FINANCIAL TIMES

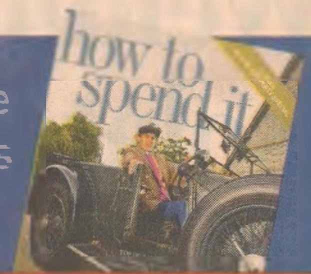
116

EUROPE Friday September 7 2012

Sharpening the axe

Investment banks set to cut more jobs. Page 15

How To Spend It Vintage cars and five-star homes In today's FT



World Business Newspaper

TOMORROW IN FT WEEKEND

Autumn food special
Glorious and gutsy recipes from Fergus Henderson's new book

● Draghi offer to purchase bonds ● Global markets welcome move ● Bundesbank opposed

ECB signals resolve to save euro

By Michael Steen in Frankfurt, James Fontanella-Khan in Brussels and Michael Stothard in London

The European Central Bank yesterday sent markets its strongest signal yet that it would deploy unlimited monetary firepower to save the single currency.

Mario Draghi, the central bank's Italian president, said the ECB would offer to purchase eurozone countries' short-term bonds in the secondary market in a programme dubbed outright monetary transactions, or OMT. He added: "The euro is irreversible".

But Mr Draghi warned that any attempt to tame Europe's distressed sovereign debt markets would come with the kind of tough fiscal and structural reform conditions that Greece, Ireland and Portugal faced when they were bailed out.

"This is your bazooka," José Angel Gurria, secretary-general of the Organisation for Economic Co-operation and Development, told the Financial Times.

"This is the muscle and the firepower which is really awesome because effectively, theoretically, it's unlimited."

Spain and Italy would have to apply to Europe's rescue funds for help before the ECB would trigger its bond-buying programme. Neither government showed any inclination to do so soon.

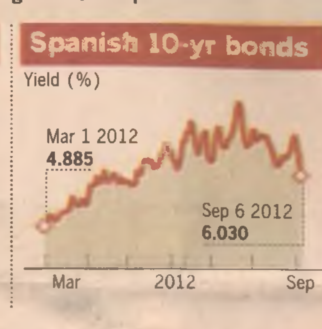
"When I have anything new to tell you, I will," Spanish prime minister Mariano Rajoy replied when asked.

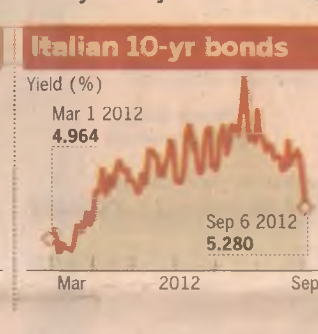
In Rome, Italian prime minister Mario Monti said it was "premature" to say Italy had already decided to apply.

The plan spearheaded by Mr Draghi – who pledged in July to do "whatever it takes" to save the euro – was welcomed by markets and European leaders, although Germany's Bundesbank remains fiercely opposed and warned that it could backfire.

"We want this to be perceived as a fully effective backstop that removes tail risk from the euro area," said Mr Draghi, who sought to play down the rift with the Bundesbank.

ECB president Mario Draghi outlines the details of the bond-buying programme at a press conference in Frankfurt yesterday AFP





Source: Thomson Reuters Datastream

Markets around the world welcomed the news with Spanish and Italian yields hitting four and five-month lows respectively.

The benchmark S&P 500 index in the US was up 1.6 per cent to a post-crisis high, the Eurofirst 300 index was up 2.4 per cent and Spanish and Italian equity indices were up more than 4 per cent. The euro reached its highest level against the US dollar in more than two months at $1.2650 though its gains were more muted following Mr Draghi's speech.

In Paris, Bruno Le Roux, leader of François Hollande's Socialist party group in the National Assembly, said the ECB decision was a "clear victory" for the president, proving austerity was not the "unreachable horizon" for Europe and signalling "the end of the reign of liberal orthodoxy".

In Germany, some media were already decrying the "death" of the Bundesbank after it failed to prevent the plan, while some analysts said that the ECB was taking on a role closer to that of the US Federal Reserve.

"Over the years, global investors have learnt that it does not pay to fight the Fed," Holger Schmieding of Berenberg Bank wrote in a note.

"Those betting on the demise of the euro may now have to realise that the ECB is as mighty as the Fed."

Additional reporting by Miles Johnson in Madrid, Giulia Segreti in Rome and Hugh Carnegy in Paris

Draghi's gambit, Pages 2-3
Editorial Comment, Page 8
John Plender, Page 9
Lex, Page 12
Unlimited firepower, Page 24

Super Mario delights investors

Mario Draghi's secret plan to save the euro is out, and investors are over the moon. The European Central Bank president's plan will see the bank buy bonds of troubled eurozone countries – as long as they submit to terms set by Brussels and the International Monetary Fund.

Bond yields of Italy, Spain and Portugal tumbled as shares soared, with Spanish equities up 33 per cent in 33 trading days. The ECB helped by relaxing collateral rules, meaning that it will lend against pretty much anything a bank owns – and it is poised to take on more credit and currency risk from investors.

Yet, the central bank will not do anything quickly; Spain still has to accept a politically toxic bailout to be eligible for help. When that eventually happens, ECB buying should take away the danger of a self-fulfilling spiral of higher bond yields hitting government finances, leading to ever higher yields.

The bond vigilantes, in other words, will not force the break-up of the euro. But the bond markets have been anticipating Europe's deeper problem: the noxious interaction of austerity with politics and the economy.

If anything, this will worsen as countries become wards of the European superstate. Far from being grateful for help, Greece has shown again that local populists are only too happy to blame economic weakness on foreign demands.

If the ECB shovels money fast enough from Germany to the periphery, perhaps it can stop recessions becoming depressions. Perhaps.

What is certain is that market euphoria never lasts. When fear returns, the ECB's resolve will be tested; unlike its 2010 foray into bond markets, this time the ECB will have to spend serious money.

James Mackintosh

News Briefing

Xstrata vote may take failed mergers to $1tn
The value of failed mergers in the natural resources sector over the past decade will rise to nearly $1tn if Xstrata shareholders today vote down a proposed tie-up with Glencore. **Page 13; Lex, Page 12**

China ire at EU probe
China attacked the EU's "regrettable" opening of a trade probe into the country's solar panel industry and warned it could harm commercial ties. **Page 5**

Twitter leads ad race
Twitter's estimated $130m revenues from mobile advertising in the US this year will almost double those of Facebook despite having fewer users, analysts predict. **Page 13**

Aid workers expelled
Pakistan is expelling six foreign Save the Children aid workers amid government suspicions that the charity helped US spies' hunt for Osama bin Laden. **Page 6**

Sweden lowers rates
Sweden's Riksbank cut interest rates by 0.25 percentage points to 1.25 per cent amid fears over contagion from the eurozone and the effects of a strong krona on exports. **Page 6**

Egypt feelgood factor
Egypt has seen a surge in consumer and investor optimism in recent months, exemplified by a 37 per cent stock market rise, an $18bn Qatari investment deal and talks over a $4.8bn IMF loan. **Page 6**

Clues that matter
The Large Hadron Collider at Cern, Switzerland – the world's most powerful atom smasher – has produced clues to one of the universe's key mysteries: why it is dominated by matter rather than antimatter. **Page 6**

Separate section

Doing Business in Mauritius
The remote island state continues to reinvent itself

Subscribe now

In print and online

Tel: +44 20 7775 6000
Fax: +44 20 7873 3428
email: fte.subs@ft.com
www.ft.com/subscribetoday

Printed in London, Liverpool, Dublin, Frankfurt, Brussels, Stockholm, Milan, Madrid, New York, Chicago, San Francisco, Dallas, Orlando, Washington DC, Johannesburg, Tokyo, Hong Kong, Singapore, Seoul, Abu Dhabi, Sydney

9 770174 736159 36

Top of the bill

Former president Bill Clinton will campaign for Barack Obama in pivotal swing states following his speech to the Democratic convention, which the party says will rouse its base supporters and drive them to the polls in November. Mr Clinton's 48-minute speech also articulated the case against the Republicans in ways which perhaps even Mr Obama has not managed.

Report, Page 4

Elysée insists Hollande will stick by pledge over 75% tax on rich

By Hugh Carnegy in Paris

French officials were forced to insist yesterday that President François Hollande's socialist government would stick to his election pledge to introduce a 75 per cent marginal income tax, as speculation grew that the controversial measure would be watered down.

Responding to reports that the 75 per cent rate would be limited to 67 per cent, that all non-salary income would be exempt and couples would be exposed only on joint income above €2m, officials said no decisions had yet been made on how the tax would be levied.

"The 75 per cent rate will be applied," said one. But the officials admitted that "lots of scenarios" were under discussion in the Elysée palace and the finance ministry on exactly how the tax would be introduced when it is put into force at the beginning of next year. A decision is due in time for the 2013 budget in two weeks' time.

Mr Hollande's promise to impose a 75 per cent top rate on incomes above €1m a year was one of the most popular moves of his campaign, helping him to defeat Nicolas Sarkozy, his centre-right predecessor, in the May election.

Along with other tax increases, including a rise in the rate of wealth tax already imposed, the pledge prompted David Cameron, the British prime minister, to say he would "roll out the red carpet" to French businesses and individuals fleeing the new regime.

French business leaders have stepped up the pressure in recent weeks on Mr Hollande to limit the tax, fearing an exodus of top earners and a drought of foreign investors and managers willing to come to France. On Wednesday, Bernard Arnault, France's richest man and head of the luxury goods group LVMH, met Jean-Marc Ayrault, the prime minister, for talks in which he was reported to have discussed the impact of the government's tax plans.

Responding to business concerns, Pierre Moscovici, the finance minister, said last week that the 75 per cent levy would be introduced in "an intelligent manner" to avoid prompting an exodus of high earners.

The websites of the newspapers Les Echos and Le Figaro reported yesterday that the 75 per cent rate would include other marginal taxes that would in effect render the new rate at 67 per cent. They said it would be limited, in effect, to salary, with sports and other professional stars able to avoid the tax.

World Markets

STOCK MARKETS	Sep 6	prev	%chg
S&P 500	1430.07	1403.44	+1.90
Nasdaq Comp	3131.62	3069.27	+2.03
Dow Jones Ind	13276.29	13047.48	+1.75
FTSEurofirst 300	1104.76	1079.24	+2.36
Euro Stoxx 50	2524.95	2441.81	+3.40
FTSE 100	5777.34	5657.86	+2.11
FTSE All-Share UK	3011.0	2949.81	+2.07
CAC 40	3509.88	3405.79	+3.06
Xetra Dax	7167.33	6964.69	+2.91
Nikkei	8680.57	8679.82	+0.01
Hang Seng	19209.3	19145.07	+0.34
FTSE All World $	(u)	210.65	

CURRENCIES	Sep 6	prev		Sep 6	prev
$ per €	1.263	1.260	€ per $	0.791	0.793
$ per £	1.594	1.591	£ per $	0.628	0.628
£ per €	0.793	0.792	€ per £	1.261	1.263
¥ per $	79.0	78.3	¥ per €	99.78	98.70
¥ per £	125.8	124.6	£ index	84.4	84.4
$ index	80.5	80.6	€ index	87.86	87.57
SFr per €	1.206	1.204	SFr per £	1.521	1.520

COMMODITIES	Sep 6	prev	chg
Oil WTI $ Oct	95.36	95.36	
Oil Brent $ Oct	113.09	113.09	
Gold $	1,693.65	1,694.75	-1.10

INTEREST RATES	price	yield	chg
US Gov 10 yr	99.73	1.65	0.06
UK Gov 10 yr	100.55	1.69	0.03
Ger Gov 10 yr	102.25	1.50	0.06
Jpn Gov 10 yr	99.94	0.81	0.01
US Gov 30 yr	99.77	2.76	0.05
Ger Gov 2 yr	99.94	0.03	0.04
	Sep 6	prev	chg
Fed Funds Eff	0.16	0.14	0.02
US 3m Bills	0.11	0.11	
Euro Libor 3m	0.17	0.17	0.00
UK 3m	0.67	0.67	

Prices are latest for edition

Cover Price

Austria	€3.50	Malta	€3.30
Bahrain	Din1.5	Mauritius	MRu90
Belgium	€3.50	Morocco	Dh40
Bulgaria	Lev7.50	Netherlands	€3.50
Croatia	Kn29	Nigeria	Naira715
Cyprus	€3.30	Norway	NKr30
Czech Rep	Kc120	Oman	OR1.50
Denmark	DKr30	Pakistan	Rupee 130
Egypt	E£19	Poland	Zl 16
Estonia	€4.00	Portugal	€3.50
Finland	€3.80	Qatar	QR15
France	€3.50	Romania	Ron17
Germany	€3.50	Russia	€5.00
Gibraltar	£2.30	Saudi Arabia	Rls15
[illegible]	€3.50	Serbia	NewD420
Hungary	Ft880	Slovak Rep	€3.50
India	[illegible]	Slovenia	€3.50
Italy	€3.50	South Africa	R28
Jordan	JD3.25	Spain	€3.50
Kazakhstan	US$5.20	Sweden	SKr34
Kenya	Kshs300	Switzerland	SFr5.70
Kuwait	KWD1.50	Syria	US$4.74
Latvia	Lats3.90	Tunisia	Din6.50
Lebanon	LBP7000	Turkey	TL7.25
Lithuania	Litas15	UAE	Dh15.00
Luxembourg	€3.50	Ukraine	€5.00
Macedonia	Den220		

DRAGHI'S GAMBIT

Weidmann isolated as ECB plan approved

News analysis

Bundesbank chief is lone holdout to 'outright monetary transaction' programme, writes **Michael Steen**

For a man who had just finished a gruelling month's consensus-building around a plan to save the euro, Mario Draghi, president of the European Central Bank, was looking his usual calm self as he addressed reporters yesterday.

The bank's new unlimited bond-buying plan, aimed at restoring the borrowing costs of countries such as Italy and Spain to sustainable levels, had been under open attack from the *eminence grise* of European central banking – the once-mighty German Bundesbank, which is now just one of 17 central banks in the euro system.

Sure enough, one member of the ECB's governing council, composed of those central banks and the ECB's executive board, withheld a vote on the bond-buying programme during yesterday's monthly meeting, which also agreed to loosen collateral requirements for banks in bailout countries and kept the main refinancing rate unchanged at 0.75 per cent.

The holdout was Jens Weidmann, Bundesbank president – although Mr Draghi did not name him.

"Perhaps I have a low sense of drama," Mr Draghi said. "People had a difference of views but in the end we converged and it was, as I said, a very, very massive majority of the governing council on this concept."

In a clear attempt to calm nerves in Germany and other northern European countries that the prospect of unlimited ECB bond-buying in the secondary market would remove any pressure on governments in Spain and Italy to stick to reform programmes, the ECB's new "outright monetary transactions" (OMT) will come with tough conditions – like those placed on Greece, Portugal and Ireland when they agreed bailouts.

Nonetheless, the Bundesbank took the unusual step of commenting publicly after the meeting.

Mr Weidmann "regards such [bond] purchases as being tantamount to financing governments by printing banknotes", it said.

"The announced interventions carry the additional danger that the central bank may ultimately redistribute considerable risks among various countries' taxpayers."

And even among proponents of bond-buying, the are doubts that remain.

"One question is whether the benefits from the bond-buying are going to be enough to offset the damage inflicted by the conditionality attached," said Simon Tilford, chief economist at the Centre for European Reform, a think-tank, reflecting fears that spending cuts and tax rises may kill off economic growth.

"Countries are highly unlikely to be able to meet targets if those targets include stepped-up fiscal austerity," Mr Tilford said.

Significantly, Spanish officials played down any suggestion they had an urgent need to apply for the OMT programme.

Much remains uncertain about OMT. As expected, the ECB is deliberately not making public the bond yields that it considers are sufficiently elevated to warrant intervention. It also said it would pull the plug on any country that reneged on reform or fiscal consolidation pledges – even though such a course of action could theoretically

> 'People had a difference of views but in the end we converged'
>
> **Mario Draghi**
> **ECB president**

trigger market panic and an exit from the euro.

Mr Draghi's justification for a programme that mixes monetary and fiscal policy is that the so-called "transmission mechanism" by which the ECB attempts to guide rates across the eurozone has broken down, because financial markets are pricing in the "convertibility risks" for countries that may leave the euro.

This justification is, however, logically at odds with the fiscal conditions that the ECB is demanding before it embarks on OMT.

Mr Draghi argued there was a case for central bank intervention in countries that found themselves in "a bad equilibrium in which you may have self-fulfilling expectations that feed on themselves". He added: "But we must remember why these countries found themselves in a bad equilibrium to start with – this is because of policy mistakes."

"That's why we need both legs to fix the situation," he said. "We are convinced there is no intervention by any central bank that is actually effective without concurrent policy action by the governments."

Editorial Comment, Page 8
John Plender, Page 9

Bond yields fall but hurdles remain to be cleared

Reaction

By Michael Stothard and Alice Ross in London

Spanish and Italian bond yields fell sharply and US equities hit a post-crisis record as investors cheered news that Europe's central bank was poised to expand its bond-buying programme.

The gains came despite an already substantial rally during the past six weeks after Mario Draghi, the ECB president, hinted at the bond-buying plan in late July. Spanish and Italian 10-year yields had fallen 16 per cent since his pledge to do "whatever it takes" to save the euro.

Yesterday, benchmark Spanish 10-year bonds fell a further 40 basis points to their lowest in four months, while Italian 10-years fell 25bp to a five-month low.

The S&P 500 index in the US climbed 1.9 per cent to its highest since the collapse of Lehman Brothers in 2008. The Eurofirst 300 index was up 2.2 per cent, while Spain's Ibex 35 rose 4.9 per cent.

Some investors and analysts warned that the rally in risk assets could prove short lived once the market took a second or third look at the announcement from Mr Draghi.

"It is not at all clear that this rally can be sustained," said Paul Marson, chief investment officer of Lombard Odier.

"The buying of sovereign debt by the ECB is subject to that country asking for a bailout under existing eurozone programmes. It is doubtful that Spain, for one, would find that acceptable in current, more favourable, market conditions," Mr Marson said.

Events over the coming weeks, including a decision by the German constitutional court in Karlsruhe on whether to ratify the eurozone's new bailout fund, the European Stability Mechanism, also have the potential to derail this rally, analysts said.

"This is very positive but it is only the first day in a big couple of weeks for news, and everything could turn around quickly after such a long rally," said Jean-Marc Mercier, global head of debt syndication at HSBC.

> 40bp
>
> **Fall in Spanish benchmark 10-year bonds yesterday**

"The Dutch election, non-farm payrolls and the US central bank meeting are all hurdles that need to be cleared," he added.

But risk appetite was firmly higher after the announcement yesterday. The euro rose against the Swiss franc for the second day in a row, reaching its strongest level since May, and also hit a two-month high against the yen.

Analysts suggested that risk assets were also reacting to improving signs on the US economy, with figures showing an unexpectedly large rise in job creation in August.

The ADP National Employment Report, released shortly before the European Central Bank press conference, found that 210,000 jobs had been created in August in the US.

The strong figure raised expectations that monthly non-farm payrolls to be released today – a measure of the health of the US economy – could be better than expected.

The report also reduced the expectations that the US would embark on a third round of monetary easing, said analysts.

The bank's action plan

Bloomberg

Bond-buying

The ECB has promised open-ended purchases of short-term government bonds to keep costs down for countries struggling to borrow

Conditions

In return, countries must sign up to a bailout from the EU's rescue funds and a programme of strict economic reforms supervised by the EU and IMF

Risk-sharing

The ECB will have no special rights over private owners of a country's bonds, so in the event of a sovereign default it would also lose money

Collateral

The ECB will now ignore credit downgrades for the bonds of countries in a rescue programme, so that banks are no longer forced to find new collateral each time a country's rating is cut

Sterilisation

All the money the ECB injects into Europe's economy through buying bonds will later be sucked back out of the system in order to combat inflation risk

What was missing...

Convertibility risk

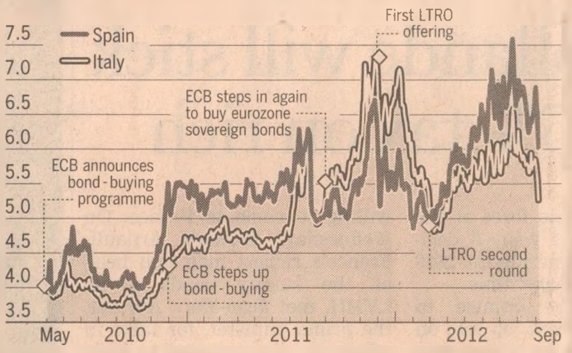
How will the ECB decide when to stop buying a country's bonds because its borrowing costs are in line with economic fundamentals, rather than inflated by market panic?

Cap on yields

Speculation that the ECB might decide to intervene automatically once a country's bond yields passed a certain ceiling turned out to be groundless, as reported this week by the FT

What goes up *must* come down

Spanish and Italian 10-year government bonds yields (%)



Spanish 10-year government bond yields (%)

Italian 10-year government bond yields (%)

Times are GMT

Source: Thomson Reuters Datastream

Shift in IMF role raises fears for influence

EU finance

By Alan Beattie in Washington

A true seal of quality or just a rubber stamp? Mario Draghi's comments that the International Monetary Fund should help to set conditions for the ECB's bond-buying programme marks a further shift in the fund's role away from providing finance towards monitoring rescues led by others.

And while a gatekeeper role will give IMF staff more freedom to express their views, it does not guarantee they will be listened to.

"A lot of the IMF staff will be worried about the institution's credibility," said Jacob Funk Kierkegaard, a fellow at the Peterson Institute think-tank in Washington.

"There is – and there should be – a concern that the IMF will be brought in to rubber-stamp something over which they don't have much control."

The shape and size of a possible rescue for Italy or Spain remains unclear. But in contrast to the Greece, Ireland and Portugal rescue programmes, IMF money is unlikely to play much, if any, role.

The fund can lend only direct to governments and is not permitted to buy sovereign debt in secondary markets. And because IMF loans have senior creditor status, eurozone authorities may wish to avoid loading up Spain and Italy with debt that would push current creditors further down the list.

When eurozone finance ministers announced a rescue programme for Spain's banking system in July, the IMF said it would confine its role to "providing independent advice".

Yesterday, Christine Lagarde, the IMF's managing director, welcomed the ECB announcement but merely added: "The IMF stands ready to co-operate within our frameworks."

The advantage of a purely monitoring role in future rescues would be to reduce pressure on the fund's staff and management from the executive board, which is dominated by European countries.

Critics have often complained that, since the IMF joined the ECB and the European Commission to form the "troika" of rescue lenders in 2010, shareholder governments have put undue influence on IMF staff to sign off unrealistic lending programmes.

When the Greece rescue was revised in February, the fund was persuaded to overcome serious reservations about whether Greek sovereign debt was sustainable.

But the traditional IMF view is that, without "skin in the game" in the form of its own money at stake, the fund's views are easier to ignore.

"Draghi's comments essentially mean the IMF is out," said Simon Johnson, a former IMF chief economist at the Massachusetts Institute of Technology. "There has been a remarkable shift in approach."

In practice, much of the work of imposing conditions will fall to the ECB, Prof Johnson added.

Q&A

Programme aims to bring health to weak sovereigns and banking system

Mario Draghi said his revamped bond-buying programme was aimed at ensuring "appropriate monetary policy transmission". What did he mean?
So-called "monetary transmission" refers to the process by which a central bank's monetary policy decisions are passed on, through financial markets, to businesses and households.

Since the financial crisis, borrowers around the world have not always felt the full benefit of central banks' ultra-low interest rates because of the poor health of banks on the high street.

The problem is particularly pronounced in the eurozone periphery, where businesses and households in countries such as Italy and Spain face much higher borrowing costs than the ECB's main interest rate of 0.75 per cent as their countries are so exposed to the eurozone crisis.

Borrowers in the periphery pay far more than their counterparts in "core" euro-area states, such as Germany. Eurozone policy makers are concerned that this could stoke opposition to the single currency in the bloc's periphery.

Reducing the variation in interest rates, often referred to as "financial fragmentation", is what Mr Draghi means when he refers to the "singleness of monetary policy", long seen as a cornerstone of European economic convergence.

How is bond-buying meant to address the problem?
An important channel through which interest rates are passed on to a country's businesses and households is through the price of its sovereign debt. Local banks tend to own a significant portion of their government's bonds. This creates a vicious circle between the health of the sovereign and the condition of its banking system.

By saying it will buy government bonds in potentially unlimited quantities, the ECB hopes to break this interdependence, which should lower the price paid by banks in the periphery to access funding. The ECB will hope lenders pass on these lower costs to businesses and households.

Mr Draghi said the liquidity created through the bond purchases will be "fully sterilised".

Mario Draghi: intends to reduce variation in rates

What does this mean?
When the ECB buys government bonds, it creates cash to do so. Because of this, there is more cash, or liquidity, in the financial system than before the purchases were made.

Some members of the governing council have voiced fears that the liquidity added by the bond purchases could stoke inflation. In order to counter this risk, the ECB "sterilises" the bond purchases by removing the additional cash through the system.

There are two main ways in which it can do so. The first, used to "sterilise" its existing bond purchases, involves calling on banks to park funds at the ECB, on which the central bank will pay interest. The second is for the ECB to issue bills in exchange for banks' cash.

There is some doubt whether sterilisation is effective in reining in inflation. But that is a question for another day – at the moment there is plenty of excess liquidity in the system, but relatively little inflationary pressure.

The issue of sterilisation is not particularly contentious. Mr Draghi revealed yesterday that not a single member of the bank's governing council had objected to sterilising its bond purchases.

Mr Draghi has talked about countering the "convertibility risk" associated with a break-up of the eurozone. But how will the ECB calculate its impact on bond prices?
There was no clear answer from yesterday's press conference, and doing so with any degree of accuracy is fraught with difficulty. It will ultimately boil down to a judgment by the governing council on several factors, such as the amount of volatility in financial markets, the spreads between yields in the core nations and the periphery, along with economic fundamentals.

Claire Jones, London

FINANCIAL TIMES
Number One Southwark Bridge, London SE1 9HL

SUBSCRIPTIONS AND CUSTOMER SERVICE:	LETTERS TO THE EDITOR:
Tel: +1 44 207 775 6000 fte.subs@ft.com www.ft.com/subscribetoday	Fax: +44 20 7873 5938 letters.editor@ft.com
ADVERTISING: Tel: +44 20 7873 3794 emeaads@ft.com	**EXECUTIVE APPOINTMENTS:** Tel: +971 4299 754 www.exec-appointments.com

Published by: The Financial Times Limited, Number One Southwark Bridge, London SE1 9HL, United Kingdom. Tel: +44 20 7873 3000; Fax: +44 20 7407 5700. Editor: Lionel Barber.

Printed by: (Belgium) BEA Printing sprl, 16 Rue de Bosquet, Nivelles 1400; (Germany) Dogan Media Group, Hurriyet AS Branch Germany, An der Brucke 20-22, 64546 Morfelden - Walldorf; (Italy) Poligrafica Europa, S.r.l, Villasanta (MB), Via Enrico Mattei 2, Ecocity - Building No.8, Milan; (South Africa) Caxton Printers a division of CTP Limited, 16 Wright Street, Industria, Johannesburg; (Spain) Fabripress, C/ Zeus 12, Polígono Industrial Meco-R2, 28880 Meco, Madrid. (Sweden) Bold Printing Group/ Boras Tidning Tryckeri AB, Odegardsgatan 2, S-504 94, Boras. (Abu Dhabi) United Printing & Publishing Company LLC, Muroor Road, PO Box 39955, Abu Dhabi

France: Publishing Director, Adrian Clarke, 40 Rue La Boetie, 75008 Paris, Tel. +33 (0)1 5376 8250; Fax: +33 (0)1 5376 8253; Commission Paritaire N° 0909 C 85347; ISSN 1148-2753. **Germany:** Responsible Editor, Lionel Barber, Responsible for advertising content, Adrian Clarke. **Italy:** Owner, The Financial Times Limited, Rappresentante e Direttore Responsabile in Italia: I.M.D.Srl-Marco Provasi - Via Guido da Velate 11 20162 Milano Aut.Trib. Milano n. 296 del 08/05/08 - Poste Italiane SpA-Sped. in Abb.Post.DL. 353/2003 (conv. L. 27/02/2004-n 46) art. 1 comma 1, DCB Milano. **Spain:** Legal Deposit Number (Deposito Legal) M-32596-1995; Publishing Director, Lionel Barber; Publishing Company, The Financial Times Limited, registered office as above. Local Representative office: Castellana, 66, 28046, Madrid. ISSN 1135-8262. **Sweden:** Responsible Publisher, Bradley Johnson; Telephone +46 414 20100. **UAE:** Publisher, Adrian Clarke, Tel: +33 (0)1 5376 8250; origin of publication, twofour54, Free Zone, Abu Dhabi.

Rajoy stance sets stage for stand-off with EU

Spain's PM refuses to be rushed

Premier aware of political minefield

By Miles Johnson in Madrid and Peter Spiegel in Brussels

Spain will not be forced into requesting a rescue until the attached conditions become crystal clear, senior officials in Madrid insisted yesterday, setting the stage for a prolonged stand-off between the government of Mariano Rajoy and European authorities.

After Mario Draghi, European Central Bank governor, made clear that any assistance from the central bank to reduce Spanish borrowing costs would come with "strict and effective" conditionality, the Rajoy government remained steadfast that a request would be made only if, and when, it was ready.

"There is no urgency," a Spanish official said after a press conference with Mr Rajoy and Angela Merkel, where the German chancellor deftly avoided questions over possible new conditions for Spain.

But bravado aside, Mr Rajoy faces a decision that will define the 57-year-old Galician's political career, and shape the outcome of the eurozone debt crisis.

"Now the ball is in our court, as the government will have to publicly ask for a rescue," said Jordi Fabregat, professor of financial management at Esade business school.

The Spanish prime minister is aware of the disastrous political consequences a request for a bailout would have on a nine-month-old government that was elected on a pledge to avoid the fate of Greece, Portugal and Ireland.

Yet Mr Draghi's comments have in effect scrapped the "conditionality-lite" programmes Spain agreed to when requesting €100bn of aid for its banking sector in June, erasing political gains the Rajoy government thought it had secured.

Worse still, from Madrid's perspective, is the possible arrival of what Cristóbal Montoro, Spain's budget minister and Rajoy ally, has called the "men in black".

German chancellor Angela Merkel greets Spain's prime minister Mariano Rajoy in Madrid yesterday. A Spanish official says there is 'no urgency' Reuters

Mr Draghi's favouring of monitoring of any programme by the International Monetary Fund would be likely to lead to a so-called "troika" mission being sent to Madrid, and would destroy any semblance of Spain not having suffered the ignominy of an intervention. The troika includes monitors from the ECB, IMF and European Commission, and such missions have become politically poisonous in Ireland and Greece. Senior European officials are divided over how hard to push Mr Rajoy to accept a bond-buying programme through the €440bn eurozone bailout fund, which Mr Draghi set as a prerequisite for any ECB action. One senior EU official involved in the discussions said the French government was pushing hardest for Spain to request aid, believing it would calm unsettled peripheral bond markets.

Germany was also in favour, but was urging delay for domestic reasons: Berlin is reluctant to return to the Bundestag immediately for the tortuous process of getting political approval for another bailout programme.

Still, another senior EU official said he believed Mr Rajoy would eventually be forced to accept aid. Mr Draghi has made that route more difficult, however, by insisting any ECB assistance would have to come with the harsher conditionality, and likely monitoring from the IMF.

Only two months ago, EU leaders tried to make Mr Rajoy's path to a bond-buying programme easier. At an EU summit in June, eurozone heads of government agreed to demands from Mario Monti, the Italian prime minister backed by Mr Rajoy, to impose no new conditions on aid other than complying with existing EU budget rules. In addition, no troika missions would be included.

Mr Draghi's decision appears to reverse the agreement. Although assistance from the eurozone fund and the ECB would be aimed at different markets – eurozone aid would be used to buy bonds at auction; ECB money in the open market – Madrid would have to abide by the ECB's tougher standards to get aid from both.

Merkel seeks to hold line amid deep divisions

Mood in Germany

By Gerrit Wiesmann and Quentin Peel in Berlin and James Wilson in Frankfurt

Angela Merkel, German chancellor, backed the European Central Bank's new sovereign-bond buying programme, but also gave a stern reminder to eurozone leaders that it was ultimately up to elected politicians to fix the crisis.

The ECB's decision fell "within the framework of its mandate" to ensure monetary stability, she said yesterday after a meeting with Mariano Rajoy, Spanish prime minister. But, she added, the bank's steps could "not replace political action" such as the fiscal reforms Germany has pushed for since the crisis began.

Her words were testament to the balancing act she has practised since EU leaders at the end of June bowed to pressure from Mr Rajoy and Mario Monti, Italian prime minister, again to intervene in sovereign bond markets to stop yields spiking. That decision – which Mario Draghi, ECB president, yesterday fleshed out with an outline of the central bank's role – kicked off a heated debate in Germany.

> Data published yesterday in Germany showed a high level of mistrust of Draghi

Jens Weidmann, Bundesbank president, in past weeks led the charge that it put the eurozone perilously close to using the printing press to finance governments.

While trying to avoid an open clash with the Bundesbank – revered among Ms Merkel's conservatives – the government quietly defended Mr Draghi's more pragmatic approach by saying it would buy stricken nations time to enact reforms.

But with the inflationary trauma of Weimar Germany part of the national discourse, her government's line failed to prevent cracks showing in the coalition that underpins it. Squaring up to eurosceptic independents in a Bavarian state election next year, the Christian Social Union in particular has loudly warned of dangers.

Indeed, data published yesterday showed a high level of mistrust of Mr Draghi. A poll conducted by Forsa for Stern magazine and RTL TV showed 42 per cent of those questioned had little or no trust in the ECB president – although 40 per cent had no opinion or did not know who he was. Only 18 per cent said they trusted him.

Alexander Dobrindt, general secretary of the CSU, Bavarian sister-party of Ms Merkel's Christian Democrats, yesterday warned the ECB was turning from "a bank of stability" into the "bank of inflation" thanks to a "very risky" policy.

Nonetheless, other coalition grandees were more sanguine, repeating Ms Merkel's June pledge that bonds of a government would only be bought if it had first agreed to political conditions, such as reforming public finances or raising competitiveness. Germany's banking associations were also largely in favour of the ECB.

Philipp Rösler, economics minister and the head of the Free Democrats, Ms Merkel's junior partners, said it was vital "to agree the conditions for countries as quickly as possible". ECB bond purchases could "never be a long-term solution".

Norbert Barthle, a budget policy expert in Ms Merkel's Christian Democratic Union, similarly welcomed bond buying as a "useful . . . short-term crisis-fighting tool". Linking such measures to conditions – to be agreed with the eurozone rescue funds – would mean "help will continue to come only in return for reforms".

The opposition said it was Ms Merkel's failure to enforce political reforms which had forced Mr Draghi's hand. While warning of the "risks" of his course, Carsten Schneider, a Social Democrat budget expert, said Ms Merkel's lack of leadership had left the ECB as "the only institution in the eurozone with any power to act".

Greece sets jobless record in June

Greece's official jobless rate hit another record in June, underscoring the effect on the private sector of two years of austerity aimed at bringing the budget deficit under control, **writes Kerin Hope in Athens.**

Unemployment climbed to 24.4 per cent in June from 23.1 per cent in May, with 1.2m people out of work, according to data released yesterday by Elstat, the independent statistical agency. The jump was announced as an opinion poll published in Pontiki, a satirical weekly, showed the far-right, anti-immigrant Golden Dawn party had increased its support to 10.5 per cent, overtaking the socialists for the first time.

The poll, by Pulse, gave the ruling centre-right New Democracy party, governing in coalition with Pasok and the Democratic Left, 25 per cent, compared with 24 per cent for the leftwing opposition Syriza party.

FINANCIAL TIMES

"Without fear and without favour"

Friday September 7 2012

Mario Draghi's audacious gamble

Conditionality key to success of new bond-buying scheme

Time and again throughout the crisis, investors have called on the European Central Bank to provide more of a financial backstop for troubled countries, thus limiting the risk of a eurozone break-up. In the words of Mario Draghi, ECB president, the central bank's new bond-buying scheme, announced yesterday, should do just that.

The stakes could not be higher. The eurozone's financial market is fragmenting. The wide divergence in rates between different countries is raising fears that the monetary policy mechanism may be broken. This is filtering through to the underlying economy. Both the ECB and the OECD yesterday slashed their growth forecasts.

Elements of the "outright monetary transactions" – the name Mr Draghi has given his brainchild – offer hope that the scheme may be more effective than past attempts to drive down rates in peripheral eurozone countries. The size of the programme is uncapped lending credence to Mr Draghi's remarks that he will do "whatever it takes" to save the euro. The ECB has dropped any claim to seniority, which should reassure investors that any purchases will not subordinate their own holdings of peripheral bonds.

Mr Draghi stressed that any purchases under the OMT will be subject to "strict and effective conditionality". This is an important statement. Given the uncapped nature of the programme, the central bank could suffer politically and financially were governments in trouble to renege on their promises after receiving help.

This commitment, while welcome, does not eliminate the risk of moral hazard. Mr Draghi may claim that the ECB will stop buying the bonds of countries which are not compliant with their agreed programmes. But doing so after the central bank has stuffed itself with a country's bonds is like putting a gun to one's own head and threatening to pull the trigger.

Enforcing conditionality is also crucial politically. The Bundesbank and the German public remain opposed to bond-buying programmes. While Mr Draghi is right to do what he feels is necessary to save the currency bloc, he has to ensure that Europe's largest economy remains on board.

Markets have applauded the ECB's move. But European leaders should not get carried away. Spain and Italy still have to decide whether to apply for help. The process of closer eurozone integration remains uncertain.

For all Mr Draghi's bravery, his audacious gamble remains just that.

THE LEX COLUMN

Friday September 7 2012

Glencore/Xstrata

Baar is a stone's throw from Zug, but Glencore, based in the former, seems to be a world apart from Xstrata, in the latter. Investors are expected to reject the pair's so-called merger of equals today. What the cuckoo-clock has happened? When the deal was launched in February, Glencore boss Ivan Glasenberg and Xstrata chief Mick Davis both trumpeted its operational and financial logic. The ratio was agreed. Now both appear to be washing their hands of the deal, and preparing for failure – even though it is the only possible combination. At best they are being inconsistent; at worst the men are showing scant regard for their shareholders.

Sure, Qatar Holding's accumulation of a 12 per cent Xstrata stake and call for the agreed 2.8 ratio to be lifted to 3.25 has put the kibosh on the merger. Qatar has every right to lose money. Xstrata's shares are down by a quarter since the deal was announced, as the commodity cycle turned, and will fall further if a no vote prevails. Trouble is, Mr Glasenberg, not used to dealing in the public domain, has been openly hostile towards the Qataris. His recent dissing of Xstrata's greenfield projects in Australia also jars with the original merger of equals love-in. But Mr Davis has hardly rushed to

Hello, big buy

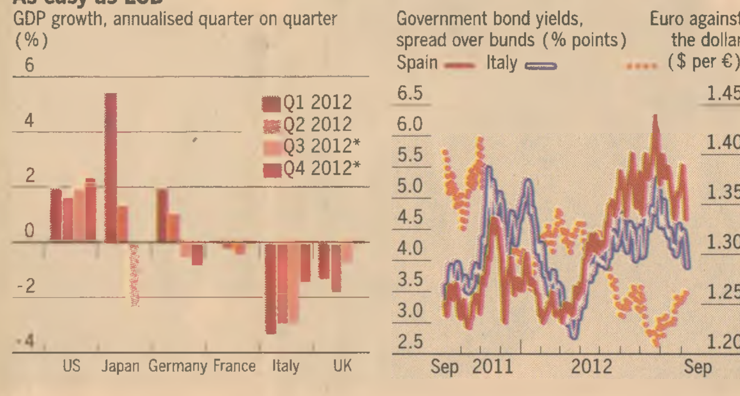
Somebody (a German!) addressed Mario Draghi as "Mr Weidmann" yesterday. At which the president of the European Central Bank began to laugh. As well he might. His big idea for ending the eurozone crisis – purchasing the shorter-dated bonds of floundering eurozone countries – is an unmistakable *auf Wiedersehen* to German central bank orthodoxy. (Bundesbank president Jens Weidmann thinks bond purchases are a terrible idea.) So Mr Draghi's plan really, *really* needs to work.

Consider what Mr Draghi is trying to achieve and the means at his disposal. The ECB wants to eliminate "convertibility risk", a fancy name for the widespread belief among investors that the eurozone will break up. All the central bank can do, however, is undertake a technical operation to buy sovereign bonds in the secondary market, which would bring yields down by pushing up bond prices, and load such actions up with conditions on more structural and fiscal reforms. There is substantial execution risk between technical means and political and existential ends.

Mr Draghi has already succeeded in bringing down borrowing costs. Since he said in late July that the ECB would do everything required to save the euro, "and believe me, it will be enough", Spanish and Italian two-year bond yields have tumbled from 6.5 per cent to 2.8 per cent and 5 per cent to 2.3 per cent, respectively. The aim of outright monetary transactions, or OMT, as the bond purchases will be known, is presumably to keep them there (or bring them down further).

The ECB's plan will make life exceedingly difficult for the Italian and Spanish governments, which want lower bond yields but not the conditions attached. It also raises a troubling question. The plan is predicated on the conviction among eurozone policy makers that convertibility risk has created false prices in the bond market. Why do they think they are better judges of what bond prices should be than the aggregate of investors? Somebody will have the last laugh here, and it may not be Mr Draghi.

As easy as ECB



* Forecasts

Sources: OECD; Thomson Reuters Datastream

strong industry position, its exposure to "ageing" demographics and its scope to expand in emerging markets. Long-sighted investors should not be deterred.

Nomura

It has not taken Koji Nagai long to spot that Nomura's international investment banking operations are in trouble. Yesterday, a month into his new job as the Japanese broker's chief executive, he confirmed that it would cut a further $1bn of costs in its equities and investment banking back offices by March 2014, almost half in its European outposts. It was already in retreat: since November it has cut $1.2bn of costs. Europe accounts for two-fifths of wholesale revenues, and has one of its highest cost bases. Nice start, Mr Nagai.

Nomura's purchase of the Asian and European arms of Lehman Brothers in 2008 was supposed to catapult it into the global bulge bracket of investment banks. So much for that. However, Nomura's lacklustre rankings in most areas – except fixed income – limited its ability to offset the high cost of its overseas foray. Nomura's wholesale division, which generates 70 per cent of group revenues outside Japan, lost almost Y9bn pre-tax in the first quarter

what it is. So a partnership with one

as will cutting the losses on its

Still, even modest