Germany: Bavarian bank hit hard by financial crisis

Population to pay for speculation

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It became clear April 3 that the losses incurred by the Bavarian State Bank (BayernLB) resulting from its high-risk dealings on the US subprime mortgage market were much higher than government representatives had formerly stated. The BayernLB is half owned by the state of Bavaria. The latest declared losses of €4.3 billion are more than twice the sum originally made public. Depreciations of €2.3 billion in security stocks arose from BayernLB dealings up to the end of 2007. The bank's additional €2 billion losses were incurred in the first quarter of 2008.

A number of other banks owned or partly owned by German states were victims of the financial crisis prior to the BayernLB. Already last year the SaxonyLB announced massive losses and the WestLB also declared billions in losses.

In order to relieve its disastrous balance sheet, the BayernLB plans to transfer risk-affected securities amounting to €24 billion into a special fund backed up with warranties of €6 billion. Speaking just after the latest losses were declared, the Bavarian finance minister and head of the Bavarian-based Christian Social Union (CSU), Erwin Huber, announced that these warranties would be provided by savings banks and the state of Bavaria. This means that taxpayers and ordinary citizens will be forced to bail out the speculators behind the high-risk and, for some period, highly profitable financial transactions.

The crisis of the WestLB has been met with similar measures. It has transferred high-risk investments valued at the sum of €23 billion on the basis of guarantees from the state of North Rhine-Westphalia and savings banks amounting to €5 billion.

Although the state government in Munich is doing everything it can to limit the damage and secure the survival of the BayernLB, Germany's second biggest state bank is not out of trouble yet.

The BayernLB has a total staff of 19,200 and was founded in 1972. It is the clearing bank for the state and the central bank for Bavaria's 75 savings banks. As the clearing bank for Bavaria it backs the state government's economic policy—normally without batting an eyelid. It played a major role, for example, in providing billions in loans to the media mogul Leo Kirch.

In 2007 the BayernLB notched up pre-tax profits of €255 million. This represented a massive reduction compared to the profits of €1.3 billion the previous year. Just two months ago it was estimated the bank would announce profits of €1 billion for 2007, but then this figure was dramatically revised down to compensate for the losses arising from the dubious investments in US real estate.

While the executive committees of other banks confronting similar problems have reluctantly admitted to having made mistakes, Michael Kemmer, the chairman of the BayernLB, defended the policy of the bank and also demanded that additional bailout funds be made available if necessary. In an interview with the *Süddeutsche Zeitung*,Kemmer casually responded to the question whether €6 billion was enough to secure the bank: "There cannot be absolute certainty in this respect, nobody can foresee at present what could happen."

In the same interview Kemmer made clear that the BayernLB was currently refraining from such high-risk investments for "psychological reasons," but that the bank would resume such dealings as soon as there was some indication of "recovery tendencies."

Kemmer had taken over the bank on March 1 following the sacking of his predecessor Werner Schmidt, but his comments to the *Süddeutsche Zeitung* make clear there will be no change of policy under his leadership.

The leadership of the Bavarian CSU reacted to the crisis in a similar manner. The Bavarian state government, like the executive of the BayernLB, was long since informed of the massive losses incurred by the bank. Bavarian Prime Minister Günter Beckstein described the losses as "unpleasant facts," but declared that it was important in politics "to stay on course—even if the weather was unfavourable." CSU chief Erwin Huber also called the losses painful, but refused to assume any responsibility. Both Huber and Beckstein were active in the leading bodies of the bank up until the end of last year.

Kurt Faltlhauser, the former Bavarian Finance Minister, also defended the speculative investments by the BayernLB on the US property market. Faltlhauser told the *Münchner Merkur* that the real level of risk was for him "just as hard to detect" as for "bankers all over the world, as well as bank supervisory authorities and the rating agencies." Faltlhauser was a member of the board of directors of the BayernLB from 1998 to 2007. This is precisely the period during which the bank undertook its shaky investments.

The CSU state government has made clear it is prepared to pump even more money from the state budget into the ailing BayernLB. In the current budget negotiations the state has drawn up contingency plans for further massive sums to bail out the bank. It should be noted that the billion-strong fund the state government is proposing to prop up the BayernLB was acquired through the privatisation of formerly major state-owned enterprises and public property.

There are many speculators who have made their fortune through the dubious investments made by BayernLB, but none of them are to be held to account. Instead the taxpayer and ordinary citizen must foot the bill. With reference to the bank losses the state government will invariably introduce further cuts in public services and public service jobs. Subsidies for vital public services will be slashed along with welfare and social security benefits. The funds accumulated from the drastic austerity course of the past few years is now to be used to cover the speculative losses of an irresponsible tiny political and business elite.

This has become increasingly clear to broad layers of the population and has unleashed a crisis within the ruling CSU. Party chief Huber, who as finance minister also shares responsibility for the dealings of the Landesbank, is under increasing pressure. Only last December he had referred to possible losses for the BayernLB of around €100 million. The Social Democratic Party and the Greens in the Bavarian parliament have already called for Huber's resignation, and there are "rumours of a putsch" in the CSU against the leadership duo of Huber and Beckstein.

The recent annual conference of the CSU, which last year saw the departure of long-time CSU chairman Edmund Stoiber, was once again wracked by crisis. Following heavy losses in local elections in February the party was determined to put up a show of unanimity. But the close links between the CSU and the Landesbank made it impossible for Huber and Beckstein to disguise the social and financial interests at stake.

In the February local elections the CSU notched up its worst ever result. This was the payoff from the electorate for the massive cuts implemented by the CSU government in the state's education, health and social systems—cuts imposed although the state has had a balanced budget for years.