French, European credit ratings slashed as Greek debt talks collapse

By Alex Lantier and Barry Grey
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Standard & Poor's slashed the credit ratings of countries across Europe yesterday, including France, Italy, Spain and Austria. The same day, talks between Greece and the major financial institutions that hold its bonds collapsed over the bankers' demands for higher interest charges in return for bondholders taking a 50 percent reduction in previously held Greek debt.

Both developments represent a ratcheting up of pressure by finance capital for even more brutal austerity measures against the European working class combined with the allocation of hundreds of billions of euros in additional public funds to prop up the banks.

The two developments abruptly dashed hopes in financial circles of what European Central Bank President Mario Draghi had called a "tentative stabilization" of the European debt crisis in the first days of the new year. The downgrade of sovereign debt, especially that of France, will intensify the debt crisis of many European countries, increasing their borrowing costs and further undermining confidence in their solvency.

Since France is one of the major underwriters of the European bailout fund—the 440 billion euro European Financial Stability Facility (EFSF)—the creditworthiness of that entity is now in doubt. In its statement Friday, S&P said it would soon be issuing credit evaluations of international financial organizations, including the EFSF.

The decline in the borrowing costs of countries such as Spain and Italy at the start of the year was largely the result of a massive injection of virtually free credit to European banks by the European Central Bank at the end of 2011. The ECB extended three-year, low interest loans totaling 489 billion euros to the banks in return for highly questionable collateral, in part to encourage them to use a chunk of the money to buy bonds of embattled countries, thereby lowering their interest rates.

This represented a boondoggle for the banks, which could relend the cheap ECB cash at extortionate rates to countries such as Spain and Italy and make a fortune in the process. But the banks' purchase of new euro zone debt has evidently only increased their determination to force further cuts in government spending in order to safeguard their new investments.

The euro continued to drop Friday, hitting a 16-month low against the US dollar.

S&P lowered the credit ratings of nine countries. It removed the top AAA credit rating from France and Austria, which both fell one notch to AA+. Spain fell two notches from AA- to A, and Italy two notches from A to BBB+. S&P also cut the credit ratings of Cyprus, Malta, Portugal, the Slovak Republic and Slovenia.

S&P put all these countries on negative credit watch, except for Cyprus, indicating that it anticipates further rating cuts. Germany and the Netherlands, on the other hand, kept their top AAA ratings.

In its statement explaining the downgrade decision, S&P wrote that it expected growing popular anger across the euro zone at austerity measures that have already plunged millions into unemployment and poverty. "We believe 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 warned that "lower levels of predictability exist in policy orientation."

S&P warned of a continuing economic crisis, citing: "(1) tightening credit conditions, (2) an increase in risk premiums for a widening group of euro zone issuers, (3) a simultaneous attempt to deliver by governments and households, (4) weakening economic growth prospects, and (5) an open and prolonged dispute among European policy makers over the proper approach to address challenges."

The rating agency dismissed decisions taken at the end of 2011 by European Union and government leaders to enforce fiscal austerity across the euro zone as inadequate and even counterproductive. It characterized "the policy initiatives that have been taken by European policy makers in recent weeks" as "insufficient," specifically singling out the "outcomes from the EU summit on Dec. 9 2011." Implicitly criticizing Germany and the ECB for resisting a bigger bailout of the banks, S&P wrote that the EU agreement "does not supply sufficient additional resources."

"As such," the statement continued, "we believe that a reform process based on a pillar of fiscal austerity alone risks become self-defeating, as domestic demand falls in line with consumers' rising concerns about job security and disposable incomes, eroding national tax revenues." This was a reference to the vicious spiral of deepening recession, falling tax revenues and higher debt being experienced by Greece and threatening Spain, Italy, Portugal, France and other countries as Europe as a whole slides into recession.

What S&P, speaking in behalf of finance capital, wants, however, is not relief for the masses of people, but rather a combination of deeper cuts, labor "reforms" that wipe out all forms of job protection, privatization and deregulation, and the sell-off of state assets to private investors.

S&P threatened the newly-installed right-wing Spanish government of Prime Minister Mariano Rajoy with further credit downgrades if "either the labor reforms [i.e., attacks on labor law] or reforms of other types needed to create growth were to slow."

On France2 television, French Finance Minister François Baroin tried to downplay the impact of the credit downgrade on France and on France's deeply unpopular President Nicolas Sarkozy, who is running for reelection this year. Baroin said there would be "strong propositions" for further social cuts, though France's "structural reforms are praised" in financial circles.

Baroin implied that he wanted to dramatically slash wages in order to rebuild industry in France on the basis of cheap labor. He said, "We have one weakness, also, which is our labor costs. We must protect jobs and de-offshore the entirety of the economic structure."

The Greek debt talks collapsed after International Monetary Fund (IMF) director Christine Lagarde warned of a weak Greek economy and called for banks to take a larger loss, or "haircut," on their Greek bonds. Financiers representing Greece's private creditors—Charles Dallara of the Washington-based International Institute of Finance (IIF) and Jean Lemierre of French bank BNP Paribas—then pulled out of talks, complaining that there had not been "a constructive consolidated response" by "all parties" in the negotiations.

The IIF had agreed last October to accept a 50 percent cut in the value of Greek government bonds held by the major banks and hedge funds by accepting newly issued bonds at the lower value. However, the organization has taken a hard line in working out details of the terms of the transaction, insisting on provisions that will end up costing the Greek government more and reducing the creditors' losses.

Agreement on the terms of the "haircut" on Greek bonds is a precondition for Greece beginning to receive funds from a second bailout package totaling 130 billion euros. Greece faces a 14.5 billion euro bond redemption in late March, for which it is relying on cash from the new bailout fund. If no deal is worked out with the banks by the time of a European Union summit set for January 31, Greece could default soon after.

The *Financial Times* wrote Friday that the "unexpected breakdown" of the Greek debt talks made it "increasingly likely that Athens will become the first government of a developed country in more than 60 years to suffer a full-scale default on its debt."