SPIEGEL ONLINE

07/20/2009 12:00 AM

THE BANKS THAT WOULDN'T LEND

Experts Warn of New Credit Crunch in Germany

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Many economists are already talking about a light at the end of the recession tunnel. But a new crisis is looming in Germany as companies find it increasingly difficult to borrow money. The government is coming up with increasingly desperate ideas to get liquidity flowing again.

There was little evidence of a crisis as German Chancellor Angela Merkel hurried through a production building at Opitz Holzbau GmbH, a manufacturer of prefabricated building elements based in the eastern German town of Neuruppin, on Wednesday of last week. Production was in high gear, and the chancellor chatted with assembly workers, handed out praise and shook hands.

DPA

Idle cranes in Hamburg harbor: The economic crisis is hitting German exporters hard.

Merkel was making the second stop on her summer tour of German small- and mid-sized businesses. She was trying out the central message of her election campaign, which will begin in the coming weeks: "Everything will be just fine."

After the factory tour, Merkel and local business owners retired to a drab conference room -- and suddenly the crisis was back. The discussion revolved around banks, the slowdown in the flow of credit and the resulting cash crunch many companies are experiencing. This is the subject that is currently capturing the attention of economists, politicians, business owners and ordinary people alike.

Merkel complained that even though the government has spent billions to support the banks, there are now "massive problems with investments over €10 million ($14 million)." She said that she is gradually losing her inclination to take responsibility for the financial industry. "It's time for the banks to do their part," Merkel said.

The government is preparing for the next stage of the economic crisis. While some experts are already declaring the imminent end of the recession, Berlin's grand coalition government of conservative Christian Democrats (CDU) and the center-left Social Democratic Party (SPD) fears that the financial crisis could come to a head in the fall.

Because the banks have been reluctant to lend money, even healthy small-and medium-sized companies lack the funds for much-needed investments and future-oriented projects.

Senior officials at the Economics Ministry warn of a "serious danger," while Hans-Peter Keitel, president of the Federation of German Industries (BDI), warned in an interview with SPIEGEL that "even completely healthy companies could get into difficulties that could threaten their survival." Merkel is worried: If the prognoses prove to be correct, the weeks leading up to Germany's national elections on Sept. 27 could be filled with bankruptcy filings by firms in Germany's traditional export industries, like mechanical engineering, electronics and the automotive sector.

Even as companies threaten to go under, which would set off waves of layoffs, financial firms like US investment bank Goldman Sachs and Germany's Deutsche Bank are raking in substantial profits once again. Merkel's advisers fear that the prospect of widespread company failures could poison the mood among voters.

This concern has prompted government leaders to assign the blame for the malaise to the reluctant bankers. Lenders would rather invest the money "in the trading of foreign currency, bonds and stocks," Finance Minister Peer Steinbrück says. Economics Minister Karl-Theodor zu Guttenberg calls the banks' behavior "unreasonable," and SPD chancellor candidate Frank-Walter Steinmeier says that "healthy companies are going under, merely because banks are hording their money."

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Graphic: German measures to tackle the financial crisis to date

Assigning the blame to the financial managers, who were indeed partly responsible for the financial crash, may be popular, but it is not particularly accurate. In truth, the government is mainly to blame for the fact that liquidity has yet to return to important segments of the German credit market.

For reasons partly of parsimoniousness and partly of misunderstood market ideology, the Merkel cabinet has designed its billions in bailout programs (see graphic) in such a way that they have often narrowly missed their mark.

For instance, the German government had expected that its €480 billion ($672 billion) financial market stabilization fund would ensure that banks with heavy losses would boost their equity reserves. But instead of requiring banks to accept the government bailout funds, as was the case in the United States and Britain, the German government made participation in its program voluntary.

The outcome was inevitable. Fearing that the public would perceive them as ailing, even banks that urgently needed the money shied away from accepting the government's capital injection.

Only Commerzbank and a few smaller institutions took the government up on its rescue offer. Meanwhile, the majority of players in the financial industry are trying to survive the crisis without any outside help, which severely restricts their ability to lend money.

The upshot of the so-called "bad bank" law, which the grand coalition hoped would enable lenders to get rid of their now worthless toxic securities, has been similarly sketchy. The Christian Democrats and the SPD spent half a year discussing one detoxification model after the next. In the end, they decided on a version whose main feature is that it minimizes the burden on the federal budget.

For financial institutions, on the other hand, the aid was tied to so many conditions that hardly any banks have wanted to participate. To date, not a single institution has submitted the relevant applications, and only three banks have even expressed their "interest" in the program. As a result, toxic securities continue to burden bank balance sheets and tie up capital which is urgently needed for loans.

The most disastrous outcome of the failed policies, however, has been the federal and state governments' inability to recapitalize Germany's troubled state-owned regional Landesbanken. After playing a larger role in the global investment casino than any other sector of the financial industry, institutions like WestLB and HSH Nordbank faced enormous losses when the crisis hit.

In Poor Shape

Experts have long recommended that if these institutions are to become viable again, unprofitable business segments will have to be abandoned and several institutions merged -- a step many governors of Germany's states are unwilling to take. Fearing a loss of control and of jobs, states like Bavaria and Baden-Württemberg are even turning down offers of federal assistance and are trying to bail out their troubled state-owned banks on their own.

The consequences have been disastrous. Because the government's cleanup efforts have been so unsuccessful, Germany's banking industry is in worse shape than that of almost any other industrialized nation. Foreign banks like the Royal Bank of Scotland have withdrawn from the German market, private banks lack the necessary capital and the ailing state-owned banks are largely incapable of lending money for investment.

Thus, it comes as no surprise that the flow of capital has stagnated. The banks increased their lending volume by 5 percent in the first quarter of this year, compared with the same period last year. But this growth stems primarily from short-term liquidity loans, an area in which banks are still eager to lend money. For long-term loans, however, which companies need for their capital investments, banks have "tightened their standards across all types of businesses and for all repayment terms," a survey conducted by Germany's central bank, the Bundesbank, concluded.

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But the worst is yet to come. Experts predict that the credit crunch will worsen in the second half of the year. When that happens, the recession will affect larger numbers of companies, causing their credit ratings to decline. The banks, in turn, will be even more reluctant to lend money.

The government is familiar with the experts' predictions. But instead of addressing the root causes of the problem, Finance Minister Steinbrück would rather resort to belligerent rhetoric. Unless the banks finally toed the line, he blustered, he would take "unprecedented measures."

Steinbrück's aggressive tone makes it all the more embarrassing that his announcements have proven to be nothing but empty threats until now. They have included the suggestion that the Bundesbank issue loans directly, and that the equity capital requirements under the Basel II rules -- international banking regulations that stipulate how much capital banks need to have -- be relaxed. But no matter what Steinbrück has proposed, he has consistently failed in the face of legal constraints and the objections of European partner countries. Are German banks in such poor shape, EU negotiators in Brussels jeered, that Berlin is already torpedoing its own regulatory ideas?

Steinbrück is now pursuing yet another plan. Officials at the Finance Ministry have prepared another version of an emergency financing plan, which calls for the government-owned KfW development bank to take action, instead of the Bundesbank. Before the crisis began, KfW and the banks through which it channels its loans onto the market each bore half the credit risk. In exceptional cases, KfW may assume 80 percent of the risk, while the other bank assumes the remaining 20 percent. In the future, however, KfW's share could be even higher, perhaps even 100 percent, according to the Finance Ministry's latest plans. The Economics Ministry is fashioning similar schemes.

Some plans are even more radical, including the possibility of KfW lending directly to businesses in the future. The funds for the new loans would come from the existing stimulus programs.

The plan could indeed benefit some cash-strapped companies, but it can hardly replace a functioning money and capital market. As Merkel has learned from her visits to small and mid-sized businesses, companies are the first to suffer when banks are not functioning properly.

Admittedly Martin Opitz, the CEO of Opitz Holzbau, was able to report to the chancellor that business is good. With its prefabricated roof trusses, some of which come with attached solar panels, Opitz is profiting from the alternative energy boom.

But Martin Opitz has also had his unfortunate experiences with the credit crunch. In May, a large bank approved a loan of €2.2 million ($3.1 million) for his company. But after spending two months calling the bank in an attempt to actually get the promised funds, he ended up going to the local Sparkasse savings bank, which lent him the money within two weeks.

Since then, Opitz has followed a simple rule of thumb. "I no longer work with large banks," he says.

Translated from the German by Christopher Sultan

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