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IMF urges eurozone to bolster banks

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By Claire Jones in Washington

The International Monetary Fund has urged the eurozone to step up efforts to recapitalise its banks, using the bloc's rescue fund to ward off another financial crisis.

In its World Economic Outlook published on Tuesday, the IMF praised the European Central Bank's three-year longer-term refinancing operation (LTRO), and credited officials for strengthening the region's firewall. However, it warned that "there can be no pause". The warning follows the re-emergence of tensions in eurozone financial markets, with yields on Spanish 10-year government bonds edging above 6 per cent on Monday.

"Austerity alone cannot treat the economic malaise in the advanced economies," the IMF said, adding that weaker nations needed to be supported "by drawing on the resources of their stronger peers".

The IMF edged up its forecasts for global growth but emphasised that recovery remained "very fragile". It predicts that the eurozone economy will shrink this year, though to a lesser degree than forecast in January.

The fund called for Europe's banks to be recapitalised through taxpayer funds via the European Financial Stability Facility or the European Stability Mechanism.

"Partial public recapitalisation of banks should remain on the agenda. To the extent that it would increase credit and activity, it could easily pay for itself, more so than most other fiscal measures," Olivier Blanchard, the IMF's chief economist, said.

The IMF says in its outlook report that, without more capital, the eurozone could see an "excessively fast deleveraging" by its banks, resulting in a fall in lending to the real economy.

The IMF repeated its call for more rate cuts by the ECB and urged it to continue to provide liquidity through LTRO and government bond purchases. The IMF flagged the risk of a deflation-debt spiral in Greece, Ireland and Spain – the three eurozone economies receiving IMF support – and said inflation was likely to fall below the ECB's target – "below but close to" 2 per cent – to 1.5 per cent in 2013.

The IMF said it expected the global economy to grow 3.5 per cent this year, up 0.2 percentage points from its January estimate. The eurozone economy is forecast to shrink 0.3 per cent,

compared with its prediction of 0.5 per cent in January. Forecasts for growth in other advanced economies have been edged up.

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