S&P Puts 15 Euro Nations on Watch for Downgrade Amid Sovereign-Debt Crisis

By Mark Deen & Ben Livesey - 2011-12-06T00:21:45Z

Standard & Poor's said Germany and France may be stripped of their AAA credit ratings as the debt crisis prompts 15 euro nations to be put on review for possible downgrade.

The euro area's six AAA rated countries are among the nations to be placed on a negative outlook, and their credit ratings may be cut depending on the result of a summit of European Union leaders on Dec. 9, S&P said today in a statement. The euro reversed its gains and U.S. Treasuries rose earlier today after the Financial Times reported that the credit-ranking firm planned to reduce six AAA outlooks.

"Systemic stress in the eurozone has risen in recent weeks and reached such a level that a review of all eurozone sovereign ratings is warranted," S&P said in a statement.

The downgrade warnings come as German Chancellor Angela Merkel and French President Nicolas Sarkozy push for a rewrite of the EU's governing rules to tighten economic cooperation in a demonstration of unity on ending the debt crisis. With the fate of the currency shared by the 17 euro countries at risk, Merkel and Sarkozy presented a common platform for a Dec. 8-9 summit of EU leaders in Brussels that aims to halt the crisis now in its third year.

"The S&P move is yet another signal that euro area countries must take decisive action to deal with the crisis or else the problems will spread from Greece and others with the most acute fiscal problems to the rest of the euro zone," said Phillip Swagel, a professor of economics at the University of Maryland's School of Public Policy who was an assistant Treasury secretary for economic policy in the George W. Bush administration. "It is time for Germany and France to act -- either to save Greece and the others or to let them fail."

Germany, Belgium

The firm said that ratings could be cut by one level for Austria, Belgium, Finland, Germany,

Netherlands and Luxembourg, and by up to two notches for the other governments.

The other countries warned were Estonia, France, Ireland, Italy, Malta, Portugal, Slovakia, Slovenia and Spain, according to S&P. The company said it maintained the negative outlook for Cyprus, and Greece wasn't put on "creditwatch."

The euro pared gains against the dollar, trading at $1.3401 per euro at 5:01 p.m. in New York after rising as high as $1.3487.

In a joint statement, the governments of France and Germany said they "recognize" the move by S&P and "affirm their conviction that the common proposals made today will strengthen coordination of budget and economic policy, and promote stability, competitiveness and growth."

S&P roiled global equity, bond, currency and commodity markets on Nov. 10, when it sent and then corrected an erroneous message to subscribers suggesting France's rating had been downgraded.

Stability Facility

Downgrades of Germany and France would affect the rating of the European Financial Stability Facility, the bailout fund for struggling euro member countries that has funded rescue packages for Greece, Ireland and Portugal partially through bond sales. If the EFSF has to pay higher interest on its bonds, it may not be able to provide as much funding for indebted nations.

Yields on EFSF 3.375 percent bonds due in July 2021 2 basis points, snapping a five-day rally, to 3.6 percent, according to Bloomberg prices.

"Negative news is going to continue to spur rallies in the Treasury markets, at least until the ECB steps in to end this mess once and for all," Guy LeBas, chief fixed-income strategist at Janney Montgomery Scott LLC in Philadelphia, said before the announcement. "With the euro currency in a state of flux, the U.S. markets remain the only true safe haven."

U.S. Downgrade

S&P downgraded the U.S.'s AAA credit rating by one level to AA+ for the first time Aug. 5, citing the nation's political process and criticizing lawmakers for failing to cut spending or raise revenue enough to reduce record budget deficits.

Investors nevertheless sought Treasuries after the S&P rating cut sparked financial market turmoil. Treasuries gained 6.4 percent last quarter, their best performance since the last three months of 2008, according to Bank of America Merrill Lynch index data.

The rating company's decision on the U.S. was flawed by a $2 trillion error, according to the Treasury Department. S&P disputed the Treasury's assertions and said using the department's preferred spending measures in its analysis didn't affect its credit grade.

Moody's Investors Service and Fitch Ratings affirmed their AAA credit ratings on Aug. 2, the day President Barack Obama signed a bill ending an impasse with lawmakers over raising the nation's debt ceiling.

Federal Reserve Chairman Ben S. Bernanke said Treasury securities remain a core holding for investors. “The downgrade didn’t scare off any investors,” and the action, along with the prospect of other downgrades, hasn’t done “significant damage” to the economy, Bernanke said at a Nov. 10 at a town-hall-style event in El Paso, Texas.

German bunds are underperforming Treasuries for the first time since the European debt crisis began in 2009.

Best-Performing

Treasuries due in 10 years or more are 2011’s best- performing sovereign securities, returning 26 percent as of Nov. 30, according to Bloomberg/EFFAS indexes. German 30-year bunds yielded more than their U.S. peers last month for the first time since May 2009 as the government was only able to find buyers for 65 percent of a 6 billion euro ($8.1 billion) offering on Nov. 23, its worst auction in 16 years.

Credit-default swaps tied to France climbed 4 basis points on Dec. 2 to 196 basis points, while contracts insuring against a default on Germany’s debt were about unchanged 97 basis points, CMA data show. That compares with 51 basis points for credit swaps on the U.S. and 90 basis points for the U.K.

A basis point on a credit-swap contract protecting $10 million of debt for five years is equivalent to $1,000 a year. Swaps pay the buyer face value in exchange for the underlying securities or the cash equivalent should a borrower fail to adhere to its debt agreements.

Bond yields of countries stripped of their AAA ratings since 1998 have historically been little changed following the credit grade change, according to an Oct. 28 report from JPMorgan Chase & Co. analysts led by Terry Belton, global head of fixed-income and foreign-exchange research. The yield on 10- year Japanese government debt rose 10 basis points the week after it was cut to Aa1 by Moody’s in November 1998. The interest rate declined 3 basis points following the cut by S&P to AA+ in February 2001.

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Downgrades of Germany and France would affect the rating of the European Financial Stability Facility, the bailout fund for struggling euro member countries that has funded rescue packages for Greece, Ireland and Portugal partially through bond sales. Photographer: Jacques Demarthon/AFP /Getty Images