Will G7 Governments Close Down World's Financial Markets?

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Berlusconi Says Leaders May Close World's Markets

By Simon Kennedy and Steve Scherer

Oct. 10 (Bloomberg) — Italian Prime Minister Silvio Berlusconi said governments may shut financial markets as the credit freeze pummels stocks and threatens a global recession.

As equities suffered their worst week since the 1970s, Berlusconi said in Naples, Italy that markets may be shut while policy makers "rewrite the rules of international finance."

The discussions were revealed as finance ministers and central bankers from the Group of Seven nations sought a united front aimed at thwarting the crisis. Among the options: Pumping taxpayer funds into loss-ridden banks and guaranteeing lending between them and their deposits.

"Doing nothing is not an option at this stage," Bundesbank President Axel Weber told reporters in Washington. French Finance Minister Christine Lagarde said "a coordinated basis is the only way to react to the situation."

Unprecedented interest-rate cuts and bank bailouts have failed to quell panic in markets, putting officials under pressure to pull even more policy levers today or risk exacerbating the financial and economic turmoil.

"The gravity of the current situation is sinking into officials' mindsets," said Charles Diebel, head of European rates strategy at Nomura International Plc in London. "It's time for the kitchen sink, as in throw everything there is at the problem, and on such a scale that the shock and awe will break the cycle of fear."

Statement Today

The officials from the U.S., Japan, Germany, U.K., France, Canada and Italy are gathering for the first time since the financial crisis intensified last month and spread more virulently beyond U.S. borders. They will release a statement about 6 p.m.

Reflecting the seriousness of the crisis, President George W. Bush will meet the G-7 officials tomorrow, and the broader Group of Twenty will also convene.

"This is an opportunity to make sure that they're all on the same track," said former Federal Reserve Chairman Paul Volcker. He urged that "all of them now admit or all of them own up to the fact their own banks are going to need support," in an interview with PBS Television's Charlie Rose show.

The G-7's dilemma is that even after a battery of policy actions, money markets remain gridlocked as banks shun lending to each other for fear they will lose the money or because they need it themselves. The cost of borrowing dollars for three months in London today rose to its highest this year and the rate in Tokyo jumped to the most since 1998.

`Lukewarm at Best'

"Mistrust is set to persist," said Nick Stamenkovic, a fixed-income strategist in Edinburgh at RIA Capital Markets. "While measures are moving in the right direction, reaction has been lukewarm at best."
Policy makers are lining up more initiatives and may find the deepening crisis forces them to put aside initial concerns about the strategies of opposite numbers. U.K. Chancellor of the Exchequer Alistair Darling wants countries to guarantee lending between banks, either by turning central banks into clearing houses for the loans or having governments back them. That would "be an effective way of easing the crisis," said Marc Chandler, head of currency strategy at Brown Brothers Harriman & Co. in New York.

Reviewing Darling Plan

While U.S. officials have played down the idea without dismissing it outright, expressing concern that the step would be biased against financial institutions outside the banking sector, White House spokesman Tony Fratto said today "we're reviewing" the U.K. proposal.

The U.S. already plans to follow Darling in another way by purchasing stakes in a wide range of banks within weeks, tapping authority included in the $700 billion rescue package passed by Congress last week. The U.K. is engineering a 50 billion pound ($87 billion) strategy to partly nationalize at least eight British banks. Japanese lawmakers are also considering reviving a law that expired in March that would allow them to inject public money into regional financial companies.

The Federal Deposit Insurance Corp. said today it has "significant latitude" to take further steps to support banks and their depositors using emergency powers. European leaders have already promised to protect savers.
"Governments must act now and decisively to restore confidence otherwise we are in for serious trouble and a long- run recession," said Moorad Choudhry, head of treasury at Europe Arab Bank Plc in London.

`Country to Country'

While arguing against "taking ad hoc measures" and suggesting an immediate relaxation of accountancy rules, German Finance Minister Peer Steinbrueck said solutions may still "be different from country to country." He has argued banks in his country are in better shape than elsewhere.

"Apparently it's difficult to get the point across that banks and financial systems are facing different problems," he said in Washington.

If governments fail, central banks may have more work to do having already executed emergency rate cuts this week. New York University professor Nouriel Roubini recommended they pare interest rates by at least 1.5 percentage points to avert a depression. Jacques Cailloux, an economist at Royal Bank of Scotland Group Plc in London, said today the European Central Bank will cut again before its governing council is next scheduled to meet Nov. 6.

"While a coordinated government response in the coming days through the G-7 is possible, it might not be sufficient to boost confidence in the system sufficiently quickly," said Cailloux.

In a report published yesterday, University of California Berkeley economist Barry Eichengreen warned against a disjointed approach. "The policy response needs to be decisive," he said. "It needs to be global. The stakes could not be higher."

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