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Bundesbank at odds with ECB over loans

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By Patrick Jenkins and Mary Watkins in London and James Wilson in Frankfurt

The head of Germany's Bundesbank has launched a powerful attack on Mario Draghi, president of the European Central Bank, in a sign of mounting concern in Europe's biggest economy at measures being taken to try to contain the eurozone financial crisis.

Jens Weidmann's warning of increasing risk stemming from some ECB policies highlights fears of potential costs for Germany from its role as the eurozone's biggest creditor nation and may spark fresh doubts about the eurozone's ability to deal with the long-running banking and sovereign debt crisis.

Mr Weidmann, who has an influential voice on the ECB's governing council, said the central bank risked endangering its reputation and called for a quick return to stricter rules on the collateral that the ECB accepts from banks in return for central bank funds. The criticism in a letter to Mr Draghi was revealed on Wednesday by Germany's Frankfurter Allgemeine Zeitung.

The pointed criticism came on the day that the ECB injected an extra €529.5bn into the eurozone financial system, taking the total supplied to banks under the three-year loan programme beyond €1tn.

The broader collateral rules used by the ECB helped to draw smaller banks into the scheme, with take up from some 800 bank edging ahead of demand in December, when 523 banks borrowed €489bn.

More than half of the institutions that borrowed were German, according to people familiar with the auction.

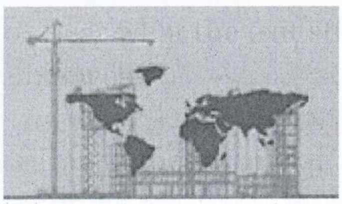
The ECB's injection has boosted investor sentiment and lifted markets, enabling banks to make a flurry of bond issues.

But Peter Sands, chief executive of Standard Chartered, said that the glut of central bank money risked "laying the seeds for the next crisis". Mr Sands, whose Asia-focused bank is insulated from the eurozone crisis, said that no thought had been given to long-term consequences. "It is not clear what the exit strategy is. What happens in three years' time when it needs to be refinanced?"

Writing in the Financial Times today, former ECB board member Lorenzo Bini Smaghi added to Mr Sand's concerns. He said that banks may become "addicted to easy financing", creating a disincentive for them to "stand on their own feet once the crisis is over".

Analysts had predicted European banks would tap about €500bn in the second phase of the ECB's three-year, longer-term refinancing operations, which charges banks interest of just 1 per cent.

Money Supply



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They said it was easing funding strains on banks but there was little sign it was filtering down to the real economy as loans to companies.

Markets reacted fairly positively to the announcement by the ECB, although Portuguese yields rose. By contrast Italian 10-year bond yields fell 16 basis points to 5.18 per cent.

The ECB figure included funds rolled over from shorter-dated operations. About €310bn of net new liquidity was added to the system – much more than in December.

"This is at the higher end of market expectations and should have a positive impact on risk assets," said Divyang Shah, global strategist at IFR Markets.

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