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France fights pressure to recapitalise banks

By Hugh Carnegy in Paris

Nicolas Sarkozy, who will be in Berlin on Sunday for euro crisis talks, must have winced when he heard Angela Merkel, the German chancellor, say on Wednesday that her government was prepared, if necessary, to recapitalise the country's banks.

The French president, his ministers and officials have stuck rigidly to the exact opposite line through the past few torrid months of crisis – that France's banks do not need recapitalisation, despite being under constant attack in the financial markets for their heavy exposure to risky eurozone sovereign debt.

Paris held on publicly to the same mantra again on Thursday when it denied a report in *Le Figaro*, a French newspaper, that the government was preparing plans to take stakes in the banks.

The centre-right government insists the banks are stable, based on plans set out by the big three – [BNP Paribas](#), [Société Générale](#) and [Crédit Agricole](#) – to meet minimum capital requirements under Basel III regulations by 2013, six years ahead of deadline.

And the banks themselves are keen to avoid state equity injections, which would likely be dilutive to shareholders.

Lurking in the background is the issue of France's triple-A sovereign debt rating, described recently by one minister as an "essential asset" and which the government is determined to retain. It potentially could come back under scrutiny if the state had to put large amounts of new funding behind the banks.

For Mr Sarkozy, battling not just the eurozone crisis but economic stagnation at home and trailing badly in the polls before April's presidential election, that is a prospect he will not want to contemplate.

The issue has become more acute this week with the near-collapse of Dexia, the Franco-Belgian bank which Paris – along with the Belgian government – has pledged to prop up with state guarantees.

François Fillon, the prime minister, angrily condemned as irresponsible suggestions from Laurent Fabius, one of his socialist predecessors, that the Dexia rescue could have implications for the triple A rating.

But while Mr Fabius may have been guilty of mischief-making, the issue of France's rating is highly sensitive for Mr Sarkozy and his government, given the vulnerable state of public finances.

Public debt is set to rise to 87.4 per cent of gross domestic product next year and debt repayments now make up the biggest single item in the government's annual spending. France does not want to risk the likely rise in borrowing costs that the loss of triple A would cause. The plan to reduce the budget deficit to the official eurozone limit of 3 per cent by 2013 could be knocked off course, and with it the credibility of Mr Sarkozy's economic recovery programme.

Paris accepts that the eurozone must soon implement a programme of bank recapitalisation to help stem the crisis. It also accepts that the banks will probably have to shoulder a greater burden of the cost of bailing out Greece than the 21 per cent "haircut" on Greek debt written off on their books. But it remains reluctant to accept national-level recapitalisations, arguing that they should be organised through the nascent European financial stability facility, which gets new powers under the July 21 eurozone bail-out agreement for Greece.

"This European fund will be there to aid the states to recapitalise the banking institutions which wish it," said François Baroin, the finance minister, on Wednesday.

But with France's position on this strongly challenged elsewhere in the eurozone Paris may find itself forced to act.

The nearest any senior official came to suggesting that Paris has a contingency recapitalisation plan was when Christian Noyer, governor of the Bank of France, said in a newspaper interview last month that the support mechanism set up to bolster the banks in 2008 was still in place in case of an "extraordinary event".

That scheme made €360bn (\$483bn) available to the banks of which €40bn was for strengthening capital. The six biggest banks took a total of €21bn then in subordinated loans and preference shares. Analysis by JPMorgan suggests that, under stress test scenarios, a similar sum could be needed this time around by the big three alone.

Christophe Nijdam, a bank analyst at Alphavalue in Paris, said state capital injections on a 2008 scale would not be problematic for the triple A rating. But a problem would arise if the scale of guarantees, coupled with guarantees to Dexia, were similar to those of 2008, potentially pushing up the public debt burden above 100 per cent.

"The risk to triple A comes from having to guarantee large amounts of liquidity, not just from cash injections," he said.

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