International Economy

Governments urged to deter banks' risky habits

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BANKS will need a "healthy push" by governments to fix balance sheets, abandon risky businesses and serve the public to avoid prolonging the financial crisis, according to the Bank for International Settlements (BIS).

Lenders, almost four years after the collapse of Lehman Brothers Holdings, still hold overvalued assets and are postponing necessary recapitalisation while relying on official funding, especially in Europe, the BIS said in its annual report, released yesterday. Banks were returning to risks akin to those that led to the crisis, it said, and governments should put more pressure on them by enacting and enforcing new rules.

"Public policy must move banks to adopt business models that are less risky, more sustainable and more clearly in the public interest," the BIS said.

Global regulators have warned that the US, European Union and Japan may fail to fully implement bank-capital rules drawn up to prevent a repeat of the financial crisis that followed Lehman's collapse. Countries face a deadline of January next year for implementing the new rules, which more than triple the core capital that lenders must have to stave off insolvency, and require banks to build up buffers of easy-to-sell assets.

The BIS, based in Basel, Switzerland, is owned by 60 central banks for which it acts as a counterparty and trustee. It is also hosting policy-making groups, including the Basel Committee on Banking Supervision and the Financial Stability Board, and provides research and statistics.

While the implementation of the new rules by the Basel committee is lagging behind, banks are still highly leveraged, partly because they continue to expect state bail-outs, the BIS said. Another "worrying sign" was that trading had returned as a major revenue source for banks.

In some emerging markets, credit and asset price booms had inflated banks' profits in ways "reminiscent of advanced economies" before the crisis.

Euro-area policy makers, in the third year of fighting a debt crisis that started in Greece, faced the biggest immediate challenges, the BIS said.

European banks are still weighed down by overvalued legacy assets that are a drag on profits and a cause for mistrust between banks that continues to clog interbank lending, it said.

Euro governments on June 9 budgeted as much as €100bn for a possible rescue of Spanish banks, which are creaking mostly under bad real estate loans and form the most acute epicentre of banking problems in the area now. The banks may need as much as €62bn to withstand a worst-case scenario, auditors have said.

The BIS joined the International Monetary Fund in saying that the currency union must create a cross-border banking system by unifying bank regulation, supervision, deposit insurance and the resolution of failing lenders. That could revive interbank lending and sovereign access to funding, it said.

While European banks are the main focus now, market developments for lenders' equity and debt worldwide signal that investors do not see much progress in the global banking sector since the period following Lehman's collapse, the BIS said. "The magnitude of this unfinished business is clear from investors' continued distrust of banks.

"The cost of buying compensation for a bank default is as high now as it was at the peak of the crisis, and bank equities continue to lose ground relative to the broad market," the BIS said.

While banks' profits have recovered from their lows in 2008, that recovery was driven by trading income, a revenue source that proved fickle in the crisis, the BIS said. *Bloomberg*

Hollande unlikely to convince reluctant Merkel on euro-zone debt

NEWS **Analysis** Catherine Bremer

FRENCH President Francois Hollande may have set himself up for a fall this week, as Germany's Angela Merkel shows no sign of yielding to his push to provide more financing guarantees to stabilise the euro zone.

The Socialist leader has raised the stakes for the European Union (EU) summit on Thursday and Friday with his drive for a bank deposit guarantee scheme to protect euro-zone savers and governments, and for steps towards mutualising debt and reviving growth. He is also backing a push by Italy to let the bloc's bail-out fund buy troubled states' sovereign bonds on the secondary market without having to invoke emergency procedures, as a way to curb their borrowing costs and fight speculation.

Public sparring between Mr Hollande and Ms Merkel, who will not consider such steps before euro states sign up to much deeper fiscal integration, suggests he is in for a blunt reminder that as long as it holds the cheque book Berlin calls the shots.

In a pointed, if indirect, exchange at a news conference in Rome last Friday, Mr Hollande said there must be more solidarity in Europe before countries hand over more sovereignty over their national budgets, while Ms Merkel said she would not accept extra liabilities without control.

As well as potentially damaging Mr Hollande's image at home, a failure to get Ms Merkel to bend may also spook financial markets, which are looking for firm action to stem spiralling bank woes in Spain and underpin the euro.

"There is a real conflict here and the future of Europe is at stake," says a French economist who asked not to be named because he informally advises the five-week-old government. "Mr Hollande has exerted the maximum pressure on Ms Merkel but if she remains intransigent and only agrees to the growth pact, I believe he will cave in and give her what she wants. He is not the type to get into an arm wrestle or serious clash over this."

Mr Hollande has invited Ms Merkel to Paris for a working dinner on Wednesday for a last push to square their widely differing positions. "We will be working with our German partners on a compromise up until the very last minute," a French source says.

As things stand, the summit looks set to agree to Mr Hollande's proposal for a growth package worth €130bn in joint bonds to fund infrastructure projects, a redirection of EU regional development funds and a capital increase to give the European Investment Bank more firepower. In return, Mr Hollande is expected to go along with a 10-year programme Ms Merkel wants towards deeper political and fiscal integration among the euro-zone states. The growth pact should allow Mr Hollande to save some face, and a strong signal of intent on deeper integration could win EU leaders some time from impatient financial markets.

But Mr Hollande looks set to be defeated on his call for steps towards creating joint eurobonds which he made the centrepiece of his debut on the European stage last month.

Ms Merkel has not softened her opposition to eurobonds and will not meet Mr Hollande halfway by agreeing to test the waters with short-term "euro bills". Unwilling to be seen signing expensive cheques ahead of a federal election next year, Ms Merkel is also opposed to a proposal backed by Mr Hollande to set up a redemption fund to manage public debt above 60% of gross domestic product. The deadlock is fanning impatience as the crisis saps growth worldwide.

"This is really serious. We're at the end of the road," says a senior diplomat, reflecting the views of non-euro countries.

Mr Hollande is determined to show he is standing up to Berlin after his predecessor Nicolas Sarkozy was seen as having let Ms Merkel have her way at euro-zone crisis talks. Critics say he may be overplaying his hand.

Conservative former foreign minister Alain Juppe drew attention last week to a growing impatience in Washington and Beijing over the Franco-German deadlock. "Europe is being shown the finger because it is divided and this cacophony is really weakening us," he said.

The tension was tangible at four-way talks in Rome between Ms Merkel, Mr Hollande and the leaders of Italy and Spain. The brief meeting steered clear of discussing eurobonds or a debt redemption fund, sources says.

Afterwards, Mr Hollande made a slightly scornful reference to Ms Merkel's attending the Germany-Greece Euro 2012 football match. "We must do this step by step. New instruments, additional solidarity, a reinforced union," he said: "This is what we discussed today — before Madame Merkel went off to see the football match." *Reuters*

FANS: **German Chancellor Angela Merkel, president of the German soccer federation Wolfgang Niersbach and German Interior Minister Hans-Peter Friedrich, right, watch the quarterfinal Euro 2019 soccer match between Germany and Greece on Saturday.** Picture: REUTERS

Illness hits Greece's new leaders

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Athens

GREECE's new prime minister and incoming finance minister, who have been ill, will miss this week's European Union (EU) summit when Athens will propose easing the terms of its bail-out as lenders have had to postpone a first meeting with the team.

Prime Minister Antonis Samaras underwent eye surgery on Saturday and Vassilis Rapanos is in hospital after suffering from nausea, abdominal pains and dizziness on Friday before he could be sworn in as finance minister.

The foreign minister and outgoing finance minister will attend the meeting on Thursday and Friday, to ask for the terms of the €130bn bail-out to be loosened, including a two-year extension, VAT adjustment and freeze of public sector job losses.

An EU official said the unexpected turn of events had forced the postponement of a visit to Athens today by officials from Greece's "troika" of lenders — the EU, European Central Bank and International Monetary Fund.

Mr Samaras's coalition government, sworn in last week, has called for the renegotiation of the terms of the financial lifeline, which is keeping Greece from bankruptcy but has deepened its recession, now in its fifth year.

German Finance Minister Wolfgang Schaeuble said Greece had already forfeited much of Europe's trust. "The most important task facing Mr Samaras is to enact the programme agreed upon quickly and without further delay instead of asking how much more others can do for Greece," he told Bild am Sonntag. *Reuters*