European stock markets in freefall following Paris financial summit

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The response of European stock markets to the crisis summit held in Paris on Saturday could have not been clearer. On Monday, share prices across Europe plummeted.

The Dax (Frankfurt) lost 7 percent, the TecDax 11 percent, the FTSE 100 (London) 8 percent and the CAC 40 (Paris) 9 percent. In Iceland, share trading was halted altogether. Following the nationalisation of the country's third biggest bank, the government itself was threatened with bankruptcy.

The government heads of the four European members of the G8—France, Germany, Great Britain and Italy—met on Saturday in Paris to discuss common action to combat the financial crisis. The results of the summit were negligible.

The assembled leaders agreed—in the words of French President Nicolas Sarkozy, who called the summit—that "every country would resort to its own measures." A proposal to set up a common fund to bail out ailing banks along the lines of the American Paulson plan failed to appear on the summit agenda following opposition from Germany.

Over the weekend, a series of events made clear the extent to which Europe, and especially Germany, has been hit by the international financial turbulence.

On Saturday, the plan drawn up a week ago by the German government and a number of banks to rescue Hypo Real Estate (HRE), Germany's second biggest mortgage lender, collapsed. The German central bank (Bundesbank) and private banks had planned to make €35 billion available to prop up HRE, a DAX company with total assets of €400 billion. For its part, the German government issued a surety loan of €26.5 billion in taxpayer money.

On Saturday, the private banks withdrew from the bailout plan after it emerged that the financial problems at HRE were much greater than originally presented. Losses by the bank are estimated at between €50 and €60 billion this year, and could climb to over €100 billion next year.

The banks neither informed the German government of their new estimate of HRE's financial problems, nor of their intention to quit the rescue package. Angry government leaders first learned of the situation from a press statement issued by HRE.

HRE attempted to blame German Finance Minister Peer Steinbrück (Social Democratic Party—SPD) for its new problems because Steinbrück had spoken of a "liquidation" of the bank. Evidently, the banks are attempting to pressure the government to make more funds available for bailouts.

On Sunday, further crisis talks were held to draw up a new bailout plan for HRE. The government took the situation so seriously that on the same afternoon Chancellor Angela Merkel (Christian Democratic Union—CDU) and Finance Minister Steinbrück held a joint press conference to announce a government guarantee for all private savings in Germany. "The deposits of savers are safe, the government gives its assurance" Merkel declared.

The declaration of a guarantee had two aims: To appease public anger over the government's decision to make billions of euros available to cover the banks' speculative losses, under conditions where ordinary savers faced the loss of their savings, and to avert a panic run on the banks similar to that which took place in Germany in 1931.

The seriousness with which the situation is regarded by ruling circles was reflected in comments made by Interior Minister Wolfgang Schäuble (CDU). In the latest edition of *Der Spiegel* magazine, Schäuble drew direct parallels to the economic crisis of the 1920s and 1930s and warned: "Such an economic crisis can result in an incredible threat to all of society. The consequences of that depression was Adolf Hitler and, indirectly, World War II and Auschwitz."

Instead of calming the situation, the government's promise to guarantee deposits has heightened fears by revealing the scale of the crisis. The German government has committed itself to cover an almost unlimited amount. According to government data, the guarantee will include private bank assets worth some €568 billion—twice as much as the entire annual federal budget. By some calculations, the various forms of savings total €4.5 trillion.

Spiegel Online commented: "Merkel and Co. have nothing more to increase their promises to savers. There are no reserves should the German financial system collapse… if the state really does have to compensate for lost deposits beyond the legal guarantee of €20,000 and the private banks' deposit guarantee fund the state debt will rise for years, capital spending will fall, social welfare systems will be additionally burdened."

The guarantee issued by the German government met with harsh criticism from other European capitals, particularly London. At the Paris summit, the Irish government was criticised for giving similar assurances for its six leading banks. Now the German government was doing the same thing.

The *Guardian* described the "anger" in Downing Street over Merkel's moves. The newspaper said: "British officials were furious with Merkel. They said she gave no indication of the move at a summit in Paris on Saturday designed to coordinate a European response to the economic crisis." The newspaper cited a financial expert who declared, "It's every man for himself in a united Europe."

The *Daily Mail* quoted an "angry British official" who declared: "Merkel agreed that we should all work together, then got on a plane, flew home and did her own thing."

On Sunday evening, the German government and banks finally agreed on a new rescue package for HRE. In addition to the already agreed €35 billion, the financial sector said it would provide further liquidity of €15 billion, without increasing the federal guarantee of €26.5 billion.

The government justified the rescue package with reference to the "unforeseen consequences” that would result from a collapse of HRE. Merkel said it was necessary to use taxpayer money to rescue the bank because otherwise the damage “would hit not only Germany, but would be huge for many in financial services throughout Europe.”

Despite the new bailout plan, HRE shares plunged 37 percent on Monday. The banks demanded more public money.

The Deutsche Sparkassen und Giroverband (Association of German Savings Banks and Clearing Houses) demanded that the government “put up an umbrella to cover the risks of the entire banking industry.” *Spiegel Online* quoted one banker as saying piecemeal solutions would not solve the problem. “We have never looked into such a deep abyss,” he said.

The near-collapse of HRE is only the tip of the iceberg. The mortgage provider was plunged into crisis through its subsidiary Depfa, which it had purchased only last year for €5.7 billion. The Depfa boss at the time, Gerhard Bruckermann, was sent into retirement with a golden handshake of €100 million, not an unusual figure for the sector.

Depfa, which emerged from the Deutschen Pfandbriefanstalt (German Institute for Mortgage Bonds), has its headquarters in Dublin, where it enjoys a far lower tax burden than in Germany. It specializes in financing public bonds, which are usually considered to be without risk. It was thrown into crisis because it made long-term loans and financed them with short-term credit raised on the interbank market, where banks lend one another money.

Since the collapse of Lehman Brothers, however, the interbank market has virtually run dry, since banks are no longer willing to lend each other money. Depfa could no longer find short-term credit at favourable rates, and HRE now has to dig into its pockets to come up with the missing billions.

HRE is one of the most important players in the €900 billion German mortgage bond market, which provides financing to many other banks and insurance companies. It is feared that bankruptcy for HRE will lead to the collapse of the entire mortgage bond market and set off a chain reaction that would hit pension funds and mutual associations, as well as the länder (states) and municipalities.

Depfa is not an isolated case. According to an analysis by *Der Spiegel*, other German banks have made even bigger long-term loans that are financed with short-term credit. According to the magazine, Landesbank Baden-Württemberg will have to “refinance some 100 billion euros by December 2009,” more than twice as much as HRE. At Nord/LB, the figure is €42 billion, at WestLB and Eurohypo the figure is approximately €30 billion each, while the Landesbank Rhineland-Pfalz must find €10 billion and Saxonia LB needs €3.5 billion.

The financial meltdown is far from reaching its nadir. What is taking place is the bursting of an enormous bubble of fictitious capital that was accumulated over recent decades at the expense of the working class.

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