Europe gripped by fear of global crash

Stefan Steinberg
18 September 2008

Europe's ruling elite has reacted with shock and disbelief to what they fear will be the most serious crisis for world capitalism since the Wall Street Crash of 1929.

The European Central Bank (ECB) responded to the bankruptcy filing by the US investment bank Lehman Brothers with a massive infusion of liquidity aimed at propping up European stock markets. On Monday, the ECB announced a one-day tender for 30 billion euros and declared in a statement that it "stands ready to contribute to orderly conditions in the euro money market."

The action of the ECB was followed by that of the Swiss National Bank, which provided further liquidity as Asian and European stock markets tumbled.

Anticipating sharp falls in the British stock market, the Bank of England released £5 billion in fresh liquidity to ease markets on Monday.

The German finance ministry, the Bundesbank (central bank) and the Bafin financial supervisory authority all tried to restore calm in German markets with a joint statement saying the exposure of German banks to Lehman was manageable.

Such reassurances by European central bankers, combined with massive infusions of cash, did little to calm fears on the markets. On Monday, the London-based FTSEuro First 300 index of leading European shares fell 5 percent, while the German Dax index fell by 4.7 percent—reaching its lowest level in two years. Bank stocks were especially hard hit.

Following the huge stock market losses on Monday and growing fears of a collapse of America's largest insurance group, American International Groups (AIG), European banks intervened once again on Tuesday, with the ECB pumping in an additional 70 billion euros and the Bank of England a further £20 billion.

Once again, the massive infusions of cash failed to re-stabilise markets. On Tuesday, London's FTSE 100 fell below 5,000 for the first time in seven years. German stocks continued to fall. The blue chip Dax index fell by 98.99 points to 5,965.17, a 1.63 percent decline. The main French CAC index also registered heavy falls of 3.78 percent on Monday and 1.96 percent on Tuesday.

Contrary to official protestations in Germany, the full extent of the involvement of Europe's major banks in Lehman Brothers is massive.

On Tuesday, for example, it was reported that the German state lender KfW had transferred 300 million euros in swaps to Lehman Brothers on the very day it applied for bankruptcy, while the Swiss UBS financial group announced that it expects similar losses of at least 300 million euros due to its involvement in Lehman Brothers. UBS is the world's largest wealth manager and has already been forced to write down assets of $37 billion in connection with the US sub-prime mortgage crisis.

According to the German business newspaper *Handelsblatt*, it is probable that the entire emergency fund set up by a consortium of German banks to guard against financial crises will be absorbed by the collapse of Lehman. The Deposit Guarantee Fund of the Association of German Banks (BdB) is estimated at $4.6 billion, a sum that is swamped by the 6 billion euros required to cover the liabilities of Lehman's bankrupt subsidiary in Germany. The 6 billion euro loss from the collapse of Lehman is the largest single loss in German financial history.

Britain is even more exposed to the US financial crisis. Following the collapse of the Northern Rock bank earlier this year, Britain's largest mortgage lender, the Halifax Bank of Scotland (HBOS) also faces bankruptcy. Its shares plummeted by 40 percent on Tuesday and it looks set to be acquired by Lloyds-TSB.

Other major European banks could be swept into the financial maelstrom, under conditions where between April and June the combined economies of the European Union already shrank by 0.2 percent. Britain and Spain, which have been hit by a severe housing crisis, are both estimated to already be in recession. According to the Kiel Economic Institute, Europe's single biggest economy, Germany, will also be hit by recession this year.

With inflation on the rise throughout Europe, in many countries exceeding 4 percent, economic commentators have already raised fears of stagflation within the European Union.

French and German politicians have issued reassuring bromides declaring that the fundamentals of the European

© World Socialist Web Site

economies and banking system are sound and in better shape than the US. But economic commentators have sounded dire warnings to the contrary, emphasising that it is not possible for Europe to insulate itself from the ongoing collapse of US financial institutions.

Pointing out the implications of the threatened collapse of the insurer AIG, the *New York Times* noted that European banks owned three-quarters of the $441 billion in unregulated AIG securities held by a consortium of banks. These securities are tied to the plunging sub-prime mortgage market and expose European financial institutions to enormous risks in the event of an AIG bankruptcy.

Writing in the *Frankfurter Rundshau* on Monday, Jan Pieter Krahnen spoke of the “great dangers of a shock wave” enveloping German and European banks should confidence in the type of credit default swap deals favoured by Lehman Brothers and AIG be shaken in Germany. On Wednesday, the *Süddeutsche Zeitung* headed its interview with a leading finance expert, “The Worst is Yet to Come.”

A number of near apocalyptic commentaries have appeared in the British media, stating that the current crisis is at least comparable to the financial collapse of 1929.

Writing in the *Guardian* on Tuesday, economics editor Larry Eliot headlined his piece “This Week the Crash Went Nuclear, and Britain Will Feel the Worst of the Fallout.” He wrote:

“Clearly, the events of the weekend now make a prolonged and deep recession far more likely. Forget all the talk about soft landings, or a recession so short and sharp that it will barely be noticed. The way things stand, it is now a question of whether there is a complete meltdown of the financial system, with institutions crashing like ninepins, or whether a severe rationing of credit over a prolonged period leads to falling house prices, weaker consumer spending, lower investment and rising unemployment.”

“This is without doubt the most serious financial shock since 1929,” he continued.

In an article for the right-wing *Daily Mail,* Alex Brummer recalled that the first indications of the swelling international crisis began with troubles at a European bank.

“The crunch began,” he wrote, “on August 9 last year after the leading French bank BNP Paribas announced it could not value assets in two of its investment funds because of the toxic securities they contained.”

He went on to refer to “tens if not hundreds of billions of assets which have turned bad and might be worthless,” and concluded, “Only now at Lehman, Merrill Lynch, AIG and elsewhere is the true size of the black hole being recognised. At Lehman, for example, the figure for suspect or toxic assets more than doubled from £17 billion to £44 billion in the course of last weekend alone.”

The *Mail*’s editorial declared, “For decades, we have worshipped at the shrine of gold. Prime ministers and presidents have bowed before its keepers. The monarchs of cash, arbiters of wealth, supposed founts of all wisdom, have bestridden Europe and the United States, humbling all in their path... Today, we awaken to discover that like so many wizards of Oz, these supremely confident figures are in reality foolish old men—and some young ones—mouthing hollow incantations from behind curtains.”

“A vision of capitalism stands discredited,” it concluded.

Willem Buiter, professor of European political economy at the London School of Economics, made one of the clearest statements on the global implications of the financial meltdown in the US.

In the *Financial Times*, Buiter said of the $85 billion bailout of AIG by the US government, “The largest insurance supermarket in the world, with a balance sheet in excess of $1 trillion, nationalised because it was seen to be deemed too big and too globally interconnected to fail!”

He continued, “The fear that drove this extraordinary decision is that AIG’s failure would increase counterparty risk, actual and perceived, throughout the financial system of the US and the rest of the world, to such an extent that no financial institution would have been willing to extend credit to any other financial institution. Credit to households and non-financial enterprises would have been the next domino to fall, and voilà!, financial Armageddon.”

To contact the WSWS and the Socialist Equality Party visit:

wsws.org/contact

© World Socialist Web Site