Key German bank rescued, Italy revives bailout talks

By Gernot Heller and Kevin Krolicki 1 hour, 31 minutes ago – 8:27pm CST October 5, 2008
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BERLIN/WASHINGTON (Reuters) - Germany offered a blanket bank deposit guarantee on Sunday in a bid to contain the spreading credit crisis as officials clinched deals to rescue Germany's Hypo Real Estate and recapitalize two other European banks.

From Iceland to Italy, officials scrambled to contain the fallout from the deepest financial crisis since the 1930s amid a continued debate about whether a fragmented European response could keep pace with a fear-driven market.

In a sign that the credit crunch is being felt in Asia, South Korea's finance minister said Korean banks were having trouble securing funds in foreign currencies and said the government would offer loans from its reserves.

On Saturday, leaders of Europe's four biggest economies -- Germany, France, Britain and Italy -- decided against a coordinated bank bailout, while vowing to stabilize markets.

But in what would mark a stunning reversal after just a day, Italian Prime Minister Silvio Berlusconi said on Sunday that Italy would revive the idea of a common bank bailout fund at a meeting of finance ministers on Monday.

Germany shot back that it remained opposed to any such shared bank rescue fund like the $700 billion bailout approved last week by the United States.

A French official said there was no fund proposal up for discussion.

Meanwhile, Germany said it would guarantee deposits in German banks to protect savers. Austria and Denmark quickly followed suit with the same kind of blanket guarantee first offered by Ireland last week.

"We say to savers that their deposits are safe," German Chancellor Angela Merkel said at a news conference in Berlin. "The federal government is also committed to that."

The pledge came as German officials clinched a renewed rescue deal for lender Hypo Real Estate, Belgium and Luxembourg found a buyer for troubled financial group Fortis in BNP Paribas, and UniCredit, Italy's second-biggest bank, announced plans to raise new capital.

In New York, Citigroup Inc won a court order blocking rival Wells Fargo & Co from moving ahead with its acquisition of hobbled U.S. bank Wachovia Corp in a contested deal that also grew out of the credit crisis.

But Wachovia insisted its agreement with Wells Fargo was valid and vowed to pursue the union.

Meanwhile, expectations are building that finance leaders from the Group of Seven scheduled for this week in Washington could set the stage for coordinated rate cuts.

The United States last week approved a $700 billion fund authorizing the U.S. Treasury to begin buying up bad debt from banks. But questions abound about how successful that will be in unblocking credit markets as the economy slips into a deeper downturn.

U.S. stocks are expected to remain under pressure after the sharpest single-week decline in seven years with loan markets still extremely tight.

U.S. stock index futures dropped in early Asian trade and oil prices dropped more than 2 percent, both in reaction to slowing growth.

EUROPEAN BANKS UNDER PRESSURE

European banks have been hit hard by the fallout from a crisis which began in the United States when the housing market collapsed and bad mortgage debts multiplied.

In Berlin, the German government and banks agreed to a new rescue package for Hypo Real Estate.

Banks and insurers had withdrawn their support for a government-led 35 billion euro ($48.50 billion) rescue deal after problems came to light at the Munich-based lender.

Under the revised deal, commercial banks and insurers would provide an extra 15 billion euros ($20.8 billion) in liquidity for HRE in addition to the initial pledge of 35 billion euros.

Germany's finance ministry said the deal would stabilize HRE, a key player in commercial property and infrastructure lending and government financing.

BNP Paribas, meanwhile, struck a deal with the governments of Belgium and Luxembourg to take control of the key remaining assets of troubled financial group Fortis.

BNP Paribas will buy 75 percent of the Belgian banking arm of Fortis as part of a deal in which Belgium will receive new shares in the French bank.

In Milan, Italy's second-biggest bank, UniCredit, convened a special board meeting to ask shareholders for an additional 3 billion euros in capital to protect it from the crisis in international markets.

In Iceland, officials, including the central bank, were at work on a financial stability plan to address a crisis that has sent the country's currency spiraling lower and is seen as threatening its financial sector.

The banking upheaval that began on Wall Street has effectively shut down interbank and other loan markets and is seen as pushing industrialized countries toward recession.

The resulting pinch has shut down corporate access to credit as earnings fall. As companies cut back, analysts are bracing for tens of thousands of more job cuts and pressure on consumer spending, which represents about two thirds of the U.S. economy.

JPMorgan and Goldman Sachs both predict that the United States entered a recession over the past week with growth expected to contract for two consecutive quarters.

Fed fund futures have fully priced in a 50-basis point rate cut by the Federal Reserve this month as expectations have built that the European Central Bank could cut rates for the first time in five years.

With Asian markets set to open for the first time since passage of the U.S. bailout deal, analysts said the risk for sharply slower U.S. growth would loom increasingly large.

Goldman Sachs economist Tetsufumi Yamakawa said in a note issued on Sunday that he would cut his forecast of 1.9 percent growth for Japan for 2009 in light of the expectation that the U.S. economy had slipped into recession.