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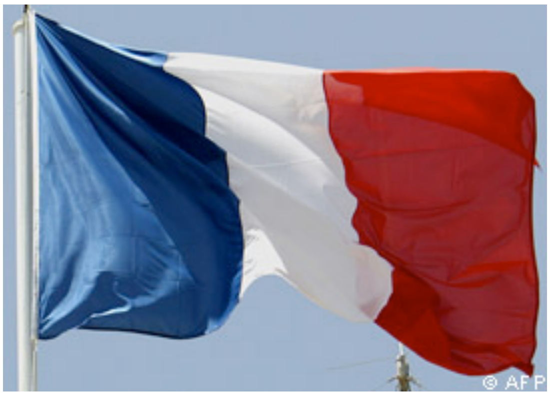
Noyer takes swipe at British economy

By Hugh Carnegy in Paris and Peter Spiegel in Brussels



The governor of France's central bank has said Britain is more deserving of losing its top-notch credit rating than France as Paris braces itself for a potential downgrade of the country's triple A status.

Christian Noyer, head of the Bank of France, said a French downgrade would not be justified on economic fundamentals. On that basis, he said: "They should begin by downgrading the United Kingdom which has bigger deficits, more debt, higher inflation, less growth than us and where credit is shrinking."

Accusing the agencies of being driven by political factors, Mr Noyer said they had become "incomprehensible and irrational".

"They launch threats, even though [eurozone] states have taken strong and positive decisions ... a downgrade does not seem to me justified based on economic fundamentals," he told Le Télégramme newspaper in Brittany.

François Fillon, prime minister, added to rising expectations of a French downgrade, saying during a visit to São Paulo that it was probable that Paris would face "more jolts" as it battled to overcome the crisis. He was the fourth senior government member this week to suggest that a downgrade was looming, including President Nicolas Sarkozy.

Underlining the potential for a downgrade, Insee, the official statistics body, on Thursday evening predicted the French economy would shrink in the last quarter of 2011 and the first quarter of 2012, threatening the government's deficit reduction plans.

Mr Sarkozy's centre-right government had until this week stressed the importance of preserving the country's triple A, making it a central political goal. It has rolled out two emergency Budget packages since August in a bid to contain France's rising debt and hold on to the rating.

But officials now argue that markets have already largely priced in the additional borrowing costs that would be a principal effect of a downgrade. With yields on French 10-year bonds still only just above 3 per cent despite recent rises, they argue the country could withstand even a further increase.

However, a French downgrade could still cause major upheaval for the eurozone's main financial rescue fund, the European Financial Stability Facility, which also currently has a triple A rating but is on an S&P credit watch.

The EFSF's €440bn in lending capacity is based on guarantees from the six eurozone countries with triple A ratings, and a French downgrade would mean the fund would lose €158bn in those guarantees – in essence lowering its headline firepower to about €300bn.

With existing commitments for Greek, Irish and Portuguese bail-outs, the fund would potentially have only about €150bn to deal with the heightening strains in Italy and Spain.

In order to maintain its triple A rating, which officials have vowed to do, the EFSF would likely have to be restructured so that it holds on to some cash that it would have originally lent to bail-out countries – a scheme abandoned earlier this year in an effort to increase its firepower.

France was among 15 eurozone members put on negative watch by Standard & Poor's earlier this month – but it was the only one of six single currency countries with a triple A rating threatened with a two-notch downgrade. Britain's triple A is not currently under threat.

S&P said it would decide on taking action after it had judged the outcome of last week's European Union summit on the sovereign debt crisis. Moody's, a rival agency, has already commented that the summit did not diminish the risk of downward ratings revisions.