53

KERMIT'S BACK
MUPPETS IN TH
ERA OF PIXAR

PAGE 11 | CULTURE

22/11/011

Crisis strikes ever closer to the center of Europe

BRUSSELS

Warning on French debt threatens to derail plans to beef up rescue fund

BY STEPHEN CASTLE
AND DAVID JOLLY

Financial markets tumbled Monday as sharply divided European leaders faced multiplying signs that the debt crisis was striking at the heart of the euro zone.

A major credit agency warned Monday of a cut in the top-grade rating of France was one factor in a more than 3 percent slide in many of Europe's major indexes. Markets in the United States were also falling sharply, in part because of the failure of a congressional supercommittee to reach agreement on trimming the deficit.

Amid the turmoil, a feasibility study on the creation of euro bonds — an idea increasingly promoted as the best way to solve the crisis — drew comment from European politicians. Euro bonds, securities that would be backed by all 17 members of the euro currency union, are not expected to provide a short-term fix to the problem, José Manuel Barroso, president of the European Commission, said Monday in Brussels. "We are not linking the proposals to the situation we have been discussing today," he said. "We believe that when there is the appropriate levels of integration and discipline it makes sense to have some kind of stability bonds in Europe."

The ratings agency Moody's Investors Service on Monday said that rising borrowing costs and a deteriorating economic outlook was putting pressure on France's creditworthiness. Moody's, which in October warned that it could put France's top-notch credit rating on review, has maintained France's triple-A rating so far, as have the other major ratings agencies.

"This crisis is hitting the core of the euro zone," Olli Rehn, the European commissioner for economic and monetary affairs, said Monday. "We should have no illusions about this."

Financial markets appear to echo that sentiment. "We suspect this spells the death of 'muddle through' as market pressures effectively force France and Germany to strike a momentous deal on fiscal union much sooner than currently seems possible," said a note from analysts in London for Credit Suisse.

The idea of France losing its triple-A rating would have implications beyond Paris. It would signal that the euro zone crisis had spread to core members, and that its effects could no longer be contained to peripheral nations like Greece, Portugal and Ireland. Spain and Italy have also seen their borrowing costs rising significantly. The yields on Spanish 10-year bonds rose 0.16 percentage point, to 6.472 percent, on Monday, while the yield on Italian 10-year bonds held steady at 6,624 percent. Yields above 6 percent set off alarm bells in markets because of fears that they are unsustainable.

"Elevated borrowing costs persisting for an extended period would amplify

CRISIS, PAGE 16

French debt fears shake markets

CRISIS, FROM PAGE 1

the fiscal challenges the French government faces amid a deteriorating growth outlook, with negative credit implications,'' Moody's said.

Officials are working hard to bulk up the euro zone's bailout fund, the European Financial Stability Facility, to around €1 trillion, $1.35 trillion, but that task would be dealt a huge blow were France to lose its top-notch credit rating.

The French government will provide a large guarantee to the fund — €158 billion — and a reduction of its credit rating could sway euro zone leaders to abandon the idea of pumping up the fund to buy troubled countries' bonds, effectively bringing down their borrowing costs, and switch to a more radical set of proposals.

Talks with the new Italian prime minister, Mario Monti are intensifying ahead of an European Union summit meeting next month. Mr. Monti is due to visit Brussels on Tuesday and will then meet with the French president, Nicolas Sarkozy and the German chancellor, Angela Merkel, in Strasbourg on Thursday.

With Germany resisting calls for the European Central Bank to be given a direct role in protecting Spain and Italy by buying both countries' bonds, pressure has returned to allow it to help finance the rescue fund, allowing it to intervene in the bond market. Under a model being discussed, countries that received help could be required to undertake reforms.

''A lot of things that people currently think are impossible could change significantly,'' said one European official, who requested to not be identified because of the sensitivity of the subject.

But with Germany's resistance complicating those efforts, European policy makers are trying to push ahead with the deal they struck at a summit meeting late last month, which calls for the fund to take on debt to buy bonds and a 50 percent write-down of Greece's debt.

Even the Greek part of the deal is far from done. Though Greece needs €8 billion in international aid next month to avoid bankruptcy, Lucas D. Papademos, the new Greek prime minister, said after talks Monday in Brussels that he was still seeking a written guarantee of support for additional austerity measures from Greece's leading politicians.

Euro zone members have demanded those pledges in exchange for signing off on any new funds. Antonis Samaras, who leads Greece's center-right party, New Democracy, has rejected the demand, characterizing it as a humiliation.

DANIEL OCHOA DE OLZA/THE ASSOCIATED PRESS

The stock exchange in Madrid on Monday, where the benchmark index fell 3.5 percent.

Mr. Papademos said that the undertaking demanded by the euro zone was ''necessary to eliminate uncertainties and ambiguities concerning actions to be taken in the future by parties that may be in power.'' Turning to Greece's hopes of restoring its finances, he said that ''the task ahead of us is a Herculean one.''

Drafts of the European Commission's feasibility study on euro bonds, set to be published Wednesday, make clear that for the bonds to be effective, the European Union's founding treaty would have to be changed — a lengthy process that can be vetoed by any member nation.

The draft paper also underlined that the project would also ''require an immediate and decisive advance in the process of economic, financial and political integration within the euro area.''

''Increased surveillance and intrusiveness in the design and implementation of national fiscal policies would be warranted,'' it added.

The paper outlines three possible approaches, including the most radical proposal in which countries would jointly offer ''several'' guarantees covering all euro zone debt.

But only the most limited option — one which would provide the least advantages — ''would seem feasible without major treaty changes and therefore relatively little delay in implementation,'' the document said.

''This crisis is hitting the core of the euro zone. We should have no illusions about this.''

Under this approach, the bonds would only be partially by used by individual nations would be underpinned by prorata guarantees of euro zone member states, the document added.

''This approach to the stability bond would deliver fewer of the benefits of common issuance but would also require fewer preconditions to be met,'' the document said.

The government in Berlin signaled its opposition, however. ''The chancellor and the German government do not share the belief of many that euro bonds would be a kind of cure-all for the crisis now,'' said Mrs. Merkel's spokesman, Steffen Seibert, Reuters reported.

David Jolly contributed reporting from Paris