FINANCIAL TIMES

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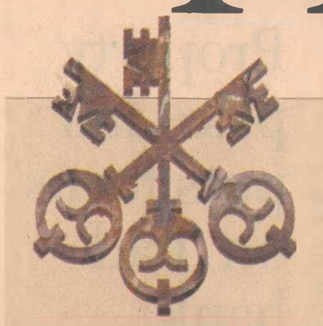
EUROPE Tuesday October 4 2011



Changing the locks

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Gold bugs beware – the bubble is finally bursting
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World Business Newspaper

News Briefing

Abramovich accused of betrayal by oligarch
Roman Abramovich, owner of Chelsea Football Club, "demonstrated that wealth and influence mattered more than friendship and loyalty", according to the lawyer for Boris Berezovsky, a fellow Russian oligarch who is fighting Mr Abramovich for $6bn in London's commercial …urt. **www.ft.com/abramovich**

…nvestors on guard
Investors are funnelling more assets to tail-risk funds that protect them against extreme events, amid the European sovereign debt crisis and global economic recession. **Page 17**

US defies double-dip
September data confirmed that the US economy was still afloat and defying fears of a double-dip recession. **Page 4**

AMR Corp shares drop
Fears the holding company for American Airlines, the fourth-biggest US carrier by passenger miles, will file for bankruptcy sent shares in AMR Corporation tumbling. **Page 17**

Libya looks to stability
Post-revolutionary Libya's ruling body will be headed by Mahmoud Jibril, the country's new leaders said on Monday, as they try to project an image of political stability. **Page 6**

Mining deals optimism
Miners expect a pick-up in dealmaking after a 40 per cent drop in sector share prices in the past 10 months flushed out corporate predators. **Page 17**

Khamenei scandal vow
Iran's supreme leader Ayatollah Ali Khamenei vowed there would be "no mercy" for anyone found guilty in the country's biggest financial scandal. **Page 8**

Airlines fear trade war
Airlines face being caught up in a global trade war as opposition grows to the EU's plan to make carriers pay for pollution, the International Air Transport Association has warned. **Page 3**

Fatty foods taxed
Denmark has become the first country in the world to tax foods that are high in saturated fats, such as pizza and butter. **Page 3**

Yen weighs on Japan
The strength of the yen and a slowing global economy are weighing on the outlook for …siness in Japan. **Page 4**

Fifth monk fire protest
A fifth Tibetan monk has set himself alight in mountainous western China at a monastery that has become a centre of defiance against Beijing. **Page 8**

Separate sections

Chile
Wealth brings changing priorities
Investing in Russia
Putin return puts future in doubt

Printed in London, Liverpool, Dublin, Frankfurt, Brussels, Stockholm, Milan, Madrid, New York, Chicago, Los Angeles, San Francisco, Dallas, Atlanta, Orlando, Washington DC, Johannesburg, Tokyo, Hong Kong, Singapore, Seoul, Abu Dhabi, Sydney

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● Sovereign debt crisis hits bank ● Euro tumbles amid Greece tensions

Dexia holds emergency talks

By Stanley Pignal in Brussels and Peter Spiegel in Luxembourg

Europe's sovereign debt crisis forced Dexia, the Franco-Belgian banking group, into emergency talks on Monday to consider strategic options including an effective break-up, people familiar with the matter said.

The lender, a municipal financing expert, was looking at setting up a "bad bank" to hold a portfolio of assets which has long burdened it, the people said. The Brussels-based group, one of the first European banks to be bailed out in 2008, holds €20.9bn ($27.6bn) in sovereign debt issued by Greece, Italy and other troubled eurozone countries. It remains heavily reliant on short-term borrowing to finance its operations, while much of its lending is long term.

Belgium's finance minister, Didier Reynders, said at a meeting of finance ministers in Luxembourg: "The French and Belgian governments are behind their banks, whether that is Dexia or another. To help banks and to help, for example, French and Belgian savers, the first thing to do is to help Greece."

Dexia has traditionally been the biggest operator in the funding of French municipalities – although analysts say wholesale funding difficulties have curtailed this. It also runs a significant retail network in Belgium and Turkey.

A state guarantee by Belgium and France would be available if required, the people familiar with the matter said. A spokesman for Mr Reynders declined to say whether a bad bank would receive such guarantees.

Since the 2008 bail-out, Dexia has been majority owned by the French, Belgian and Luxembourg governments and state-led bodies such as the French CDC.

The talks at Dexia came after a heavy sell-off in European bank shares after Greece said it would miss budget deficit targets for this year.

Commerzbank, Germany's number two lender, fell 7.3 per cent, Société Générale dropped 5.2 per cent and BNP Paribas shed 4.6 per cent. The Dexia board meeting was organised at the close of another day of heavy losses for its shares, which dropped 10 per cent after it was put on a negative downgrade watch by Moody's, the rating agency, which cited concerns about a further deterioration in its liquidity position.

The euro tumbled to a more than decade low against the yen amid tensions over Greece, which has warned it will run out of cash next week unless it is offered fresh loans. The euro also fell to an eight-month low against the dollar. However, the meeting of finance ministers in Luxembourg was expected to delay a decision on a much-needed €8bn aid payment for Athens.

Under the plans being discussed by Dexia's board, the bank's activities in France and Belgium would be either merged or develop partnerships with other entities, according to the people familiar with the talks.

In particular, financing for French municipalities could be done in conjunction with the Banque Postale and the Caisse des Dépôts et Consignations, the French sovereign wealth fund which is a shareholder in both Postale and Dexia.

Other activities would be likely to be spun off to raise capital, including Dexia's stake in Denizbank, the Turkish retail bank, and Dexia's well-regarded asset management arm.

"Nothing is off the table," said a senior executive in the group. "There is a call for state guarantees, so nothing can be off the table."

Dexia declined to comment on the board meeting or on Monday's downgrade. But people close to the group acknowledged that the current financing situation was "strained", as short-term markets have dried up.

Additional reporting by David Oakley in London

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Jean-Claude Trichet, president of the European Central Bank, arrives in Luxembourg yesterday Reuters

Osborne to 'ease' credit for smaller businesses

By George Parker in Manchester and Chris Giles in London

The UK government is to throw a multibillion-pound credit line to small and medium-sized companies after the Bank of England refused to support the business sector by buying anything other than corporate bonds.

According to Treasury officials, the Bank told the government that any additional quantitative easing would focus o… buying government bon… insisting that the Treasury should take the lead in purchasing riskier corporate bonds.

The chancellor George Osborne responded on Monday by announcing a new programme of "credit easing" in which the Treasury would support business lending, using the Bank as its agent, or operating through a new arm's-length agency.

Aides said the Treasury's corporate bond purchases could eventually total "tens of billions of pounds".

The programme would operate along the lines of the Asset Purchase Facility operated by the Bank in 2009, which bought corporate bonds in exchange for government bills.

John Longworth, director-general of the British Chambers of Commerce, said: "Credit easing could help solve the problems in delivering much-needed credit to businesses but the devil will be in the detail as to how this could work."

The chancellor is still relying on Bank-led quantitative easing as its first line of economic defence. Mr Osborne said he supported a resumption of QE, which could come as soon as Thursday when the Bank's monetary policy committee meets.

Mr Osborne told the Tory party conference in Manchester that credit easing would support small companies "struggling to get credit" from weak banks.

Additional reporting by Brian Groom

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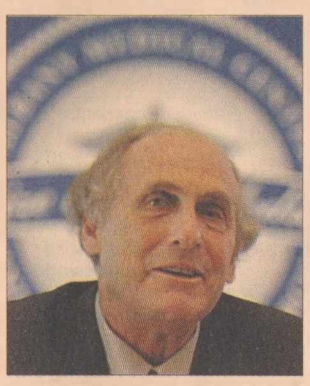
www.ft.com/westminsterblog

Nobel winner dies



One of three researchers to be awarded the 2011 Nobel prize for medicine died at the end of last week from pancreatic cancer, having been kept alive in recent months by a treatment he helped develop. The Nobel Assembly voted on Monday to give half of its annual Skr10m (€1.1m) prize to Ralph Steinman (above), 68, professor of immunology at Rockefeller University in New York, without knowing he had died.

Report, Page 3

India offers to provide security training to Afghanistan police

By James Lamont in New Delhi and Matthew Green in Islamabad

India has offered to train Afghan police to help them prevent future terrorist attacks in a move likely to be seen as highly provocative by long-time rival Pakistan.

Over recent weeks, Islamabad has rebuffed accusations from senior US and Afghan officials that its allies in Afghanistan are responsible for a spate of attacks.

A move by New Delhi, which has long accused Pakistan of backing terror groups operating in India, to train Afghan police for the first time would risk raising the temperature further in one of the world's most volatile regions.

India hopes to reach agreement on the security training programme with Hamid Karzai, Afghan president, during his two-day visit to the Indian capital which begins on Tuesday, according to a person familiar with the offer. If Mr Karzai accepts, specialist training of high-ranking Afghan police officers could begin before the end of the year, according to people close to the talks.

An Indian foreign ministry spokesman said Mr Karzai's visit to New Delhi, his second this year, was also "an opportunity for both countries to consolidate their strategic partnership and discuss bilateral, regional and global issues".

Pakistan's military has long feared that India would seek to foster closer ties with Afghanistan. For decades, Islamabad has covertly supported Afghan militant groups in an effort to prevent the emergence of a pro-Indian government in Kabul.

Afghan officials maintain that the Pakistan army's Inter-Service Intelligence agency has stepped up support for Afghan Taliban factions in recent years – claims Pakistan denies. Mr Karzai's government recently accused the ISI of playing a role in last month's assassination of Burhanuddin Rabbani, Afghanistan's former president, and investigators have said his assassin was a Pakistani national. An attack on the US embassy in Kabul was blamed on the Haqqani militant network, which the Pentagon considers to be an arm of Pakistan's intelligence services.

Mr Karzai renewed his criticism of Pakistan in a speech on Monday, condemning what he called its "double game" in backing Afghan militancy. But he reiterated that the only effective route to negotiating an end to the insurgency would be through talks with Pakistan.

Two into one won't go, Page 8
www.ft.com/afghanistan

World Markets

STOCK MARKETS

	Oct 3	prev	%chg
S&P 500	1108.58	1131.42	-2.02
Nasdaq Comp	2355.9	2415.4	-2.46
Dow Jones Ind	10723.08	10913.38	-1.74
FTSEurofirst 300	912.26	923.41	-1.21
Euro Stoxx 50	2138.24	2179.66	-1.90
FTSE 100	5075.5	5128.48	-1.03
FTSE All-Share UK	2628.41	2654.38	-0.98
CAC 40	2926.83	2981.96	-1.85
Xetra Dax	5376.7	5502.02	-2.28
Nikkei	8545.48	8700.29	-1.78
Hang Seng	16822.15	17592.41	-4.38
FTSE All World $	(u)	184.57	

CURRENCIES

	Oct 3	prev		Oct 3	prev
$ per €	1.327	1.342	€ per $	0.753	0.745
$ per £	1.548	1.558	£ per $	0.646	0.642
£ per €	0.858	0.861	€ per £	1.166	1.161
¥ per $	76.7	77.1	¥ per €	101.7	103.4
¥ per £	118.6	120.1	£ index	79.8	79.8
$ index	80.1	79.8	€ index	92.41	93.13
SFr per €	1.215	1.219	SFr per £	1.417	1.415

COMMODITIES

	Oct 3	prev	chg
Oil WTI $ Nov	77.61	79.20	-1.59
Oil Brent $ Nov	102.76	102.76	
Gold $	1,623.50	1,614.60	8.90

INTEREST RATES

	price	yield	chg
US Gov 10 yr	103.08	1.78	-0.14
UK Gov 10 yr	112.55	2.33	-0.09
Ger Gov 10 yr	103.89	1.82	-0.07
Jpn Gov 10 yr	100.65	1.03	0.00
US Gov 30 yr	119.97	2.76	-0.16
Ger Gov 2 yr	100.53	0.47	-0.09
	Oct 3	prev	chg
Fed Funds Eff	0.06	0.08	-0.02
US 3m Bills	0.02	0.03	-0.01
Euro Libor 3m	1.50	1.50	0.00
UK 3m	0.92	0.92	

Prices are latest for edition

Cover Price

Austria	€3.50	Malta	€3.30
Bahrain	Din1.5	Mauritius	MRu90
Belgium	€3.50	Morocco	Dh40
Bulgaria	Lev7.50	Netherlands	€3.50
Croatia	Kn29	Nigeria	Naira715
Cyprus	€3.30	Norway	NKr30
Czech Rep	Kc115	Oman	OR1.50
Denmark	DKr30	Pakistan	Rupee 120
Egypt	E£19	Poland	Zl 16
Estonia	€4.00	Portugal	€3.50
Finland	€3.80	Qatar	QR15
France	€3.50	Romania	Ron17
Germany	€3.50	Russia	€5.00
Gibraltar	£2.30	Saudi Arabia	Rls15
Greece	€3.50	Serbia	NewD370
Hungary	[illegible]	Slovak Rep	€3.50
India	Rup85	Slovenia	€3.50
Italy	€3.50	South Africa	R28
Jordan	JD3.25	Spain	€3.50
Kazakhstan	US$5.20	Sweden	SKr34
Kenya	Kshs300	Switzerland	SFr5.70
Kuwait	KWD1.50	Syria	US$4.74
Latvia	Lats3.60	Tunisia	Din6.50
Lebanon	LBP7000	Turkey	YTL6.75
Lithuania	Litas15	UAE	Dh15.00
Luxembourg	€3.50	Ukraine	€5.00
Macedonia	Den220		

Eurozone woes

Greek budget to 'correct for slippage'

Draft plan aims for primary surplus

Warning on revenue collection

By Kerin Hope in Athens

Greece has unveiled a draft budget for 2012 that aims to compensate for a higher than projected spending deficit this year and put the public finances back on track as agreed with international lenders.

The draft budget revises this year's deficit projection upwards to 8.5 per cent of gross domestic product against a target of 7.6 per cent of GDP, mainly because of a deeper than forecast recession and weak revenue collection.

Evangelos Venizelos, finance minister, said in a written statement to parliament that the budget reinforced "a difficult fiscal adjustment effort – transforming a primary deficit [before interest payments on debt] of €24bn in 2009 into a €3.2bn primary surplus in 2012".

A €5bn package of tax increases and spending cuts for 2012, on top of €2.1bn in the fourth quarter, would "correct for slippages" this year, he said. "We have merged the fiscal targets of 2011 with those of 2012 as agreed with the troika [experts from the European Union and International Monetary Fund] in terms of absolute figures." But he warned that, unless revenue collection improved significantly in the fourth quarter, this year's deficit could rise by another 0.5 percentage points.

Spending cuts in the budget include a 5.8 per cent overall reduction in wages and pensions next year. The elimination of 30,000 public sector jobs would bring savings of €200m in 2012, with a further €950m coming from the launch of a unified payment system for civil servants. Spending on health and welfare would fall by a record 9 per cent.

Platon Monokroussos, at EFG Eurobank, said: "The overall deficit target this year remains ambitious. But the execution of the budget is likely to improve thanks to new taxes, as well as earlier measures such as the recent hike in value-added tax."

Greeks are due to pay an extra "solidarity" tax this month of 2-5 per cent of their annual income and a separate property tax in the coming weeks that would be added to household electricity bills. But the burden of additional contributions has darkened the popular mood, revitalising a grassroots opposition movement known as "I won't pay".

Protesters in several cities last week burned documents from the tax authorities requesting payment of the solidarity contribution.

The budget assumes the country will remain in recession for a fourth year in 2012, with the economy projected to contract by a further 2.5 per cent on top of 5.5 per cent this year.

The primary surplus, if achieved, would reduce annual payments on debt by 1.5 percentage points of GDP. But the debt will continue its upward trend, rising from 162 per cent to 172 per cent of GDP by the end of 2012, according to the draft budget.

The draft may be revised before a vote in parliament later this month. Any changes would reflect updated economic statistics, such as the final debt and deficit figures for 2010 and fresh projections based on third-quarter reporting by the national accounts office.

● Opposition parties in Cyprus have called for President Dimitris Christofias's resignation after an independent report said he carried "the main responsibility" for a deadly blast at a Greek Cypriot naval base in July. Thirteen people died when boxes of confiscated Iranian munitions exploded following a brush fire.

For full report see www.ft.com/europe

Lenders want Athens to show more zeal

Deficit talks

Finance minister tries to persuade troika that Greece is an innocent victim of recession, writes **Chris Giles**

Greece's failure to meet its targets for government borrowing in 2011 has laid bare a key argument with its creditors: is Athens the innocent victim of an unexpected and deep recession, or has it shown insufficient zeal in its efforts to get borrowing down?

As Evangelos Venizelos, Greek deputy prime minister and finance minister, entered the eurogroup meeting in Luxembourg on Monday night, he insisted the problem was the former.

"Greece has decided all the necessary and difficult measures to fulfil its obligations towards its institutional partners," he claimed. But the country's latest budgetary tax increases and spending cuts, forced on Athens by the troika of the European Commission, the European Central Bank and the International Monetary Fund suggests its lenders believe it has more to do.

In the negotiations between Greece and its lenders one enduring feature since May 2010 is that both sides have been consistently disappointed by the high level of borrowing, forcing Greece to announce ever more swingeing austerity measures. In May 2010 the European Commission expected a budget deficit of 7.6 per cent of national income in 2011 after the government had brought in tax increases and spending cuts of 6.6 per cent of national income in the first two years of the first rescue programme.

By August this year the Commission was still expecting a deficit of 7.6 per cent of national income in 2011 but that came after the troika had forced much higher spending cuts and tax increases on Greece, equivalent to 10.9 per cent of national income.

Even more tax increases followed this September as Greece's borrowing was again off-track, including an unpopular property tax.

This time Athens has admitted borrowing will overshoot in 2011 by a margin of 0.7 per cent of national income, or €1.5bn, according to the finance ministry.

Rather than introduce yet more austerity measures, Mr Venizelos hopes the measures he has already announced will get the country's borrowing back on track for 2012.

The latest slippage can be blamed on the deeper than expected recession rather than foot-dragging by the government. In June Athens expected the economy to contract by 3.5 per cent in 2011, a figure accepted by the troika, following a 4.5 per cent contraction in 2010 and 2 per cent in 2009.

But with confidence drained, unemployment rising faster than expected and households refusing to spend, the Greek economy is now expected to contract by 5.5 per cent this year, leaving output 12 per cent lower than three years ago.

With tax revenues accounting for 40 per cent of national income, the additional contraction of 2 per cent of national income this year leads to a tax revenue shortfall of 0.8 per cent of GDP. That is almost exactly the amount by which the government believes it will overshoot its borrowing target in 2011.

Analysis of tax revenues and public spending in the eight months of this year to August also suggests the problem lies on the tax side of the ledger, which is more dependent on economic forces beyond the government's control. With figures available until August, the government had collected only 56.8 per cent of net tax revenues it had hoped in June for the whole year.

Public spending is also running ahead of budget, with spending at 69 per cent after two-thirds of the year.

Mr Venizelos' negotiating position is weak and the eurogroup might yet demand more tax increases and spending cuts.

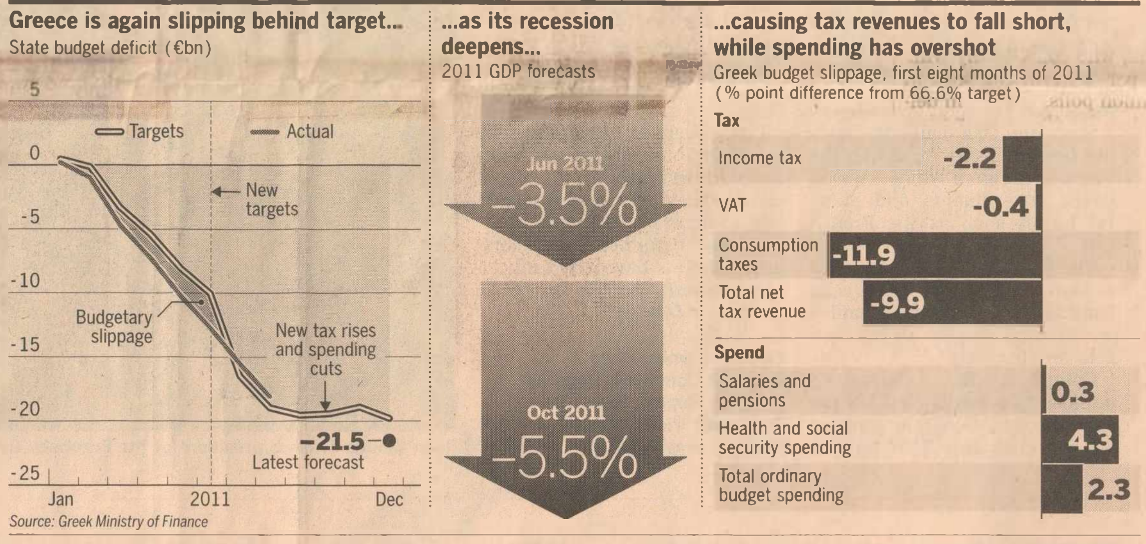
G20 told to act

The G20 group of leading nations must act to stem the sovereign debt crisis, sustain global trade and deal with long-term unemployment when it meets in November, the International Chamber of Commerce said, **writes Hugh Carnegy in Paris**.

The Paris-based ICC's G20 advisory group also warned on Monday against regulatory over-reach in areas such as banking and commodities. It said "the minimum requirement" of the summit was to take credible action to tackle the European debt crisis and address concerns about the growing size of US sovereign debt.

Full story at www.ft.com/europe

High school students clash with riot police during a protest march against austerity in Athens yesterday Reuters



Property price fall puts focus on 'bad bank'

Ireland

By Jamie Smyth in Dublin

A five-bedroom period house in one of Dublin's most exclusive suburbs, bought by developer Derek Quinlan for €11m in 2007, is being sold for a quarter of its peak value as Irish house prices continue to plummet.

Two surveys published on Monday show prices have fallen as much as 55 per cent from their peak in parts of Dublin, plunging hundreds of thousands of homeowners into negative equity and further dampening consumer spending.

Falling prices are also raising questions over the ability of Ireland's National Asset Management Agency – the "bad bank" set up to take over the banks' toxic property loans – to turn a profit on the loans it now controls.

Mr Quinlan's luxury home, which is being sold by a receiver appointed by Nama, is one of about 16,000 properties securing these loans. The sale price of €2.5m-€3m ($3.3m-$4m) is substantially below the average 58 per cent discount the agency applied when it paid €30.2bn to acquire bank loans originally valued at €71.2bn.

The surveys, compiled by property websites Myhome.ie and Daft.ie, show prices fell 3.2 to 3.5 per cent in the July to September quarter. Prices were 42 to 48 per cent off their peak and still falling, they said.

"It is very difficult to see how Nama will be able to meet its target of turning a profit or breaking even, given that it applied lower discounts to loans linked to properties than those linked to land," said economist Ronan Lyons, author of the Daft.ie survey.

Prices in Dublin were unlikely to stabilise until the second half of 2012, Mr Lyons said, and prices outside Dublin might not stabilise until 2014 or 2015. He said between 200,000 and 330,000 homeowners were now in negative equity.

House price surveys have traditionally been compiled by private companies in Ireland, where privacy laws still prevent the sale price of individual properties from being published. However, the Irish national statistics office began compiling surveys of house prices in March 2011 for the first time. Its last report in August showed house prices in Dublin 47 per cent below their 2007 peak.

Some 9 per cent of residential mortgages are in arrears of 90 days or more, according to research by Moody's, the credit rating agency.

Next week the Irish cabinet will consider how to deal with the growing number of people having problems paying their mortgages.

Residents share Spanish town halls' fate in struggle to make ends meet

Debt

Municipalities have been unable to pay workers and bills after running out of cash, writes **Victor Mallet**

For seven years, Jeremiah Ekenobaye made a good living in Spain. Now 38, the Nigerian immigrant says he worked as a van driver, obtained his residency permit, and even bought a flat in the fast-growing Madrid suburb of Parla.

Now, on a weekday morning, he is standing on a street corner looking for work. He depends on government handouts of €530 ($702) a month – less than half the amount he needs just to pay his mortgage – and is convinced that the bank is about to repossess the flat where he lives with his wife and three children.

"I am legalised here, but for more than five years I've not been working," says Mr Ekenobaye.

Mr Ekenobaye's fate is shared by tens of thousands of immigrants and native Spaniards who live in the belt of depressed dormitory towns and industrial suburbs south of Madrid.

More than three years into Europe's financial and economic crisis, the town of Parla, like Mr Ekenobaye himself, has run out of cash and credit. "In the past four years we have lost 25 per cent of our income," says José Maria Fraile, the town's mayor. "At the moment there's no liquidity . . . The [credit] window has closed."

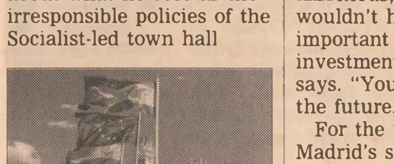
Mr Fraile is negotiating with trade unions to fire 190 people, a quarter of the city's workforce, as a way to save money. One private company responsible for sports facilities has obtained a court order to sequester municipal assets to cover millions of euros of unpaid debts. Valoriza, another company, is owed €80m for years of garbage collection and cleaning.

Parla, with a population of some 130,000, is far from the only Spanish town with financial problems. Spanish banks, which freely financed property developers and municipal governments during the housing and infrastructure investment mania that gripped the country before 2007, are turning off the taps. The central government and the autonomous regions are desperate to curb the public sector deficit to avert the risk of defaults.

Meanwhile, town hall budgets have been squeezed by the collapse of income from taxes on property and construction permits, leaving some of Spain's 8,000 municipalities unable to pay their workers' wages on time or meet their electricity bills.

Parla's public finances are in a particular mess. "If the municipality was a company, it would be in liquidation," says Miguel Angel López, a city councillor and local leader of the rightwing opposition Popular party.

Reflecting the PP's criticism of the Socialist government at the national level, Mr López is scathing about what he sees as the irresponsible policies of the Socialist-led town hall during the past decade. Parla, he says, has €300m of debt.



190

Number of staff to be made redundant by Parla

€300m

Amount of debt owed by the town

He pins much of the blame on a former mayor and ambitious Socialist politician who left for the bigger arena of regional politics three years ago after investing millions of euros in big projects such as a local tram line "for his personal ego".

Mr Fraile, the current mayor, defends the party's record. The town has doubled its population in 10 years, has an unusually high unemployment rate of 26 per cent, and hosts one of the biggest populations of immigrants in Spain – more than one in four residents is from Africa, South America or elsewhere. Mr Fraile says Parla needed to spend money on transport and a new industrial park.

"If we hadn't been ambitious, the city wouldn't have been an important focus of investment," Mr Fraile says. "You have to bet on the future."

For the inhabitants of Madrid's southern suburbs, however, there is no sign of an end to the crisis. "We think it looks bad," says Jesus Sánchez of Caritas, the Roman Catholic charity, when asked about Parla's prospects. Caritas has seen a sharp rise in demand for its services as the municipalities have run out of cash.

"People watch their money more," says Aurora Cozar, a 50-year-old housewife and Parla resident whose husband owns a food shop. "Instead of going out every weekend, people just go out occasionally now."

As for Mr Ekenobaye, he is considering his options while continuing to hunt for work. "I am even planning to get out of Spain. Maybe Holland or the UK. But it's difficult to make a move. Where am I going? And whom am I going to meet there?"

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LETTERS TO THE EDITOR: Fax: +44 20 7873 5938, letters.editor@ft.com

Published by: The Financial Times Limited, Number One Southwark Bridge, London SE1 9HL, United Kingdom. Tel: +44 (0) 20 7873 3000; Fax: +44 (0) 20 7407 5700. Editor: Lionel Barber

Printed by: (Belgium) BEA Printing sprl, 16 Rue de Bosquet, Nivelles 1400; (Germany) Dogan Media Group, Hurriyet AS Branch Germany, An der Brucke 20-22, 64546 Morfelden - Walldorf; (Italy) Poligrafica Europa, S.r.l. Villasanta (MB), Via Enrico Mattei 2, Ecocity - Building No 8 Milan; (South Africa) Caxton Printers a division of CTP Limited, 16 Wright Street, Industria, Johannesburg; (Spain) Fabripress, C/ Zeus 12, Poligono Industrial Meco-R2, 28880 Meco, Madrid; (Sweden) Bold Printing Group/ Boras Tidning Tryckeri AB, Odegardsgatan 2, S-504 94, Boras; (Abu Dhabi) United Printing & Publishing Company LLC, Muroor Road, PO Box 39955, Abu Dhabi

France: Publishing Director, Adrian Clarke, 40 Rue La Boetie, 75008 Paris, Tel. +33 (0)1 5376 8250; Fax +33 (0)1 5376 8253; Commission Paritaire N° 0909 C 85347; ISSN 1148-2753. **Germany:** Responsible Editor, Lionel Barber. Responsible for advertising content, Adrian Clarke. **Italy:** Owner, The Financial Times Limited; Rappresentante e Direttore Responsabile in Italia: I M D.Srl-Marco Provasi - Via Guido da Velate 11 - 20162 Milano Aut Trib. Milano n. 296 del 08/05/08 - Poste Italiane SpA-Sped. in Abb.Post DL 353/2003 (conv. L. 27/02/2004 n 46) art. 1 comma 1 DCB Milano. **Spain:** Legal Deposit Number (Deposito Legal) M-32596-1995; Publishing Director, Lionel Barber; Publishing Company, The Financial Times Limited, registered office as above. Local Representative office; Castellana, 66, 28046, Madrid. ISSN 1135-8262. **Sweden:** Responsible Publisher, Andrew Ward; Telephone 070357088. **UAE:** Publisher, Adrian Clarke, Tel: +33 (0)1 5376 8250; origin of publication, twofour54, Free Zone, Abu Dhabi.

FINANCIAL TIMES

"Without fear and without favour"

Tuesday October 4 2011

Curing Europe's banking ills

Liquidity scare is merely symptom of sovereign debt crisis

Another day, another crisis of confidence in Europe's banks. This time it is Dexia that has set alarm bells ringing, after Moody's placed the Franco-Belgian banking group on review for a possible downgrade amid fears that the short-term funding on which it so heavily relies has dried up.

There is indeed every reason to be concerned about Dexia. The banking group is still in a delicate transition phase after its €6.4bn government bail-out in 2008. Though much has been done to bolster capital and reduce risk, it is disturbing to see that Dexia remains relatively highly-exposed to peripheral sovereign debt compared with its bigger peers. No wonder money-market funds are reluctant to lend.

But the jitters over short-term financing are bigger than Dexia. [illegible]ight deposits with the ECB [illegible]p last week – a clear signal that interbank lending may be drying up, not just for Dexia but for others also. French banks will be in the front line, as they rely more heavily on short-term funding than their European peers.

The European Central Bank has sought to stem concerns about this short-term funding squeeze with pledges of unlimited three-month liquidity until the beginning of 2012. But the market is not in the mood to listen and it is clear that the ECB will have to go further. It could promise to keep this offer in place until market conditions improve, for example.

But the ECB should reject calls from those who argue they need two-year funding to have time to restructure their business models and deleverage. This seems excessive when, so far, the banks have been reluctant to take advantage of the ECB's three- and six-month offers. Even after the collapse of Lehman Brothers in 2008, the ECB did not feel the need to go beyond a year.

Moreover, stretching liquidity to infinity and beyond is simply not the answer. A drought in wholesale financing is merely the symptom of a much deeper problem – the crisis of confidence over sovereign debt. The markets simply do not have faith that a divided and hesitant Europe will be able to meet the challenge of contagion should Greece default.

This raises too much uncertainty over where the inevitable losses will ultimately fall. Someone, somewhere has to take the pain. The honest solution is for the banks to own up to all of their losses now. Failing that, it is up to Europe's leaders to make them do it. Shock therapy is better than chronic paralysis.

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Greece and eurozone

Greece is a lost cause. No amount of fiddling, massaging or austerity is going to get the country to meet its fiscal targets for 2011. It may be that the Greek government is ducking the most difficult challenges because it lacks political courage. But that hardly matters. Athens is in a vicious spiral that poses a grave threat to the eurozone. It is time for policymakers to get their priorities right. The task now is not to save Greece, but to save the eurozone.

It is true that Greece needs vast structural and social reforms to be able to stand on its own feet again at some point in the future. For now, though, asking it to slash and burn even further is counter-productive. Not only has the response worsened the country's plight, it has raised doubts about the durability of the eurozone. These two issues must be separated. Allowing Greece to default within the eurozone – including as a prelude to its exit from the bloc – is the way to achieve that.

An orderly default is still possible, provided that the eurozone's other exposed members are ringfenced against the worst effects of such a development. The most vulnerable is Portugal, whose plight is eerily similar to that of Greece (and which may ultimately need a Greek-style resolution). The Greek economy represents only about 2 per cent of total eurozone gross domestic product: even a 100 per cent default should not be excessively disruptive, especially if the European Central Bank and the European financial stability facility are ready to stand behind its consequences.

There is a horrible truth that eurozone policymakers have yet to grasp. It is that solving Greece is the easy bit. The euro's structural flaws are a bigger threat to the survival of the eurozone than what happens in Athens. Greece has become a sideshow and a distraction. Eurozone policymakers need to accept that the stakes are much higher.