.

The euro: better for Germany than for others



Source: Thomson Reuters Datastream

* Euro overnight deposit rate

Emerging markets debt

It takes some nerve to ask for an upgrade amid a sovereign debt crisis. Yet César Purisima, the Philippines' finance minister, is entitled to ask the big two agencies to reconsider his nation's double-B credit rating, as he did this week. In terms of trading spreads over US Treas... Indonesia, one notch above. Besides, that baseline is more than a little dubious. In August alone the US government's spending will exceed income by $134bn – more than the Philippines' entire outstanding government debt stock ($121bn).

Emerging market treasury departments will be watching crisis talks in the US and eurozone with a quizzical eye. Yes, many are under strain from rising subsidy bills and patchy revenues. But unlike most developed markets, they have the growth get-out. The liabilities accrued in clearing up China's banking system, for example, fell from about 55 per cent of GDP in 1998 to 10 per cent last year, thanks to a rapidly rising denominator.

Second, many emerging economies can broaden their revenue bases by privatising state assets, extracting bigger dividends from state-owned companies, or simply collecting tax more diligently (which is one reason why Chinese revenues were up almost 30 per cent in the first half).

Third... reckoning, emerging G20 nations will cut their fiscal deficits by a quarter this year, to an average 2.7 per cent of GDP. Developed G20 nations will manage a 6 per cent reduction, to 7.6 per cent of GDP. Mr Purisima should rest assured. Even allowing for some market froth, there is good reason why protecting against default by his double-B rated nation costs a third less than for a default by double-A Belgium – whatever the agencies say.

BSkyB

The sky is clearing over British Sky Broadcasting. At some point in the phone-hacking scandal BSkyB was always going to decouple from News Corp. That moment came on July 13, when Rupert Murdoch scrapped News Corp's bid for the 61 per cent of the UK satellite broadcaster it does not own. The disappearance of the takeover premium lets investors look again at the standalone company and ask whether its future is as rosy as its past.

... trade on a forward price to earnings ratio of about 16, compared with 19 before the June 2010 bid approach.

BSkyB reached its target of 10m subscribers (set in 2004) in November last year; subscribers to its "triple play" (TV, phone and broadband) have grown from zero to 26 per cent in five years. It is weaning itself off pure customer growth to focus on premium products: entertainment and high definition services. UBS estimates that growth will expand 2.1 per cent over the next three years with average revenue per customer growing at 3.9 per cent, compared with 4.5 per cent and 7 per cent in the past five years.

That is a reasonable medium-term growth scenario. In the short term, however, there is the prospect of returning cash to shareholders, which – with whatever dubious justification – supports the shares.

BSkyB has little debt; Deutsche Bank forecasts that net debt to earnings before interest, tax, depreciation and amortisation will be ... increasing leverage to just 1.5 times. Something for chairman James Murdoch to think about ahead of next week's full-year results, if he is not otherwise too busy.

LSE

If the gossip is to be believed, the merger endgame is approaching for the London Stock Exchange. If so – and its executives talk this down – investors should look at the strength of the LSE's hand when that moment arrives. If it has what business schools call a good Batna (best alternative to a negotiated agreement), it can get a better price.

The LSE says it has a fine Batna, which is to go it alone. Two years ago, this was scarcely believable. It had strong businesses in cash equities and listings – among the lowest-margin lines for a modern exchange – and barely anything else.

Now, a feisty negotiator from another exchange might just believe that the LSE has a valid alternative to doing a deal. The latest trading data show that the LSE is growing in the right, higher-margin places. Cash equities, its traditional stronghold, accounted for only £32m, or 17 per cent, of its £190m revenues in the first quarter of this financial year, which ended on June 30. Its relatively new fixed income business saw revenues rise by 32 per cent to £9.8m. It has decent footholds in derivatives and in "post-trade services" (the exchange's catch-all term for the work of clearing and providing centralised counterparties).

But this can only go so far. LSE's greatest improvement came from net interest income, generally earned on collateral held to support trades, which rose 30 per cent compared with the previous quarter, to £25.8m. This is relatively low-quality income that cannot be relied on. Revenue from derivatives dropped slightly, while post-trade services, after accounting for the sale of its Servizio Titoli business, rose only 4 per cent.

The plan to diversify organically is working. The LSE still has to prove it can work well enough and fast enough to convince its investors, or potential acquirers, that carrying on without a big deal is a decent Batna.

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