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E.C.B. efforts fail to calm markets

FRANKFURT

Unexpected bond buying comes up short of what traders deemed adequate

BY JACK EWING
AND JULIA WERDIGIER

Once again seeking to calm market tension after efforts by euro zone governments failed, the European Central Bank on Thursday unexpectedly intervened in bond markets in an attempt to prevent the region's sovereign debt crisis from engulfing Italy.

The show of force initially bolstered Italian and Spanish bonds. But the move appeared to backfire as stock markets in Europe and the United States fell sharply after Jean-Claude Trichet, the central bank's president, warned of dangers ahead. The modest scale of the bank's bond buying apparently fell short of what investors considered adequate.

The market downturn began in Europe but quickly spread to the United States as soon as trading opened Thursday morning on intensifying investor fears about a slowdown in global economic growth and worries about Europe's debt crisis, which is centered now on Italy and Spain.

In another response to the escalating crisis, the E.C.B. moved to prop up weaker banks that may be having trouble raising funds, expanding its lending to euro zone institutions at the benchmark interest rate. The central bank left that rate unchanged at 1.5 percent, while the Bank of England left its benchmark rate at a record low of 0.5 percent.

Mr. Trichet declined to say what bonds the bank was buying or how much. He said the bank acted in response to "renewed tensions in some financial markets in the euro area." It was the first such intervention since March.

Mr. Trichet also said that uncertainty created by the U.S. budget debate had unsettled European markets.

"It's clear the entire world is intertwined," he said. "What happens in the U.S. influences the rest of the world."

As markets demanded higher risk premiums on Spanish and Italian bonds during the past week, analysts began to speculate that the E.C.B. would return to the bond market. But most had not expected the bank to act so quickly.

The E.C.B. will not disclose the scope of its bond buying until next week at the earliest, but early indications were that the amounts were relatively modest.

"It might be interpreted as more of a warning shot rather than a broad-based onslaught," analysts at Barclays Capital wrote in a note.

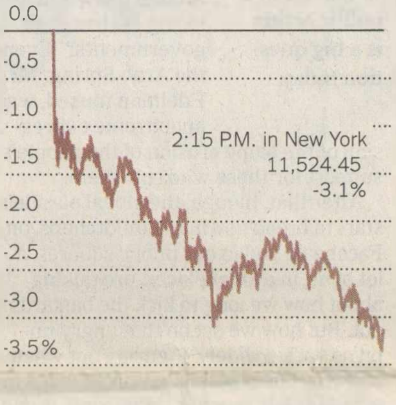
The E.C.B. first began buying bonds in the open market in May 2010, but tapered off the interventions earlier this year, a move investors may have interpreted as a lack of resolve. Michael T. Darda, chief economist at MKM Partners in Stamford, Connecticut, warned Thursday that half-hearted forays into the bond market "will fail, just like they did last year."

"In each case, the debt crisis got worse instead of better," he wrote in a note.

The E.C.B. also responded to signs of stress in interbank markets as institutions, wary of each other's exposure to troubled government paper, became reluctant to lend to each other. One worrisome sign was a spike in the cost for European banks to borrow dollars in the open foreign exchange market.

E.C.B., PAGE 15

Change in Dow industrials Thursday



Source: Bloomberg

STOCKS TUMBLE ON ECONOMIC FEARS
In Europe and the United States, markets dived on intensifying worries about global prospects. *PAGE 15*

BOND EXPOSURE THREATENS BIG BANKS
The vulnerability of banks in Italy and Spain has raised fears the debt crisis could inflict pain across Europe. *PAGE 15*

Market slump deepens in Europe and America

LONDON

Stocks tumble as qualms grow about currencies, debt and anemic growth

BY MATTHEW SALTMARSH

Stocks tumbled in Europe and on Wall Street on Thursday while bond yields gyrated amid intensifying concerns about the weakening global growth outlook and the euro zone's ability to find a path out of its debt crisis.

In Europe, there continued to be mixed signals from the authorities about how far they were willing to move to bolster their market support mechanisms. In the United States, weak economic activity has led to speculation about a possible new round of quantitative easing, the program of huge asset purchases, from the U.S. Federal Reserve.

''Everyone is watching for action from policy makers,'' said Philippe Gijsels, head of research at BNP Paribas Fortis Global Markets in Brussels. And so far, he added, there had not been enough from Europe and the United States to stem plummeting confidence.

The Bank of Japan intervened Thursday to dampen the value of yen and signaled it would try to stimulate growth, while the Swiss National Bank on Wednesday took monetary steps to weaken the franc. Both currencies have benefited from inflows from investors seeking safe assets.

Having opened higher, European stocks tumbled in late trading and continued their recent slide after a weak opening on Wall Street. The benchmark Euro Stoxx 50 index fell 3.3 percent and the DAX in Frankfurt shed 3.4 percent. In New York the S.&P. 500 index was down 3.6 percent in late trading, over a 10 percent drop from its April peak. The Dow Jones industrial average was down 3.3 percent and at one point had lost more than 400 points.

Analysts were also wary of possible bad news on Friday when the August U.S. jobs report will be released. A fear haunting markets in the United States is that the economy may be heading for a double-dip recession. Although the fractious debt ceiling debate is over, investors fear that spending cuts and weaker economic data point to a softer economy. The latest weekly jobless data Thursday again showed the economy was still fragile.

Keith Wade, chief economist at Schroders, said the investment house had cut its forecast for U.S. growth to 1.8 percent this year from 2.6 percent. He cited disappointing manufacturing and second-quarter growth data. In a report on the U.S. economy released Thursday, analysts at ING said, ''Three years into the recovery U.S. growth remains feeble. The U.S. is starting to look more and more like Japan in the 1990s.''

The European Central Bank tried to act Thursday to calm jittery bond markets. The bank's president, Jean-Claude Trichet, said the central bank's program of buying government bonds, which has been inactive since March, had by no means been dismantled. He also announced new steps to keep banks supplied with unlimited, longer-term funds.

European leaders committed themselves last month to increasing the powers of the bailout fund, known as the European Financial Stability Facility, to allow it to enter the market itself.

But that is unlikely to be ratified by national governments until late this year. In addition, they did not increase its size, leaving questions about whether it would be up to the task if a country as big as Italy or Spain needed help.

PAUL HANNA/REUTERS

Traders in Madrid on Thursday during a Spanish debt auction. Dealers said confidence was ebbing as policy makers seemed unable to find solutions on either side of the Atlantic.

The European Commission president, José Manuel Barroso, has been pushing euro zone leaders to do more. In a letter released Thursday, he called for a ''rapid reassessment of all elements related to the E.F.S.F.'' so that it was ''equipped with the means for dealing with contagious risk.''

He also criticized European politicians for ''the undisciplined communication and the complexity and incompleteness'' of the package agreed to at the summit meeting on July 21.

''Markets remain to be convinced that we are taking the appropriate steps to resolve the crisis,'' he wrote. ''Whatever the factors behind the lack of success, it is clear that we are no longer managing a crisis just in the euro area periphery.''

Those remarks met with a cool reaction from officials in Germany and the Netherlands.

In Rome, Prime Minister Silvio Berlusconi pledged Thursday to hammer out sweeping overhauls with business and labor union leaders by September to lift growth and stave off a debt crisis.

He said the measures would include privatization, infrastructure projects, cutting administrative hurdles, reducing the cost of politics and carrying out a ''historic'' change to Italy's constitution that would require balanced budgets.

''We want to adopt a comprehensive pact'' between the government, labor unions and businesses ''absolutely by September,'' Mr. Berlusconi said, a day after addressing Parliament.

Mr. Berlusconi played down growing fears that Italy could become the next country at risk in the spreading European debt crisis. ''I don't think the crisis will get worse,'' he said.

But Italian business and labor union leaders called for swifter action. ''We cannot allow ourselves to stay in neutral and at the mercy of the markets until September,'' they said in a statement.

The Italian Parliament is expected to go on recess on Friday until Sept. 6, but it could be reconvened in an emergency.

At a news conference, Finance Minister Giulio Tremonti, who has been weakened by a corruption investigation into a former aide, said Italy was in contact with the European Union, International Monetary Fund and Organization for Economic Cooperation and Development on strategies for growth.

A research report from Douglas McWilliams, the chief executive of the London-based Center for Economics and Business Research, added to the overall sense of pessimism about the prospects for the euro. While there was a ''real chance that Spain may avoid default and debt restructuring unless it gets dragged down by contagion,'' Mr. McWilliams said the outlook for Italy was far worse, with its starting debt position over 120 percent of gross domestic product.

''If one euro zone country defaults, the markets are likely to put pressure on the other weak economies and push up bond yields,'' he said, adding that this would make leaving the euro increasingly attractive.

Rachel Donadio contributed reporting from Rome.

Weak government bonds threaten big European banks

LONDON

As value of debt holdings falls, problems mount for lenders in Spain and Italy

BY LANDON THOMAS JR.

Ever since the European debt crisis began, the risk of contagion — of problems spreading from smaller countries to bigger ones, like Italy and Spain — has worried officials and investors.

Now, another type of contagion is causing concern: the risk that problems will spread to big banks, especially in Italy and Spain.

The growing vulnerability of the giant banks in the two countries is causing investors to fear that Europe's latest bid to get a handle on its festering debt crisis, adopted just a few weeks ago, has come up short.

The banks own so many bonds issued by their home countries that they are being weakened as the value of those bonds falls, amid concerns that the cost of government borrowing could become too expensive for Italy and Spain to bear.

Now there are signs that these concerns are, in turn, starting to make it harder and costlier for the banks to borrow money to finance their day-to-day operations, a troubling trend that, at the worst, could lead to liquidity problems.

Since Europe's second major rescue package was announced last month — aimed as much at calming fears over Spain and Italy as well as providing funds to Greece — the yields on Spanish and Italian bonds have hit more than 6 percent, sharply higher than they were paying on new debt just a couple of months ago.

In doing so, they have entered what analysts refer to as the ''danger zone'' for 10-year bond yields, with the cost of government borrowing so high that investors become unnerved, as was the case with bailed-out Greece, Ireland and Portugal.

Bearing the immediate brunt of this development are regional banking heavyweights like UniCredit in Italy and Santander and Banco Bilbao Vizcaya Argentaria, widely known as BBVA, in Spain, which traditionally have been reliable financing machines for their home governments and, as a result, are now saddled with large bond holdings that are losing value by the day.

Many of these banks hold domestic bond portfolios that exceed their capital levels.

According to a report issued Wednesday by Sanford C. Bernstein, a research firm, UniCredit's exposure to mostly Italian bonds is 121 percent of its core capital ratio. For Banca Intesa Sanpaolo, a less-diversified competitor, that figure rises to 175 percent. For Spain, the ratios are no less daunting: a startling 193 percent for BBVA, the second-largest Spanish bank, and a less alarming 76 percent for the global banking giant Santander.

As a result, the markets have begun to focus on a number of signs warning that some European banks are finding it harder to meet their financing needs, especially in dollars.

They are borrowing larger amounts directly from the European Central Bank in its weekly lending operations, suggesting they cannot find all the money they need from the private sector to keep themselves going.

GIANLUCA COLLA/BLOOMBERG NEWS

A UniCredit branch in Milan. The bank, which reported higher earnings than expected Thursday, has large holdings of Italian government securities, which are losing value by the day.

Some analysts said that perhaps most worrying was the rate it cost European banks to borrow dollars in the open foreign exchange market, by swapping their holdings of euros.

The rate has doubled in the past few days — still far below 2008 levels, when the market virtually froze, but the highest rate since May 2010, when the European debt crisis first started to intensify.

Recent write-offs by French banks over their own Greek bond holdings have compounded fears about the health of European banks.

UniCredit, the largest lender in Italy, on Wednesday reported better-than-expected earnings for the second quarter, and during a conference call, its chief executive said it had completed 83 percent of its borrowing needs for the year.

Nevertheless, that profit snapshot does not fully take into account the steep rise in the yields on Italian government bonds, to just over 6 percent now from about 4.6 percent in early June, which means that the value of those bonds has fallen.

As markets continued to hammer Italy, Prime Minister Silvio Berlusconi rebutted calls for his resignation Wednesday, saying that Italy's economic fundamentals were strong and pledging that his government was ''up to the task'' of fostering growth. But neither the center-left opposition nor the financial markets seemed to share Mr. Berlusconi's optimism or his confidence in his government's ability to carry out long-promised overhauls.

Even more worrying is that the European Financial Stability Facility, the so-called bazooka rescue fund that the members of the euro zone endowed last month with the powers to recapitalize weak banks, will not be able to offer any such aid for at least two months.

According to an official of the rescue fund, staff members there are working night and day to recast the entity, but do not expect to be finished until the end of August. At that point, the fund must be approved by the parliaments of the 17 members of the euro zone.

Only then could it go to the market and raise money to help a bank in need.

That may well be too late.

As investors flee Spanish and Italian government bonds, these huge bond holdings have become a significant millstone on their countries' banks — curbing their ability to lend and, consequently, heightening the prospect of a double-dip recession in Italy and Spain, two of the euro zone's slowest-growing economies.

Despite their best efforts to deleverage, all these banks have loans that significantly exceed their deposits. That makes them dependent on the good lending graces of their banking peers in Europe and the United States. That is one of the reasons U.S. money market funds had more than 40 percent of their assets invested in European banks.

Standard banking practice has been for these banks to put up as collateral their home market government bonds, which in the past were seen as liquid, risk-free investments — much like U.S. Treasury securities.

If, as was the case with Ireland and Greece, lenders stop accepting these bonds or start demanding more of the bonds to reflect their lower value, these banks may no longer be able to get the day-to-day financing that is their life blood. This is what happened during the crisis in the autumn of 2008, when banks stopped lending to one another, causing markets to seize up — and leading governments to bail them out or risk the weakest banks' failing.

''You could have a C.F.O. of a lending bank say, 'Look, I just do not want to take this credit risk,' '' said Marcello Zanardo, a European bank analyst at Sanford C. Bernstein, referring to chief financial officers. ''We are not there yet — but it is not impossible to get there.''

Investors fear that Europe's latest bid to get a handle on its festering debt crisis has come up short.

What is worrying many bank analysts — and surely the banks themselves — is that, in an investor panic, one might get there sooner rather than later.

One possibility is that LCH.Clearnet, the London clearing entity that in a transaction between two banks or other counterparties assumes the risk if the trade fails, may begin to demand more collateral if securities continue to lose value.

That would mean that an Italian or Spanish bank putting up a government bond to back a short-term loan or an agreement to repurchase a security would see that bond marked down by its clearer, requiring it to put up more bonds — or accept less cash to finance its operations.

According to LCH, once the gap between, say, a Spanish or Italian government bond and a benchmark triple-A bond index surpasses 4.5 percentage points, the issuer is liable for a trimming. At that point, the borrower has to put up more government bonds as security and, if the spread continues to widen, is ultimately forced out of the market.

But in some cases, demands for more collateral are already being imposed. According to one banker in London, who declined to be identified by name because he was not authorized to speak publicly, LCH has already begun to require large Spanish banks to put up more bonds to cover transactions.

Such was the case earlier with Greek, Irish and Portuguese banks. Exiled from the interbank market — in which banks lend to one another — they had to turn to the European Central Bank to satisfy their pressing requirements. So far, Italian and Spanish banks have made minimal use of the central bank's emergency financing facility.

If this trend continues, Merrill Lynch analysts wrote in a report Wednesday, it would have ''a very significant impact not only on Spanish spreads but also on the level of interbank stress. Resulting in full contagion within the euro zone.''

Graham Bowley contributed reporting from New York.

E.C.B. fails in its efforts to reassure markets

E.C.B., FROM PAGE 1

Mr. Trichet said that next week the E.C.B. would lend banks as much cash as they wanted for six months at the benchmark interest rate, assuming the banks could provide collateral. A six-month term is longer than is customary.

The central bank's actions on Thursday provided another example of the E.C.B. acting as the euro zone's firefighter in the debt crisis.

European leaders decided last month to authorize the European Financial Stability Facility — the European Union's bailout fund — to buy bonds in open markets, relieving the E.C.B. of that responsibility.

But it will take months before the rescue fund. known as the E.F.S.F., is able to start making purchases. In addition, European leaders did not increase the size of the fund, leaving questions about whether it would be up to the task if a country as big as Italy or Spain need help.

Speaking to reporters Thursday after a regular meeting of the E.C.B. governing council, Mr. Trichet beseeched political leaders to speed up efforts to cut their budget deficits and remove impediments to growth, like overly protected labor markets. ''The key for everything is to get ahead of the curve, in fiscal policy and structural reform,'' he said.

With Italy in danger of being swept over the same waterfall as Greece, Prime Minister Silvio Berlusconi on Thursday pledged sweeping changes to increase growth.

At a news conference later, the Italian finance minister, Giulio Tremonti, said Italy was in contact with the European Union, International Monetary Fund and Organization for Economic Cooperation and Development on strategies for growth.

Mr. Berlusconi interrupted Mr. Tremonti, to add, ''And the E.C.B.'' Mr. Tremonti looked taken aback and said, ''I think it's important, but not involved.'' But he suggested that he hoped the E.C.B. would buy some Italian bonds.

Mr. Trichet also gave a more subdued view of the European economy on Thursday.

''Recent economic data indicate a deceleration in the pace of economic growth in the past few months, following the strong growth rate in the first quarter,'' he said. While he expected moderate growth to continue, he said, ''uncertainty is particularly high.''

But some analysts said they still expected the E.C.B. to raise its benchmark rate for the 17-nation euro zone again this year, after Mr. Trichet retires at the end of October, handing the presidency to Mario Draghi, the governor of the Bank of Italy. The E.C.B. has raised its main rate in two steps since April, from 1 percent to the current 1.5 percent, in an attempt to head off rising inflation.

''The E.C.B. gave the impression that further rate hikes are necessary,'' Jörg Krämer, chief economist at Commerzbank, said in a note. ''However, the E.C.B. would probably immediately refrain from raising interest rates if the sovereign debt crisis escalated.''

Similarly, the Bank of England left its benchmark rate unchanged because the country's economy remains weak. The Bank of England also kept its bond purchasing program — which injects money into the economy to spur growth — at £200 billion, or $325 billion.

The British economy grew 0.2 percent in the second quarter from the first quarter, when its gross domestic product rose 0.5 percent. The manufacturing sector shrank in July, an u pected development that also pointe o a weak economy.

''It's not a spectacular recovery,'' said Michael Taylor, an economist at Lombard Street Research in London. ''It's choppy and it's disappointing and that does argue for an unchanged policy well into next year.''

A far-reaching government austerity program that froze public sector pay and pensions and increased some taxes is another factor holding back growth. At the same time, consumer price inflation remains well above the Bank of England's target of 2 percent — conditions that would normally lead the bank to raise interest rates.

Prime Minister David Cameron of Britain warned last month that the economic recovery would be difficult. His government is sticking to the deepest budget-cutting program since World War II despite criticism from members of the opposition, who argue it is too punishi

There is also growing pressure on the British government and the central bank to consider other measures to fuel economic growth. The National Institute for Economic and Social Research, which supplies information to the Bank of England and other clients, said on Wednesday that cutting taxes would be one way to help the economic recovery.

British businesses continue to feel the impact of the weak economy. Holidays 4U, a travel service, ran out of money on Wednesday, leaving hundreds of passengers stranded. Many retailers have started to discount merchandise early to lure wary consumers, whose disposable incomes have been reduced by inflation.

Julia Werdigier reported from London. Rachel Donadio contributed reporting from Rome.

Daily deal sites jostle in virtual land grab

Window on Wall Street

EVELYN M. RUSLI

PHOTOGRAPHS BY LEAH NASH FOR THE NEW YORK TIMES

Using a Groupon voucher at a coffeehouse in Portland, Oregon. The company has recently entered Indonesia, South Africa and Israel.

NEW YORK One maxim rings true in the burgeoning world of online coupons: Everybody wants a deal.

In recent months, Groupon and LivingSocial have been leading a virtual land grab, with dozens of companies angling for bigger shares of the fast-growing market and swallowing start-ups at a rapid rate.

There have been 37 acquisitions in the online coupon industry so far this year, compared with five in all of 2010, according to the 451 Group, a research firm that tracks the market. This week Google purchased Dealmap, a discount aggregator; CrowdSavings acquired Lucky Monkey, a deal site based in Kansas; and LivingSocial bought Ticket Monster, one of the largest players in South Korea.

While the acquisitions remain small, at $10 million or less, the frenetic pace reflects the industry's ambitions.

Companies are looking to cash in on the highly fragmented but lucrative local advertising market. Restaurants, retailers and other small merchants are expected to spend $16.1 billion this year on Internet advertising, according to Borrell Associates.

As sites jostle for the attention of local businesses and consumers, scale matters. Companies need a large sales force to connect with local vendors in major cities across the globe. Groupon, for example, has more than 7,000 employees. Merchants also tend to spend more money to list deals with sites that can attract greater numbers of potential customers, or subscribers.

With Ticket Monster, LivingSocial will increase its base by two million users and add about $24 million in revenue a month. Ticket Monster, a one-year-old Korean start-up, is a deal maker in its own right, having purchased Integrated Methods, a Malaysian social shopping site, less than three months ago.

''We thought Korea was an incredibly attractive market; Asia in general is an area we are really excited about,'' said Jake Maas, a LivingSocial senior vice president, who would not disclose the terms of the deal. ''In Ticket Monster, we also saw a team that could innovate quickly and drive innovation in the category.''

The leaders have moved especially quickly to expand overseas. On top of Ticket Monster, LivingSocial has bought four other daily deal sites this year, covering cities in Europe, Dubai and Thailand. Groupon, which made its

"Asia in general is an area we are really excited about."

first major foreign acquisition last year, with the $126 million purchase of CityDeal of Germany, has recently entered Indonesia, South Africa and Israel via acquisitions.

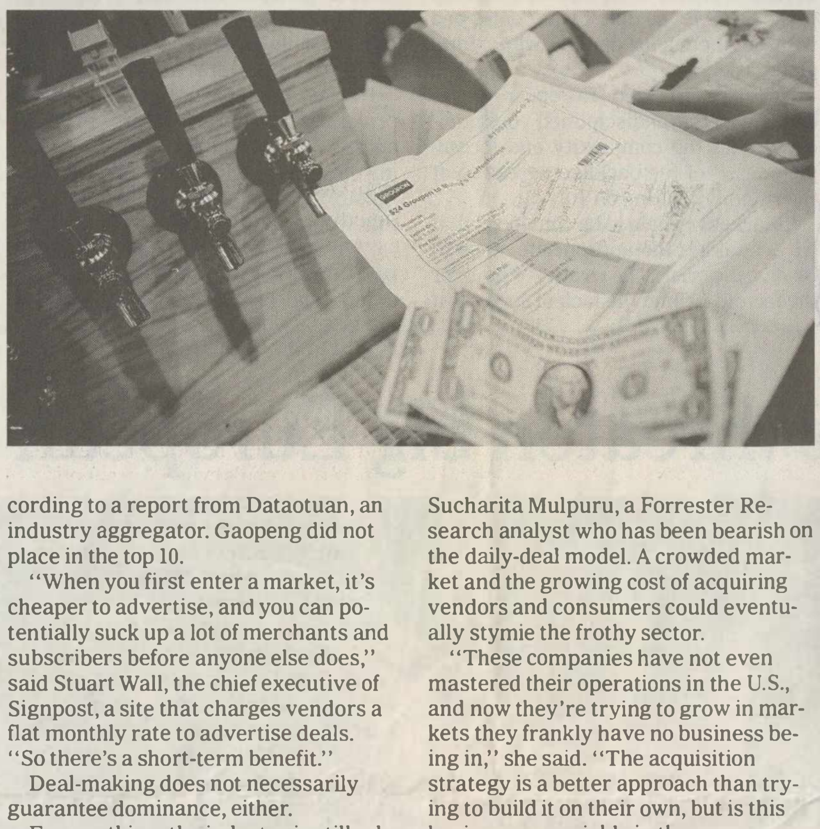
''Snapping up international start-ups is one way for companies like Groupon and LivingSocial to gain a foothold before competitors lock up the market, as we've seen happen with slower-gestating e-commerce and social networking properties in the past,'' said Tim Miller, a vice president at the 451 Group.

But the frenzy also underscores the vulnerability of the business model. With thousands of clones across the globe, Groupon, LivingSocial and other players need to expand into new markets and acquire rival teams. If they do not, they risk losing out to competitors — or worse, becoming the MySpace of the online coupon industry.

That is because first-mover advantage is crucial. This year, Groupon started a venture in China with a local partner, Tencent, one of country's largest Internet companies.

But the site Gaopeng was among the later entrants to the space, and it has floundered among thousands of competitors, armed with robust local sales teams.

In June, a site called Meituan was the top daily deal service by revenue, according to a report from Dataotuan, an industry aggregator. Gaopeng did not place in the top 10.



''When you first enter a market, it's cheaper to advertise, and you can potentially suck up a lot of merchants and subscribers before anyone else does,'' said Stuart Wall, the chief executive of Signpost, a site that charges vendors a flat monthly rate to advertise deals. ''So there's a short-term benefit.''

Deal-making does not necessarily guarantee dominance, either.

For one thing, the industry is still relatively young. Groupon is less than three years old. And it is unclear whether the companies can sustain their growth trajectories or what will happen as the industry matures, according to Sucharita Mulpuru, a Forrester Research analyst who has been bearish on the daily-deal model. A crowded market and the growing cost of acquiring vendors and consumers could eventually stymie the frothy sector.

''These companies have not even mastered their operations in the U.S., and now they're trying to grow in markets they frankly have no business being in,'' she said. ''The acquisition strategy is a better approach than trying to build it on their own, but is this business even viable in these countries?''

ONLINE: DEALBOOK
Read more about deals and the deal makers. nytimes.com/dealbook

For Italy, rescue isn't a certainty

James Saft

INSIDE THE MARKETS

Silvio Berlusconi is right to blame speculators, as he did again Wednesday, for Italy's deteriorating financial situation.

That is, the Italian prime minister is right in the same way and with the same implication that one of his Roman emperor predecessors would have been right in blaming barbarians for their troubles. The speculators behave as they do, just as the barbarians did in their northern forests, not out of caprice but because of the facts on the ground.

Italian 10-year bond yields have risen in recent weeks and are not far from the point at which Italy's finances will rapidly become unsustainable. This is despite a European plan to bail out Greece, an Italian plan of budget austerity and powers for the euro zone bailout vehicle, all established last month.

In short, markets are beginning to believe that Italy, which needs to sell about €200 billion, or $286 billion, each year in bonds, will be unable to finance itself in the public markets.

Why Mr. Berlusconi thought his own intervention — exhorting confidence on one hand while blaming speculators and the global economy on the other — would be helpful is unclear. Investors have lost confidence in Italy and, almost more to the point, in the euro zone framework that would need to come into play should Italy be required to seek aid.

This is a self-reinforcing prophecy, but so too was the false confidence that used to allow Italy to borrow money at just hundredths of a percentage point above the rates for Germany, despite the poor competitiveness of its industries and the evident shakiness of its political institutions.

To know whether a government is solvent, you have to anticipate long-term growth rates, financing rates and budget balances. Italy's problem is not the size of its debt per se, or even its budget balance outlook, but the outlook for long-term growth, which is poor, and its financing rate, which is rising sharply as people come to understand how the three factors interact. Italy will not be able to starve its way to growth through austerity, and there is no reason to have faith that it will be able to embark quickly on economic overhauls that would make it more competitive.

The implication is that Italy, and the euro zone, is embarking on yet another crisis, and that this one will be big enough to destabilize global markets and the debt markets in which banks finance themselves. That crisis is likely to end in yet another rescue, but Italy is so large, and the global economy so weak, that this is no longer a sure thing.

With Italy auctioning about €200 billion a year in debt, the European Financial Stability Facility, the fund set up to provide assistance to troubled member states, may not be large enough, as currently capitalized, to handle that much — especially as that a bailout would need to assure Italy's finances not for one year but for two or three.

So the fund needs to be increased beyond its current €440 billion. As soon as the fund gets the financing to grow, the debt profiles of the remaining member states in on the deal will decline. This can be seen clearly in French bond prices, which have performed poorly. If both Spain and Italy require help, France will be on the hook as guarantor of almost a third of the stability fund,

SAMANTHA ZUCCHI/EPA

Mr. Berlusconi has assailed speculators.

and a much larger one at that. That is a threat to France's triple-A credit rating.

The concept that the fund will serve as a fire break against contagion may well be false; the fund instead may turn itself into the means of contagion, as it will illustrate that the problems have grown too large for the guarantors.

There is also the fact that an increased bailout fund would probably need the approval of the German Parliament, something that may not politically be possible.

A wild card here is the European Central Bank. It had appeared to be backing away from direct purchases of bonds in the secondary market, but it surprised many Thursday by announcing that it had bought bonds on the open market, though it did not say which ones. But the E.C.B. action is likely to be temporary, and will have to be replaced quickly with a democratically backed solution.

The euro zone may just have one more round of moral hazard bailout ammunition in its chamber. But then again, it may not.

James Saft is a Reuters columnist.

E.U. opens a full review of stock market merger

BRUSSELS

BY JAMES KANTER

E.U. antitrust regulators on Thursday opened an full review of the $9 billion acquisition of NYSE Euronext by Deutsche Börse after complaints from customers and rivals that the combination could harm competition.

Approval by the European Commission, the European Union's executive arm, is the main hurdle for the deal, which would create the world's biggest operator of markets for stocks and derivatives and enhance the importance of Frankfurt, the home of Deutsche Börse, as a global financial hub.

The main concern of regulators in Europe is the hold Deutsche Börse and NYSE Euronext would have on exchange-based European futures trading, partly because of overlaps between the Eurex derivatives system, operated by Deutsche Börse, and Liffe, a similar system operated by NYSE Euronext.

''The proposed merger would remove a strong competitor from the market and would give the merged company by far the leading position in derivatives trading in Europe,'' said Joaquín Almunia, the E.U. commissioner for competition policy. ''The commission needs to make sure that markets which are at the heart of the financial sector remain competitive and efficiently deliver to users.''

The commission said it had 90 working days, or until December 13, to make a decision on whether to clear or block the deal. It could extend that deadline if the exchanges offered concessions.

The decision in Europe to give the merger a longer review was widely expected after Mr. Almunia, in March, described the tie-up as a complex case. Since then a number of groups representing the financial services sector have warned that the combination risks being too powerful in some areas.

The tie-up ''will create an exchange with a near monopoly in European exchange-traded derivatives,'' the FIA European Principal Traders Association, a futures industry group, said in a policy paper in July.

Antitrust experts said the exchanges would be seeking ways to make significant concessions without undermining the value of the deal by being required to sell part of their combined derivatives and clearing businesses.

''The key to a green light sometime in late 2011 or early 2012 will likely be a creative approach to remedies,'' said Kristina Nordlander, a partner in Brussels with the law firm Sidley Austin.

Executives from NYSE Euronext had already made plain that they expected a longer review in Europe.

The focus was likely to be on ''on what conditions may be placed on us, not on how to make or break the deal,'' Duncan L. Niederauer, the chief executive of NYSE Euronext, said this week.

Mr. Niederauer also suggested that some of the loudest complaints were coming from competitors including the London Stock Exchange and Nasdaq OMX rather than from customers, like banks, funds, traders and brokers.

Kraft to split into 2 businesses

NEW YORK

BY ANDREW ROSS SORKIN AND CHRIS V. NICHOLSON

Kraft Foods said Thursday that it would spin off its North American grocery business from its global snacks group, a move that comes 18 months after it bought Cadbury, the European candy maker.

The company said the snacks business would focus on ''fast-growing developing markets and in instant consumption channels,'' while the North American business would continue to develop the brands distributed through more traditional grocers.

''We have built two strong, but distinct, portfolios,'' the chief executive, Irene B. Rosenfeld, said in a statement. ''Our strategic actions have put us in a position to create two great companies, each with the leadership, resources and strong market positions to realize their full potential.''

The split is happening at a point of strength for the company. In its earnings announcement Thursday, it raised its outlook for the year, saying that internal net revenue, excluding any acquisitions, should increase at least 5 percent this year.

PAUL SANCYA/THE ASSOCIATED PRESS

The assembly line for the 2012 Chevrolet Volt at a General Motors plant in Hamtramck, Michigan. The company produced 2.4 million vehicles in the second quarter, up from 2.25 million a year earlier, and sales were strongest in its core North American markets.

G.M. posts 89% jump in quarterly profit

DETROIT

Improvements in mileage and quality given credit for solid sales increase

BY BILL VLASIC

General Motors said Thursday that it earned $2.5 billion in the second quarter, an 89 percent increase over its results a year earlier.

The United States' largest automaker, G.M. reported that revenue for the period increased 19 percent, to $39.4 billion.

The results were driven by strong sales in the company's core North American market, where it had profit of $2.2 billion, compared with $1.6 billion during the second quarter of 2010.

''G.M.'s investments in fuel economy, design and quality are paying off around the world as our global market share growth and financial results bear out,'' Daniel F. Akerson, G.M.'s chief executive, said in a statement.

The company said it had profit of $100 million at its European unit, which has been struggling with higher costs and sluggish sales. The results included a $100 million restructuring cost, G.M. said. In Asia, income was $600 million, while in South America it was $100 million.

The results were higher than expectations, given the slow rate of industry sales in the U.S. market.

''It's a solid quarter,'' said Dan Ammann, G.M.'s chief financial officer. ''It's on plan. We had good revenue growth and good earnings growth.''

G.M. ended the quarter with cash reserves and available credit of $39.7 billion, compared with $33.6 billion a year earlier. The company produced 2.4 million vehicles in the second quarter, compared with 2.25 million a year earlier. Its global market share was 12.2 percent, up from 11.6 percent a year earlier.

''We were able to get prices up and incentives down and that really highlighted the value of the product,'' Mr. Ammann said. ''Our goal is to drive long-term, sustained performance.''

The company said it expected income in the second half of this year to be ''modestly lower'' than in the first half, because of market conditions and the overall outlook for the industry.

Mr. Akerson said the company was counting on several new model introductions to fuel earnings growth.

Study points to risks of gas drilling

FRACKING, FROM PAGE 14

water sources, they are very difficult to remove, according to U.S. government and industry studies. One E.P.A. official involved with a current study being conducted by the agency on the risks of fracking on drinking water said the agency encountered continuing challenges to get access to current cases because of legal settlements.

''Our hands are tied,'' said the official, who spoke anonymously because he was not authorized to speak to reporters.

Brendan Gilfillan, a spokesman for the agency, said it had indeed encountered these barriers but that there were still enough alternate cases to study.

A 2004 study by the agency concluded that hydraulic fracturing of one kind of natural gas well — coal-bed methane wells — posed ''little or no threat'' to underground drinking water supplies. The study was later criticized by some within the agency as being unscientific and unduly influenced by industry.

Asked about the 1987 E.P.A. report and the West Virginia well, Mr. Gilfillan said the agency was reviewing them closely.

Instances of gas bubbling from fracked sites into nearby water wells have been extensively documented. The industry has also acknowledged that fracking liquids can end up in aquifers because of failures in the casing of wells, spills that occur above ground or through other factors. The drilling industry emphasizes, however, that no such cases exist in which the fracking process itself caused drilling liquids to contaminate drinking water.

Both types of contamination can render the water unusable. But contamination from fracking fluids is widely considered more worrisome because the fluids can contain carcinogens like benzene.

The risk of abandoned wells serving as conduits for contamination is one that the E.P.A. is currently researching as part of its national study on fracking. Many states lack complete records with the number or location of these abandoned wells and they lack the resources to ensure that abandoned and active wells are inspected regularly.

A 1999 report by the U.S. Department of Energy said there were about 2.5 million abandoned oil and natural gas wells in the United States at the time.