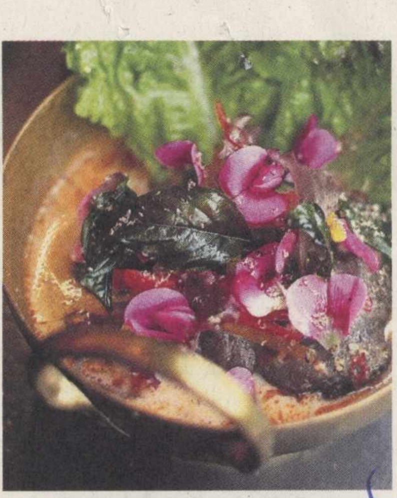

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Stocks sway on gloomy outlook for economy

FRANKFURT

Faith that governments and banks can cope with debt is widely questioned

BY JACK EWING
AND JULIA WERDIGIER

Stock markets in Europe and Asia sustained another day of setbacks as investors questioned the ability of governments and banks to cope with debt problems at a time of slowing economic growth.

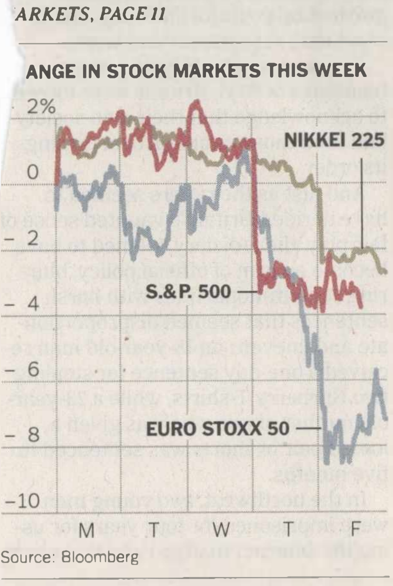
"There's a lot to worry about," said Laurent Fransolet, head of European fixed-income strategy at Barclays Capital. He attributed market losses to fears that slowing growth means "we may be at a very bad turning point globally."

U.S. markets were more sanguine Friday, trading lower by midafternoon but not repeating the steep slide of a day earlier on economic worries. Most major European indexes lost 2 percent on Friday, while Asian markets, which were catching up with heavy U.S. selling on Thursday, sank 2 percent to 6 percent.

The losses over the past few days relect an accumulation of discouraging news, including feeble economic data in the United States and Europe, and signs that some European banks were having trouble borrowing on the interbank market. Indications that banks were nistrustful of each other's creditworthiess revived unwelcome memories of

ARKETS, PAGE 11

ANGE IN STOCK MARKETS THIS WEEK



Source: Bloomberg

RISKS ABOUND IN FLIGHTS OUT OF STOCKS
A rush into gold or U.S. Treasury securities may not be the best long-term strategy, Paul Sullivan writes. *PAGE 9*

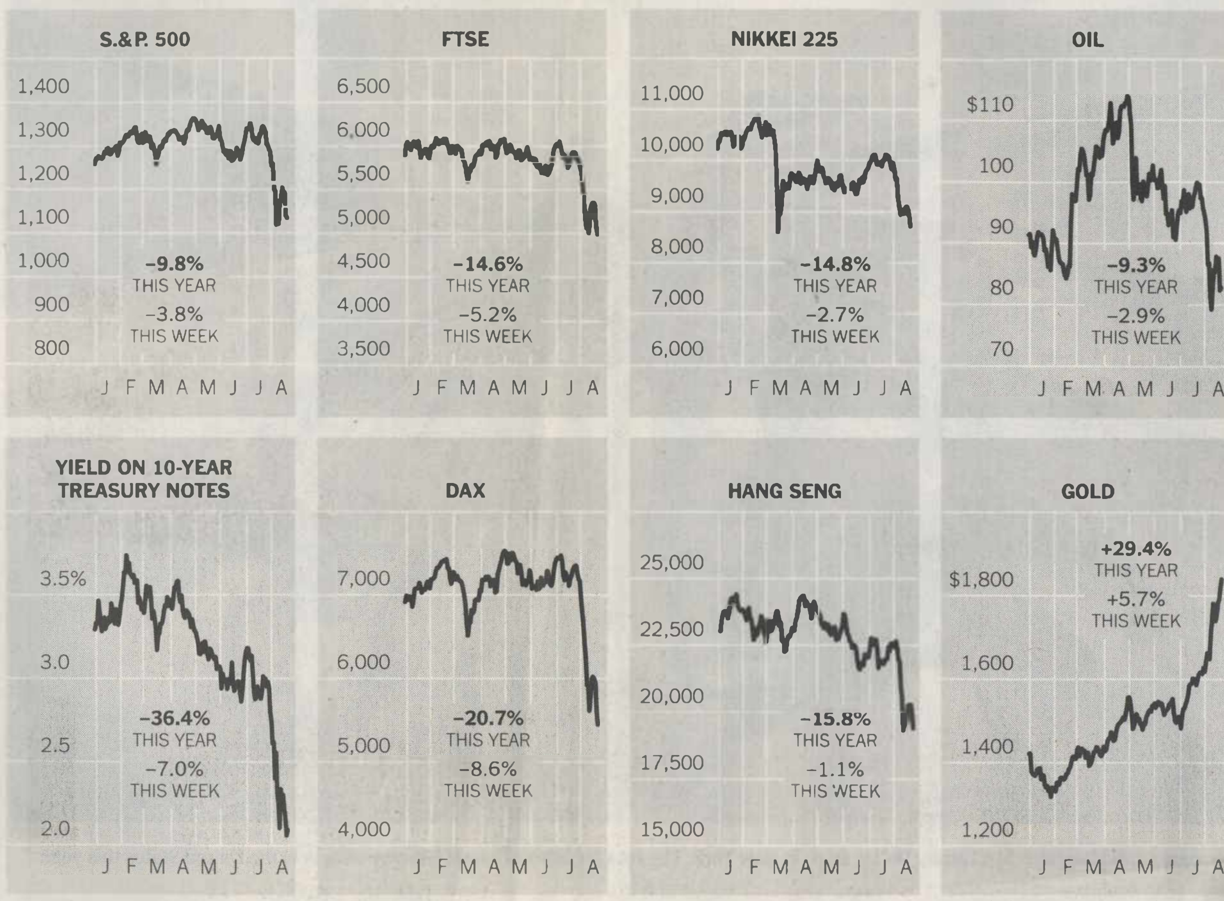
AMONG THE TITANS, THE PARTY RAGES ON
As some criticize the symbolism of it all, equity financiers continue to throw opulent birthday bashes. *PAGE 11*

MARKETS COMPAN

Rising doubts over debt add to stocks' wild ride

MARKETS, FROM PAGE 1

After relative stability earlier this year, many equity markets have fallen sharply amid slow economic growth and debt worries.



Source: Bloomberg

Note: Figures as of afternoon trading in New York.

the seizure in interbank lending that followed the collapse of Lehman Brothers in September 2008.

The sell-off "seemed to have its roots in free-floating anxiety about euro land's economic and financial stability," Carl B. Weinberg, chief economist at High Frequency Economics in Valhalla, New York, wrote Friday in a note.

European banks were once again the focus of investors' wrath Friday, losing 1.8 percent across the board. The selling spree included institutions that have so far weathered the debt and financial crises fairly well. Deutsche Bank slipped 2.7 percent Friday, while shares of Banco Santander in Spain fell 3.1 percent.

Some banks that had slid the most Thursday stabilized, however. Commerzbank in Frankfurt, which sank almost 10 percent Thursday, was down an additional 0.4 percent on Friday. Dexia, based in Brussels, nudged up 0.1 percent after plunging 14 percent Thursday. Société Générale in France fell 3.4 percent after it fell over 12 percent Thursday.

This month Dexia reported a €4 billion, or $5.8 billion, loss in the second quarter as it recognized losses on Greek bonds and other damaged assets. The bank also said that it borrowed €17.5 billion from the European Central Bank in March. When banks borrow from the E.C.B., investors may conclude that they are having trouble raising money at reasonable rates on open markets.

Dexia did not respond to telephone and e-mail requests for comment.

In the broader market, the Dow Jones industrial average was down 0.8 percent Friday afternoon, while the Standard & Poor's 500-stock index was 0.7 percent. The FTSE 100 in London fell 1 percent and the Euro Stoxx 50, a barometer of European blue-chip stocks, pulled back 2.2 percent. The Euro Stoxx 50 tumbled 6.4 percent over the week, while the Dow industrials were down 3.3 percent for the week by midafternoon.

Asia, which had missed the worst of the selling Thursday, pulled back sharply Friday. The Nikkei 225 stock average in Japan closed down 2.5 percent; the Kospi in South Korea plummeted 6.2 percent; and the Hang Seng index in Hong Kong fell 3.1 percent.

All the markets were moving on worries over the health of European banks and renewed concerns over the global economy. A top official at the European Central Bank confirmed that the bank was seeing tension in interbank markets. Jürgen Stark, a member of the E.C.B. executive board, said in an interview with the German newspaper Handelsblatt that many banks were choosing to park money at the central bank, earning a modest 0.75 percent interest. Analysts take that as a sign that banks would prefer to earn a low interest rate at the E.C.B. rather than risk lending the money to each other.

"We take this signal seriously," Mr. Stark said in the interview published Friday. He added, however, that "the situation is not comparable with the situation at the outbreak of the financial crisis in autumn 2008 after the bankruptcy of Lehman Brothers."

One of the things investors will be looking in the coming week is whether the E.C.B. can continue to hold down the yields on Italian and Spanish government bonds. If not, Rome's and Madrid's borrowing costs could again spike to the point that the countries' debt loads become unsustainable. The yields on both Spanish and Italian bonds had surpassed 6 percent in recent weeks but have since fallen back significantly and were under 5 percent on Friday.

Mr. Fransolet said that the E.C.B. appeared to have spent about €9 billion to €10 billion on Wednesday alone, intervening in bond markets, after disclosing that it had spent €22 billion the previous week. Bloomberg News reported that the E.C.B. bought small amounts of Italian bonds Friday.

The action has worked so far, but the E.C.B.'s resolve is likely to be tested when trading volume picks up at the end of the month as the European vacation season comes to a close, and as countries attempt to sell new debt.

"We have not seen wholesale selling over the past week or so," Mr. Fransolet said, about government bonds. But he added, "The bigger test will be when you go back late August and then Sept. 1, when you've got auctions."

Mr. Weinberg, at High Frequency Economics, said, "It is only a matter of time before one of the big hedge funds decides to take a poke at the markets to see if they can dislodge the E.C.B.'s hold on prices."

"If the E.C.B.'s support is undermined, we should be looking for banks to fail," he added. "This is our end-of-summer nightmare."

Mr. Stark of the E.C.B., who is believed to be among a minority on the central bank's governing council who oppose the bond purchases, told Handelsblatt that the intervention would continue "as long as tensions in the market continue."

The E.C.B.'s bond purchases are still less than a tenth as big as the U.S. Federal Reserve's securities purchases, measured as a proportion of gross domestic product, Mr. Stark said.

Many analysts regard the E.C.B. intervention as merely a stopgap measure; they hold that ultimately the onus is on European leaders to find a solution to the debt crisis. Efforts so far have fallen short, including promises by President Nicolas Sarkozy of France and Chancellor Angela Merkel of Germany this past week to take concrete steps toward a closer political and economic union of the 17 countries in the euro zone.

"Investors are willing to consider any concrete plans which may be put forward to tackle these issues," said Richard Hunter, head of British equities at Hargreaves Lansdown Stockbrokers, "but for the moment none are forthcoming, which in turn is leading to an increasing sense of frustration."

Debate continued about whether one solution might be for European countries to issue common debt known as euro bonds and backed by the euro zone as a bloc. The European Commission may present draft legislation on euro bonds after completing a feasibility report, Bloomberg reported, quoting Olli Rehn, the European commissioner for economic and monetary affairs. Mr. Rehn made the statement in a written response to questions from the European Parliament.

But Mr. Stark of the E.C.B. said that euro bonds would be a "sham solution" that would "create completely wrong incentives," encouraging countries to postpone urgently needed efforts to cut debt.

Shares of several British banks fell after data showed they were payin more to borrow dollars, Reuters repo ed. A shortage of dollar financing w one of the nastier features of the 2008 crisis. Shares of Royal Bank of Scotland, Barclays fell 5.4 percent and Lloyds Banking Group dropped 4.8 percent.

Some analysts said that the level of market fear was out of proportion. "While some of the data is clearly worrying, our central scenario is of a slowdown, and not a meltdown," analysts at HSBC wrote Friday. Corporate balance sheets — unlike those of governments — remain, on the whole, very healthy, HSBC said.

Still, "the structural debt problems in Europe, weaker U.S. economic data and growing concerns on the impact to growth are all recurring concerns that are likely to keep markets volatile," the HSBC analysts wrote.

That volatility pushed gold prices up to a new nominal record Friday. Seen as a haven at times of market turmoil, gold soared as high as $1,881 an ounce in trading of contracts for December delivery. That price has soared about 30 percent since the start of July.

The yen, which has also been rising amid the turmoil, reached a post-World War II high against the dollar, which slipped as low as ¥75.95. The dollar traded at ¥76.51 by midafternoon Friday on Wall Street.

Julia Werdigier reported from London. Bettina Wassener contributed reporting from Hong Kong and Hiroko Tabuchi contributed reporting from To'