Germany's slump risks 'explosive' mood as second banking crisis looms

Warning that downturn will see unemployment hit 4.7m by 2010

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Global Research, April 23, 2009
Daily telegraph (London) 23 April 2009

Region: Europe
Theme: Global Economy

The country's politicians will hope any slump does not lead to the sort of civil unrest which saw this building catch fire in 1933 Photo: AP A clutch of political and labour leaders in Germany have raised the spectre of civil unrest after the country's leading institutes forecast a 6pc contraction of gross domestic product this year, a slump reminiscent of 1931 and bad enough to drive unemployment to 4.7m by 2010.

Michael Sommer, leader of the DGB trade union federation, called the latest wave of sackings a "declaration of war" against Germany's workers. "Social unrest can no longer be ruled out," he said.

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While authorities have belatedly agreed to create a "bad bank" to absorb toxic loans and stabilise the credit system, further financial troubles are almost certainly in the pipeline.

Swiss risk advisers Independent Credit View said a "second wave" of debt stress is likely to hit the UK and Europe this year as the turmoil moves from mortgage securities to old-fashioned bank loans. A detailed "stress test" of 17 lenders worldwide found that European banks have much lower reserve cushions than US banks, leaving them acutely vulnerable to the coming phase of rising defaults. "The biggest risk is in Europe," said Peter Jeggli, Credit View's founder.

Deutsche Bank has reserves to cover a default rate of 0.7pc, against non-performing assets (NPAs) of 1.67pc; RBS has 1.23pc against NPAs of 2.43pc, and Credit Agricole has 2.63pc against NPAs 3.64pc. None have put aside enough money.

By contrast, Citigroup has reserves of 4pc against NPAs of 3.22pc; and JP Morgan has 3.11pc against NPAs of 1.95pc.

"The Americans are ahead of the curve. European banks are exposed to US commercial real estate and to problems in Eastern Europe and Spain, where the situation is turning dramatic. We think the Spanish savings banks are basically bust and will need a government bail-out," said Mr Jeggli.

The IMF said European banks have so far written down $154bn (£105bn) of bad debts, or just 17pc of likely losses of $900bn by 2010. US banks have written down $510bn, 48pc of the expected damage.

Analysts say America's quicker response has given the impression that US banks are in worse shape, but this is a matter of timing and "transparency illusion". Europe risks repeating the errors made by Japan in the 1990s when banks concealed losses, delaying a recovery.

Europe's banks are exposed to a hydra-headed set of bubbles. They not only face heavy losses from US property, they also face collapsing credit booms in their own backyard and fallout from high levels of corporate debt in the eurozone.

Mr Jeggli said the financial crisis was "front-loaded" in the Anglo-Saxon countries and Switzerland because their banks invested heavily in credit securities. As tradeable instruments, these suffered a cliff-edge fall when trouble began, forcing harsh write-downs under mark-to-market rules.

It takes longer for damage to surface with Europe's traditional bank loans, which buckle later in the cycle as defaults rise. The ferocity of Europe's recession leaves no doubt that losses will be huge this time.

http://www.telegraph.co.uk/finance/financetopics/financialcrisis/5209033/Germanys-slump-risks-explosive-mood-as-second-banking-crisis-looms.html