Downgrade of France's credit rating dashes uplifting week for eurozone
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Unexpectedly successful bond auctions for Spain and Italy and additional lending from the European Central Bank generated speculation about a turnaround - until S&P announced it had downgraded France.

A downgrade of France's triple-A credit rating brings not just a sour note but mild shock waves inside Europe's financial capitals, coming at the end of a week that seemed to bode well for chances of staunching the eurozone crisis.

The ratings agency Standard and Poor's is preparing to drop France's rating to double-A+, confirmed this evening by Finance Minister Francois Baroin, who said it "is not good news," but noted that the reduced rating will match that of the US, downgraded last summer following a standoff on raising the debt ceiling.

The downgrade raises the question of whether the eurozone can rely entirely on the German-led prescription of austerity to battle a debt crisis that turns three years old this month.

A lower rating will likely mean higher borrowing rates for France, the No. 2 economy in Europe. The rating may also decrease confidence in France's guarantees to the European Financial Stability Fund, created in 2009, which has been used to help bail out Greece, Portugal, and Ireland and to bolster a "firewall" to stop the European debt crisis fire from spreading to the core EU countries.

The rating also raises the hurdle for French President Nicolas Sarkozy, who is fighting an uphill battle in the polls ahead of national elections this spring.

The downgrade was not entirely unexpected - Standard and Poor's warned France and several other European countries at the end of last year about a potential downgrade - but its timing dashes a rare moment of optimism in Europe.

The economic significance of the downgrade may be secondary to what it implies about faith in eurozone leadership, some say.

"This is more a downgrade of the eurozone's management of the crisis," argues Sony Kapoor, of the Brussels-based economic think tank Re-Define.

"The impact of the ratings downgrade may be limited by the fact that many investors use an average of ratings and Fitch and Moody's have maintained higher ratings on countries such as France, for now," he added.

'Tentative' hope

Spain and Italy managed to pull off robust sales of their bonds this week at surprisingly favorable terms. Italy's new leader, Prime Minister Mario Monti, has gone hammer-and-tong at his country's debt, books, unpaid taxes, and structure. Unlike his predecessor, Silvio Berlusconi, he seems engaged and knowledgeable, which seems to have given investors confidence.

Meanwhile, the European Central Bank gave signs of "tentative" hope for reversing the euro crisis. Nearly $632 billion went out the side door of the ECB last month, bound for Europe's banks.

Sarkozy, and later Italy's Mr. Monti, met this week with German Chancellor Angela Merkel amid new talk in Berlin of the need for growth policies to match austerity measures.

Also salutary was the holiday break from constant eurozone crisis meetings throughout 2011 - held as Ireland and Portugal, and then Greece and Italy, sank, and malaise and debt servicing rates rose across the Continent. Each of those meetings promised to solve the debt crisis, but within 24 hours the markets typically realized they did not and responded accordingly.

After the sale this week of some $28 billion in Spanish and Italian bonds - nearly twice the catch that financial fishers expected - the Financial Times quoted Peter Schaffrick of the Royal Bank of Scotland saying that the eurozone "could be entering a more positive feedback loop."

It's far from over

At the outset of 2012, economists warned of a tough road ahead, noting slowing growth in Europe's economic engine, Germany, and a startlingly steep need in the EU to raise roughly $2.4 trillion in loan paybacks in coming months.

Beyond the numbers, there's a deeper concern that under the "German doctrine" of austerity, eurozone countries are drifting further apart, rather than becoming more fiscally united.

**There's a lack of what the eminent Paris economist Jean Paul Fitoussi calls "team spirit" - a sense that "we are in this boat together," as Mr. Fitoussi put it to EU prime ministers and finance ministers at a conference in Paris last week.**

**The Monitor caught up today with Fitoussi, who hangs out with economists such as Amartya Sen and Joseph Stiglitz. He does not think the euro crisis is over.**

**In a brief interview, he cited the lack of a serious growth policy under the "German doctrine" that requires states to "raise taxes and decrease spending." European banks are not buying public bonds, he notes, "and are saying they are not buying them," as the French bank Societe Generale announced this week. Nor is the $632 billion lent last month by the ECB to European banks being re-lent.**

**"Banks are not lending to the private economy, or to states, and there is a rampant credit crunch in Europe," he said. "I don't see an instrument of growth. The one thing that could promote growth, eurobonds, Germany doesn't want to contemplate. Today, if a bank buys public bonds they are exposed. What has now happened is that public bonds are no longer risk-free. That was their allure. But there is no protection in the market for public bonds any longer and no state has a central bank to rely on."**

**Fitoussi said the "fiscal unity" pact that EU leaders agreed on in December, which tightened the rules of behavior for members. Fitoussi finds it unrelated to the immediate problems facing the eurozone.**

**"The specific decisions in December had nothing to do with banking crisis, financial crisis, or the sovereign debt crisis. They don't actually encourage fiscal unity, but fiscal separation. Making each member states follow rules that keep them separate at a time they are already in trouble ... there is no analytical reason why this is an answer to the present problem."**