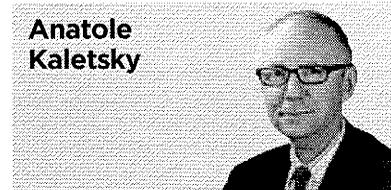


09.15 Germany confirms €50bn rescue for Hypo Real Estate +++ 10.27 Pope says world financial system built on sand

# Act of faith is needed to stop the flight of cash

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Once a run gets started it is rational for other people to join in." Those may sound like the words of an irresponsible scaremonger, but they were spoken by Mervyn King, the Governor of the Bank of England, commenting on the BBC about the bank run at Northern Rock. After what Alistair Darling said in Parliament yesterday — or rather what he failed to say — a run on the entire British banking system is, almost incredibly, the danger that we all face today.

The bank run this time does not consist of people patiently queueing outside branches to draw out their thousands, but of financial institutions and corporate treasuries calling back overnight deposits worth tens of billions of pounds. The basic dynamics, however, are the same today as they were a year ago. And now, as then, the only way to reverse the financial vicious circle will be for the Government to put its full faith and credit behind every penny deposited in every British bank.

The reason why strong — and immediate — government action is needed in a banking crisis is very simple, even if neither the British nor the US treasuries appear to understand it. Banking is always

based on faith, because no bank ever has enough ready money to repay all its deposits and debts — and the public's confidence in any nation's banks depends ultimately on faith that the Government will stand behind them. Only the Government can ultimately guarantee a banking system, because the Government has the unique ability to print the money with which debts are repaid.

Normally it is enough for the Government's support to be implicit. It is even desirable for financial hygiene if some minor banks occasionally fail. But when money is flooding out of the entire banking system, then the

**'The Government must offer a guarantee, with no qualifications, no ifs and no buts'**

Government has to stand four-square behind it and make it absolutely explicit that no depositor or creditor of any bank will lose a penny under any circumstances — regardless of anything that might happen to the bank in question or to the economy as a whole.

This is what the Irish Government stated last week and what the Germans and many other European governments promised, in one form or another, over the weekend. It is also, ironically, the reassurance that Mr Darling offered temporarily a year ago after the failure of Northern Rock.

Yesterday, however, Mr Darling

specifically refused to match the Germans' weekend assurance. To say that the Government will do "whatever is necessary to ensure stability of the financial system" is no comfort to an individual saver — or an inter-bank depositor or corporate treasurer — who is not concerned about the system's stability but only about repayment of his own money, with interest and on time.

Bizarrely, Mr Darling seemed to think that he could bolster

confidence for British banks by arguing that the German bank guarantees were not really as firm as they seemed — and then pointedly refusing to offer even such half-hearted guarantees himself. However, the impression he conveyed was not of confidence but of chaos. Yesterday's may only have been a holding statement while the Treasury works out what to do next, but talk of recapitalising the banks, tightening regulation, changing accountancy rules or

international co-operation are on completely the wrong timescale.

The flight of wholesale deposits from Britain's banking system, like the flight of retail deposits from Northern Rock a year ago, must be stopped in days or hours, not months or weeks. The only way to do that is for the Government to offer a temporary guarantee on all liabilities of all British banks — with no qualifications, no ifs and no buts. And the time to do that is fast running out.