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In Europe, constant drip of crisis with no catharsis

BRUSSELS

Lehman-style moment never comes to pass, so tough choices are put off

BY STEVEN ERLANGER

People keep worrying that Europe is about to have a Lehman Brothers moment, a sudden financial meltdown or default that sets off a new phase of panic around the world.

But the problem in Europe may be

NEWS ANALYSIS

precisely that it has not had a "Lehman moment," a shock that clarifies problems and forces hard decisions, and may well not have one.

Instead of a sudden jolt — a bankruptcy that shatters illusions about financial stability nearly overnight — Europe has had a slow-motion leak of confidence and credibility that has cumulatively extracted a large and growing toll on stock and bond prices and on the livelihoods of its citizens.

The long euro crisis, which began with Greece and has now spread to include large banks and large countries like Spain and Italy, has also taken a significant toll on economic growth, without the reckoning — and full-blown emergency response — that followed the collapse of Lehman Brothers, the Wall Street investment bank, on Sept 15, 2008.

To be sure, a sudden event could overturn expectations and create a new and compelling urgency that finally requires France, Germany and the European Central Bank to agree on a real cure for what ails Europe.

But for now, political leaders are buying time, handling issues as they come, like propping up Dexia, and making vague promises, as European officials did Wednesday, about new meetings to better coordinate the recapitalization of some European banks that have too much Greek debt as well as other troubled borrowers.

"Economists are trained to think about eventual outcomes and work backwards, and that's the way financial markets function, too," said Charles Wyplosz, an economist at the Graduate Institute in Geneva. "That's 180 degrees from how politicians function. They ask themselves about tomorrow or next week or maybe the next election and solve problems as they come. So they're always behind the markets."

For example, despite the fact that nearly every serious economist and banking analyst now expects that Greece will have to formally default on its debt, no European leader will say so, at least not for the record. Instead, the countries in the euro zone are continuing to act publicly as if measures agreed to in July to shore up Greek finances — and that slow-moving European Parliaments have yet to implement — are sufficient to put the crisis behind them.

One way to break the circle, of course, would be a big dose of candor about the real condition of Greece and the inevitability of a major restructuring of its

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Continent girds itself for new bank brush fires

BRUSSELS

Merkel ready to speed aid to financial sector, saying situation is urgent

BY STEPHEN CASTLE

Alarmed at the speed with which bad news from Greece brought one vulnerable European bank to its knees, Chancellor Angela Merkel of Germany said Wednesday she would consider a swift recapitalization of her country's financial institutions to try to calm the latest phase of the euro zone crisis.

The comments came amid reports of customers withdrawing savings from the French-Belgian financial institution Dexia, which is about to receive its second bailout in three years. Shares of the bank, which is weighed down by its exposure to Greek debt, plunged following an acknowledgment Sunday from Athens that Greece would miss financial targets.

The frightening speed of that chain reaction has prompted European regulators to review the results of the bank stress tests to test for a possible Greek default. Dexia passed the test last time around. European policy makers also face discussions on a broader effort to pump money into the banking sector to reassure jittery investors.

"Germany is prepared to move to recapitalization," Mrs. Merkel said during a visit to Brussels, adding that the cri-

JOCK FISTICK/BLOOMBERG

Mrs. Merkel in Brussels on Wednesday. "We are under pressure of time," she said.

teria for such a move would need to be established by experts and that other European countries should do the same with their banks. "We are under pressure of time," she said. "I think we need to take decisions quickly."

Her comments, allied with a call for recapitalization from the International Monetary Fund, increased pressure on countries at the center of the euro zone to strengthen their vulnerable banks — something that might put national finances under strain.

"There is a general consensus that this is urgent, and should be done in the next few weeks," said Antonio Borges, the I.M.F.'s European department head, adding that Europe would need to prime its banks with as much as €200 billion, or $267 billion, in fresh capital. "We would recommend that it move to a European approach. More should be done on a cross-border basis," he added.

The French finance minister, François Baroin, endorsed calls for an exam-

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U.K. caught in euro zone debt fallout

LONDON

Prime minister warns of long road to recovery, yet insists on austerity

REUTERS

The British economy remains on the brink of recession despite a bounce in service-sector growth in September as consumers cut spending sharply and risks from the euro zone debt crisis loom, making more credit easing by the Bank of England increasingly a question of time.

A services-sector purchasing managers' index, released Wednesday, posted an unexpected jump in September, but businesses gave a bleaker outlook. Other surveys indicated that unemployment was expected to rise. Data on gross domestic product in the second quarter showed that growth was weaker than previously thought as consumer spending slumped.

Pressure on British consumers was also clear as a main retailer, Tesco, posted one of its biggest quarterly declines in underlying sales and a rival, J Sainsbury, reported only modest growth.

In response to the data, Britain's Finance Ministry said that the country could not insulate itself from the turbulence in the euro zone, where governments are struggling to contain the Greek debt crisis and prop up banks. But the government reiterated its determination to stick to austerity plans aimed at erasing a huge budget deficit.

The Markit/CIPS services purchasing managers' index for Britain rose to 52.9 in September from 51.1 in August, bouncing back from its biggest one-month fall in a decade. A reading above 50 indicates an expansion.

The pound fell against the euro and the dollar. Futures contracts on British government securities extended losses as the positive data dampened speculation the Bank of England would begin a fresh round of quantitative easing, or bond buying to pump more money into the economy, at its meeting Thursday.

Economists, however, said the case for more asset purchases was still in place.

"I doubt it changes the underlying perceptions of where the U.K. economy is heading," said Marchel Alexandrovich of Jefferies International. "It is pretty anaemic growth."

Britain's faltering recovery has increased pressure on the government to bolster growth as households experience their worst squeeze in over 30 years, inflation nears 5 percent and unemployment rises. Prime Minister David Cameron warned Britons at the Conservative Party's annual conference Wednesday that the road back to economic health would be long, but that the budget deficit did not allow for extra spending. In an attempt to increase confidence, the chancellor of the Exchequer, George Osborne, on Monday announced a program to funnel lending directly to companies starved of credit by banks.

While businesses and many economists like the idea, such a program would be more of a medium-term aid for small and midsize companies than a quick fix for the economy. The government is counting on private business to offset the sharp cuts in public spending as it tries to shift the economy's balance from credit-fueled consumption and toward investment and export-driven growth.

But business lobbying groups warned the risk of a renewed recession had risen and called on the Bank of England to act.

"Hopefully we can still avoid a slide back into recession but it's getting scary," said Graeme Leach, chief economist at the Institute of Directors.

KOSTAS TSIRONIS/BLOOMBERG NEWS

During a general strike Wednesday, as many as 20,000 marched peacefully through Athens, in contrast to the bigger, more tense demonstrations that took place during the summer.

Signs of resignation on streets of Athens

ATHENS

Amid unrelenting gloom, protests grow muted and draw smaller crowds

BY SUZANNE DALEY AND NIKI KITSANTONIS

Dino Giannopoulos, 50, kept right on selling papers from his newsstand in Syntagma Square on Wednesday even as thousands of public servants gathered nearby to protest a relentless series of government austerity measures.

Riot police officers were fanning out. Some stores were beginning to pull down their steel shutters. But even so, like many Athenians who continued to sit in nearby cafes, Mr. Giannopoulos was unimpressed.

The protesters did not represent him, he said, or most Greeks for that matter. Most Greeks, he said, were weary these days, unsure what to think.

"We have become zombies," he said "What we see ahead is a dead end. There is no way out."

The protest march Wednesday, which was over in about an hour and a half, drew about 13,000 participants, the police said. Organizers said 20,000. But whichever number is accurate, it is still about half the rate of participation seen earlier this year — a sign, some say, of growing resignation in the face of a constant stream of bad news.

The march was part of a general strike called by the country's two main labor unions, the first since June. The unions, with 2.5 million members, have led resistance to the newest austerity measures, which include more cuts to civil servants' pay and pensions as well as a controversial plan to cut 30,000 jobs. They have called for another general strike on Oct. 19.

During the march, a few brief clashes broke out between the police and masked youths, some hurling rocks and wearing swimming goggles to protect their eyes from the tear gas. But the incidents, and a few that carried over into the afternoon, were isolated. For the most part the march was peaceful, with neatly dressed demonstrators sipping iced coffees as they walked and talked or waved banners printed by their unions.

Last summer, the protests were far more lively and spontaneous as many young people, coordinating over the Internet, descended on the square across the street from Parliament. But since then the news has been unrelentingly bad for Greece and the numbers of demonstrators have dwindled.

Alexandros Zachiotis, 22, a student of mechanical engineering with a part-time job who was one of the participants last summer, said there was still interest in some sort of political activism, but it was not always clear what to do and, for many, depression had set in.

"The problem is that Greeks have lost hope," he said. "We look into the future but we see black — more poverty, more austerity."

The latest polls show that political opinions have changed drastically since the beginning of the year. Prime Minister George A. Papandreou, who used to lead in the polls, is now behind. Several recent polls have given the New Democracy leader, Antonis Samaras, an edge of one to five percentage points, but neither leader has wide support.

One poll found that only 17 percent of the public had faith in Mr. Papandreou, a Socialist, to manage the country's financial crisis, but just 26 percent of Greeks believe Mr. Samaras could do a better job. Of those questioned in several polls, more than 30 percent said they were undecided or would abstain from voting.

The 24-hour strike Wednesday — which shut down central and local government operations, including schools, courts and airports — comes at a time when Greece is rushing to meet the demands of its international creditors, who are pressing for more change before they will release an €8 billion, or $10.69 billion, installment of aid.

Without that money, Greece may be unable to pay its bills next month. But even that money, part of a €110 billion rescue package negotiated last year, will not be enough to solve its problems.

"The problem is that Greeks have lost hope. We look into the future but we see black — more poverty, more austerity."

Some who joined the march Wednesday said they hoped a show of anger would mean something, though many said it was an important way to vent their frustration.

"I wish that more came out to march," said Mandeou Meropi, a 50-year-old doctor, who had goggles in her handbag. "It's my personal opinion that if more people don't show up then something really violent will happen. Let's not forget that such a recession is what brought Hitler to power."

But others were less convinced that another protest march would make any difference. "I came because my students don't have any text books this year," said Irini Karioti, a secondary school philosophy teacher. "But I really can't see that these protests do anything."

Demonstrating has a noted place in Greek history. It was not so long ago that street protests in the 1970s helped bring down the military junta.

But Babis Papadimitriou, a political commentator, said that Greeks were tired of street protests.

"They're bitter and they're angry, but they've realized that demonstrations aren't an effective way of bringing about change," he said.

He noted that most of the roughly 20,000 Greeks that walked off the job Wednesday were civil servants, who are protesting salary cuts and plans for thousands of redundancies in the public sector.

"The other Greeks have to work for a living, they don't have the luxury of going on strike," he said.

During the protests, many businesses did their best to stay open. Much about the event seemed choreographed, as onlookers followed unwritten rules.

It was understood, for instance, that stepping across the street from the square was a safe zone. One man had even parked an antique car he rents for weddings there, hoping to pick up business.

Vassilis Sarris, 48, who has been driving a taxi for 24 years, was parked on a side street hoping to get a radio call from a nearby hotel. His income is way down this year, he said. He has had to cancel his daughter's dancing classes, even with his parents lending a hand.

"If this goes on," he said, "In six months, I won't be here. The bank that is chasing us can have the house. And I don't see a chance that Greece will get out of this thing. I am not at all optimistic that things will change."

In Europe, constant drip of crisis with no catharsis

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huge, increasing and unsustainable p of debt.

But European leaders, especially in France and Germany, whose own banks are exposed, are reluctant to broach the inevitable. Why? Because they do not yet have in place the mechanism to make a Greek restructuring — a managed default — orderly, or to "ring fence" the much larger economies of Spain and Italy.

Without the "bazooka" in place to shock and awe increasingly skeptical markets and recapitalize banks, Europeans are still buying time. That may postpone the day of reckoning, but it also pushes up the cost of an eventual Greek default. And it renders any bad news — even bad news that has been anticipated and published in advance, like Greece again missing its debt targets — enough to move markets.

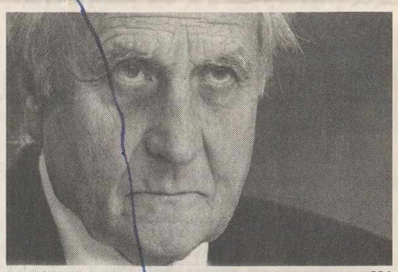
Markets have already priced in a Greek default and are looking anxiousl at Italy, in part because they have bee presented no solution to the larger problem of sovereign debt.

"The markets need clarity," Mr. Wyplosz said. "They have no reason to believe there's a floor on public debt so they fret. Once they have a floor, they can calculate their losses. Markets accept losses and can deal with them, but need a backstop."

Only the E.C.B can provide such a huge guarantee. But its outgoing president, Jean-Claude Trichet, has ruled out the idea of the bank acting as the lender of last resort, even if it guarantees only the bond purchases of another fund, the European Financial Stability Facility. Germany, the Dutch and the Finns, too, are against using the bank for essentially unlimited bond purchases from sovereign states.

The disagreement blocks even obvious moves, like restructuring Greek debt to 50 percent of its face value when it is already trading at 40 percent or less. And there has not yet been a sufficient emergency — no Lehman moment — to drive an agreement on how to use the E.C.B. to stifle market speculation.

"Greece is small and its problems can easily be contained," said Sony Kapoor,



SEBASTIEN PIRLET/REUTERS

Jean-Claude Trichet, the E.C.B. president.

managing director of Re-Define, an economic consulting firm with offices across Europe. "But the inability of officials to deal with this successfully over a year and a half inspires little confidence in their ability to deal with much larger troubled countries such as Italy over the much shorter time frame now available to the euro zone."

"The E.C.B. can still stem the panic though a strong intervention," Mr. Kapoor continued. "But unless this is done soon, the crisis may spin further out of control."

Now that, of course, would be a Lehman moment.

For now, despite the fact that mar leading economists and bankers sa that major banks in Europe need hefty infusions of capital to weather the inevitable downgrade of European sovereign debt they have on their books, the banks themselves and their regulators continue to preach the fiction that the debt is worth more, and in some cases considerably more, than the markets think. So investors, with increasing rapidity, now simply ignore their promises and sell.

In that sense, the Lehman crisis, as damaging as it was, may have helped the United States grapple with the worst effects of the first stage of the global financial crisis, forcing the Federal Reserve into crisis mode and pushing a reluctant Congress to shore up the U.S. banking system.

Europe, in contrast, has a more traditional central bank that has resisted cuts in interest rates, much less a full scale intervention in debt markets, a opposes any significant monetary ea ing, even when Europe may be slipping into a recession.

Moreover, Europe is a collection of sovereign states that all must agree on any painful steps. So even while Europeans are talking more seriously about how to leverage the €440 billion, or $588 billion, bailout fund, once it is ratified, there is fierce opposition in Germany and in the E.C.B. itself to the idea.

So until the bailout fund is safely put into place, French and German leaders are refusing to discuss this issue, too, just as they are refusing to acknowledge the inevitability of a managed Greek default and the need to recapitalize their banks in the aftermath. That kind of uncertainty — and a politically driven lack of candor — is what markets are feeding on.

Lehman Brothers provided the United States with a moment of reckoning. Europe, in trying to avoid one, may be condemning itself to unending pain.

Continent girds itself to battle latest eruptions of banking brush fires

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ination of whether Greece's private creditors should face higher write-downs on their investment as part of Greece's second bailout.

"Given what's happened over the last three months, we should perhaps look at the extent of the private-sector involvement," Mr. Baroin said on the French radio station RTL.

Mrs. Merkel also appeared to support that position, which was the subject of debate by euro zone finance ministers at a meeting Monday in Luxembourg.

But the immediate concern appears to be what to do with big European banks deemed to have dangerously-high exposure to Greek debt.

France's caution over recapitalization illustrates how each potential solution to the euro zone crisis tends to raise fresh problems to the surface.

If the French government pours large financial resources into its banking sector, it risks losing its triple-A credit rating because the large-scale spending that may be required could worsen its public finances. A lower rating would be economically undesirable because it would increase French borrowing costs; politically, it would be damaging to the current government ahead of presidential elections next year.

"The problem is that if you recapitalize the banks then you have a problem with sovereign debt," said one European official not authorized to speak publicly. "That is Paris's big issue."

The issue of bank recapitalization also raises a question of strategy: whether governments should concentrate on shoring up European banks or spend resources instead on resolving the crisis in Greece, whose debt and financial troubles prompted the latest wave of anxiety about the banking sector.

The French president, Nicolas Sarkozy, is scheduled to meet with Mrs. Merkel for talks on Sunday.

The two leaders face a raft of complex questions, including whether efforts to strengthen European banks should be left to national governments; whether they should involve all banks; and whether money should come from the euro zone's bailout fund.

Daniel Gros, director of the Center for European Policy Studies, said that the best solution would be a euro zone program, using the currency's bailout fund, so that the burden on any one country is reduced.

"There is no easy way out," Mr. Gros said. "You can't protect all banks from all sovereign risk. You need to have many things happening at the same time."

Regulators are reviewing the data from this year's stress tests of European banks with an eye on which banks to recapitalize and by how much, but the assumptions on which to base new calculations are political as well as economic.

THIERRY ROGE/REUTERS

Chancellor Angela Merkel of Germany with José Manuel Barroso, president of the European Commission, in Brussels on Wednesday as financial firms came under new pressure.

Suggestions that imply a write-down of Spanish or Italian debt would prove highly controversial because that would be a public admission that they may not be able to repay some of their debt. And constructing a recapitalization that would protect banks from all risk associated with southern European debt would be so expensive as to be impractical.

The European Commission, the executive arm of the European Union, played down suggestions Wednesday that a large-scale recapitalization plan was taking shape. One official said the commission had been pushing for bank recapitalizations and was advocating a European approach and added, "That's all. There is no big master plan."

Using the euro zone bailout fund as a vehicle for a pan-European approach is likely to be controversial in Germany and the Netherlands, which prefer coordinated action by national authorities.

Belgium's prime minister, Yves Leterme, said that nationalization of Dexia's banking activities, including a large retail operation, was being considered.

Mr. Baroin said that the rescue, likely to be finalized Thursday, might involve Dexia's French municipal financing operations being merged with the French state bank Caisse des Dépôts and Banque Postale, the banking arm of France's post office.

Dexia "cannot continue in its present form, that is indisputable," Mr. Baroin said on RTL. "We are working on a solid, structured solution."

Belgium's central bank issued a statement Wednesday insisting that "the savings of customers of Dexia Banque Belgique are perfectly secure and there is no reason for clients to make withdrawals."

But the Belgian newspaper De Tijd reported that rival banks had received many deposits from customers withdrawing cash from Dexia.

A Dexia spokeswoman told Reuters: "We have had some customers taking money out, but it has been limited. We have faced many questions and we have been explaining the situation a lot."