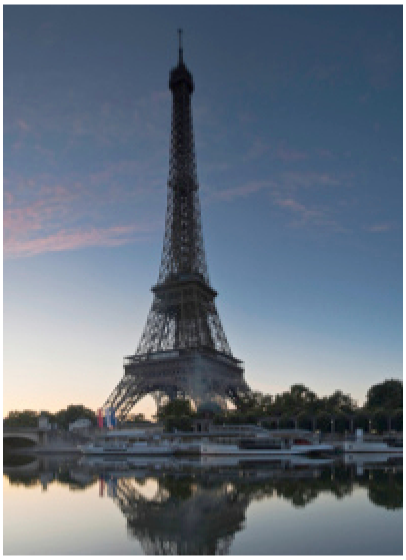
# Is France's Credit Rating the Next Domino in the Eurozone's Demise?



Two months ago, however, Italy — one of the largest economies in the world — had its sovereign debt downgraded by Standard & Poor's and then by Moody's, which reduced the bond rating for Italian government bonds by three notches. The GDP of those five nations — Portugal, Ireland, Italy, Greece, and Spain — equal about $3.7 trillion, or more than 20 percent of the economy of the European Union.

The latest news is that France could have its AAA credit rating downgraded before Christmas. Standard & Poor's is expected to make that decision imminently. The French economy is about $2.5 trillion, and if that economy is moved into the contagious disease ward of the global health hospital, then that $6.3 trillion is equal to about 40 percent of the entire European Union, and an even more sobering 10 percent of the global economy.

Belgium is also feeling the heat, and its economy is about half a trillion dollars. On Monday Moody's downgraded Belgian government bonds by two notches. This would seem a strong precursor to a French downgrade because Belgium is closely integrated into the French economy. As is true in so many other nations with serious financial problems in Europe, Belgium has an unstable government. It holds the world's record for the longest time period between holding a general election and forming a government in a parliamentary democracy. (It took parties 18 months from the time of the election to form a full-time government.) The fissure of the nation into Flemish and Walloon states remains a real possibility.

Cyprus, a relatively small economy but facing grim finances, finds itself tied to the Greek economy and also split, as it has been for centuries, by hostile Greek and Turkish populations on the island. In Cyprus, as in Belgium, if banks begin to close and bonds begin to lose significant value, it would not be too surprising if old ethnic hatreds and mistrust bubble to the surface. Fitch Ratings has already served notice that it might downgrade government bonds in Belgium, Slovenia, Ireland, Spain, Italy, and Cyprus.

Andrew Tyrie, chair of the Commons Treasury Select Committee, noted that the continued problems of Greece created uncertainty: "Few people believe that Greece can remain solvent within the eurozone. Should Greece have to leave, the recapitalization of a number of continental banks would be necessary." If French banks, which have seen their assets in the sovereign debt of Italy, Spain, Greece, and Portugal drop, are called upon to help with the recapitalization, then the French banks will have much less available credit because the credit is largely a function of assets the banks possess.

Although Prime Minister Cameron continues to stress the priority of helping the eurozone survive this unfolding crisis, British euroskeptics such as Conservative M.P. Bill Cash are blunt: “The entire European Union project is unraveling as the euro itself unravels.” The weakening of France also will inevitably rekindle some old history because the French economy is weaker than Germany’s. One analyst put it: "The overall perception is that French finances are weaker than Germany’s and this imposes significant extra costs on France." A diplomat also observed that the French electoral system was contributing: "We can only guess that what’s behind it is that they’re so nervous about losing the triple-A rating, nervous not just for political and economic reasons, but because there’s an election coming up."

The bond rating declines of nations in the eurozone mean that the amount of interest these nations have to pay, simply to service existing debt, increases even if tax revenues do not drop. Governments entering the securities markets also reduce the amount of capital available for new businesses, consumer purchases of big-ticket items, and even the normal cash flow that healthy businesses need to maintain through a line of credit with their banks.

As more bad news comes out of the eurozone (and it is almost all bad news nowadays), the more the nations of northern Europe such as Britain, Finland, and Germany, are going to have to consider a true firewall or the steady decline of the nations in trouble will pull all Europe into the maelstrom.