

## Europe Hit by Downgrades

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PARIS—France and eight other euro-zone countries suffered ratings downgrades on their sovereign debt Friday, sparking renewed global worries over Europe's ability to bail itself out of financial crisis.

Standard & Poor's Ratings Services stripped triple-A ratings from France and Austria and downgraded seven others, including Spain, Italy and Portugal. It retained the triple-A rating on Europe's No. 1 economy, Germany.

The downgrade to France, the zone's second-largest economy, will make it harder—and potentially more expensive—for the euro zone's bailout fund to help troubled states, because the fund's own triple-A rating depends on those of its constituents. The downgrades also speak to how deeply the concerns over countries on the euro zone's periphery have penetrated its core.

The downgrades also come just at the moment when Greece, the cradle of Europe's current crisis, is desperate for support. In Athens, talks broke down Friday between Greece and a group of creditors negotiating to restructure its debt.

If no deal can be reached, Greece will need billions of euros in additional aid to help it make a big bond repayment in March. The alternative is a messy default.

The move surely wounds French pride, and lays bare the fragility of a rescue plan that requires Europe to pull itself up by its own bootstraps. But financial markets' relatively muted reaction to reports of impending downgrades makes equally plain that neither France's nor Europe's weaknesses had been hidden. Worst-case fears also weren't borne out: France avoided the two-notch downgrade S&P had warned of last month.

S&P, which in December placed 15 of the 17 euro-zone countries on watch for possible downgrades, said Friday it had decided to lower the debt ratings of nine of them because it felt the currency bloc has so far failed to take adequate action.

"In our view, the policy initiatives that have been taken by European policy makers in recent weeks may be insufficient to fully address ongoing systemic stresses in the euro zone," the ratings firm said.

S&P cut the debt ratings of France and Austria by one notch to AA+ from triple-A. Malta, Slovakia and Slovenia were also downgraded by one notch. S&P lowered the ratings of Italy, Spain, Portugal and Cyprus by two notches. S&P cast a dark outlook for the currency bloc, assigning France and 13 other euro-zone nations a negative outlook, indicating at least a one-in-three chance of a further downgrade in the next two years. S&P said it feared Europeans may grow tired of austerity and change.

"We believe that there is a risk that reform fatigue could be mounting, especially in those countries that have experienced deep recessions and where growth prospects remain bleak," it said in a statement.

The downgrade of France, the world's fifth-largest economy, marks the second high-profile downgrade of a top tier triple-A nation by S&P in less than six months, after it stripped the U.S. of the ranking and sparked a wave of controversy in August.

France continues to hold triple-A ratings from Fitch Ratings and Moody's Investors Service. Earlier Friday, France attempted to blunt the impact of the impending news, which came after U.S. markets closed.

Finance Minister François Baroin went on prime-time television Friday evening in France and said that while the country would have preferred to keep the rating, the downgrade is not a catastrophe. "It is not ratings agencies that dictate French policy," Mr. Baroin said. "It is clearly [related to] the governance of the euro zone and to its instability."

News that the downgrades were imminent was reported by DJ FX Trader. As word of the downgrades emerged, France's CAC-40 index was nearly flat and Germany's DAX fell 0.6%. The Dow Jones Industrial Average fell 48.96 points, or 0.39%, to 12422.06, after falling as much as 159 points at its intraday low.

The euro fell more sharply, hitting an intraday low of \$1.2623, its weakest level since late August 2010. The euro has lost more than 10% against the dollar since Oct. 27. That pronounced weakness in the common currency is something of a new development in the crisis, say observers.

Prices of French and Austrian government bonds fell modestly while prices of safe investments like German bonds and U.S. Treasuries jumped. The muted bond market moves suggested the chance of a downgrade had been largely priced in. Still, market observers remained wary of potential follow-on effects of the downgrades.

Although S&P left Germany's triple-A rating unscathed, the company's assessment offers stark evidence of the extent to which many industrialized countries have been relying on debt during both periods of economic expansion and contraction, as they pursued the increasingly elusive goal of buoyant growth and full employment. France, for example, hasn't recorded a balanced budget since 1974.

Friday's downgrade highlights major limitations in the euro-zone's strategy to ride out of the protracted sovereign debt crisis, and casts doubts over whether France can continue to assist others while coping with domestic woes. The downgrade will rekindle debate about the role of the European Central Bank, which has so far maintained that bailing out euro-zone countries wasn't part of its mandate.



Since Greece ran into financial troubles in spring 2010, followed by Ireland and Portugal, euro-zone countries have been relying on core members of the monetary union to take on more debt and help their struggling neighbors.

But the bailout bills dangerously piled up on top of other debt France, Germany and other euro-zone nations had contracted in late 2008 and 2009 when their economies slipped into recession. Making matter worse, the sovereign-debt crisis began infecting larger countries such as Spain and Italy, leaving the euro zone with a shrinking number of paymasters.

S&P's decision means that Europe's rescue fund, the **European Financial Stability Facility**, could lose the triple-A rating it needs to borrow cheaply and lend to ailing euro-zone governments. As France is the second-biggest contributor to the fund's guarantees, the chances are greater that the EFSF's capacity will be crimped or its borrowing costs will rise.

The decision to cut Italy by two levels, from single-A to triple-B-plus, caught some analysts off-guard. The move is likely to have a ripple effect on the ratings of Italian banks, driving up their borrowing costs and exacerbating their funding woes. Italy's banks, which are major holders of Italian bonds, are struggling to meet demands by European regulators to raise more capital to cushion against the debt crisis.

S&P expressed concern over the euro zone's decision in recent weeks to focus mainly on reinforcing fiscal discipline within the bloc, without elaborating growth strategies. "We believe that a reform process based on a pillar of fiscal austerity alone risks becoming self-defeating, as domestic demand falls in line with consumers' rising concerns about job security and disposable incomes, eroding national tax revenues," it said.

Euro-zone leaders are scheduled to meet later this month to consider ways to boost growth and create jobs across the continent, notably by launching infrastructure and renewable-energy projects.

Fitch Ratings, which has placed six euro-zone countries on negative ratings watch, has said it expects to complete its review by the end of January. But France isn't one of them and Fitch has said it doesn't plan to downgrade the country's triple-A rating in 2012, although it has a negative outlook.

Moody's Investors Service is also reviewing European sovereign ratings, including those of Italy and France.

S&P's decision further dwindles the elite global club of countries that hold the triple-A ranking from the three main credit-ratings firms to less than 15.

Once a country loses its triple-A, it is an uphill struggle to get it back. S&P stripped Canada of its triple-A foreign currency rating in 1992 and the country didn't win it back until 2002. Australia was out of S&P's top league for even longer, from 1986 to 2003.