

Despite ECB Funny Money: EU Banking Crisis at a Dead End

by Claudio Celani

May 3—Look for a giant new European Central Bank (ECB) liquidity injection in the short term, in the orders of trillions of euros.

“The European banking system is on the leading edge of collapse for the whole system. These institutions are by all evidence now badly deficient of the three hallmarks of real banks—deposits, capital, and collateral.”

This quote is not from Lyndon LaRouche, but from a director of the White House office of Management and Budget (under Reagan), David Stockman, taken from an e-mail he sent to the editor of the *Wall Street Examiner* last December. Since then, the collapse has been postponed, but in no way solved, by the two ECB “bazooka shots” of EU1 trillion Long-Term Refinancing Operation (LTRO) loans. If anything, it has been aggravated.

The IMF warned in its semi-annual Global Financial Stability Report, issued on the eve of the April 20-22 IMF-World Bank meeting in Washington, of an imminent \$3.8 trillion (EU2.87 trillion) meltdown of Eurozone banks (about 10% of their assets). However, a senior finance ministry official attending the meeting told *EIR* that an earlier draft version, seen by the source, had painted a much worse picture of the non-performing debt on the books of the big European banks, concluding that at least \$9 trillion (EU6.8 trillion) would be needed to bail out the private European banks this year.

That is why, on the eve of the May 1 Labor Day holiday in Europe, a desperate ECB demanded a European bank bailout fund, thereby letting the cat out of the bag. The Central Bank confessed that the euro crisis is no longer a “sovereign debt” crisis but a banking crisis, and the various EFSF/ESM (European Financial Stability Facility/European Stability Mechanism) funds are not “state bailout” funds, but bank bailouts.

Speaking at an event at the ECB headquarters in

Frankfurt, ECB vice chairman Vitor Constancio stated: “The sequence now is to go as much as possible for a pan-European [bank] resolution regime that is harmonized,” adding, “Also for the biggest systemically relevant banks—there are around 36 big banks—we really need a resolution fund, because that is the only way of overcoming the very thorny question of burden sharing in a crisis.”

At the same time, the ECB let it be known that a ECB/EU Commission group is studying the possibility of using the ESM as a facility to directly finance the banks. The rationale for this is that if a state needs money to bail its banks out, it would be more convenient to directly finance the banks instead of risking state insolvency.

In referring to “a state,” the ECB has Spain in mind.

Spain Has Been the ‘Model Pupil’

The Spanish banking crisis is now the leading edge of the European crisis, which is the leading edge of the trans-Atlantic crisis.

Spain has been the “model pupil” of the IMF and the ECB, having implemented each step of ECB-IMF-dictated austerity policies. As a result, unemployment is at 25%; the budget deficit is 8.5%; state debt has risen from 70% of GDP in 2011, to 80% in 2012; there is a brain-drain, as professionals and skilled workers, along with capital (EU65 billion in recent months), flee the country.

Spanish banks have postponed insolvency through accounting tricks and by borrowing from the ECB: In March, the total amount of borrowing from the ECB by the Spanish banking sector was EU316 billion, EU200 billion of which was from the ECB’s LTRO program. This is one-third of Spanish GDP.

A single bank, the Inter-Alpha Group’s flagship Banco Santander, has larger assets than Spain’s GDP, a situation which is shared by other EU national sectors, but is now highlighted by the collapse of the

Spanish physical economy, largely built around the real estate sector. According to a Barclays report, Spanish banks have already lost EU155 billion from real estate assets, and they will lose EU100 billion more in the coming year. However, real estate values are in free-fall, and these figures will have to be adjusted down.

Although the Spanish government has announced plans to form a “Bad Bank” to bail out the banking sector, Spain alone won’t be able to do that. Standard & Poor’s has downgraded Spanish government debt to BBB+, two steps above junk. Spain now pays more than Italy to refinance its debt, an unsustainable situation, for both countries.

S&P followed its sovereign downgrade by downgrading 11 Spanish banks, including Santander, the largest in Europe, and Spain’s second-largest bank, BBVA. “What this means is that the whole British Rothschild system is hopelessly bankrupt,” LaRouche commented. “Santander is British, with major extensions into Ibero-America, including Brazil. All of that debt is bankrupt as well.”

If a large Spanish bank goes bust, the entire world financial system falls in a domino collapse. But Spain is only the tip of the iceberg. Take French banks, for example. In the above-mentioned e-mail, Stockman wrote:

“BNP-Paribas is the classic example: \$2.5 trillion of asset footings vs. \$80 billion of tangible common equity (TCE) or 31x leverage; it has only \$730 billion of deposits or just 29% of its asset footings compared to about 50% at big U.S. banks like JPM; is teetering on \$500 billion of mostly unsecured long-term debt that will have to be rolled over at higher and higher rates; and all the rest of its funding is from the wholesale money market, which is fast drying up, and from repo where it is obviously running out of collateral. Looked at another way, the three big French banks have combined footings of about \$6 trillion compared to France’s GDP of \$2.2 trillion. So the Big Three French banks are 3x their ... GDP. Good luck with that!...

“It is only a matter of time before these French and other European banks, which are stuffed with sovereign debt backed by no capital due to the zero risk weighting of the Basel lunacy, topple into the abyss of the shadow banking system where they have funded their elephantine balance sheets. And that includes Germany, too. The German banks are as bad or worse than the French.

Did you know that Deutsche Bank is leveraged 60:1 on a TCE/assets basis, and that its Basel ‘risk-weighted’ assets are only \$450 billion, but actual balance sheet assets are \$3 trillion? In other words, due to the Basel standards, which count sovereign and other AAA assets as risk free, DB has \$2.5 trillion of assets with zero capital backing!”

A Systemic Problem

Thus, the Spanish banking system is not a Spanish problem, but a systemic one. An additional complication is the fact that, due to the euro transfer system called “Target2,” the risk of insolvency of a national banking sector or of a single large bank has been concentrated in one central bank, the Bundesbank!

Target2 is a clearing house system, by which part of the money transferred among Eurozone banks goes through their respective central banks. Money is never transferred physically, but is written as a credit or as a debt on the bank’s books. As a result, Bank A no longer has a debt towards Bank B in another Eurozone country, but national central bank A does have a debt towards national central bank B.

When there is a massive bank transfer, as in the case of capital flight from one Eurozone country, as we see now, liabilities tend to be concentrated between respective central banks. Currently, the Bundesbank is exposed with EU615 billion claims, EU252 billion of which is with the Banco de España, and EU270 billion with the Banca d’Italia. As analyst Martin Hutchinson put it in a recent article, “the Target2 payments system is [like] the hydrogen in the Hindenburg.”

Eurozone financial authorities and political leaders will predictably react to this explosive situation as they have done so far: blindly adding gasoline to the fire and cutting the real economy. Since there is no time to implement all ESM or Bank Resolution Fund schemes, expect another major hyperinflationary ECB liquidity injection.

As Helga Zepp-LaRouche pointed out in an Internet dialogue dedicated to Spain and Portugal (*EIR*, May 4, 2011), EU hyperinflationary bailout schemes such as the ESM must be rejected, and “we need to go to a credit system” like Alexander Hamilton’s National Bank combined with Franklin Roosevelt’s Glass-Steagall solution, to finance a recovery of the physical economy through large-scale infrastructure investments.