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Germany Said to Ready Plan to Help Banks If Greece Defaults

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By Alan Crawford

Sept. 9 (Bloomberg) -- Chancellor Angela Merkel's government is preparing plans to shore up German banks in the event that Greece fails to meet the terms of its aid package and defaults, three coalition officials said.

The emergency plan involves measures to help banks and insurers that face a possible 50 percent loss on their Greek bonds if the next tranche of Greece's bailout is withheld, said the people, who spoke on condition of anonymity because the deliberations are being held in private. The successor to the German government's bank-rescue fund introduced in 2008 might be enrolled to help recapitalize the banks, one of the people said.

The existence of a "Plan B" underscores German concerns that Greece's failure to stick to budget-cutting targets threatens European efforts to tame the debt crisis rattling the euro. German lawmakers stepped up their criticism of Greece this week, threatening to withhold aid unless it meets the terms of its austerity package, after an international mission to Athens suspended its report on the country's progress.

Greece is "on a knife's edge," German Finance Minister Wolfgang Schaeuble told lawmakers at a closed-door meeting in Berlin on Sept. 7, a report in parliament's bulletin showed yesterday. If the government can't meet the aid terms, "it's up to Greece to figure out how to get financing without the euro zone's help," he later said in a speech to parliament.

Schaeuble travelled to a meeting of central bankers and finance ministers from the Group of Seven nations in Marseille, France, today as they face calls to boost growth amid increasing threats from Europe's debt crisis and a slowing global recovery.

Progress Report

The German government is awaiting the results of the Greek progress report and will decide what course of action then, a government spokesman said, speaking on customary condition of anonymity.

European bank credit risk surged to an all-time high today and stocks fell worldwide on concern that the debt crisis is escalating. German two-year yields declined to a record as investors sought a haven and Greek two-year note yields added as much as 86 basis points to 55.91 percent, a euro-era record.

Credit-default swaps insuring Greek sovereign bonds jumped 212 basis points to a record 3,238, according to CMA. The five- year contracts signal there's a 92 percent probability the country won't meet its debt commitments.

"Countries must act now and act boldly to steer their economies through this dangerous new phase of the recovery," International Monetary Fund Managing Director Christine Lagarde said in a speech in London today. “We must not underestimate the risks of a further spread of economic weakness or even a debilitating liquidity crisis,” she said. “That is why action is needed urgently so banks can return to the business of financing economic activity.”

Barroso Meeting

Merkel, who is due to discuss the crisis with European Commission President Jose Barroso in Berlin on Sept. 12, is battling to secure a majority among her coalition bloc to push an overhaul of the European Financial Stability Facility through the lower house of parliament on Sept. 29. The changes would give the EFSF the power to buy bonds in the secondary market, raising German guarantees to 211 billion euros ($290 billion) from 123 billion euros.

Longer term, euro countries will “only preserve the common currency if there is more integration” in the European Union, Merkel said in a speech in Berlin today. The EU “won’t be able to avoid treaty change.” While intensive discussions lie ahead and the path won’t be easy, policy makers “shouldn’t be afraid” of tackling the challenge, she said.

Policy makers in Europe “are moving,” U.S. Treasury Secretary Timothy F. Geithner said in a Bloomberg Television interview from the G-7 in Marseille. “But I think they’re going to have to demonstrate to the world they have enough political will.”

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