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E.C.B. chief faces challenging month

LONDON

After August revival, markets set to pounce if Draghi can't deliver

BY LANDON THOMAS JR.

Mario Draghi, the president of the European Central Bank, has helped the euro zone survive the month of August. But can he save September?

This month, Mr. Draghi stared down bearish international traders who were convinced that Europe's common currency project would collapse.

"It is pointless to bet against the euro — it is pointless to go short on the euro," Mr. Draghi said at a news conference on Aug. 2, a week after telling the world that the E.C.B. would do "whatever it takes" to save the euro union.

Investors, or at least the ones venturing into the lightly traded markets this month, have taken heed.

Since Aug. 2, the euro is up 3.1 percent against the dollar. More notable, battered stocks and bonds in Spain and Italy have soared, as the euro bears have rushed to close out their negative bets and even some risk-averse traders have piled into assets they had previously scorned.

But it will be September and not the lazy days of August that will truly test Mr. Draghi's market-moving mettle. He will face severe pressure in the coming month to provide specific details of his plan to shore up the euro zone's weaker members by buying their bonds.

The first big test could come next week, on Sept. 6, when the E.C.B. Governing Council meets. Afterward, Mr. Draghi will once again hold a news conference to try to explain whatever the central bank has or has not done. Bearish traders will be poised to pounce yet again on any signs of E.C.B. waffling.

Worries are also swirling that Germany will refuse to grant Greece the time and resources it is seeking to reduce its debt, something that could push it out of the euro currency bloc. Looming as well is the possibility that a decision from Germany's Constitutional Court, expected on Sept. 12, will rule out German involvement in the region's new bailout fund, the European Stability Mechanism.

The schism within German policy circles has been revealed in recent days. In an interview with the magazine Der Spiegel published Sunday, the head of the German central bank, Jens Weidmann, who is also on the E.C.B. Governing Council, fiercely criticized the idea of having the European bank intervene in bond markets.

But on Monday, Jörg Asmussen, a German on the E.C.B.'s Executive Board who was a colleague of Mr. Weidmann in the government of Chancellor Angela Merkel, said during a speech in Hamburg that the E.C.B. had to buy bonds to stabilize European debt markets.

The stakes are sufficiently high for Mr. Draghi that on Tuesday, the E.C.B. announced that he was canceling plans to attend the annual meeting of global

DRAGHI, PAGE 20

Talking up the euro

The euro has rebounded from its recent low against the dollar, buoyed by comments from the president of the European Central Bank, Mario Draghi.

Source: Bloomberg

MONTI HEADS TO BERLIN FOR TALKS
The Italian prime minister will meet with Chancellor Angela Merkel to discuss efforts to ease the crisis. *PAGE 17*

SPANISH REGION SEEKS EMERGENCY FUNDS
Catalonia's request for €5 billion in aid complicates Spain's efforts to meet fiscal goals laid out by the euro zone. *PAGE 17*

Ryan's rapid rise in politics fueled by earnest dedication

WASHINGTON

BY JENNIFER STEINHAUER AND JONATHAN WEISMAN

During the early 1990s, Tortilla Coast, a popular Capitol Hill watering hole, was staffed by ambitious young men and women flinging Tex-Mex and margaritas for patrons whose jobs in the nearby House and Senate office buildings they not-so-secretly coveted.

One of those waiters, a tall, dark-haired Midwesterner named Paul D. Ryan, stood out. He was the guy who always showed up for work on time, wore neatly pressed khakis, and liked to chat about economic policy as he floated along in a kayak at an after-work party.

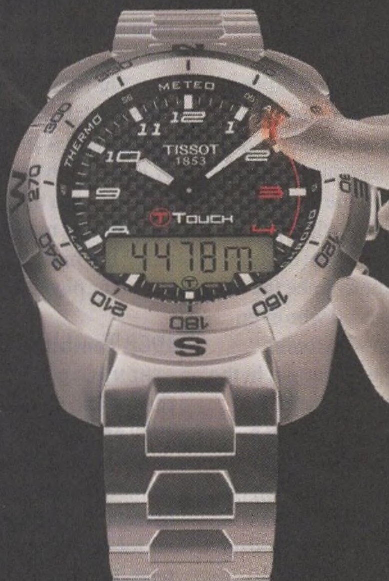
"I think even then he probably had an eye toward his future," said Scott Johnson, another waiter who was looking for work in the incoming Clinton administration.

Mr. Ryan's careful seriousness extended to the conservative research organization where he was also working at the time, winning the sort of approbation from Republican elders that would help pave Mr. Ryan's remarkably propitious path in Washington

"We were the beginnings of the network that he has now developed," recalled former Senator Bob Kasten of Wisconsin, in whose office Mr. Ryan

RYAN, PAGE 8

TISSOT, LEADER IN TACTILE WATCH TECHNOLOGY SINCE 1999



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Venture capital in an unexpected place

Window on Wall Street

WILLIAM ALDEN

MILWAUKEE When the hedge fund manager David Einhorn was just another investment analyst in the mid-1990s, his family gave him $500,000 to get his fund, Greenlight Capital, off the ground. Now that he is a billionaire after a career of doing battle with large companies, he has returned the favor.

A world away from Wall Street and the technology money culture of Silicon Valley, the Einhorn family started a venture capital firm in Milwaukee, which raised a $40 million fund last year.

David Einhorn is the largest investor in the fund, run by his brother, Daniel, and their father, Stephen. The firm, Capital Midwest Fund, also led by another partner, Alvin Vitangcol, aims to tap the Midwestern work ethic and has ambitions of changing the way early-stage investments are run.

"This isn't Silicon Valley, where you're almost encouraged to fail a couple times, and your next opportunity is in walking distance," said Daniel Einhorn, who is 40.

Capital Midwest, however, is still a smaller player in the sector. Located in an office building across the street from a strip mall near the city limits, the company got started years after prominent venture firms in the region and around the country had established themselves. Its fund is about a fourth the size of the industry average, according to Thomson Reuters and the National Venture Capital Association.

But the company has its own views on how to manage investments. Instead of merely serving as an angel investor that provides money but little hands-on support, Capital Midwest pays close attention to a company's ability to chart a path to generating revenue. And if a company financed by the new fund does not provide the investors an exit within five years — through an acquisition — then Capital Midwest requires the company to buy back its shares.

Daniel Einhorn does not hesitate to put executives on the spot. Last month, surrounded by Milwaukee Brewers baseball memorabilia in his office, he questioned over the phone the chief executive of one of his portfolio companies. It was a start-up based in Ann Arbor, Michigan, called CytoPherx, and the company was discussing clinical trials of a medical device that were not going smoothly. At one point, with the receiver on mute, Mr. Einhorn said the chief executive was making a "poor me" excuse.

So far, Capital Midwest has benefited from a scarcity of venture capital in the

JEFFREY PHELPS FOR THE NEW YORK TIMES

From left, Stephen Einhorn, Alvin Vitangcol and Daniel Einhorn head Capital Midwest. The small firm has benefited from its location, where venture capital is scarce.

"You can't live your life trying to compete with your brother."

region. Its current fund had an internal rate of return of about 43 percent through late August, according to Daniel Einhorn. In March, the firm sold its stake in one company, Therapeutic Proteins, which manufactures generic versions of biological drugs, for double its initial investment.

David Einhorn, 43, sits on the advisory board but is not involved in the day-to-day operations of Capital Midwest. While they work in different sectors of finance, the two brothers share a contrarian spirit when it comes to investing.

Unlike many hedge funds that prefer a low-key, almost invisible approach to their holdings, David Einhorn rose to prominence with short-sale bets against Allied Capital and Lehman Brothers. He has mastered the art of harnessing the spotlight to hammer away at companies he views as troubled.

Family ties were enough to persuade David Einhorn to invest in Capital Midwest. He and his family committed $15 million out of $40 million to a second fund the firm started.

"My parents were big supporters when we launched Greenlight," David Einhorn wrote in an e-mail. "When Dad and Danny started Capital Midwest, I was thrilled to support them and the firm."

Daniel Einhorn sees little need to measure his track record against his brother's, whose comportment with corporate management is the stuff of Wall Street legend. Pictures of David Einhorn decorate Capital Midwest's office, but here, the hedge fund manager is just family.

"You can't live your life trying to compete with your brother," Daniel Einhorn said. "I wish him all the success in the world. I don't need to get to that level."

And certainly, a good portion of the investors for the second venture fund were local foundations and dozens of individuals, many of whom were drawn in by longstanding relationships with Stephen Einhorn rather than by a need to chase after a star Wall Street hedge fund manager.

The family has been based in Milwaukee since 1976, when Stephen Einhorn, 69, left New Jersey with his wife and two young sons and started an investment banking business, a firm that became Einhorn Associates, from a bedroom office. Daniel Einhorn, whose career began in country club management and took him to a Texas hedge fund and a position overseeing an investment portfolio at an insurance company, joined the firm in 2004.

Only recently did the family move into venture capital, when Stephen Einhorn, who had a long career advising specialty chemical companies, opted to try something new. In 2008, tapping Stephen Einhorn's local connections, the firm raised its first venture fund, of $4.5 million, and became known as Capital Midwest.

With few competitors in the region, the new fund was able to invest in 11 young companies. One went bankrupt last year, and the others, though they have yet to go public or be sold as hoped for, are still in business.

"The bottom line is, there's a lot of low-hanging fruit here — a lot of great opportunities and very few funding sources locally," said John Neis, the managing director of Venture Investors, a competing firm based in Madison, Wisconsin, that manages about $200 million.

Daniel Einhorn has focused on companies in the biomedical sector. After his daughter, Emma, received a diagnosis of leukemia at age 3, Mr. Einhorn raised more than $50,000 for cancer research and was honored by the Leukemia and Lymphoma Society in June. Emma, now 7, has been in remission for 19 months.

Family connections have helped the venture capital firm, but not all have proved fruitful. Sheryl Sandberg, the chief operating officer of Facebook, is Daniel and David Einhorn's cousin. She arranged a meeting this year with one of Capital Midwest's portfolio companies, LiquidCool Solutions, to discuss using the company's technology to cool Facebook's computer hardware.

The meeting did not go particularly well. Soon after, for broader reasons, Capital Midwest replaced LiquidCool's entire management team. Such a move might seem unusual in Silicon Valley, where founders are often chief executives and are closely identified as crucial to the success of the company.

Capital Midwest tends to keep its distance from flashy young companies. A frequent target of Daniel Einhorn's scorn is Groupon, a Midwestern company that became a darling of Silicon Valley but has suffered since its public debut last year. Daniel Einhorn says he advised David to bet against Groupon when it went public. The hedge fund manager declined. (A representative of Groupon declined to comment.)

"He still owes me for that one," Daniel Einhorn said with a laugh, adding, "It was one of the best ideas I've had."

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Once again, rewards for bad behavior

James Saft

INSIDE THE MARKETS

Some boats are lifted far higher than others, it seems, when it comes to the effects of quantitative easing.

A Bank of England study, released last week, showed that its £325 billion, or $512 billion, in bond purchases had disproportionately benefited the wealthiest, driving up the value of the assets they own. Quantitative easing refers to a central bank's buying of assets like government bonds to increase liquidity in the financial markets.

Standing as we are on the eve of what many expect to be another round of quantitative easing — in the United States and possibly elsewhere — the study by the British central bank makes somewhat depressing reading, yet another example of crisis mitigation in which advancing the interests of the well-off plays a central role.

In Britain, quantitative easing drove a 26 percent rise in shares above where they otherwise would be, the study found, in turn fueling a nominal increase of almost $1 trillion in household wealth, though with the richest 5 percent owning 40 percent of financial assets, those gains were hugely slanted toward the wealthiest.

Quantitative easing, as distinct from simply lowering interest rates, acts on the economy through many channels, several of which tend to push asset prices higher. First, and most simple and most powerful, when a central bank creates money and buys a government bond, the person selling it is faced with a question of what to do with the money. Many will elect to plow the money back into shares and corporate bonds, increasing prices.

As well, the liquidity created by quantitative easing — in other words, the money sloshing around the markets — will tend to support prices by raising confidence that the market will be there if and when an owner wants to sell an asset.

There are good reasons to suspect that both types of gains are at least in part illusory, though in the here and now, it is real money that owners can gain access to, borrow against or swap into other assets, like houses.

While quantitative easing will improve the earning power of companies, via the wealth effect from higher asset prices and more generally through higher overall economic growth, it seems unlikely, to cite the Bank of England's figures, that it has raised the long-term value of corporate earnings by the 26 percent it has raised the price of a share in those earnings.

Furthermore, the so-called liquidity premium may not last forever. Remember, assumptions that the market would always be there and welcoming were in part what got financial institutions — and savers — in trouble in 2008.

None of this is to say that quantitative easing does not increase economic growth; it clearly does. What it also does, however, is favors some over others. It is also unclear, at best, whether quantitative easing based in the financial markets will, over the long term, produce a good risk-adjusted return.

Charles L. Evans of the Federal Reserve Bank of Chicago is part of a minority advocating for much stronger policy by the U.S. central bank. Mr. Evans, speaking Monday in Hong Kong, called for the Fed to start buying bonds and keep buying them until unemployment showed an extended improvement, a tactic that would, if followed, perhaps reduce the upward skew of benefits. Sandra Pianalto, president of the Federal Reserve Bank of Cleveland, in contrast, was much more circumspect, arguing that there are limits to what monetary policy can achieve.

An ironic effect of quantitative easing is that it acts as a subsidy for the banking industry.

The other, and ironic, effect of quantitative easing not covered in the Bank of England report is that it acts, in essence, as a subsidy for financial intermediation. The big winners, almost certainly, are not just those with assets that rise in price, but they are also those who make their living from the financial markets. Very much like the special treatment given to the banking industry, this is another example of reward for bad behavior and market failure.

Ultimately, the way out of the debt crisis has two parts. First, reduce debt, preferably gently. Quantitative easing obviously has a useful role here.

The real point, however, is to increase the productive capacity of the economy, preferably of things that can be exported. Quantitative easing might well retard this process, as it continues to give primacy to financial intermediation, which itself has a strong track record of misallocating capital away from export industries and toward where the greatest returns can be extracted by, you guessed it, those in finance.

Even those who benefit might someday regret quantitative easing.

James Saft is a Reuters columnist.

Crédit Agricole hoping to sell Greek arm soon

PARIS

REUTERS

Crédit Agricole, whose quarterly results were hit hard by costs stemming from its operations in distressed euro zone countries, said Tuesday that it could reach an agreement to sell its troubled Greek arm, Emporiki Bank, within weeks.

The bank has been selling assets as it retreats from an ill-fated expansion binge and returns to its roots in French consumer banking.

Before the September 2008 financial crisis, Crédit Agricole moved aggressively into countries including Spain, where it bought a 20 percent stake in Bankinter, and Greece, where it acquired Emporiki in 2006.

On Tuesday, Crédit Agricole said it would take a charge of €427 million, or $537 million, after cutting its stake in the Italian bank Intesa Sanpaolo to below 2 percent from 5 percent. It also took a €370 million charge from its business in Greece.

Crédit Agricole, in which cooperative French regional banks hold a 56 percent stake, said talks were continuing with the Greek authorities and the European Commission about a sale of Emporiki, which has been a major drag on the bank's valuation.

Crédit Agricole said it had not yet entered advanced negotiations with any bidder. But the chief executive, Jean-Paul Chifflet, said a deal could be reached in "a matter of weeks."

Mr. Chifflet said Crédit Agricole might also further reduce its holding in Bankinter, which recently fell below 20 percent after the French bank opted out of a recent share issue.

Bankinter has been hit by soured real estate deals and a rising number of problem loans, though it is less exposed to the collapsed property market than other Spanish lenders.

Crédit Agricole said its net profit fell 67 percent in the second quarter, to €111 million, while revenue slid 14 percent, to €4.75 billion. The bank said its core Tier 1 ratio, a measure of a bank's ability to withstand losses, increased to 9.6 percent from 9.4 percent, but did not disclose where the ratio now stands according to the tougher Basel III standards taking effect next year.

E.C.B. chief faces grueling challenge to deliver on promises

DRAGHI, FROM PAGE 1

central bankers at the end of this week in the United States, citing his workload.

Despite the uncertainties, even the most savage euro bears seem willing for now to give Mr. Draghi the benefit of the doubt. And to the extent that Mr. Draghi can sustain this market mood, he will have resolved a problem that goes to the heart of the long-running euro crisis: how to compel traders to buy and hold euro-denominated stocks and bonds in the region's higher-risk economies.

"You do not go back to the lira or the drachma or whatever," Mr. Draghi declared at that same early-August news conference. By alluding to the former currency of his home country, Italy, and seeming to place it in the same category of woebegone Greece, Mr. Draghi — who played a crucial policy role in the euro's creation — signaled that he was taking the bears' skepticism personally.

"It's like Dirty Harry saying, 'Make my day,'" said Stephen Jen, a former economist at the International Monetary Fund who now manages a hedge fund based in London. "You can't imagine Greenspan or Bernanke saying something like this," he said, referring to the previous and current U.S. central bank chairmen, Alan Greenspan and Ben S. Bernanke. "It was very Italian and very powerful."

Mr. Draghi's weapon of choice, of course, is more subtle than the Smith & Wesson .44 Magnum favored by Clint Eastwood in the "Dirty Harry" movies. But from a financial markets perspective, there is no less firepower in his suggestion that the E.C.B. might buy the bonds of countries like Spain and Italy if they commit to tough measures to reduce deficits and restructure their economies.

Since Mr. Draghi took the E.C.B. reins in Frankfurt last autumn, investors have been calling his bluff in this regard. They have been betting that he could not persuade the euro zone's biggest financier, the German central bank, to support any form of sustained bond buying because it would be seen as bailing out spendthrift governments.

But a view is now growing that Mr. Draghi may be on the way to convincing Germany that some form of central bank intervention — by committing to

MICHAEL PROBST/AP

Mr. Draghi won't attend a meeting of central bankers this week, citing his workload.

buy Spanish or Italian bonds when they climb above a certain interest rate, for example — can be justified. The challenge is to present it as simply one more step toward fiscal union as troubled euro zone members cede more control over their budgets to Brussels.

That is how Axel Merk sees it. Mr. Merk is president and chief investment officer of a mutual fund in Palo Alto, California, who manages about $600 million in currency-related investments. Long a euro bear, he began to aggressively buy the currency immediately after Mr. Draghi's news conference, convinced that a policy Rubicon had been crossed.

"By imposing a vision, backed by rules and conditions, Draghi is achieving what politicians are not achieving," Mr. Merk said. "He is basically saying to these countries that 'if you give up control of your budgets, I will buy your bonds.' He is laying out what he will do and holding people accountable. Some might call it genius, but it is really common sense."

That said, many investors have not altered their core outlook that the currency must weaken over the longer term as economic conditions in the troubled countries worsen and richer countries like Germany resist putting up more bailout cash. Some even are pointing to Italy as more of a concern than Spain. Bond buying may help in the short term, but it does little to address the fact that Italy cannot grow fast enough to pay down its debt, which is now more than 120 percent of its overall economy.

"The real problem is Italy," said Gennaro Pucci, the chief investment officer at PVE Capital, a hedge fund in London with a focus on European bonds. "The banks are not lending and the debt-to-G.D.P. is going up."

Over the longer term, such a view may very well be valid. But when it comes to putting money to work in the euro zone, investment perspectives hew very much to the short term. And that, for Mr. Draghi, is the core problem, as this frenetic buying and selling by foreign investors sustains a broad climate of fear and uncertainty in the market.

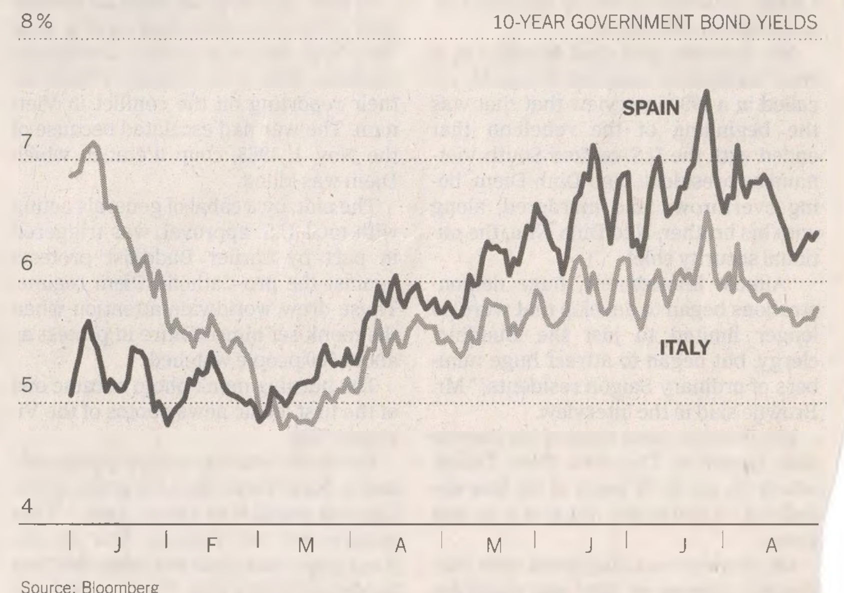
For example, from January through March of this year, investors were net sellers of close to €80 billion, or $100.6 billion at the current exchange rate, in euro zone stocks and bonds on fears that Greece would leave the euro. In May and June of this year, they bought €86 billion of euro zone securities as it became clear that a worst-case forecast would not materialize. Market mood swings of that sort are not conducive to the sort of long-term capital investment that can sustain economic growth.

For Mr. Draghi then, his challenge is to persuade the newly optimistic euro zone traders to keep their positions and to convince others that the waters are once again safe for swimming. And to do that he must convince them that unlike his predecessor, Jean-Claude Trichet, he is not hostage to the doctrines that limit the bank's powers of intervention.

"Draghi has put bond buying back on the table, even though there is no solution to the crisis — and that takes a lot of risk out of the equation," said Jens Nordvig, a bond and currency strategist in New York for Nomura. Mr. Nordvig is advising clients to close out bearish euro trades in advance of Mr. Draghi's news conference next week.

"Draghi is perceived to be very pragmatic and that is what the market respects," Mr. Nordvig said. "The market does not respect dogma. If you are dogmatic in the markets, you will die."

STRESS RELIEF Borrowing costs for Spain and Italy have fallen in recent weeks on expectations that the European Central Bank will institute a new program to buy bonds of struggling euro zone countries.



REUTERS BREAKINGVIEWS
Ten months into his term, Mario Draghi seems to be hitting his stride. *PAGE 22*

Monti hopes to nudge Germany to support bond buying proposal

MONTI, FROM PAGE 17

Italy has a high tax burden, more than 45 percent on average, on a relatively small tax base. A recent report from Eurostat found that Italy's employment rate is 37 percent, compared with 47 percent in Germany, and that since 2007, Italy's gross domestic product has shrunk 3.6 percent, compared with a 6.3 percent rise for Germany's.

Adding to the pressures, Mr. Monti government's mandate is expected to end next spring. That is when Italian national elections are scheduled, and every day the climate in Italy becomes more pre-electoral. The two main parties supporting the government, the center-left Democratic Party and center-right People of Liberty, are struggling to keep pace with a new social and economic reality that has also seen the rise of populist, anti-euro sentiment.

This month Mr. Monti angered many Germans when he called in an interview with the newsmagazine Der Spiegel for governments to be given more independence from their parliaments in order to resolve the crisis. Attempts by Ms. Merkel to move swiftly, and independently of lawmakers, have resulted in legislation ending before the country's Constitutional Court in Karlsruhe.

That court is to rule Sept. 12 on a challenge to the legality of German participation in the permanent euro zone rescue fund, the European Stability Mechanism, and the fiscal pact for Europe. It is not expected to strike down either measure. But the court could impose conditions that would make the process of German ratification even more cumbersome than it already is, with the chancellor requiring parliamentary approval for each bailout.

Such struggles, in part, have contributed to Ms. Merkel's push for a restructuring in Europe to create a stronger political union and shift the fiscal decision making away from the individual countries to a pan-European body, giving the E.C.B. a stronger oversight role.

Such a shift might also help Ms. Merkel combat the rise of anti-European sentiment among Germans who are growing increasingly frustrated with the idea of their taxes flowing to foreign countries and banks over whose spending they have no control.

Rachel Donadio reported from Rome.