Major central banks ride to aid of E.U. lenders

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cial system to its knees.

The central banks seemed determined to demonstrate that they would not hesitate to deploy their combined weight to keep the European sovereign debt crisis from leading to a collapse of the euro zone.

"They are getting together and acting together," Christine Lagarde, the president of the International Monetary Fund, said in Washington on Thursday. "To me, that is the most important message."

But Ms. Lagarde also warned that policy makers had depleted their ammunition since the financial crisis of 2008, and suggested more action was needed.

"We have entered into a dangerous phase of the crisis," she said. There is still a path to recovery, she said, but it is "a narrow one."

The central bank action comes as European finance ministers and other key policy makers are gathering in Wroclaw, Poland, for meetings on Friday and Saturday. The U.S. Treasury secretary, Timothy F. Geithner, who is scheduled to attend, is expected to urge European officials to act more aggressively to contain the crisis, which has already begun to undercut growth in Europe.

An official forecast warned Thursday that growth in Europe would come "to a virtual standstill" toward the end of the year. The European Commission, the bloc's executive, cut the growth forecast for the euro area to 0.2 percent for the third quarter and 0.1 percent in the fourth, down from 0.4 percent for both periods. It predicted, though, that Europe would just barely avoid a double-dip recession.

Analysts said they expected Mr. Geithner to press European ministers in Wroclaw to increase the resources available to their bailout fund for the euro zone countries. But among European leaders, and even within the E.C.B., deep disagreements exist over how to prevent the problems of Greece from undermining the common currency.

Members of the euro area are still struggling to ratify an expansion of the bailout fund that they agreed to in July. A further expansion of the fund has raised fears that the increased obligations could hurt some countries' credit ratings.

"Part of the problem for policy makers is that they are still waiting for

MAX ROSSI/REUTERS

Lorenzo Bini Smaghi said countries should not be left to financial markets' mercy.

last big initiative to get off the ground," said Peter Westaway, chief European economist in London for Nomura. "We're all kind of on hold until then."

Last week, divisions within the E.C.B. itself broke into the open after Jürgen Stark, a member of the bank's executive board, unexpectedly resigned in apparent dismay at the bank's growing purchases of government bonds.

During a speech in Vienna on Thursday, Mr. Stark did not discuss the reasons for his resignation but warned against "ill-considered action at the European level, which may ease market pressure in the short term, but in the long term risk the stability and ultimately the survival of economic and currency union."

Mr. Stark, while agreeing that central banks needed to assure the banking system has adequate liquidity, also said that errant government debtors should face strong sanctions. That view was echoed by the German chancellor, Angela Merkel, on Thursday during a visit to the Frankfurt Motor Show. "Everyone must do their homework," Mrs. Merkel said.

Germany has a "duty and responsibility to make its contribution to securing the euro's future," Mrs. Merkel said. But, in a comment that could reinforce perceptions that political leaders are determined to move at their own pace and not be driven by financial markets, she added that stabilizing the euro area "won't happen overnight or with any one-time thunderbolt."

The majority of members on the E.C.B.'s governing council, which is made up of the executive board and the chiefs of 17 national central banks, are less hawkish than Germany. Lorenzo Bini Smaghi, also a member of the E.C.B.'s executive board, said Thursday that it would be a mistake to leave countries at the mercy of financial markets, which he said were not functioning properly.

"We cannot hide behind principles and rules designed for a theoretical situation, which no longer corresponds to the reality," Mr. Bini Smaghi said in Rome.

His comments were an implicit riposte to German critics who have accused the E.C.B. of betraying its mandate by buying the government bonds of Greece, Italy, Spain and other euro area countries to help keep their borrowing costs from spiraling out of control.

Mr. Bini Smaghi warned, though, that E.C.B. bond buying cannot be a substitute for stronger government action.

Dollar shortages were a feature of the crisis that followed the collapse of Lehman in 2008, and can be a severe problem for banks that have obligations in the United States that they must refinance.

European banks have only rarely used an existing one-week dollar credit line offered by the E.C.B., since tapping the facility has been viewed by markets as confirmation that the banks are having problems accessing dollar funds. On Thursday, two banks borrowed $575 million from the facility. The E.C.B. does not disclose the identity of the borrowers.

The two banks were the first to tap the dollar credit line since August, when one bank borrowed €500 million. That, in turn, was the first use of the dollar facility since February.

By making dollars available for a longer three-month period, the central banks are providing reassurance that ailing banks will not be dependent on the more fragile one-week funding. The E.C.B. will offer the dollars in three operations, starting on Oct. 14 and again in November and December. The other central banks will follow similar schedules. The Fed will not offer loans directly, but will provide dollars to the E.C.B. by way of a swap agreement.

Borrowing banks must supply collateral in the form of bonds or other securities, but so far they have only used a fraction of the collateral on their books, giving them in theory unlimited access to cash.

Stephen Castle reported from Wroclaw, Poland. David Leonhardt and Leonard Apcar contributed reporting from Washington.

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As central banks come to the rescue, the obvious danger is moral hazard. *PAGE 20*

Riding to the aid of E.U. lenders

RANKFURT

Major central banks vow to provide dollars in bid to stem borrowing crisis

BY JACK EWING
AND STEPHEN CASTLE

Worried that Europe's debt impasse posed a growing threat to the global economy, the world's major central banks moved Thursday to assure investors that European banks would not run short of U.S. dollars as they nearly did at the height of the 2008 financial crisis.

The banks, in a coordinated action intended to restore market confidence, agreed to pump dollars into the European banking system in the first such show of force in more than a year.

The move, coming almost exactly three years after the collapse of the investment bank Lehman Brothers, sharply increased the value of shares in banks heavily exposed to debt from Greece and the other struggling members of the 17-nation euro zone.

The euro, which had been falling in recent days, rebounded, rising roughly 1 percent in European trading Thursday. But whether the central bank action would provide more lasting relief remained to be seen.

The European Central Bank said it would allow banks to borrow dollars for up to three months, instead of just for one week as before. The E.C.B. said it was acting in cooperation with the U.S. Federal Reserve, the Bank of England, the Bank of Japan and the Swiss National Bank.

It was the first coordinated effort to provide dollars since May 2010, and seemed to go beyond just providing reassurance that European banks would not be cut off by U.S. lenders wary of their financial state. It also echoed a similar move undertaken just a few days after the Lehman Brothers bankruptcy nearly brought the world's finan-

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SPAIN TO REINTRODUCE WEALTH TAX

The government plans to reintroduce a wealth tax Friday as it scrambles to reduce the budget deficit. *PAGE 17*

Beleaguered financial stocks rallied in Europe on Thursday as central bankers moved to support European banks.

Source: Bloomberg