Moody's Warns of Possible French Debt Downgrade

Moody's summary of its annual report on France's finances appeared on Monday sufficiently couched in calm and reasoned tones that the markets took little notice: "The country's Aaa rating with a stable outlook reflects the French economy's strength, the robustness of its institutions and very high financial strength."

Further on in the report, however, ominous phrases began appearing, such as "the government's financial strength has weakened," there is now "a deterioration in French government metrics, which are now among the weakest of France's Aaa peers," and "France may face a number of challenges in the coming months – for example, the possible need to provide additional support to other European sovereigns or to its own banking system." All of this, says Moody's, is "exerting pressure on the stable outlook of the government's Aaa debt rating," especially now that the government "has less room to maneuver in terms of stretching its balance sheet than it had in 2008." But there's nothing to worry about, as "Moody's will monitor and assess the stable outlook" over the next three months.

One of the "metrics" Moody's will be watching carefully is France's Gross Domestic Product (GDP) to see if it will reach the lofty estimates offered by the government. French Finance Minister Francois Baroin admitted that the target of 1.75% growth *for the whole year of 2012* was likely a bit optimistic, and the real number would come in much closer to 1.0%, if that. Said Baroin, "We need to keep cool heads and adapt to the economic situation. We will be there to defend the triple-A."

Another metric Moody's will be watching is the inexorable climb upwards of France's ratio of its debt to its GDP. Currently at 86.8%, it will increase to just under 90% next year under the most favorable circumstances.

When Moody's downgraded two of France's three largest banks last month, Credit Agricole and Societe Generale, the head of France's central bank, Christian Noyer, called the downgrade "[relatively good news](#)," noting that "It's a very small downgrade, and Moody's had a higher rating than the other agencies so it's just put them on the same level or slightly better than the others." In a radio interview, Noyer said

> French banks have an excellent rating, the same level as other major European banks HSBC, Barclays, Deutsche Bank, Credit Suisse. There's no really bad news on the way, and Moody's says the level of capital of French banks allows them to absorb any potential losses on sovereign debt.

The markets think otherwise. Societe Generale's common stock was valued at $74 a share as recently as May – it now trades at $26. Credit Agricole changed hands at $17 per share back in May as well – it recently closed at $6.85 per share, declines of 65% and 59% respectively. So the markets are ignoring the "nothing here, just move along" noise from the insiders, and selling off their positions before suffering further losses.

As Moody's said in its report on French sovereign debt, one of the metrics they're watching is the stability of the banks. But if the banks continue to crater, where does that leave the government debt? As William Watts noted at *Marketwatch*, "A hit to France's credit rating would leave Germany to shoulder a potentially unbearable burden in financing future bailouts." And an analyst at KBC Bank in Brussels was even more direct: "If France would lose its top rating, the EFSF's (the new bailout facility funded by French and other governments' central banks) top rating would also be at risk together with the EMU's (European Monetary Union) grand master plan."

This is watching a waterfall in slow motion, denied by the elites but understood by those who lent money to deadbeat nations like Greece, Italy, Spain and others. It's also increasingly becoming understood by the lender of last resort: the taxpayer. As Ayn Rand so eloquently expressed it, "One can ignore reality but cannot ignore the consequences of ignoring reality."

Photo: A branch of the Banque de France in Paris