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Paris prepares for Greece


By [David Brierley](#)


Sited in 12th arrondissement at Bercy, Paris, the French ministry of finance is [a post-modern tribute](#) to the arch.

Its massive arches give the ministry the appearance of a viaduct, a bridge or a pier. Indeed, at one end, it stamps its presence on and into the Seine. It was, probably, conceived as a symbol of communication and openness, reflecting the nature of modern markets and finance.

It was here that France's five leading banks met Sept. 11. They had a great deal to discuss given the massive loss of confidence they faced on international bond, equity and dollar money markets concerned about their funding and sovereign exposures.

This secret meeting has since become an open secret.

The French government [reportedly offered to](#)  [recapitalize the banks](#) with €10 billion to €15 billion while other options were discussed. These included the merger of [BNP Paribas SA](#) with [Société Générale SA](#), the issuance of state loans, the injection of preference shares or, indeed, full nationalization.

Frédéric Oudéa, the CEO of SocGen, is said to have accepted state support on the basis that others would do so too. BNP Paribas reportedly refused to "share the blame," although the bank was not above searching for a capital injection from Middle East investors. That, too, was  [another story never totally denied](#).


But despite all appearances to the contrary and the Bercy meeting, France is not about to recapitalize its banks.

"There is no [recapitalization] plan and, besides, we do not need one," said Christian Noyer, governor of the Bank of France, [in a weekend interview](#) published Sept. 24. He added, however, that there was the mechanism created in 2008 at the time of the Lehman crisis which would allow the Bank of France to subscribe to fresh bank capital "if the banks express the need."

Moreover, Noyer insisted that the French banks "are very solid." They are not hiding toxic assets and they can absorb Greek sovereign risk with "less than one quarter's profits," he said.

Jean-Francois Sammarcelli, deputy CEO of SocGen, [agreed a couple of days later](#) in an interview: "There is strictly no need to recapitalize the French banks, neither SocGen nor our French peers. ... SocGen has €40.6 billion in equity. By memory, at the end of 2007, we had €21 billion in equity. This has doubled, while during the same period we reduced our risks. There is thus no secret plan of the state to recapitalize the banks with €15 billion."

This figure does not just represent a rumor but also corresponds broadly to the €15 billion to €20 billion estimated by JPMorgan to be required by the French banks.


Reeling from the  [impact of weeks of uncertainty](#) and heavy selling of their shares, the leading French banks are responding; they are improving their liquidity and solvency by shrinking their balance sheets and reducing their short-term dollar funding needs.

The withdrawal of U.S. wholesale funding from Europe over the summer is thought to have created some temporary liquidity problems, particularly in France, which led the ECB and the Fed to operate the dollar-euro swap scheme envisaged for such purposes. French banks are thought to have availed themselves of the facility.

Jean-Paul Chifflet, CEO of [Crédit Agricole SA](#), presented Sept. 28 the bank's response to "a challenging economic environment" to investors. Chifflet insisted the bank had adapted well to the loss of U.S. money-market funds, and that short-term debt had been cut from €170 billion to €145 billion within less than three months. Moreover, its medium-term financing had gathered pace while the financing needs of the business were being reduced. This deleveraging would result in "accelerated disengagement," with the disposal of loan portfolios and withdrawal from certain businesses.

The strategy is being followed by all the French banks, although asset sales in the current climate are difficult and prices are [likely to be depressed](#). The overall aim is to comply with Basel III capital requirements by 2013.

To that end, BNP Paribas is to cut its risk-weighted assets by €70 billion. Baudouin Prot, BNP CEO, insisted Sept. 21 that the bank needed no extra capital but admitted it might withdraw from [certain lines of business](#).

SocGen is doing just that. It  [evidently](#) intends to sell Newedge USA LLC, the U.S. derivatives and brokerage business jointly owned with Credit Agricole, and also aims to sell assets worth €4 billion to shrink its balance sheet. It might also sell Société Générale Securities Services. Newedge is the biggest commodity broker in the U.S. and has "a big, big balance sheet," one source told Reuters. "Overall it's a reduction plan that is not too far from what BNP and SocGen offered," said analyst Alex Koagne, analyst at Natixis, [to Reuters](#).

Not everyone sees that French banks' restructuring of their balance sheet and improving their liquidity as delaying an inevitable capital raise.

Christophe Nijdam, analyst at AlphaValue, told SNL: "There is no problem of a lack of equity in my opinion. The markets have sold the bank shares strongly because they were worried about liquidity and solvency. Now the French banks have decided to reduce their assets and shrink their balance sheets in response to the markets' concerns."

Nijdam called this action "the best response," noting that it "meets market demands that the banks should raise their equity level; it also increases their liquidity while strengthening their balance sheet."

The analyst added, "They do not have a choice. In the current market of depressed share prices, raising capital makes no sense at all. Divesting a subsidiary or a business activity takes time, while reducing the trading book is not difficult, selling U.S. treasury bonds can be done instantly. We have seen the shares recover strongly in response to the plans in the last few days although they have fallen back slightly today."

Pierre Flabbée, analyst at Kepler Capital Markets, noted to SNL that "much will depend upon how the markets react to the plans for Greece." However, he cautioned, "I do not see the markets turning round 180% and losing their pessimism. From my point of view, there is a high probability that there will be a recapitalization by the end of the year. It will all be played out in the next few weeks."

Flabbée said that a possible recapitalization of the banks will depend on "what happens in the sovereign and wholesale debt markets."

If the access of the banks to wholesale debt markets continues to be shut, if the rescue of Greece does not bring down yields, then Flabbée thought that there could be range of measures to inject capital into Europe's banks. He did not see France acting alone and pointed to recent comments made in Brussels that it was accepted European governments might help banks again, as after the subprime crisis.

"The question is the level of stress of the European banking system on the capital markets," Flabbée observed, remarking that shrinking the banks' balance sheet would probably not suffice to reassure markets.

"There is an acceleration of the reduction of the banks' balance sheets, but that will take several years," Flabbée said.

The analyst insisted that the French banks were well able to sustain write-offs on Greek debt, and that there were many other factors, notably uncertainty about the sovereign debt of the periphery, which had led to the sell-off of French bank shares.

He observed that the loss on Greek debt even for BNP Paribas, among the most exposed French banks, would only account for half the profits from one quarter. Moreover, it would have been "impolitic" for the French banks to have written down their bond holdings to market given their participation in the Greek rescue plan; that would have implied they anticipated the rollover plan would not work.

Indeed, this rollover plan looks set to be overtaken by events. Markets accept that Greece will default and, indeed, observers believe that it is likely to happen sometime this year. To prevent contagion spreading, the Bank of France would presumably be ready to inject capital into all French banks. The widely anticipated European alternative would be for an enlarged European Financial Stability Facility to do so; the banking team at UBS has suggested the use of subordinated debt and EFSF guarantees on new unsecured bonds. This would prevent the effective nationalization of Europe's banks and might, just might, enable them to access wholesale markets at reasonable rates and on a sufficient scale in the near future.

That problem persists not just for Bercy, and not just for French banks.