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Belgium and France to take over major bank

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Even after nationalization of Dexia, euro zone may need billions for others

BY LIZ ALDERMAN
AND JUDY DEMPSEY

The sovereign debt crisis hit another grim milestone on Sunday when the French and Belgian governments agreed to nationalize Dexia, one of Belgium's biggest banks and a major lender to U.S. and European municipalities, infusing it with billions of euros in taxpayers' money after it nearly collapsed under a pile of Greek sovereign debt.

The humbling move came as Chancellor Angela Merkel of Germany and President Nicolas Sarkozy of France acknowledged that European banks still needed billions of euros more to cushion them against a possible Greek default. But after meeting Sunday in Berlin, the two leaders announced no agreement on how to do it, saying instead they would have an accord by the time leaders of the Group of 20 leading economies met in early November in Cannes.

The lack of an agreement on recapitalizing Europe's banks was likely to unsettle investors who hoped to see the governments take more decisive action. In a sign of how heightened the concern over the Continent's banks has become, government officials raced to prop up Dexia before global financial markets opened Monday, in a bid to stave off investors' concerns about other banks.

European banking shares have plunged since the summer on concerns about lenders' ability to make up for the rapidly eroding value of their European government bond holdings.

Dexia "is the biggest euro zone bank failure in quite some time," said Peter Zeihan, a vice president at Stratfor, a geopolitical risk analysis company based in Austin, Texas. "It will force investors and shareholders to take a second look at what they thought was stable."

European banks have become a flash point for governments as they try to resolve the region's debt woes without worsening their own finances.

Mrs. Merkel, Mr. Sarkozy and other top officials have only recently conceded that European banks may not be as sheltered from the storm as first thought, especially if the Greek crisis spirals to encompass larger countries.

If that were to happen, other banks in Europe and the United States — as well as the governments themselves — could come under further pressure.

But European leaders remain at odds on how to achieve their goals, including the best way to recapitalize the banks. Concerned that its triple-A credit rating remain intact, France wants to bolster lenders' capital using a bailout system already being established, the European Financial Stability Facility.

Germany insists that the rescue fund should only be used as a last resort, if the banks are not able to raise more money on their own.

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Major bank in Belgium awaits state takeover

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The International Monetary Fund has estimated that Europe's banks may need up to €300 billion, or $400 billion, more capital if the debt crisis widens.

European leaders have not put forth their own figure.

But Mrs. Merkel said Sunday that governments would do "everything necessary" during a series of upcoming meetings, including one this week involving the leaders of the 27 member states of the European Union.

The bailout of Dexia — the first victim of the European debt crisis — could not come at a worse time for the French and Belgian governments. Both are trying to pay down debts and reduce their budget deficits.

In France, some officials have warned that too big of a bailout for Dexia could menace the country's gilt-edged sovereign debt rating, a notion the finance minister, François Baroin, has been quick to dismiss.

Belgium is in a more difficult situation. Its debt is equal to 97.2 percent of s gross domestic product, the thirdhighest in the euro zone after Greece and Italy.

Moody's Investors Service warned on Friday that it could downgrade Belgium's Aa1 rating, a top investment grade, if the support of Dexia increased the country's debt and investors started raising borrowing costs for Belgium.

Belgian officials say a bailout of €4 billion would not push the country's debt ratio much higher.

It was the second bailout in three years for Dexia, a lender to European and U.S. cities and towns that got into trouble in 2008 after its huge portfolio of subprime loans turned toxic. Dexia received a €6.4 billion bailout from France and Belgium, and at the time was the biggest European recipient of loans from the U.S. Federal Reserve's discount window.

Dexia, which has global credit exposure of about $700 billion, will create a so-called bad bank to house its troubled assets, including billions of euros' worth of Greek, Italian, Portuguese and Italian debt.

On Sunday night, the Belgian and French governments were still negotiating over how to split the bill.

France gave Belgium clearance to buy up to 100 percent of Dexia's Belgian consumer bank, Bloomberg News reported. At the same time, Dexia's French municipal financing arm would be split from the group and merged with the French state bank Caisse des Dépôts et Consignations and Banque Postale, the French post office's banking arm.

Dexia had almost recovered from its previous stumble when its troubles flared anew in recent weeks. Indeed, just three months ago Dexia passed a

Dexia's collapse "will force investors and shareholders to take a second look at what they thought was stable."

round of stress tests for European banks that were supposed to be among the strictest regulators had conducted.

This month, other banks rapidly started pulling back on lending to Dexia and Moody's placed the bank on review for a possible downgrade.

Investors restless about the deepening debt crisis cast a skeptical eye on roughly €20 billion worth of Greek government bonds held by Dexia. A few years ago, the bank took on a load of European sovereign debt — including government bonds from Italy, Portugal and Spain, as well as Greece — to shift away from troubled subprime debt after its last bailout.

Two months earlier, Dexia reported its worst-ever loss, stung by lingering losses on subprime loans and its participation in a bailout plan for Greece.

Last week, Dexia's stock price plunged 42 percent and, as it neared collapse, its shares stopped trading Thursday.

Dexia's fortunes, and those of many European banks, remain tethered to what happens to Greece.

The German finance minister, Wolfgang Schäuble, said in an interview published in the Sunday edition of the newspaper Frankfurter Allgemeine, "we assumed in July a level of [illegible] reduction that was too low" for Greece, implying that the country faced more difficulties ahead and would need even more support.

Mrs. Merkel, now increasingly concerned about any run on the banking system, told World Bank and I.M.F. officials and European finance ministers last week in Berlin that Germany supported a coordinated bank recapitalization program.

Mrs. Merkel does not want to funnel more taxpayer money to the banks before they themselves try going to the markets to raise fresh capital.

But she acknowledged in recent meetings with World Bank and I.M.F. officials that Germany would bolster the banks if it was necessary. Failure to do so, she said, would lead to "vastly higher damage."

Judy Dempsey reported from Berlin.