Business

Greek credit rating cut to lowest rank

Athens sharply protests S.&P.'s 3-notch drop on expectation of default

FROM NEWS REPORTS

The rating agency Standard & Poor's cut Greece's credit rating by three notches on Monday to the lowest level of any sovereign nation, saying that the downgrade reflected the agency's view that Greece was likely to default on its debt.

The step drew an immediate and sharp rebuke from the Greek Finance Ministry, which said that the rating agency was overlooking "intense" deliberations to solve the country's debt problem.

The downgrade from B to CCC, with a negative outlook, reflects "our view that there is a significantly higher likelihood of one or more defaults" as Greece tries to close financing gaps, S.&P. said.

No other sovereign nation is graded as low as CCC by S.&P., a spokesman for the rating agency said by e-mail. Moody's Investors Service cut its rating for Greece on June 1 to Caa1, one level above the comparable S.&P. rating; only Ecuador is a worse sovereign risk, according to Moody's.

The price of credit-default swaps for Greek, Irish and Portuguese debt surged to record levels on Monday on concern that the struggles by the governments of those countries to resolve their budget deficit problems would threaten their ability to pay off their debts.

The yield difference, or spread, between 10-year German bunds and Greek securities of a similar maturity was at 14 percentage points on Monday, close to a record. The spread reflects investor perceptions of the greater risk of holding Greek debt compared to German debt, the European benchmark for safety.

"The ratings agencies are now playing catch-up with the market," said Gianluca Salford, a fixed-income strategist at JPMorgan Chase in London. "The market is pricing in a very high probability that there will be a credit event around Greece. The agencies are just catching up to the negativity that's already priced in by the market, not the other way around."

The rating cut came days after the Greek government unveiled an austerity program aiming to save around €28 billion, or $41 billion. The program is seen as essential in securing the fifth installment of a €110 billion bailout package agreed on in May 2010 with the European Union and the International Monetary Fund.

S.&P. said that the risks associated with the bailout were "rising, given Greece's increased financing needs and ongoing internal political disagreements surrounding the policy conditions required."

The Greek crisis has led to a battle between the European Central Bank and Germany over how to bail out Athens and whether officials should push Greece's creditors to share some of the costs.

Greece said Monday that the S.&P. downgrade discounted intense efforts by the European Union and the International Monetary Fund to find a viable solution to the country's debt crisis.

"The decision also overlooks the government's moves to avoid any problems relating to Greece's contractual obligations as well as the will of all Greeks to plan our future inside the euro zone," the Finance Ministry said.

The government's latest austerity plan will be voted on by the end of the month and makes even more specific commitments "with the aim of continuing the fiscal effort," the Finance Ministry said.

S.&P. held its recovery rating for Greece at 4, indicating that it estimated that bondholders would recover 30 percent to 50 percent of their investment.

A "financing gap has emerged in part because Greece's access to market financing in 2012 and possibly beyond, as envisaged in the current official E.U./I.M.F. program, is unlikely to materialize," S.&P. said.

The E.C.B. president, Jean-Claude Trichet, said Monday that his advice to E.U. governments was to "avoid what would be a compulsory concept" and "avoid whatever would trigger" a default. (AP, BLOOMBERG, REUTERS)

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E.U. delays surgery with painkillers

Paul Taylor

INSIDE EUROPE

PARIS "When will the euro zone debt crisis end and how will we know it?"

A reader's e-mailed question cuts through the daily dramas of the financial soap opera that has kept European investors glued to their screens for the past 19 months, threatening to wreak wider global turmoil.

E.U. policy makers are so busy building firewalls within the 17-nation common currency area and devising temporary fixes to avert immediate [illegible]aster that scant thought is being [illegible]en to how the story might end.

Next week, E.U. leaders are likely to buy a little more time by approving a second bailout for Greece, barely a year after Athens was granted an initial €110 billion assistance program, worth $158 billion at current exchange rates, from the European Union and the International Monetary Fund.

In Britain in the 1970s, under Prime Minister Harold Wilson, this approach became known pejoratively as "muddling through." The European Union prefers to dress it up in grand phrases like "comprehensive package" and "permanent crisis-resolution mechanism," but it isn't a solution.

Funding fatigue is growing in the North European creditor countries, especially Germany, the Netherlands, Finland and Austria, just as austerity fatigue is mounting in Greece.

Yet all the indications are that E.U. policy makers have no more of a clue about the endgame than my questioner does. No one in Brussels, Berlin or Frankfurt even pretends to believe that the new package will solve the problem of Greece's debt, already at 150 percent of annual gross domestic [illegible]

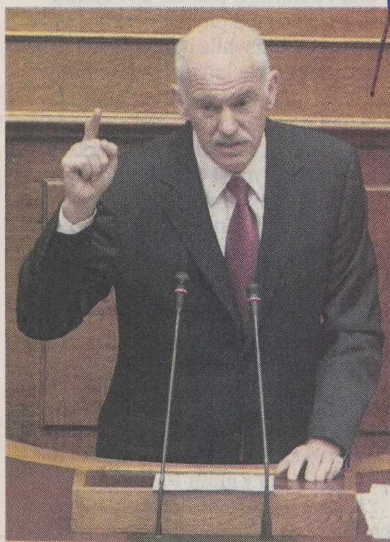
Since Athens is unable to return to the capital markets for the foreseeable future, contrary to its initial rescue plan, lending more taxpayers' money under draconian austerity conditions is seen in Europe and Washington as the least worst alternative.

"We must win time with a new package," Finance Minister Wolfgang Schäuble of Germany told skeptics in Parliament last week, acknowledging doubts about Greece's ability to repay its debt.

At German insistence, private bondholders are likely to be arm-twisted into "voluntarily" extending their exposure to Greek government debt for as long as seven years. Two-thirds of that money is likely to come from Greek banks, which depend totally on European official support and have no real choice.

By insisting that all new sovereign bonds issued after 2013 carry a clause making investors liable to share losses in case of default, Berlin has made it even harder for Greece to return to the capital markets, starting in 2014.

In private conversations, the most optimistic European officials say the second bailout may keep the show on the road until mid-2012. Pessimists say it may hold the crisis at bay only until after this summer.



ALEXANDROS VLACHOS/EPA

Prime Minister George A. Papandreou faces austerity fatigue among Greeks.

"We have no guarantee that the help is over in four years," said one euro zone minister, speaking on condition of anonymity. "We have no guarantee that help is over in seven years."

"For us ministers, it is less of a danger if we are creating help before a default, compared with the situation where we have to help after a default," the minister said.

Despite the bailout-of-the-bailout, most economists say Greece faces a harsh debt restructuring in the years ahead, with substantial losses for both private investors and taxpayers.

Yet, as the same euro zone minister said, no one is discussing such a default at the political level because leaders would then have to admit they had wasted voters' money.

The next danger may lurk in Greece's banks, where a steady leakage of deposits could turn to a hemorrhage if savers get frightened and put their euros under the mattress or offshore.

Or it may lie on the streets, where a spontaneous youth protest movement, drawing inspiration from the Arab Spring revolts, poses a growing challenge to Prime Minister George A. Papandreou's ability to enforce harsher austerity measures.

Taken together, Greece, Portugal and Ireland account for just 6 percent of the euro zone's economy, and only Greece threatens to implode imminently.

Thomas Mayer, chief economist at Deutsche Bank, compares the effect of the Greek crisis on the euro zone to a bout of appendicitis: acutely painful but usually harmless if surgery is swift.

If an inflamed appendix is not treated decisively, however, and infection spreads, it can be deadly. For now, the European Union seems determined to give the patient more painkillers rather than take the scalpel to its swollen debt.

By 2014, when the second bailout is due to expire, euro zone governments, the International Monetary Fund and the European Central Bank will hold a majority of Greek debt in circulation. At that point, they will face a choice between a radical write-down that will hurt their own taxpayers and shareholders and some form of European mutualization of the debt stock and common debt issuance by the euro zone.

So far, Germany has vehemently rejected such a solution as a "transfer union" in which the fiscally virtuous would pay for the profligate. But in a few years, perhaps after the next German election, it may appear to be the least unattractive option.

The simple answer to my reader's question is that we will know the crisis is over when we know who is going to buy Greek bonds after 2013. Don't hold your breath.

Paul Taylor is a Reuters correspondent.

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