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## European officials round on Lagarde

By FT Reporters

European officials rounded on [Christine Lagarde](#) on Sunday, accusing the managing director of the International Monetary Fund of making a “confused” and “misguided” attack on the health of Europe’s banks.

Ms Lagarde, the former French finance minister who replaced Dominique Strauss-Kahn as head of the IMF in July, used her address at an [annual meeting of central bankers in Jackson Hole, Wyoming](#), to call for an “urgent” recapitalisation of Europe’s weakest lenders, saying that shoring up the banking system was key to cutting “chains of contagion” across the region.

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But officials said Ms Lagarde’s comments missed the point of banks’ current difficulties. “The key issue is funding,” said one experienced central banker. “Banks in some countries have had trouble securing liquidity in recent weeks and that pressure is going to mount. To talk about capital is a confused message. Everybody – politicians, regulators, other officials – is quite concerned.”

Officials, nervous that Ms Lagarde’s statement would further spook bank investors, said they planned to urge the former French finance minister to clarify her statement. European politicians and regulators are still struggling to come up with a mechanism that will calm investors’ skittishness about banks’ exposure to sovereign debt across the southern [eurozone](#). A high-profile pan-European “stress test” of bank balance sheets has failed to allay investors’ concerns about their ability to withstand a default by a European government, or a severe deterioration in their credit portfolios across the region.

“We have to break the link between the sovereigns and the banks, particularly in Spain and Italy,” said one regulator.

Ms Lagarde’s allusion this weekend to the potential use of the European Financial Stability Fund, a €440bn bail-out fund, as a means to recapitalise banks by force,

would be far better directed towards a liquidity solution, some officials said. No headway has been made towards the idea of EFSF-guaranteed bank bond issuance, they admitted, though that would be the “most sensible solution”, according to one. Jean-Claude Trichet, the president of the European Central Bank, separately dismissed any idea that Europe could face a liquidity shortage in his own Jackson Hole address, saying efforts to combat the financial crisis would prevent such an outcome.

“The idea that we could have a liquidity problem in Europe” is “plain wrong,” Mr Trichet said.

The results of last month’s stress tests revealed that nine of the 91 banks tested “failed”, with a core tier one capital ratio – a key measure of financial strength – of less than 5 per cent. National regulators are due to report back in October on headway made in forcing through recapitalisations at banks that failed, or came close to failing, the tests.

*Reporting by Patrick Jenkins, Megan Murphy, Ralph Atkins and Peter Spiegel*