French bank shares crash as European debt panic spreads to France

Pierre Mabut, Alex Lantier
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France's banking sector and economy were the latest casualties of the wild swings on world financial markets and growing financial speculation against European government debt, amid the aftershocks of Standard and Poor's downgrading of the US credit rating.

President Nicolas Sarkozy called his ministers back from holiday for an emergency meeting of his cabinet Tuesday night—together with Christian Noyer, the head of France's Central Bank—amid a continuing collapse of the French CAC-40 stock index. It fell 4.68 percent that day. The meeting ended Wednesday morning with the announcement of further social cuts to be revealed in budget plans to be published on August 24.

French Finance Minister François Baroin said, "Whatever the impact of global uncertainty, or the S&P's downgrade of America's debt, or the turbulence of the markets, we will take the necessary steps."

The same day, however, the CAC-40 fell another 5.45 percent, as French bank shares were hit by panic selling. The sell-off occurred after the British *Daily Mail* tabloid published a report suggesting French bank Société Générale (SG) was "on the verge of collapse"; its profits had fallen 31 percent in the second quarter, to $1.07 billion. SG shares fell 21 percent before recovering partially. Crédit Agricole fell 13 percent and BNP Paribas fell 10 percent.

Speculators are worried about the overexposure of French banks to Greek and now Italian and Spanish debt. According to the Bank for International Settlements, French banks are exposed to €410 billion of Italian debt, making them the most exposed banks in Europe to the debt crisis in southern Europe.

In recent weeks the credit markets have driven up the interest rates Italy and Spain pay on their debt to over 6 percent, threatening to bankrupt the two governments. With French banks alone holding more of their debt than the entire €440 billion European Financial Stabilization Facility, a default by Spain and Italy would likely bankrupt the French financial system.

There are also signs that speculators could target French public debt. Though credit-rating agencies recently confirmed that France's AAA credit rating is safe, there are mounting rumours that France could become the next leading economy after the US to lose its AAA rating due to soaring debts. French public debt stands at €1.65 trillion, nearly 84 percent of GDP—compared to 64 percent in 2007, before the outbreak of the world financial crisis.

Under these conditions, French financiers and government officials are insisting that the European Central Bank (ECB) print money to be loaned out to the Italian and Spanish governments via private banks. However, there are doubts about whether Berlin will tolerate such a policy in the long term, fearing its inflationary effects. Last month a German court in Karlsruhe began hearing a challenge to the constitutionality of the European bailout schemes.

Paris also announced that Sarkozy will meet with German Chancellor Angela Merkel on August 16. Baroin stated "the profound conviction of the president and, I believe, the German chancellor is that the status quo is no longer possible." The minister guaranteed investors that "at the end of summer there will be strong proposals from the Franco-German axis on the modernisation of the governance of the euro zone."

These meetings will no doubt be extremely tense. When Sarkozy saw Merkel as unwilling to accept a German bailout of Greece last year, he reportedly threatened to pull France out of the euro.

Financial panic is spreading amid signs of a continuing economic downturn throughout Europe. According to the INSEE national statistics agency, the French economy posted zero growth in the second quarter. Eurostat, the EU's statistics office, reported that industrial production across the 17-country euro zone fell by 0.7 percent and confirmed the INSEE's finding of economic stagnation in France.

Key to French economic weakness was a renewed contraction in spending by the population. Commenting on the French economic situation, Jennifer McKeown, an economist at Capital Economics in London, said: "As for France itself, Q2's 0.7 percent drop in consumer spending was the sharpest in nearly 15 years, suggesting that the household sector can no longer be relied upon to support the economy."

Under conditions where the French economy is already sliding, the new attacks the government is preparing against the working class will only worsen the economic situation.

In France as in the United States—where they are demanding cuts to entitlement programs such as Medicare and Social Security—the credit rating agencies are demanding brutal social cuts. In a June report, S&P wrote : "If French authorities do not follow through with their reform of the pension system, make additional changes to the social-security system and consolidate the current budgetary position in the face of rising spending pressure on health care and pensions, Standard & Poor's will be unlikely to maintain its AAA rating."

The minister for the budget, Valérie Pécresse, declared the government would not budge "one iota" from its commitments to deficit reduction. To reassure the markets, Sarkozy has also been campaigning for a "Golden Rule" balanced budget amendment to the French constitution—bringing it into line with German law.

France's entire political establishment is rushing to support Sarkozy's budget cuts. The opposition Socialist Party is clamouring for the budget deficit to be cut immediately to 3 percent, so that France would not wait for the "Golden rule" to take effect in 2013. Francois Hollande, the current frontrunner for the party's presidential candidacy, commented, "the golden rule, it's for 2013. The credibility criteria now is the 2012 budget."