IMF chief warns of new financial meltdown

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Christine Lagarde, the managing director of the International Monetary Fund, warned of the prospect of a new global financial crisis in a speech Saturday at the annual meeting of central bankers, economists and international financial officials hosted by the Federal Reserve Bank of Kansas City at the Rocky Mountain resort of Jackson Hole, Wyoming.

Alluding to recent developments—a sharp fall in economic growth in the US and Europe, the mounting sovereign debt crisis in Europe, eroding confidence in the solvency of major banks in Italy, France and other countries—Lagarde said, "Developments this summer have indicated that we are in a dangerous new phase. The stakes are clear: we risk seeing the fragile recovery derailed. So we must act now."

Lagarde seemed to suggest that unless swift, coordinated and decisive action was taken to boost growth and shore up highly indebted governments and shaky banks, the global financial system would likely experience a new meltdown similar to that which accompanied the Wall Street crash of September 2008.

She asserted that "the downside risks to the global economy" were increasing, "aggravated further by a deterioration in confidence." She implied that the economy was approaching the point of an uncontrolled downward spiral, declaring, "If growth continues to lose momentum, balance sheet problems will worsen, fiscal sustainability will be threatened, and policy instruments will lose their ability to sustain the recovery."

Speaking of Europe, she said: "Banks need urgent recapitalization. They must be strong enough to withstand the risks of sovereigns and weak growth. This is key to cutting the chains of contagion. If it is not addressed, we could easily see the further spread of economic weakness to core countries, or even a debilitating liquidity crisis."

The talk of a liquidity crisis was an implicit reference to the situation that developed after the collapse of Lehman Brothers on September 15, 2008, when banks and corporations were unable to obtain funding for normal operations because of a collapse of confidence in financial markets.

Lagarde called for a mandatory program of recapitalization of European banks, to be financed, if necessary, with public funds. She suggested that the 440-billion-euro European Financial Stability Facility, established to bail out Greece and other highly indebted European countries such as Ireland and Portugal, be tapped to inject funds into shaky banks in the 17-nation euro zone.

In recent weeks, major banks, including Société Générale, France's second largest, and UniCredit of Italy, have had difficulty obtaining financing because of their heavy exposure to government bonds and private bank debt in Greece and other embattled countries and fears that they could not withstand a default of these loans. Their share prices have plummeted.

The *Financial Times* reported Sunday that a recent analysis by Morgan Stanley found bank funding had fallen significantly over the past three months and "the cost for banks is expected to be significantly higher when the markets reopen in September." The newspaper quoted a central banker as saying, "Banks in some countries have had trouble securing liquidity in recent weeks and that pressure is going to mount."

Turning to the US, Lagarde deplored the anemic rate of US economic growth and urged action to lower the rate of long-term unemployment and stem the continuing fall in home prices. "With falling house prices still holding down consumption and creating economic uncertainty, there is simply no room for half-measures or delay," she declared.

She called on the Obama administration to provide aid to distressed homeowners, either through a reduction in their mortgage principal or by enabling households whose mortgage debt is higher than the market value of their homes to refinance at the bargain basement rates that presently prevail.

While calling for a further taxpayer bailout of the banks and sharp cuts in health and pension entitlement programs in the mid and long term, Lagarde argued against drastic austerity measures in the short term and in favor of modest stimulative measures to boost consumer demand. Calling for a "dual focus," she said, "It does not necessarily mean more up-front drastic belt-tightening. If countries address long-term fiscal risks like rising pension costs or health care

spending, they will have more space in the short run to support growth and jobs."

The dire character of Lagarde's remarks may well reflect concerns within the financial establishment that the coming weeks could usher in a further deterioration in the state of financial markets. Robert Zoellick, president of the World Bank, appeared to second Lagarde's remarks, saying he was concerned that events this fall "could trigger market challenges beyond the three small countries, at the larger countries or the EU banks."

Both in tone and substance, Lagarde's remarks were markedly different from those of Federal Reserve Chairman Ben Bernanke, who addressed the conference Friday, and European Central Bank President Jean-Claude Trichet, who spoke Saturday.

Bernanke sought to reassure the markets that, despite an unanticipated slowdown this spring and summer, the US economy remained sound and would grow more rapidly in the coming period. He managed to present this generally rosy prognosis in part by virtually ignoring the signs of a global contraction and barely noting the worsening sovereign and banking crisis in Europe, indications of a new banking crisis in the US, and the implications of the downgrading of US debt by Standard & Poor's earlier this month.

Trichet avoided any direct reference to the current crisis in Europe in his prepared remarks. However, he publicly refuted Lagarde's warning of a possible liquidity crisis, saying, "The idea that we could have a liquidity problem in Europe" is "plain wrong."

Lagarde's speech has already prompted rebukes from European officials and central bankers. An article posted by the *Financial Times* Sunday under the headline "European Officials Round on Lagarde" reports: "European officials rounded on Christine Lagarde on Sunday, accusing the managing director of the International Monetary Fund of making a 'confused' and 'misguided' attack on the health of Europe's banks."

The article quoted an unnamed "experienced central banker" who said, "To talk about capital is a confused message. Everybody—politicians, regulators, other officials—is quite concerned."

These criticisms are in part driven by fears that the IMF head's grim assessment will spook bank investors, leading to a renewed run on bank shares and a further rise in lending costs and the price of insurance against loan defaults by major banks. The cost of insuring European bank debt against default has already reached all-time highs, in excess even of the costs in the period leading up to the financial crash of 2008.

But the public controversy also reflects sharp divisions within the global financial elite over how to deal with the worsening crisis. Lagarde herself, formerly the finance minister in the French government of President Nicolas Sarkozy, became the head of the IMF only last month after the forced resignation of Dominque Strauss-Kahn, who was indicted in New York on sex charges that have since been dropped.

Most European banks are fiercely opposed to mandatory recapitalization, and US banks have lobbied furiously against any legislation that would require them to reduce mortgage principal or receive significantly lower interest payments on home loans.

Within Europe, Germany is opposed to any measures, such as capital injections by the European Financial Stability Facility into banks, that would require Germany to foot the lion's share of the bill for bailing out highly indebted countries or failing European banks.

There is little prospect for Lagarde's call for prompt and coordinated action to stave off a further descend toward a full-scale depression. Moreover, her prescriptions do not differ in principle from those demanding more immediate drastic austerity measures. There may be differences in timing and tactics, but they are all agreed that the cost of the crisis must be borne by the working class.

Nearly three years after the crash of September 2008, it is clear that nothing has been resolved and no genuine recovery has been secured. As Lagarde herself indicated—"But today, it is public sector balance sheets themselves that are in the firing line"—the plundering of national treasuries to bail out the banks has only bankrupted national states. Now, the sovereign debt crisis has rebounded back onto the banks, whose basic insolvency was only covered over by trillions in cash handouts from the state.

The utilization of the crisis to lay siege to the jobs, wages and social conditions of the working class has, moreover, undercut any prospect for real economic growth. The response of the international ruling class and its political representatives, including the Obama administration in the US, is to intensify the attacks on the living standards of working people.

The only genuine solution is one that comes from below—in the form of the united action of the working class against the capitalist system and its political parties based on the fight for a revolutionary socialist program.