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Credit fears spark fresh action

The European Central Bank (ECB) has moved again to boost liquidity in the banking system, after warning of fresh volatility in financial markets.

It is lending 42 billion euros (£28bn; \$57bn) to banks in its latest effort to counter the global credit squeeze.

It will repeat the exercise again on 11 September for a yet unspecified amount.

Central banks want to cut the cost of credit after the rates at which banks lend to each other soared because of worries about their US mortgage losses.

Volatility returns

The scale of many banks' liabilities from the troubled US sub-prime mortgage market remains unknown, raising fears about their financial position.

Two German banks have already revealed huge losses stemming from sub-prime investments, while BNP Paribas suspended three investment funds last month after it said the liquidity crisis meant it was unable to calculate their value.

Thursday's move takes the total amount that the ECB has pumped into the money markets in the past month to more than 250bn euros.

But it has acknowledged that the scarcity of liquidity is still a problem.

"We must care for the money markets functioning in a correct and appropriate fashion," the bank's president Jean-Claude Trichet said following the latest credit move.

"We have done that in a very expeditious and successful fashion. We have taken decisions where and when appropriate."

The move came a day after the Bank of England increased the amount of cash banks could deposit with it and gain access to at short notice.

Inter-bank lending rates - the rate at which banks borrow from each other over a three-month period - have risen to six-year highs as the liquidity crisis deepens.



The ECB wants to lower the cost of credit to boost liquidity



“ We have taken decisions where and when appropriate ”

Jean-Claude Trichet, ECB president

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The main three-month London Libor rate, the standard by which such lending takes place, has risen to more than a percentage point above the Bank of England base rate.

Normally, the spread would be less than half a point, making banks' customary short-term borrowing to keep money flowing much more expensive and hitting potential profits.

Central banks want to provide alternative, cheaper sources of credit.

Economic impact

Analysts believe the ECB's latest intervention means it is even less likely to adjust interest rates from their current 4% mark when it meets later on Thursday.

Recent decisions by Australia and Canada to freeze rates reflected growing concerns that a prolonged credit squeeze could damage global economic growth.

This view was reinforced by comments by the OECD on Wednesday, which said the US housing slump would lead to a "substantial" slowdown in its economy later this year.



The scale of banks' liabilities to the US is a matter of debate

But opinion remains divided on the likely scale of the fallout from the sub-prime crisis.

William Rhodes, a senior executive with US banking giant Citigroup, said on Thursday that he was "very concerned" about what he was seeing in financial markets.

"It seems very clear that in the US there will be an impact on the real economy," he said.

But the World Bank's chief economist said that the current upheavals were likely to die down within a couple of months with little or no long-term repercussions.

"There will be a very small impact of the sub-prime crisis and it will be over in a couple of months," Francois Bourguignon told an Indian newspaper.

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