# Central banks seek to avert global meltdown

**Nick Beams**
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Yesterday's move by six major central banks to boost liquidity for European banks makes clear there is a growing fear in leading financial circles that the euro zone crisis threatens to set off a meltdown of the entire global financial system.

The emergency action, led by the US Federal Reserve, will cut the interest rate on dollars loaned to European banks. They have been hit by the withdrawal of funds and the drying up of credit because American and other banks fear that European authorities are losing control of the situation.

In another sign that the crisis is spreading, Chinese authorities yesterday cut the amount that the nation's banks must set aside as reserves—the first such move since 2008.

The intervention by the Fed, together with the European Central Bank (ECB) and the central banks of Japan, Britain, Canada and Switzerland, boosted share markets around the world. Wall Street's Dow Jones index rose by 500 points in its biggest one-day rise since March 2009.

While providing short-term relief, the measures have done nothing to overcome the underlying crisis, which is one of insolvency, not liquidity.

Jon Peace, head of European bank research at the Japanese finance house Nomura, told the *Guardian*: "It is an evolution of the crisis from three years ago, when countries took on the risks of the banks. Back in 2008, there was a lender of last resort—countries bailed out the banks. This time it is governments that need a lender of last resort—but there is no obvious lender of last resort."

Three years ago, the major concern about the stability of European banks was their exposure to dubious asset-backed securities, much of it sold to them by US finance houses. Today, the source of concern is the banks' exposure to sovereign debt—the bonds issued by the governments of the euro zone.

Welcoming the central banks' move, the *Financial Times* (FT) pointed to the dangers facing the American banking system. It warned that a lack of investor confidence in the European banks was "squeezing the dollar-denominated parts of euro zone balance sheets. If this sparked a fire sale of dollar assets, contagion could spread to US banks."

Serious as this problem was, the FT warned that the "real worry" was tight euro funding, with interbank loans and unsecured funding drying up in the euro area. In other words, there was an ever-present danger that European financial markets would simply freeze up.

On Tuesday, euro zone finance ministers agreed on detailed plans to boost the European Financial Stability Facility (EFSF) with increased leverage. Their actions could well be likened to lecturing on navigation while the ship goes down. Such is the reluctance of banks, governments and finance houses to place any money in Europe that there is no prospect of the EFSF receiving sufficient funding to even begin tackling the crisis, let alone resolving it. Barely a month after the leverage plan was first announced, the EFSF is being described as "yesterday's solution."

The central bank action was accompanied by series of warnings about the financial and political implications of the euro zone sovereign debt crisis.

France's central bank governor, Christian Noyer, told a conference in Singapore: "We are now looking at a

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true financial crisis—that is, a broad-based disruption in financial markets."

The breakup of the euro zone, once considered unthinkable, is being taken increasingly seriously. In Britain, the Financial Services Authority, while insisting that it is not predicting a collapse, has told UK banks to draw up contingency plans for such an eventuality.

In a speech yesterday, European Economic and Monetary Affairs Commissioner Olli Rehn warned the European parliament of the longer term implications of the collapse of the euro zone. "The economic and monetary union will either have to be completed through much deeper integration or we will have to accept a gradual disintegration of over half a century of European integration," he said.

The truth is that the European powers have no possibility of unifying Europe. One of the central causes of the current crisis is the widening of the divisions between them in the wake of the global financial breakdown that began in 2008.

In the short term, pointing to the European leaders' summit on December 9, Rehn said the European Union faced a "critical period of 10 days to complete and conclude the crisis response."

The differences remain as wide as ever, however. The two key powers of the euro zone, France and Germany, are deeply divided. The French government of President Nicolas Sarkozy wants the ECB to act as a lender of last resort for beleaguered European governments, while the German government of Chancellor Angela Merkel fears this will simply mean that Germany has to bail out the other European governments and be dragged deeper into the crisis itself.

In a newspaper interview, French Foreign Minister Alain Juppe warned of the long-term consequences if a solution were not found. Echoing remarks on Monday by Polish Foreign Minister Radoslaw Sikorski, that the breakup of the euro zone could have "apocalyptic" consequences, Juppe said Europe faced an "existential crisis." The collapse of the euro could trigger "the explosion of the European Union itself."

"In that eventuality," he added, "everything becomes possible, even the worst. We have flattered ourselves for decades that we have eradicated the danger of conflict inside our continent, but let's not be too sure."

While Juppe's comments were intended to apply pressure to Germany to accede to French demands for greater action by the ECB, there is no question that the crisis contains the potential for economic and military conflict in Europe.

Moreover, as yesterday's central bank intervention makes clear, there are fears that a breakdown in Europe will hit the rest of the global financial system virtually overnight.

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