SUZY MENKES
CHANEL'S PEARL OF A SHOW

PAGE 11 | FASHION PARIS

22

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Distress rises as Europe is engulfed by financial ills

PARIS

Spending cuts intensify downturn now spreading to Germany and France

BY LIZ ALDERMAN AND JACK EWING

Europe has had a rough ride since Greece confessed it falsified its books to join the euro. Now the economic situation is set to worsen, as the sovereign debt crisis that erupted in early 2010 threatens to send the euro zone into its second recession in three years.

Greece, Ireland, Portugal and Spain are already in downturns or fighting to escape them, as high unemployment and austerity measures bite. But in the past few weeks, Germany and France, the Continent's powerhouses, have also started to falter, hurt as struggling banks tighten their lending and orders for business from the indebted countries of Europe ebb.

''The sovereign debt crisis is like a fungus on the economy,'' said Jörg Krämer, the chief economist at Commerzbank, who last week joined the growing crowd of analysts who are now predicting that Europe is headed for a recession. ''I thought it would be just a slowdown, as is not unusual after a recovery. But I have changed my mind.''

The euro zone economy has already slowed to essentially no growth. It could stay in a slump, many economists say, at least through next spring. If that happens, tax revenues are likely to fall and unemployment is expected to rise, making it even more difficult for Europe to deal with the sovereign debt crisis and protect its shaky banks.

Worse, emerging markets that are important customers for European exports, like China and Brazil, are tightening credit to prevent their economies from overheating. The United States, another main market, is stuck in its own economic rut.

In a sign of how quickly the ground is shifting, the European Central Bank on Thursday could well lower interest

EURO, PAGE 21

For banks, reckoning on Greek debt begins

LONDON

Deutsche Bank and Dexia acknowledge depth of losses on bond holdings

BY LANDON THOMAS JR.

Europe's biggest banks may finally be ready to own up to their losses.

A surprise profit warning from Deutsche Bank on Tuesday and the proposed dismantling of the French-Belgian bank giant Dexia are the latest signs that bank executives and government leaders in Europe are inching closer to an outcome they have long resisted: acknowledging that the hundreds of billions of euros in Greek debt held by financial institutions is worth far less than its face value.

With Europe's long-festering debt crisis coming to a head, the fear of losses in institutions exposed to Greek and Italian debt is hitting bank profits and driving away lenders and depositors.

Weaker banks are moving closer to the embrace of their governments. In the past few days, the value of Dexia's shares collapsed, requiring the Belgian and French governments on Tuesday to guarantee the bank's future financing needs.

For stronger banks like Deutsche Bank, the largest in Europe, the pressure is building to cut costs and raise capital. On Tuesday, Deutsche said that it could no longer meet its 2011 profit target of €10 billion, or $13.2 billion. The bank said it would book a loss of €250 million on its Greek debt and cut 500 investment banking jobs, most of them outside Germany.

The latest banking woes prompted a broad market sell-off in Europe, hitting banks in France and Germany particularly hard.

By the numbers a Greek write-down should be affordable — indeed some banks have already written down their Greek debt to market prices. But several of the biggest holders, including Dexia, Société Générale, BNP Paribas and two German-owned state banks, have resisted acknowledging that their Greek bonds are worth at best 50 percent of their face value.

Meanwhile, European policy makers are fearful of pushing Greece into default until they can erect a firewall around Italian and Spanish debt, protecting the European banks holding it on their balance sheets at face value or close to it.

''Once you take a write-down on

BANKS, PAGE 22

MINISTERS CANCEL MEETING IN GREECE
Euro zone finance ministers canceled an Oct. 13 meeting in Greece, essentially saying relief would have to wait. *PAGE 21*

ALL EYES ON E.C.B. AS PRESSURE MOUNTS
Analysts are nearly unanimous in saying the Central Bank needs to act at its policy meeting Thursday. *PAGE 22*

E.U. DETAILS OBJECTIONS TO NYSE DEAL
An objection to the exchange's merger with Deutsche Börse does not mean the deal is necessarily in jeopardy. *PAGE 19*

feel at home

had sneaked in after Mr. Chima's most recent tenants moved out, refused to open the door, Mr. Chima was not legally allowed to enter, he said. He eventually had to go to court to reclaim the property.

Britain does not compile statistics on how many buildings are being occupied by squatters. But with a number of high-profile London cases in the news lately, like one where a pair of nurses returned from vacation to ''discover their Southgate home had been taken over by Romanians,'' as The Evening Standard put it, the government has promised to tighten anti-squatting laws to make it easier for property owners to evict uninvited tenants.

... PAGE 4

Distress rises as Europe is engulfed by debt crisis

EURO, FROM PAGE 1

rates — just a few months after it started raising them in what is now seen by many as a misguided effort to stem incipient inflation.

Distress is increasingly evident across Europe. Philippe Leydier had been feeling more upbeat about his business until this summer, when orders for his French company's corrugated boxes suddenly began to slide. Orders fell further last month as auto parts makers, electrical engineering firms, farmers and other industries reduced production.

"The euro crisis and the financial crisis linked to the debt of European countries is serious," said Mr. Leydier, whose box and paper manufacturing business in Lyon, Emin Leydier, often provides an early signal of seismic shifts in economic activity. "European governments need to find a solution — and fast."

In Italy, which has the euro zone's third-largest economy, after those of Germany and France, a €45 billion, or $60 billion, austerity program has many worried about a recession. Paolo Bastianello, the managing director of Marly's, a clothing retailer, has also seen his hopes fade.

At the start of the year, Mr. Bastianello was more optimistic that Europe might escape its troubles and that Italy's dysfunctional government would seriously tackle the country's problems. "But the turbulence of the markets and the uncertainty about this abnormal mass of public debt just scare people away from buying," he said.

Not everyone is so pessimistic, especially in Germany. But even there, indicators are pointing to slower growth.

German executives say sales remain healthy, at least so far. "We don't see any impact on our business," said Roland Busch, a member of the management board of Siemens, the electronics and engineering giant based in Munich.

"The economy is cooling down but not more than that," said Mr. Busch, who oversees a unit that supplies traffic-control systems, street cars and other products for public works.

Expecting demand for urban infrastructure improvements to grow, Siemens plans to add about 150 people over the next two years to the 850 employees at its complex in Sacramento, California, that makes light-rail cars.

Bucking the trend almost everywhere else in the developed world, unemployment in Germany continues to fall, and there are shortages of skilled workers in several key sectors.

"We know Germany is an exception," said Jörg Köther, a spokesman for the IG Metall union.

Jens Weidmann, who runs Germany's central bank and serves on the executive board of the E.C.B., predicted last week that the country would hit "a soft patch" but escape recession.

Others are not so sure. Goldman Sachs forecast Tuesday that the economies of Germany and France would both shrink. Commerzbank analysts say growth will slow almost to zero in the fourth quarter of 2011, but not decline. At best, though, it expects Germany to grow no more than 1 percent in 2012.

The International Monetary Fund is a little more optimistic, predicting growth of 1.3 percent next year in Germany after a healthy 2.7 percent pace this year.

But the I.M.F. recently acknowledged that it, too, had overestimated the rate of recovery. It now forecasts that growth in the euro zone will slip to 1.1 percent in 2012, after a 1.6 percent gain this year.

The Italian economy should be flat, the Fund predicts. In Spain, where tens of thousands of protestors have called on the government to ease its austerity plan, the I.M.F. expects growth to pick up to 1.1 percent next year from 0.8 percent this year.

Still, unemployment in Spain remains above 20 percent, and youth unemployment nearly twice that rate. Pfizer, the U.S. pharmaceutical giant, said last week that it would cut 220 jobs there.

One of the few bright spots in Europe may be Ireland, which has stuck to a tough austerity program required by its €85 billion bailout. Some analysts see Ireland already on the rebound.

Ireland's austerity programs have helped it tackle the huge deficit it took on when Dublin agreed to guarantee the debts of all its major banks. Its borrowing costs are shrinking and exports have surged in recent months.

But the domestic economy remains moribund, while the fragile export recovery could be sabotaged by slowing in the global economy.

"We're not out of the woods yet," said Cathal O'Leary, who heads the fixed-income group at the Dublin-based brokerage firm NCB. "We are so reliant on the export side of our economy that global and European growth is of the utmost interest to the continued success of the Irish economy."

The economy is worse in Portugal, which is also operating under a bailout agreement with the Union and the I.M.F. The I.M.F. warned newly installed Prime Minister Pedro Passos Coelho that Lisbon still needed to find €1 billion more in budget savings. But further austerity may only deepen the downturn, with the Portuguese economy expected to fall 1.8 percent this year and 2.3 percent in 2012.

João Figueiredo, the owner of a small ship repair yard in Lisbon, anticipates his first annual loss since 2002. "There are now many clients who are late in their payments and whose money I will probably never see," he said.

The worldwide dimension of the financial crisis, Mr. Figueiredo added, made the outcome even more uncertain. "We're now in the middle of a crisis that started in American real estate and then crossed over to Europe, and it seems really nobody has any idea where this will go next and for how long."

"I thought it would be just a slowdown, as is not unusual after a recovery. But I have changed my mind."

The Portuguese slump convinced François Libner, the president of Libner, a French manufacturer of delivery truck bodies, that it was hopeless to keep trying to sell there.

He reoriented his business toward Germany when growth in Portugal, Greece, Spain, and Italy started to trail off last year. Mr. Libner figures it will take at least a decade for any real growth to return, particularly in Spain and Greece, which he classifies as "a catastrophe."

Mr. Libner is hopeful that Paris' efforts to bring its own deficit and overall debt into line with European rules should allow France to keep its triple-A bond rating, so long as European leaders figure out a way to contain the debt crisis to Greece. If that happens, he said, Europe could rebound quickly, as investors regain faith in the euro project.

But if it doesn't, and Europe's banks get further ensnared in the crisis, he shudders to think of the implications.

"We can pay for Greece, but not for all of Europe," Mr. Libner said. If the crisis gets bigger, he added, "we won't have the means to pay for all of this."

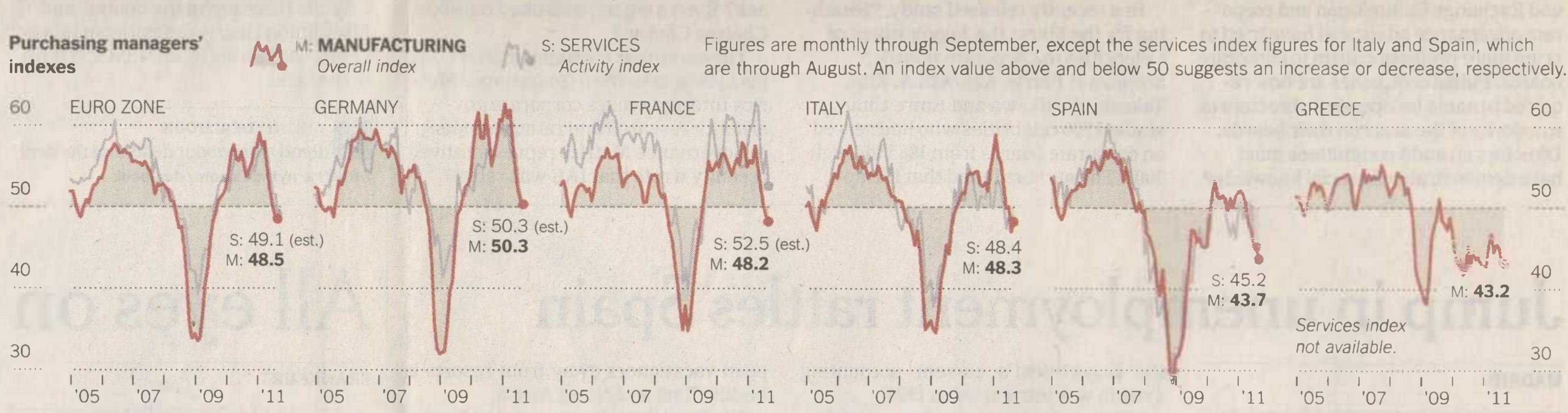
Jack Ewing reported from Frankfurt. Raphael Minder contributed reporting from Lisbon and Gaia Pianigiani from Rome.

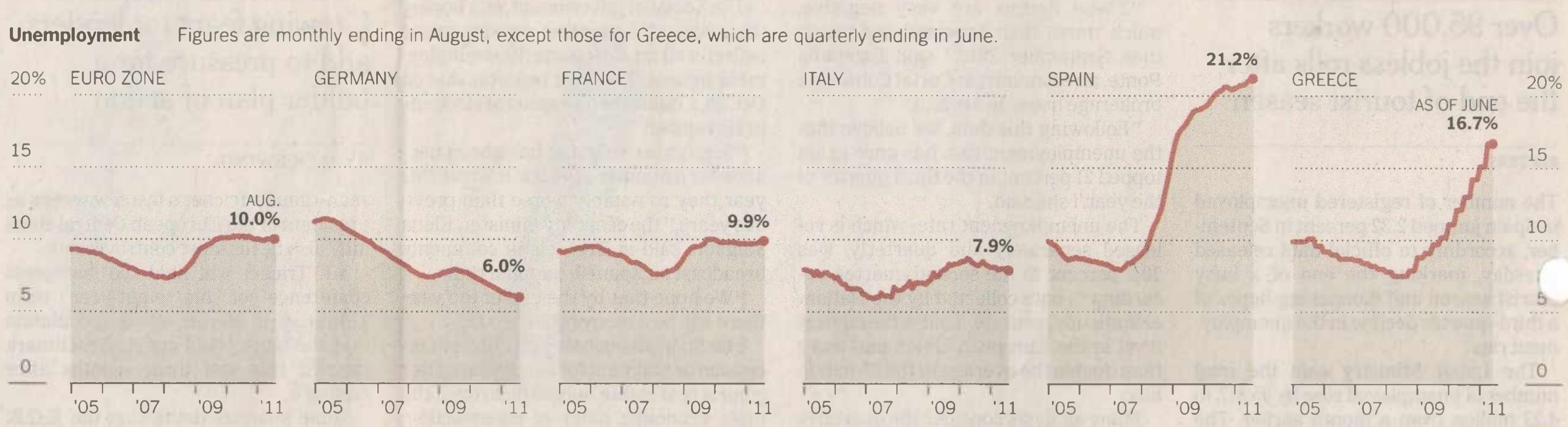
ONLINE: **FEARS OF A RECESSION**
A slide show of European businesses owners who see signs that a recession may be on the way. **global.nytimes.com/business**

A design office of the Italian retailer Marly's. Paolo Bastianello, the managing director, is pessimistic about consumer sentiment because of uncertainty surrounding the debt crisis.

Falling on hard times, again?

An indicator of economic activity has turned downward in every key country in the euro zone. The measure is based on surveys of purchasing managers within private companies, where they are asked to report increases or decreases in various aspects of their business. These results suggest a possible return to recession across the region, putting upward pressure on unemployment rates.





Source: Markit, Eurostat

Faced with rescue standoff, Greece insists it can pay its bills a bit longer

LUXEMBOURG

After euro zone delays payment, Athens says need is not immediate

BY STEPHEN CASTLE

For weeks the Greek government had been telling international lenders that it needed the next installment of aid from its bailout to stave off an imminent threat of default — and all the potentially disastrous consequences for Europe.

In the early hours of Tuesday, euro

NEWS ANALYSIS

ne finance ministers called Greece's ıff.

After several hours of talks, Jean-aude Juncker, the head of the rogroup, an organization of the euro ıe's 17 finance ministers, emerged to that a meeting he had only recently eduled for Oct. 13, where the group supposed to consider releasing the h, was now canceled.

t a news conference, he made it clear ece would have to wait until Novem- at the earliest, and hinted that the ıs of a second Greek bailout, agreed July, might be reopened to require er write-downs by private investors.

Olli Rehn, the European Commissioner for Economic and Monetary Affairs, suggested that it was "very likely" Greece would need to push through new austerity measures as well.

Back in Athens later Tuesday, the Greek finance minister, Evangelos Venizelos, assured taxpayers that the country did, after all, have enough money to last into mid-November. Asked at a news conference what had changed, Mr. Venizelos said there had never been an official deadline. He also said that no new austerity measures would be introduced, insisting that those already announced would be adequate "as long as the state mechanism functions and we see cooperation by citizens."

During an interview, the deputy finance minister, Pantelis Economou, said the extra breathing room might reflect a better-than-anticipated state of Greek finances. Tax collection was up 3 percent in July and August, he added.

He also rebuffed talk of brinkmanship between Greece and its international lenders as "conspiracy theories."

This latest stand-off may be partly tactical: Greece wants the next €8 billion installment, or $10.6 billion, installment of its €110 billion loan package agreed to last year. Hawks in the euro zone, led by Germany and the Netherlands, want to keep up the pressure to make sure that Greece and other vulnerable countries carry out the difficult, unpopular changes that they have promised.

At the same time, it also reflects real concerns that Greece has failed to make necessary structural changes and that, against the background of a continuing recession, its public finances cannot be made to add up.

Negotiations are under way in Athens with the so-called troika — the European Commission, the European Central Bank and the International Monetary Fund — which so far has been unable to produce the recommendation required for the money to be released. And though the odds are that ultimately they will, this is not a certainty.

An E.U. official said it was likely that Greece would need additional austerity measures, but Athens disagreed.

"Even if the European Commission is more political and flexible, the I.M.F have to be sure the figures work to get this through their board," said one European official, who was not authorized to speak publicly.

On Sunday, Greece acknowledged that it would miss its deficit targets for this year, partly because the recession has been worse than feared. Greek officials say that, because the shortfall has been discovered so late in the year, it is almost impossible to recover the necessary ground in 2011, so any further changes need to be undertaken in future years.

But the hardliners see a pattern.

Bailouts do not resolve the fundamental financial issues in these overstretched countries, they argue. In fact they make them worse. As one official said, as soon as the E.C.B. intervened in the summer to relieve pressure on Italy's bonds, the Italian government tried to soften its austerity package.

According to two E.U. diplomats, the real deadline for Greece is not November, although the Greek government might have problems paying its civil servants. Instead, they say, it is December, when around €2.9 billion in bond repayments are due.

With less need for urgent action, a new debate has taken hold about whether Greece's second bailout, a €109 billion package agreed to in principle by E.U. leaders in July, should be revised to increase the amount private investors are being asked to contribute, or even replaced with a new one involving a larger restructuring of Greek debt.

"We have to take into account the fact that we have experienced changes since the decisions we took on July 21, so we are considering technical revisions," Mr. Juncker said at his morning press conference. When asked whether this

Evangelos Venizelos said Greece did not need new funds until mid-November.

meant greater pain for private bondholders, he refused to elaborate.

The Austrian finance minister, Maria Fekter, said that discussion was needed because, when offered four different models, most private investors chose the option that was most expensive for governments. "We'll have to recalculate what all of this will cost and how we will deal with it," she said.

Though many see major debt restructuring for Greece as inevitable, probably next year or in 2013, one E.U. diplomat said that the timetable could accelerate if the troika could not make Greece's figures add up.

Such talk, which originally emanated from Berlin, has alarmed other vulnerable countries, like Spain, which knows that mention of bigger private-sector losses could have a dire impact on their bond markets. "I insist: no," the Spanish economy minister, Elena Salgado, said when asked about deeper write-downs.

E.U. officials complain that Germany has yet to produce a consistent plan for how to increase the burden on the private sector, or to engage in the debate over how to leverage the euro zone's €440 billion rescue fund.

They point out that only with more resources in place can vulnerable banks be recapitalized and a firewall built around Spain and Italy, which are far bigger than Greece, Portugal or Ireland — the three countries already on life support.

The debate may intensify once the last countries ratify changes to the fund that are needed to allow it to act more flexibly and talks start on leveraging it, which could allow for a Greek restructuring faster than most had imagined.

The risks of such a move are huge and many countries will fight hard to avert it, pressing instead to buy more time by releasing the €8 billion loan to Athens. But Greece may yet have to decide whether to call Germany's bluff again.

Niki Kitsantonis contributed reporting from Athens.

ONLINE: **EUROPEAN DEBT CRISIS TRACKER**
An interactive graphic of the latest country-by-country developments and coming events: **global.nytimes.com/business**

Is a name enough to merit a board seat?

Window on Wall Street

STEVEN M. DAVIDOFF

KAI PFAFFENBACH/REUTERS

Chelsea Clinton appears to be smart and capable but brings no clear credentials or experience to a corporate board position.

NEW YORK Chelsea Clinton as a corporate director? Really?

Ms. Clinton was appointed last week to the board of IAC/InteractiveCorp, the Internet media conglomerate controlled by Barry Diller.

For her efforts, Ms. Clinton will be paid about $300,000 a year in cash and incentive stock awards; not bad for a 31-year-old in graduate school.

Is IAC also getting a good deal, or is this another eye-rolling celebrity appointment?

In her favor, Ms. Clinton appears to be a smart, capable individual. She worked in her 20s at the McKinsey consulting firm and at a hedge fund run by a longtime Democratic donor.

Ms. Clinton appears to be a level-headed person, despite having grown up in the limelight. She is also popular — her wedding was one of the social events of last year.

But let's be real. Ms. Clinton has this position only because she is the daughter of Mr. Clinton, the former president, and Hillary Rodham Clinton, the current secretary of state. This is clearly an appointment made because of who she is, not what she has done, one that defies American conceptions of meritocracy. Even most celebrity directors earn their way to such celebrity — sort of.

In fairness, while the reasons for the appointment are suspect, that does not mean Ms. Clinton cannot be a good, even great, board member. But questions raised by her selection speak to the larger issue of what types of directors should be on boards.

In the past, boards were too often passive instruments of the chief executive, and they often included celebrities. Some examples: the actor Sidney Poitier (Walt Disney); the boxer Evander Holyfield (Coca-Cola Bottling); the baseball manager Tommy Lasorda (Lone Star Steakhouse & Saloon); the cycling racer Lance Armstrong (Morgans Hotel Group); and the former football player O.J. Simpson (Infinity Broadcasting). Mr. Simpson actually served on Infinity's audit committee, the body responsible for supervising a company's auditors.

In recent years, the U.S. Securities and Exchange Commission and corporate governance advocates have tried to bring more professionalism to corporate boards. Public companies are now required to name independent directors to a majority of the seats on their boards. Directors on audit committees must have demonstrable financial knowledge, and companies are required to disclose the skills of each director publicly and state why that person was chosen.

There is evidence that celebrity directors, with their extensive contacts, do create value.

In Ms. Clinton's case, IAC said her "skills and background complement the existing areas of expertise of other board members." Given her lack of experience in the Internet industry or substantial business or other life experience, presumably IAC is going to assert that she was selected because she is smart. If so, other graduate students should dust off their résumés. There are plenty of struggling students out there who could use the extra $300,000 a year.

Another argument IAC could have made is that Ms. Clinton has an extensive network of contacts that can help IAC with its business. There is evidence that celebrity director appointments do create value in that way.

In a recently released study, "Reaching for the Stars: the Appointment of Celebrities to Corporate Boards," Stephen P. Ferris, Kenneth A. Kim, Takeshi Nishikawa and Emre Unlu studied 700 celebrities who had served on corporate boards from 1985 through 2006. The authors found that the appointment of a celebrity director increased the value of a company over a period as long as three years.

The authors postulate that celebrity directors created that value by enhancing a company's prestige and visibility and by using their connections.

If celebrities can create value through prestige or networking, why can that not be done through a sponsorship agreement or a joint venture? For a company like IAC with a grab bag of Web businesses, it is also hard to see what prestige or networking value Ms. Clinton can bring.

In the wake of the financial crisis, a board position is a serious one. A board member needs to devote time and resources to the position. He or she needs to be engaged and willing to question the chief executive and fellow directors.

Too many boards, like those of Yahoo and Hewlett-Packard, have gotten into hot water when they failed to act forcefully and exercise their duties to run the company. Will a celebrity ask the hard questions we want directors to ask? Even a smart, well-liked one like Chelsea Clinton?

The particular company matters. IAC gets low marks from Governance Metrics International, a corporate governance research and rating company. A Governance Metrics representative recently wrote that IAC was rated poorly for "governance concerns including dual share classes with disparate voting rights, a board containing many overcommitted and non-independent directors, and executive compensation that is not well-aligned with company performance."

IAC's board is filled with high-powered friends of Mr. Diller's, including the former Walt Disney chairman, Michael Eisner, and the Warner Music chairman, Edgar Bronfman Jr., as well as Mr. Diller's stepson, Alexander von Furstenberg.

It would be nice if Ms. Clinton had more experience. But too often today, directors are clones. They all come from the same industry and have similar experiences. More diversity on boards may be welcome, as it could stir more effective debate and provide differing perspectives.

The real question is whether Ms. Clinton can act independently and in a way that provides value to the IAC board. Alternatively, will she just show up and collect the paycheck?

While there are many doubts, and Ms. Clinton clearly did not earn this position, she can still show that she is up to the task.

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

Bad for labor equals bad for investors

James Saft

INSIDE THE MARKETS

Right about now, even the most committed capitalist investor ought to be hoping for one thing: that labor soon has the upper hand.

That is because the whole edifice — the global economy, the consumption-based developed economies and the share prices they power — is crumbling because average workers simply do not have enough earning and buying power to play their central role.

U.S. wages, for example, have been stagnant for the best part of 40 years, during which time the consumption merry-go-round has been kept spinning only through a combination of artificially high asset prices and the spending of borrowed money.

Consumer incomes actually fell in August for the first time in almost two years, according to new data, and consumer spending eked out a modest gain only because of a sharp drop in the savings rate.

This state of affairs has allowed corporate profits, as a share of the economy, to hit their highest point in the second quarter since records began in 1947, and put them on track to hit the highest annual figure since at least 1929. Even the stock market no longer sees that as evidence of rude health, as shown by the steady, grinding decline in prices relative to earnings.

To be sure, this long-term stagnation in wages is in substantial part the result of globalization. Some of the labor lost in the developed world has been converted to gains for labor in emerging markets, where income has surged over the past decade. Nonetheless, the system is predicated on consumption in the West, and that consumption is crimped by stagnant incomes and high debt loads.

Up to a point, this will be self-correcting. Wages in China, for example, have grown strongly, which will eventually lead to increased domestic consumption there and to a balancing out in the relative costs of production.

Sadly, that long-term solution is not going to arrive in time to save equity investors, which is perhaps why so many of them are deciding to become debt investors.

This is the catch for equities: A vibrant economy depends on a rebalancing of negotiating power between labor and capital, but that very process is going to undermine corporate profits, and with them stock prices. The best strategy may well be to hold back on investing in equities until that rebalancing has happened or until the stock market moves ahead to price it in.

There has, rightly, been a great focus on debt in the current malaise, with much head-scratching over how to deal with Greek sovereign debt and individual mortgage debt. That concern is natural, because when debts are defaulted upon, they have a nasty habit of causing a chain of defaults through the economy.

The problem is that the focus has turned to protecting debt holders from the consequences of their foolishness and the foolishness of the parties they lent money to.

"Almost all remedies proposed by global authorities to date have approached the problem from the standpoint of favoring capital as opposed to labor," Bill Gross, of the bond fund Pacific Investment Management, or Pimco, wrote in a note to clients.

"If the banks could just be stabilized, if the 'markets' could just be elevated back in the direction of peak 401(k) levels, if interest rates could just be lower so that borrowers would inevitably take the bait, then labor — job creation — would inevitably follow," he wrote. "It has not."

The whole economy is crumbling because workers do not have enough buying power.

The effort to avoid incurring losses to debt holders is not helping the broader economy. In the case of Greece, austerity measures only make the country weaker and less able to bear its debt burden. In the case of overindebted mortgage holders, most loan modifications still leave the borrowers with more debt than they can afford.

All of what we are describing is deflationary, which makes the epic rally in government bonds seem not so much a bubble as a down payment on future gains.

Investors hoping to make a profit need to get some things straight in their own minds: who, exactly, is going to buy all of these goods and services, and where are they going to get the money?

It is not clear that monetary policy can address this. Its success rate so far is not great. It is far less clear that fiscal policy will even be given a chance.

It is reasonable to expect that eventually Western labor will make gains, and that emerging-market labor's new buying power will slowly build and provide a buttress to global demand. That will not happen any time soon, to judge by the run of events, which is a good reason to keep avoiding equities.

James Saft is a Reuters columnist.

Jump in unemployment rattles Spain

MADRID

Over 95,000 workers join the jobless rolls after the end of tourist season

REUTERS

The number of registered unemployed in Spain jumped 2.32 percent in September, according to official data released Tuesday, marking the end of a busy tourist season and dampening hopes of a third-quarter decline in the unemployment rate.

The Labor Ministry said the total number of unemployed rose by 95,817, to 4.23 million from a month earlier. The service industry cut 74,590 posts as hotels and restaurants along the coasts and in other tourist destinations closed their doors on the 2011 season.

The figures are the biggest increase in unemployed for a September since the department's current accounting system was introduced in 1996.

"These figures are very negative, much worse than expected and worse than September 2010," said Estefania Ponte, an economist at Cortal Consors, a brokerage house in Madrid.

"Following this data, we believe that the unemployment rate has once again topped 21 percent in the third quarter of the year," she said.

The unemployment rate, which is released separately and quarterly, was 20.9 percent in the second quarter, according to data collected by the National Statistics Institute. That is the highest level in the European Union and more than double the average in the 27-nation bloc.

Many analysts consider the quarterly report more reliable since it is based on a broad poll of job hunters rather than the Labor Ministry's figures, which tally only registered job seekers.

Tourism in Spain flourished this summer as political unrest kept many European vacationers away from resorts in Middle East and North Africa.

The Socialist government was hoping the successful vacation season would reflect well on the quarterly unemployment figures. The next report is due on Oct. 28, a month before general elections in November.

"September's figures have been negative for a number of years. It's true this year they're notably worse than previous years," the economy minister, Elena Salgado, said in Brussels in comments broadcast on Spanish national radio.

"We hope that by the end of the year there will be a recovery," she said.

The Spanish economy has been in recession or stagnant for three years after a burst real estate bubble destroyed the main economic pillar of construction, leaving tens of thousands of low-skilled laborers without work.

In recent weeks, as many as 10,000 people a day have been joining the ranks of the unemployed, the Labor Ministry said Tuesday.

For banks, reckoning of Greek debt begins

BANKS, FROM PAGE 1

Greek debt for Dexia, this has systemic implications for the French and German banks," said Karel Lannoo, the chief executive of the Center for European Policy Studies in Brussels. Dexia may be one of the worst-off banks, he said, but "the issue is the same for all banks — it will be the taxpayer that pays for this."

The question of what to do about shaky banks continues to deeply divide European policy makers. The French government supports the terms of the planned exchange between Greece and its bankers that was forged in July as part of a second bailout for Athens. It calls for a relatively modest 21 percent haircut on existing debt in return for guarantees against future write-downs.

But Germany has become increasingly forceful in pushing the view that the banks should contribute a larger share of Greece's growing bailout bill. Officials at the German finance ministry argue that the most efficient way to do this is for banks to take a 50 percent loss on their Greek bonds as part of an "orderly" default that would sharply reduce Athens' debt burden and allow Greece to stay within the euro zone.

Since the private-sector deal was agreed to in July, the prices of Greek bonds in secondary markets have plunged to about 36 percent of face value from 75 percent. That has put additional pressure on European policy makers to change the terms of the deal.

On Monday, Jean-Claude Junker, the prime minister of Luxembourg who chairs a permanent working group of euro zone finance ministers, cited these changed market conditions and added that Europe was discussing "technical revisions" to the exchange.

"It will be the taxpayer that pays for this."

Analysts point out that the cost of this private-sector initiative has increased significantly. As originally foreseen, Greece was supposed to borrow €35 billion to buy the triple-A bonds needed to back the new securities being created for the debt swap.

But the global rally in high-quality debt has made these bonds pricier; people involved in the deal say that Greece may need to borrow an extra €12 billion to complete the deal as planned.

Now the question is, who will make of the difference, taxpayers or the banks?

It is too soon to say for sure that Germany will get its way. Other members of the euro zone, worried about their fragile banks, remain reluctant to take such a step.

But a growing number of economists, as well as some voices within the International Monetary Fund, argue that banks need to formally acknowledge their losses to restore their credibility.

"It is difficult to see how Greece gets out of this without a write-down of its debt," said a senior I.M.F. official who refused to be identified because he was not authorized to speak publicly on the sensitive issue.

Dexia and Deutsche Bank are not the largest holders of Greek debt. Dexia has €3.4 billion on its books while Deutsche Bank holds €1.1 billion.

But Dexia, a bank already bailed out once before by the Belgian and French governments, also held over €18 billion of Italian, Spanish and Portuguese bonds at the end of last year, according to public documents released during the European stress tests on banks.

That figure handily exceeds the bank's €17 billion in core capital, which helps to explain investor flight from the shares.

All eyes on E.C.B. as crisis builds

FRANKFURT

Growing fears for lenders add to pressure for a bolder plan of action

BY JACK EWING

Jean-Claude Trichet's last few weeks as president of the European Central Bank may also be his most controversial.

Mr. Trichet will hold the last press conference of his eight-year term Thursday in Berlin, amid speculation that the bank could cut its benchmark interest rate just three months after raising it.

Some analysts doubt that the E.C.B. will reverse course so quickly, but they are nearly unanimous in thinking that it will need to do something at its monetary policy meeting Thursday in response to deteriorating conditions in the euro zone economy and the banking system.

Recent events have highlighted the bank's role as the only institution in the euro area with the flexibility and resources to respond quickly to a crisis that seems to grow more acute by the day.

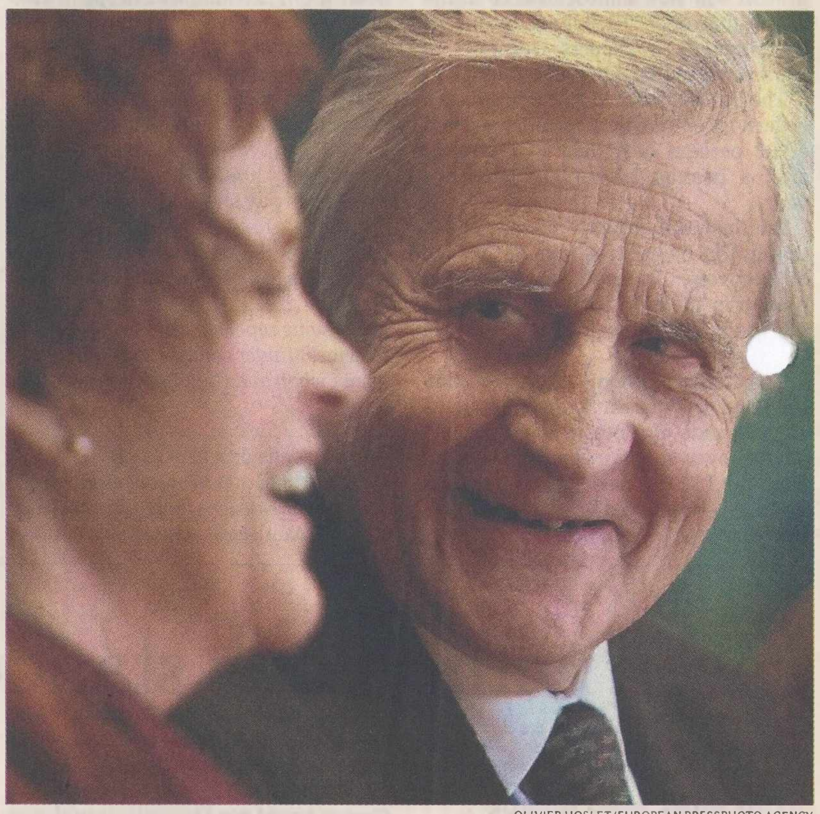
Euro zone governments are struggling to approve a bailout fund in a politically charged process that has focused an improbable amount of international attention on parliamentary debates in Finland and Slovakia. Yet the fund, at a proposed €440 billion, or $585 billion, already appears inadequate for the growing scale of the crisis.

At the same time, fears about European banks seem to be coming true. It has been reported that Dexia, a French and Belgian institution, may break up because of its exposure to Greek debt.

"We are coping with the worst crisis since World War II," Mr. Trichet said Tuesday during an appearance — his last as E.C.B. president — before the Economic and Monetary Affairs Committee of the European Parliament.

Analysts at Royal Bank of Scotland see a better-than-even chance that the E.C.B. will cut its benchmark rate to 1.25 percent from 1.5 percent Thursday, but they acknowledge that it is not an easy call.

The E.C.B.'s governing council, which includes the central bank chiefs of the 17 members of the euro zone, is divided and has been sending conflicting signals. Earlier this year, Mr. Trichet clearly flagged rate moves in advance.



OLIVIER HOSLET/EUROPEAN PRESSPHOTO AGENCY

"We are coping with the worst crisis since World War II," Jean-Claude Trichet, the outgoing president of the E.C.B., told a committee of the European Parliament on Tuesday.

One argument for cutting rates on Thursday is that Mr. Trichet will want to do a favor for his successor, Mario Draghi.

"When I listen to what the governing council members have said in the last few days, there is no consensus," said Michael Schubert, an economist in Frankfurt for Commerzbank.

One argument in favor of cutting rates Thursday is that Mr. Trichet will want to do a favor for his successor, Mario Draghi, governor of the Bank of Italy. Mr. Draghi, who will take office Nov. 1, will be under pressure to establish his credentials as an inflation fighter, and he risks undermining his credibility if he oversees a rate cut immediately upon assuming the presidency.

But inflation hard-liners like Jens Weidmann, president of the Bundesbank, are likely to argue vehemently against a rate cut even though evidence is building that Europe is going into a recession. Inflation in the euro area probably rose to an annual rate of 3 percent in September, according to official estimates, well above the E.C.B.'s target of about 2 percent.

The E.C.B. might seek a compromise and take less controversial steps to show it is not watching idly as the banking crisis becomes more acute. It could revive its purchase of secured debt issues by banks, for example, or extend low-interest lending to strapped institutions.

None of those moves will solve the debt crisis, though, nor would a large rate cut, for that matter. But the E.C.B. is very unlikely to take more radical steps like printing money to buy huge quantities of government bonds, relieving banks of damaged assets.

Mr. Trichet signaled Tuesday that political leaders should not expect the E.C.B. to rescue them. "We cannot substitute for governments," he told the parliamentary panel, before going on to mention how much he is looking forward to retirement on the coast of Brittany.