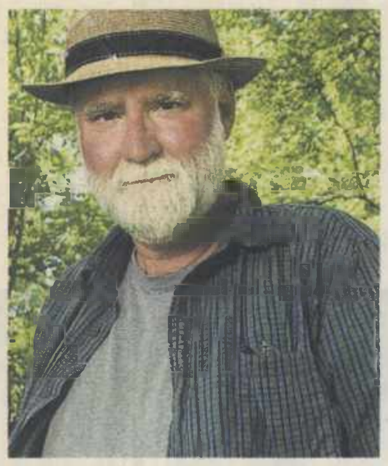

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THE MAN WHO IS SHAKING UP RESTAURANTS IS ON A ROLL

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Europe tries to get a grip on crisis

STAN HONDA/THE ASSOCIATED PRESS

The New York Stock Exchange on Friday, where trading was erratic as investors worried that the economic outlook on both sides of the Atlantic was looking increasingly precarious.

Stock markets plunged this week on concerns over faltering growth in the United States and the debt crisis in the euro zone. But the pressures eased on Friday after the U.S. government reported that job creation in July exceeded expectations.

Source: Bloomberg

U.S. HIRING INCREASES IN JULY

Employers in the United States added 117,000 jobs in July, exceeding the 46,000 created the month before. *PAGE 9*

BRACING FOR A DOUBLE DIP

Three decades ago the U.S. economy suffered one recession and then another. Will it do the same again? *PAGE 11*

Fears deepen that bad debts will hobble markets for years

PARIS

BY LIZ ALDERMAN

The leaders of Germany, France and Spain have already left for their summer vacations. But they were roused to action Friday in a bid to calm an escalating debt crisis after a worldwide rout in financial markets this week revived fears that Europe's sovereign debt problems were once again spinning beyond politicians' control.

Stocks whipsawed Friday after a better-than-expected U.S. jobs report, with many analysts increasingly concluding that Europe and the United States may be grappling with fundamental problems and the fallout from the global financial crisis for years to come.

A day after the Dow Jones industrial average plunged 512 points, the widely followed U.S. stock measure opened higher Friday, then quickly gave up its gains and fell more than 200 points before moving back into positive territory in late trading.

In Europe, the DAX in Frankfurt closed down 2.8 percent, and the CAC 40 in Paris fell 1.3 percent. The Italian stock market gave up its earlier gains at the end of the trading day, closing down nearly 1 percent.

"Politicians have done everything to demonstrate they are not ahead of the curve," said Stefan Schneider, the chief international economist at Deutsche Bank in Frankfurt. "That is hitting market confidence and creating a self-fulfilling feedback loop."

The turmoil prompted a flurry of phone calls between President Nicolas Sarkozy of France from his vacation retreat on the French Riviera and the German chancellor Angela Merkel, who chose a getaway in Italy — the main source of Europe's current troubles.

MARKETS, PAGE 10

Euro builder ending his career on a bitter note

FRANKFURT

Sovereign debt crisis rages as Trichet's 8-year term draws to a close

BY JACK EWING

Jean-Claude Trichet, the president of the European Central Bank, has spent much of his career building and defending the euro. But now, in a bitter twist, it looks as if his career may well end with the common currency in shambles.

Mr. Trichet, 68, will retire at the end of October after an eight-year term. Yet

NEWS ANALYSIS

markets are crashing, bond investors have turned on Italy and Spain, and it appears certain that when Mr. Trichet starts a new life on Nov. 1, the European sovereign debt crisis will be far from resolved.

Indeed, the euro area threatens to become the epicenter of a global financial crisis to rival the one that followed the collapse of Lehman Brothers in September 2008 — a horror sequel that Mr. Trichet himself has said the world cannot bear.

"Our democracies would not be ready to provide once again the financial commitments to avoid a great depression in case of a new crisis of the same nature," he told an audience in Madrid in May.

A lifelong civil servant who wraps his sang-froid and political toughness in French courtliness, Mr. Trichet generally gets high marks for the way he has managed the E.C.B. He may be the most influential public official on the Continent, the person who most embodies the dream of a single coin for the European realm.

But recent days have also highlighted what some critics say are policy mistakes by Mr. Trichet, or at least the institution he leads. And just as Alan Greenspan went from being lionized to lacerated after his years at the Federal Reserve were quickly followed by the global financial collapse, these missteps threaten to tarnish Mr. Trichet's legacy.

TRICHET, PAGE 10

FRANK RUMPENHORST/AFP

Critics of Jean-Claude Trichet say that recent events highlight his policy mistakes.

TONY GENTILE/REUTERS

A shopper in a market in Rome's center. The Italian economy posted a modest acceleration in its economic growth in the second quarter, but there were signs that the upturn was over.

Europe's leaders try to get grip on crisis

MARKETS, FROM PAGE 1

Prime Minister Silvio Berlusconi of Italy said G-7 finance ministers would meet "within days" to discuss the exploding financial crisis.

Officials agreed to target a balanced budget a year earlier than a 2013 deadline and to seek a constitutional balanced-budget amendment. The Italian Parliament may cut its recess short to pass the measures.

Mr. Berlusconi, who has been widely criticized for his tepid response to the recent financial attacks on his country, spoke Friday with José Luis Rodríguez Zapatero of Spain and with Herman Van Rompuy, the European Council president, his office said.

Meanwhile, leaders in Brussels sought to undo the damage done by José Manuel Barroso, the European Commission president, a day after he frightened investors by acknowledging the obvious — that Europe is gripped by political paralysis.

His remarks, which angered German policy makers trying to keep a lid on the crisis, were one of the catalysts for the markets' downward spiral Thursday, along with a half-hearted attempt by the European Central Bank to bolster the bonds of the most deeply troubled debtors.

Just days after Washington struck a last-minute deal to lift America's debt ceiling, a stark reality has come crashing in on both sides of the Atlantic: neither the United States nor Europe have yet fully recovered from the financial crisis that gripped the world from the spring of 2007 through early 2009.

Instead, brief bright spots of recovery have been overshadowed by rising unemployment and anemic economies, especially as austerity programs in Europe and spending cuts in the United States weigh on growth.

Many analysts say that the inability of politicians to speak with a unified voice, whether about the debt ceiling in the United States or the debt crisis that threatens to undermine the foundations of the European monetary union itself, is at the heart of these problems.

China, whose surging growth depends on the West, expressed renewed worries Friday about the declining fortunes of its two largest trading partners. "Europe's debt problems are still developing, and the U.S. sovereign debt default risk is escalating," China's foreign minister, Yang Jiechi, said during a visit to Poland. He urged all countries to "further increase communication and coordination."

Europe's leaders seemed to take the hint — for now. But they have been down this road before.

"All of us who are in responsible positions in Europe will have to do much better in order to ensure verbal discipline and rigor," Olli Rehn, the European economics commissioner, said at a hastily called press conference in Brussels on Friday.

"All of us who are in responsible positions in Europe will have to do much better."

European officials were "working night and day to put flesh on the bones" of an agreement they struck in July for a second bailout of Greece and to reinforce its sovereign rescue fund, the European Financial Stability Facility. The fund is supposed to keep the debt-laden economies of Italy and Spain from succumbing to market attacks the way Greece, Ireland and Portugal did.

"Once investors understand that all this work is under way behind the scenes, they will be reassured," Mr. Rehn said. "It is not as if the fundamentals of the Italian or Spanish economies have changed overnight."

That may be. But with Greece, Ireland and Portugal on the hook for an unprecedented bailout from their European partners, investors are now taking aim at any country with low growth and high debt, hallmarks that plague the much larger Spanish and Italian economies as well.

European parliaments are scheduled to vote on expanding the capacity and scope of the lending facility after their August vacations. But the worry is that financial markets will not wait that long, and will drive up borrowing costs for Italy and Spain to levels that will make it much harder for them to maintain a sustainable debt load.

If those rates get too high, the fear is they will be shut out of the credit markets and forced to turn to their European partners for financial assistance — something that would probably overwhelm the financial capacity of Germany and France, the two biggest contributors to the rescue programs, aside from the International Monetary Fund.

"If they had agreed on those measures nine months ago it would have prevented the crisis from spiraling to this extent," said Simon Tilford, the chief economist at the Center for European Reform in London. "But this is far too little too late."

Europe's politicians are being "stubborn" in the face of market pressure because they believe they put together a real package at the summit meeting that addresses the underlying problems, Mr. Tilford said. But by failing to recognize that markets act faster than they do, politicians risk inviting continued attacks by market traders.

Adding to their woes, signs of economic weakness are now emerging even in some of the healthier countries. Industrial output fell in June in Italy and Spain, and both economies grew at a tepid pace in the second quarter. While the German economy remains strong, industrial production there also unexpectedly slid in June, by 1.1 percent, as construction activity also slackened.

In their conversations Friday, the French, German and Spanish leaders agreed that governments needed to coordinate better to react to fears over the global economy, officials reported. They reiterated that the accords reached on June 21 should be applied as soon as possible in September.

"We need rapid and operational decision making," the French finance minister, François Baroin, told French radio Friday. "That's what President Sarkozy and Chancellor Merkel are working together to do."

But Germany warned Friday that it would oppose any plan to introduce common euro bonds backed by the nations of the euro zone as a group, a mechanism that many think may be necessary to stem Europe's problems. Germany fears that such a move would require Europe to adopt more fiscal federalism than it has ever been willing to embrace.

"Eurobonds are sweet poison," Joachim Pfeiffer, a lawmaker and economics spokesman for Mrs. Merkel's parliamentary conservative bloc, said on Friday. "Never should Germany cross its red lines."

Mr. Sarkozy also has something to fear: if the crises in Italy and Spain cannot be tamed, France, as one of the major contributors to the cleanup operation, would be in an increasingly weak financial position.

Already spreads on benchmark French bonds have widened against ultrasafe German bunds. And while growth is not lagging, France's fiscal position is relatively weak, and its structural budget deficit is high. If the size of the rescue fund were to increase enough to protect both Spain and Italy, investors might start to look askance at France's ability to underwrite its share, analysts said.

Meanwhile, even outside the euro zone troubles erupted. Prime Minister David Cameron of Britain, also on holiday in Italy, spoke to Mervyn King, the governor of the Bank of England, on Friday and said he was "fully in control" of the country amid financial market turbulence.

Judy Dempsey contributed reporting from Berlin, James Kanter from Brussels and Matthew Saltmarsh from London.

Crisis clouds end of Trichet's term

TRICHET, FROM PAGE 1

Mr. Trichet may be remembered "as a charming and talented leader who failed to grasp the gravity of the crisis," said Charles Wyplosz, a professor of economics at the Graduate Institute in Geneva.

Some critics, including Mr. Wyplosz, say the E.C.B. made a fatal error when it began buying Greek, Irish and Portuguese bonds in May 2010, a decision that has left the bank holding more than €74 billion, or $105 billion, worth of questionable debt. Greece should have been allowed to default and restructure under the guidance of the International Monetary Fund, Mr. Wyplosz said.

Other analysts say the bank had no choice but to intervene in dysfunctional markets, but sabotaged its own efforts by moving too hesitantly. The E.C.B. should have shown a willingness to buy Spanish and Italian bonds as well, they say.

"What isn't helpful is if you stop halfway," said Frank Engels, co-head of European economics at Barclays Capital in London, who generally holds Mr. Trichet in high regard. "Either you would have abstained entirely, or you would have gone all the way."

The E.C.B.'s interest-rate policy has also drawn scorn, with critics calling it deeply inconsistent.

The bank has raised the benchmark interest rate twice since April to prevent inflation in fast-growing countries like Germany or the Netherlands. At the same time, the E.C.B. has pursued a loose monetary policy in weaker countries like Greece and Ireland by allowing banks there to borrow central bank funds cheaply. On Thursday, amid signs of serious tension in the interbank markets, the E.C.B. expanded the availability of low-cost loans to banks.

"If this is all part of a single objective, then how can you turn one lever toward the right and one to the left?" said Marie Diron, an economist in London who advises the consulting firm Ernst & Young and previously worked at the E.C.B.

With European economies slowing and the debt crisis intensifying, critics say, the E.C.B. is making the same mistake this year that it made in July 2008. Then, the bank raised the benchmark interest rate to 4.25 percent from 4 percent even as the financial crisis was gathering force.

MICHELE TANTUSSI/BLOOMBERG

Jens Weidmann, the Bundesbank president, opposed a decision to buy bonds.

After the collapse of Lehman Brothers only two months later, the E.C.B. was obliged to throw monetary policy into reverse, lowering the rate to 1 percent by May 2009. It has been at 1.5 percent since July.

Mr. Trichet, who declined through a spokeswoman to comment, has a more limited arsenal of policy tools than Ben S. Bernanke, his counterpart at the Federal Reserve. The E.C.B. charter would not allow it to flood the economy with money the way the Fed has done through its purchases of securities.

In addition, Mr. Trichet's power is more diffuse. E.C.B. policy is set by the bank's governing council, which consists of the 17 heads of euro area central banks plus the six members of the executive board, which includes Mr. Trichet. Each member has one vote.

Divisions among the members have spilled into the open during the past two years, including this week. The split dramatizes the difficulty Mr. Trichet faces in presenting a unified front and ensuring that markets remain in awe of central bank power.

On Thursday, after the E.C.B. resumed buying bonds on open markets for the first time since March, Jens Weidmann, the president of the Bundesbank, objected and was joined by several other members, an official with knowledge of the proceedings said. The official asked not to be identified because of the sensitivity of the matter.

At a news conference Thursday, Mr. Trichet conceded that there was not unanimous support for the bond purchases. The internal divisions raised doubts about E.C.B. resolve, and led bond investors to conclude that the bank would not intervene to support Italy and Spain. A sell-off of both bonds and stocks ensued.

Mr. Trichet has also had to contend with governments that have been focused on pleasing their domestic electorates and slow to respond to the crisis. Almost since taking office in 2003, he has been badgering leaders to cut their budget deficits and deregulate to encourage entrepreneurship and growth.

He still boasts about how in 2004 he stood up to French and German leaders who wanted to loosen rules on government borrowing, part of the Maastricht Treaty that Mr. Trichet helped write. Almost every euro area country, including Germany, has violated the debt limits.

"If this is all part of a single objective, then how can you turn one lever toward the right and one to the left?"

Unlike the politicians, Mr. Trichet stuck to his part of the bargain. Since the introduction of the euro in 1999, the E.C.B. has held inflation below the official target of about 2 percent.

That no doubt was the legacy Mr. Trichet hoped to leave in October. Fiscal prudence was in many ways the theme of a career that began in elite French universities and later included high-level posts in the French government, before he was appointed governor of the Bank of France in 1993. In that job, Mr. Trichet earned a reputation as a hard-liner who helped restrain the spendthrift impulses of French politicians, winning the admiration of German leaders who backed him as E.C.B. president.

After all, fighting inflation and preserving the integrity of working citizens' hard-earned euros is the E.C.B.'s No. 1 task.

Though Mr. Trichet has only three months left, that time could be crucial. He has made a point of not discussing his retirement plans, and to appear as vigorously engaged as ever. With spreads on Italian and Spanish bonds reaching the point where officials in those countries would have trouble issuing debt at sustainable interest rates, the E.C.B. may be the only institution powerful enough to intervene convincingly in markets.

The bank would probably have to violate its own charter and effectively print money through huge purchases of Spanish and Italian bonds. But some economists predict the bank will have no choice. For Mr. Trichet, it may prove the only way to preserve his life's work.

"Only the E.C.B. can do something," Mr. Wyplosz said. "We are in a such a dangerous situation that I don't worry about legalities. Now they have to go to the bitter end and do what they have to do to prevent a breakup of the euro area and a world crisis."

With stock markets charting an erratic course, the day belongs to cash

NEW YORK

Nervousness over debt in the U.S. and Europe is driving investors' shift

BY NELSON D. SCHWARTZ

It has become a frantic flight to safety.

Investors have been roaring into Treasury bonds, cash and other low-risk assets, acting on their fears about the weak global economic outlook.

Just last week, the markets showed signs of nervousness about the government's creditworthiness during a standoff over Washington's debt limit. But now, yields are headed lower, reflecting a surging demand for Treasury debt, which has long been considered almost as secure as cash. Ten-year rates have approached depths not seen since October 2010, before the Federal Reserve began to pump billions of dollars into the economy amid fears of a slowdown.

Rates on even shorter-term credit, including six-month Treasury bills and overnight loans in the vast market for repurchase agreements, are close to zero.

Above all else, cash has become the investment of choice this past week as the deepening economic and debt worries in the United States and Europe have made stocks look like a minefield to be avoided.

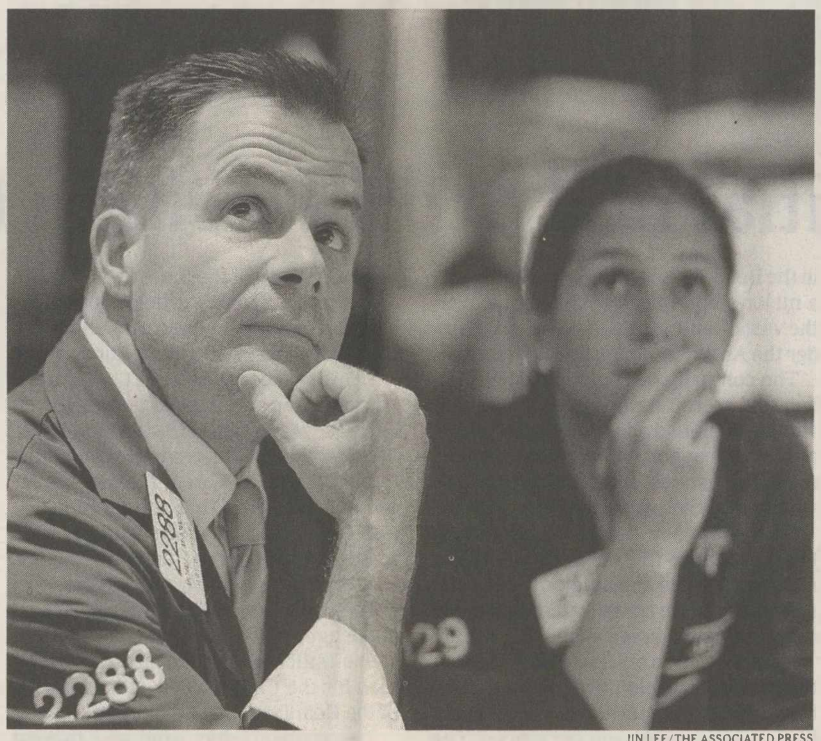
"The move to cash is symptomatic of a broader concern about growth and the stock market," said Mike Ryan, chief investment strategist at UBS Wealth Management Americas. "It's all part of a generic derisking exercise."

Tom Forester, chief investment officer for the Forester Value Fund, based in Lake Forest, Illinois, summed up the situation more succinctly. "Cash doesn't go down," he said.

Mr. Forester said he was shifting assets into a money market fund that invests in Treasury notes. For other institutional investors, even money market funds seemed risky, and they instead sought the security of cash invested in commercial bank accounts.

The huge buildup in cash does not suggest that the world financial system is on the brink of another Lehman-style panic. But it does underscore the broader economic challenges facing the United States and Europe, particularly the fear and uncertainty that have taken hold among companies, financial institutions and individuals.

Many companies are holding off on investing in new capacity and creating new jobs, instead stockpiling cash in case of another panic. And banks on both sides of the Atlantic are cautious about lending, restricting the money available to both businesses and consumers. Finally, individuals are clamping down on spending, too. U.S. consumer spending in June dropped for the first time in nearly two years, according to government data released a few days ago.



JIN LEE/THE ASSOCIATED PRESS

Traders who worked the floor on the New York exchange Thursday had a wild ride.

At the height of the uncertainty over whether the debt ceiling would be raised and with a potential default in the offing, in late July, investors pulled more than $100 billion from money market funds and put much of it into banks, raising fears that the funds could see a run that resembled the one after Lehman Brothers' collapse in 2008.

Through July 20 this year, holdings of cash in U.S. commercial banks surged 85 percent, or $912.7 billion, to $1.98 trillion, according to the Federal Reserve.

In a sign of just how much cash had poured into commercial bank accounts, Bank of New York Mellon said Thursday that it would charge institutional clients with more than $50 million on deposit a fee of 0.13 percentage point. The move is intended to recover some of the cost of managing the money, but is also a bid to slow the so-called hot money that has been ricocheting among Treasury securities, money market funds and pure cash balances at the big banks.

Bank of New York Mellon said the fee would be applied only "to a small number of institutional clients with extraordinarily high deposit levels where the deposits have increased significantly in recent weeks, well above market trends." The bank did not disclose how much cash had poured into its coffers recently.

Over all, U.S. banks took in nearly $200 billion between mid-June and mid-July as institutional investors fled money market accounts and sought the safety of accounts protected by the Federal Deposit Insurance Corp., according to Joseph Abate, a money market strategist at Barclays Capital.

While its rivals have not yet announced similar moves, Bank of New York's charges are likely to force cash out of banks and back into money market funds and Treasury debt, driving rates even lower where possible, Mr. Abate said in a note to investors Thursday.

"The movement into deposits during a financial crisis is expensive for U.S. banks because they have to pay deposit insurance on these extra inflows," Mr. Abate wrote. "These inflows mostly represent 'hot money.'"

There are signs that money market funds are beginning to regain some of their appeal now that the debt ceiling has been raised and as stocks swoon.

Amid the decline on Wall Street and approval of the debt ceiling increase this past week, $13.1 billion went back into money market funds Tuesday and Wednesday, said Peter Crane, the president of Crane Data, which tracks money market mutual fund flows.

"Bad news for everyone else is good news for money market funds," he said.

That is certainly why they appeal to Mr. Forester. He has been building up his cash position for weeks, he said, selling shares of past winners like International Business Machines and Honeywell.

The weak growth in U.S. gross domestic product in the first half of 2011, a figure released by the government last Friday, only confirmed his doubts, he said. Now, Mr. Forester's cash position in his $210 million stock fund equals 22 percent of assets, about double the average since he started the fund 11 years ago.

"You do this ahead of time, you don't do it when the world's falling apart," he said. "We've seen a lot of this coming."

Julie Creswell contributed reporting.