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# THE EFFECT OF THE EUROZONE DEBT CRISIS ON THE FRENCH BANKING INDUSTRY

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## Abstract

The Eurozone debt crisis has inflicted a serious impact on the European financial sector and, due to the critical global position of the European economy, has developed into a widespread phenomenon. Because the French banks had been the most ambitious and acquisitive since the creation of the European common currency, the euro, they are now the largest holders of public and private debt in the euro area, making them the most vulnerable players within the crisis. As of June 2012, French banks held a total of $540 billion in debt from Greece, Ireland, Italy, Portugal, and Spain. In order to determine what effect this exposure has had on the French banking industry, data and information was gathered from various news sources, official bank reports, and publications from international organizations. Textbooks and other knowledgeable sources were used to help explain certain aspects or anomalies within the crisis, such as the crowding out effect. This paper attempts to analyze to what extent the Eurozone debt has impaired the banking sector and to investigate viable solutions for the industry.

## Introduction

Business and economics are continually amalgamating on an international scale as trade, investments, currencies, information, and technology become more and more global. As a result of this increasing interconnectedness, when a major economy suffers, it tends to have a global effect. Further economic integration leads to even harsher results when a crisis is at hand. Such is the case with the current situation of Europe's monetary union, the Eurozone. The poor debt management and uninhibited government spending (primarily in the form of social expenditures and excess labor costs) of many of the member states of the Eurozone have caused a widespread recession and continue to weaken the healthier European economies, such as the Netherlands and France. The most troubled members of the union include Greece, Ireland, Italy, Portugal, and Spain due to their extremely high debt levels and their volatility with regard to their risk of default. The European Central Bank (ECB) and the euro area nations have been working together to try to save the Eurozone and its individual economies. However, the leaders of the countries are struggling to come up with rescue packages large enough and realistic enough to reassure the markets, yet small enough to appeal to their own voters. This discrepancy between the varying fiscal policies of each sovereign nation and the overarching monetary policy of the European Central Bank is a key factor in the ongoing recession.

The French banking industry has been greatly influenced by the Eurozone debt crisis because of its substantial exposure to the debt of the aforementioned problem countries. Since the creation of the euro currency, the French banks had been the most active in acquiring and utilizing assets in the other euro-area markets. By the end of 2010, French banks held $93 billion (65 billion euros) in Greek debt alone - compared to Germany who held, at that point, $57 billion (40 billion euros) in Greek bonds. (Fontevecchia, 2011) As of June 2012, French banks held a total of $540 billion in private debt (debt from private institutions such as commercial and investment banks) and public debt (debt from government owned/controlled institutions) in Greece, Ireland, Italy, Portugal, and Spain after reducing it from $833 billion since 2009. As such, the French banks are the largest holders of private and public debt in the euro area, making them the most vulnerable in the event of a default. (Benedetti-Valentini, BNP Paribas Third-Quarter Net Doubles on Trading Gains, 2012) According to Dylan McClain (2012), the assets of the French banks, which equaled 4.43 trillion euros in April 2012, are more than twice the size of the country's economy, whose gross domestic product (GDP) for 2012 is estimated at 2.04 trillion euros. Because the banks are so much larger than the French economy, it is impossible for the government to prop up the banks and provide the capital needed to get the industry back on track. These dynamics validate the importance of understanding how the crisis has become as severe as it is and what actions the French government, the European Central Bank, and the other Eurozone countries have taken and must take in the near future in order to ensure the survival and success of the banking industry and the financial markets.

## Literature Review

In 2001 Nigel Dodd, from the London School of Economics, published a report, "What Is 'Sociological' About the Euro?" on the sociological aspects of a European monetary union. Dodd organizes his commentary into four sections: the economics of convergence, the politics of the European Central Bank, labor mobility and material interest, and money and culture. In his report, Dodd investigates the issues with a single monetary policy and the concerns about the collaborative efforts (or lack thereof) of the sovereign governments and the European Central Bank. Though the source was written prior to the Eurozone debt crisis, it provides a solid background on the creation of the Eurozone, such as the requirements to join and the structure, goals and responsibilities of the ECB. In order to understand what is happening now, it is crucial to understand how and why the euro area formed as well as the social implications of a "Eurozone." Dodd concludes the article by stating, "We need to account for the ways in which the euro's progress will be monitored by those who are using it," (Dodd, 2001) which is appropriate considering the lack of monitoring of the peripheral Eurozone members is a primary cause of the current financial crisis.

"A Very Short History of the Crisis," written by Edward Carr, provides a solid foundation for understanding how the debt crisis developed. Carr, the Foreign Editor for The Economist, elucidates that extreme government spending was not the main cause of high debt levels for frailer countries like Ireland and Spain. He explains that the majority of their government expenditures, such as increased welfare and bank support, occurred as a result of slow growth and the burgeoning financial crisis. The article suggests, however, that these same countries were running unsustainable, harmful current-account deficits that were bound to catch up to them; that is, they were importing far more than they were exporting. The last part of the article discusses how far Europe has to go before it is restored to health, despite the measures already taken to abate the crisis. (Carr, 2011)

Dylan McClain's article from The New York Times, "Understanding the European Crisis Now," provides a brief but concise description of why the weakening of the European economies is hurting their banks, using data gathered from the European Central Bank, the International

Monetary Fund, and Eurostat to support his claims. The author explains that “the governments lack the ready resources to prop up banks in trouble” because the countries’ banking systems are significantly larger than their corresponding economies. (McClain, 2012) As investors become more uncertain of the banks’ ability to pay back loans, they are financing less which means the banks have less capital and less possibility of sustaining necessary growth. He states that the more fragile banks have had to turn to other European countries (i.e. Germany and the Netherlands) for help, putting pressure on the banks of these stronger economies. This article offers a rudimentary perspective on the effect of the crisis on the Eurozone banking industry as a whole.

In March of 2012, Global Insight, the world’s largest economics organization, issued their annual report on current French economic policies in a publication called France Country Monitor. They examine the recent developments in monetary (the ECB) and fiscal (French government) policies and their outlooks. This source presents the data (e.g. changes in key interest rates, changes in Eurozone and French GDP, growth in private loans, changes in national deficit and debt, etc.) and then provides an analysis of what the data indicates. Many of the sources that are used in this paper offer information on events that have already happened, but this publication provides economic projections based on the available data. While it is only speculation, it is important to understand the potential effects of the crisis on the banking industry in addition to the antecedent effects.

The article written by James Neuger, titled “EU Cuts 2013 Growth Forecast as Crisis Weighs on Germany,” provides a macroeconomic and fiscal outlook for France and the Eurozone. Neuger, citing the European Commission, reports that “the 17-nation euro economy will expand 0.1% in 2013, down from a May [2012] forecast of 1%.” (Neuger, 2012) This poor growth outlook follows a 0.4% contraction of the euro area economy in 2012. European forecasters also decreased economic growth predictions for both Germany and France. The data presented in this source demonstrates the effects of the crisis on the stronger European countries, explains how and why the crisis continues to worsen, and offers insight on France’s weakening competitiveness due to the economic decline.

“A Less Magnifique Era for French Banks,” written by Bloomberg reporter Fabio Benedetti-Valentini, focuses on the three largest French banks by market value: BNP Paribas, Société Générale, and Crédit Agricole. The author reports that, due to their high exposure to Greek debt (Greek bonds), these banks have experienced about 5.4 billion euros in losses in the last year. (Benedetti-Valentini, 2012) This source also addresses the job cuts that the French banks had to make in early 2012, signifying the macroeconomic consequences of the debt crisis. According to Benedetti-Valentini, Société Générale cut 1,800 jobs in France during the first quarter of 2012, while BNP Paribas and Crédit Agricole cut 373 and 550 jobs, respectively, from their corporate and investment banking divisions. (Benedetti-Valentini, 2012) The reporter asserts that these reductions of their “home” workforces are contributing to investor and depositor fears and, therefore, making it difficult for Paris to regain any business leadership.

Benedetti-Valentini also published three articles in November of 2012 via Bloomberg, which provide pertinent analyses of the third quarter results of BNP Paribas, Société Générale, and Crédit Agricole. The first article, entitled "BNP Paribas Third-Quarter Net Doubles on Trading Gains," explains that the bank was able to increase profits by disposing of risky assets, cutting jobs, and encouraging consumer banking. In addition, the European Central Bank issued 1 trillion euros in long-term loans to the bank in September of 2012; these loans, which primarily took the form of bond buybacks, helped to stabilize the bank's funding situation. (Benedetti-Valentini, BNP Paribas Third-Quarter Net Doubles on Trading Gains, 2012) The second article, "SocGen Quarterly Net Falls 86% on Debt Charge, Greek Sale," paints a different picture for France's second largest bank. According to a statement made by Société Générale, "net income for the bank dropped to 85 million euros from 622 million euros a year earlier." (Benedetti-Valentini, SocGen Quarterly Net Falls 86% on Debt Charge, Greek Sale, 2012) The author explains how the sale of the bank's Greek unit, the losses amassed from the toxic assets remaining from the U.S. subprime mortgage crisis, and other debt write-downs contributed to their poor performance this quarter. Benedetti-Valentini's third article discusses Crédit Agricole's extensive third quarter losses; Crédit Agricole is France's third largest bank by market value. The author states that the bank incurred a net loss of 2.85 billion euros ($3.62 billion) during the months of July, August, and September in 2012. This was primarily due to the sale of the bank's Greek unit, Emporiki, at a loss of 1.96 billion euros. (Benedetti-Valentini, Credit Agricole Posts $3.6 Billion Loss after Greek Sale, 2012) The article identifies other sources of debt that contributed to the income losses and also how Crédit Agricole is attempting to curb these deficits in the coming months. These articles offer a more in-depth understanding of the current state of France's three largest banks and, therefore, illustrate the grander picture that is the French banking industry.

The International Monetary Fund publishes their comprehensive economic reports, the *World Economic Outlook,* semi-annually; these reports include crucial data on every country in the world and analyses of the global trends that are occurring at the time of publication. Because the Eurozone debt crisis has become such a widespread epidemic, it has been a major topic in the last few publications. The *World Economic Outlook* of October 2012 provided statistics on euro area unemployment levels, debt ratios, gross domestic product, current account balances, and other useful and insightful data. The International Monetary Fund website where the publications can be found also allow visitors to create their own data tables. This feature made it possible to compare the economic indicators of European countries with those of the United States.

French banks are required to publish annual reports that include details about their executive boards, their financial standings for the year ended, their plans and policy changes for the upcoming year, their social responsibility, etc. BNP Paribas, France's largest bank by total assets, and Société Générale, the country's second largest bank, have made their reports available to the public on their websites. These publications provide the data needed to quantify the effects of the debt crisis on these banking conglomerates; the banks also publish quarterly reports that offer more recent financial figures, which is crucial as the debt crisis continues its daily progression. The annual and quarterly reports of BNP Paribas and Société Générale allow for comparisons between the previous years' data with respect to net income profits and losses, earnings per share, and other figures that are necessary in order to tell the story of the Eurozone debt crisis.

## Beginning of the Eurozone and the European Central Bank

The Eurozone was created on January 1, 1999. The original members included Belgium, Germany, Ireland, Spain, France, Italy, Luxembourg, the Netherlands, Austria, Portugal and Finland; Greece joined on January 1, 2001, and the last five countries joined between 2007 and 2011. Euro banknotes and coins were officially introduced in 2002. According to the official European Union website, in order to become a member of the monetary union, each country had to meet a specific convergence criteria, which includes price developments (e.g. maintaining inflation rate), fiscal developments (e.g. excessive deficit and debt procedures), and long-term interest rate developments (e.g. maintaining interest rates relative to member states). (Europa, 2006)

The European Central Bank, in collaboration with the central banks of the member states, was established to govern the Eurozone, with the primary task of maintaining the euro's purchasing power and therefore maintaining price stability within the euro area. (The European Central Bank, 2012) The principal administrative body of the ECB is the Governing Council, comprising the six members of the Executive Board and the governors of the national central banks of the seventeen Eurozone countries. (The European Central Bank, 2012) Therefore, the governors of the national central banks are held accountable to the entire euro area as well as their own political sphere. In his report on the sociology of the euro, Nigel Dodd argues that, because the majority of the voting members of the Governing Council are actually governors of their own national banks, questions of accountability, interests, and outlooks should be raised. (Dodd, 2001, p. 28)

In 2004 the Greek administration admitted that the country joined the Eurozone in 2001 despite the fact that their budget deficit exceeded the obligatory limit (3% of GDP); Greece falsely recorded their financial figures from 1997 to 2001 so the deficit would appear lower than it was. (Greece admits fudging euro entry, 2004) "The government initially disguised the true state of its finances with the help of U.S. bankers. Goldman Sachs, for example, did off-market currency trades with the government of Greece." (Lewis, 2011) Yet, Greece was still allowed to join the monetary union because other founding countries, such as Germany and France, had joined under similar pretenses, though their deficit levels were not nearly as high as Greece's. Once Greece had joined the Eurozone, the country was able to borrow money as easily as the more reliable countries like Austria and the Netherlands. Jack Ewing explains that not only did Greece exploit this borrowing ability often, but Germany and France continued to lend money to the government despite being aware of the country's debt discrepancies so that Greece, as well as Spain and Italy, could use the borrowed money to buy French and German exports. (Ewing, In Euro Crisis, Fingers Can Point in All Directions, 2012) Moreover, these leading euro nations continually lent money to Spanish banks, property developers, and home-buyers; these loans helped fuel a real estate bubble in Spain in the years leading up to the crisis that inevitably popped when the Eurozone debt crisis began. Consequently, the French and German lenders have been withdrawing their funds from the risky nations and moving them to safer places, which in turn oblige these countries to borrow even more money to replace the fleeing funds. (Knight, 2012)

## The Eurozone Debt Crisis

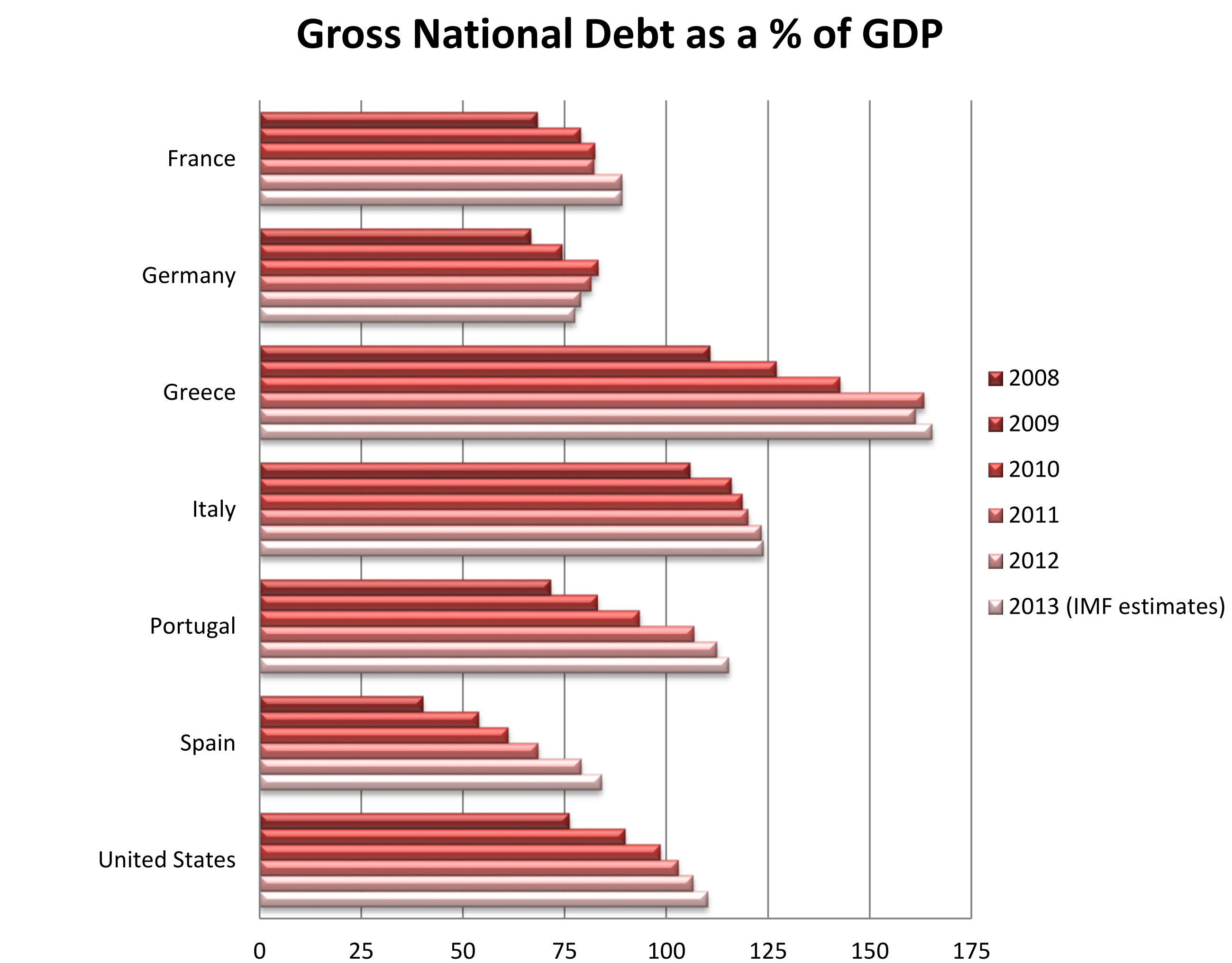
In 2008 the Eurozone was beginning to feel the effects of the global financial crisis that began in the United States; in December of that year, EU leaders settled upon a 200 billion euro stimulus plan to encourage European growth and halt any concerns that their markets would be significantly influenced by the American crisis. In the months following, the extent of Greece's financial problems, and the other nations' soon thereafter, became clear. After revising the irregularities in their accounting procedures, the Greek budget deficit increased from 3.7 in 2008 to 12.7 in 2009 as a percent of the country's GDP. (Timeline: The Unfolding Eurozone Crisis, 2012) As the global economy weakened, interest rates rose, unemployment increased, and the financial sectors of the Eurozone incurred more and more debt. The economies and banking industries of Ireland, Italy, Portugal, and Spain were more heavily influenced by the economic downturn because of the slow growth they had experienced over the last decade. As stated in Carr's article from The Economist:

> Even where troubled euro-zone countries had not been profligate[1], they have been running unsustainable current-account deficits. Low interest rates fueled domestic spending and spurred inflation in wages and goods, which in turn made their exports more expensive and left imports relatively cheaper. (Carr, 2011)

Due to the increased risks of investing in these countries, their banks continued to weaken, bond prices fell, and growth came to a halt. "Because the likelihood of a Greek default was increasing, investors demanded a higher yield on the Greek bonds they bought, pushing up the cost of borrowing for Greece and creating a vicious cycle." (Burn-Murdoch, 2012) This cycle of increased government borrowing/spending, increased interest rates, and decreased investments has created what is called the "crowding out effect." The euro area nations have borrowed so much capital in order to finance government debt that interest rates have increased for other types of borrowing, which has led to the crowding out of private consumption and investment. According to the secretary of the U.S. Treasury, Timothy Geithner, "higher borrowing costs for households and businesses discourage future private investment, lower capital stock, lessen economic growth, and depress the standard of living." (Geithner, 2011)

[1] Spanish sovereign debt was only 36% of the country's GDP in 2007, compared to Germany whose debt to GDP ratio was 65%. (Knight, 2012)

**Table 1. Debt to GDP Ratios in the Eurozone**




| | United States | Spain | Portugal | Italy | Greece | Germany | France |
|---|---|---|---|---|---|---|---|
| 2008 | 76.137 | 40.173 | 71.582 | 105.809 | 110.721 | 66.699 | 68.27 |
| 2009 | 89.879 | 53.929 | 83.051 | 116.055 | 127.1 | 74.416 | 78.99 |
| 2010 | 98.523 | 61.173 | 93.443 | 118.652 | 142.757 | 83.212 | 82.39 |
| 2011 | 102.937 | 68.471 | 106.785 | 120.106 | 163.343 | 81.506 | 82.26 |
| 2012 | 106.599 | 79.041 | 112.396 | 123.357 | 161.246 | 78.868 | 89.02 |
| 2013 (IMF estimates) | 110.17 | 84.027 | 115.32 | 123.801 | 165.347 | 77.448 | 89.02 |

Source: IMF World Economic Outlook Database (2012)

Bond investors, who underpriced the risk of Greek debt prior to 2010, and credit rating agencies are also major wrongdoers of the Eurozone debt crisis. A credit rating is an evaluation of a country's or institution's ability to pay back its debt; a high credit rating indicates less risk so investors are more willing to invest in or lend to those governments or corporations with a higher rating. The foremost credit rating agencies are Standard & Poor's (S & P's), Moody's, and Fitch. These agencies, especially S & P's, have had no qualms about downgrading countries and their banks at the first sign of risk or instability since the start of the crisis. Even the credit rating of the ECB's bailout fund, the European Stability Mechanism, has been reduced. In his article from Forbes, Steve Schaefer argues that countries with impaired credit ratings have less capacity to support their banks; therefore, the ECB has begun to serve as lender-of-last-resort to Europe's banks, much like the Federal Reserve of the United States. (Schaefer, 2012) In January of 2012, Standard & Poor's downgraded nine different euro area nations, including France. France was just hit again by Moody's in November of 2012, losing its prized rating of AAA. The credit rating agencies cite the French banks' vulnerability to the debt crisis as one of the reasons they reduced the country's credit rating. The three largest banks in France have all received credit downgrades as well. While it is crucial for investors to understand the risk involved when considering financial transactions, these downgrades have provided serious momentum to the vicious cycle of the debt crisis. After a bank's credit is relegated, the stock oftentimes drops and investors lose confidence in the institution, as has been the case with BNP Paribas, Société Générale, and Crédit Agricole, which only exacerbate a bank's financial problems (e.g. lack of capital).

Over the last four years, the ECB, the IMF, and the sovereign countries have introduced a number of measures in an attempt to curb the crisis. By the summer of 2011, Portugal and Ireland had each received bailout packages from the ECB and the International Monetary Fund (IMF), while Greece had received two bailouts amounting to a total of 219 billion euros; the Eurozone and the IMF agreed on the first Greek bailout in May of 2010, and, after conditions worsened, agreed on a second bailout package in July of 2011. (Timeline: The Unfolding Eurozone Crisis, 2012) To fund these bailouts, European leaders established a bailout fund called the European Stability Mechanism (ESM) that has a lending capacity of 500 billion euros. However, Jack Ewing from The New York Times argues that the ESM will still not be enough to compensate for a downfall in investor confidence in both Spain and Italy. (Ewing, The Euro Zone Crisis: A Primer, 2012) Since the end of 2011 and the inauguration of a new president, Mario Draghi, the Governing Council of the European Central Bank has steadily decreased its key interest rates as well as the minimum required reserve ratio (currently at 1%) for banks so that they are able to lend out more money. On July 5, 2012, the ECB decided to lower its key interest rate to a historic low of 0.75%. (ECB: Timeline of the Financial Crisis, 2012) These record lows are a sort of double-edged sword in that the low interest rates allow banks to borrow more easily and inexpensively, yet there is now little to no room left to use interest rates as economic stimulus. To lower them any more could be just as detrimental as deflation becomes a real possibility. While the expansionary monetary policies, debt swaps, and bail-out packages are helping, the fragile euro area nations still lack the financial resources to support their weakening banks; the banks need capital, and, with so many credit rating downgrades, there are few investors willing to provide the necessary funds.

## State of the Political and Economic Climate in France

In May of 2012, the conservative French president, Nicolas Sarkozy, was ousted by François Hollande, a member of the Socialist Party of France, by consistently advocating pro-growth economic policies. Yet, just six months after being elected, the new president's popularity had dropped to a record low of 36% of public support due to his administration's communication errors and Hollande's seemingly indecisive, inactive performance. (Chrisafis, 2012) Nevertheless, the French president has been taking measures to stimulate business and reduce the country's record trade deficit so as to improve the country's competitiveness. In November of 2012, President Hollande announced plans to lower labor costs, boost corporate investment, and facilitate small and medium-sized business expansion through fiscal incentives (i.e. tax cuts). (Vinocur, 2012) However, the competitiveness package has received much criticism as many believe that these measures will not be nearly enough to resuscitate French commerce. Hollande is continuing Sarkozy's work with German Chancellor Angela Merkel and the other euro area leaders to combat the debt crisis, and he has made promises to significantly reduce the French deficit. Yet, because of the poor growth in 2012 and the negative projections made for 2013, the European Commission does not believe that France will meet "its target of cutting the budget deficit to the euro-area limit of 3 percent of GDP in 2013 and keeping it there in 2014." (Neuger, 2012) Hollande has stated that he prefers a partial pooling of debt through Eurobonds and has stressed that he wants "to see progress towards Eurozone-wide regulation of the banking sector before the end of the year [2012] as a prelude towards greater shared decision-making in all areas of economic and monetary policy." (Eurozone 'very near' to end of crisis, says Hollande, 2012) Hollande had plans to pass legislation in December of 2012 that would separate the French banks' retail (commercial) and investment activities with the aim of isolating banks' more speculative activities and thereby increasing domestic bank regulation. (Daneshkhu & Carnegy, 2012) However, when the bank reforms were unveiled, they were found to be much less tough and much more timid than had been promised. In the end, the reforms kept the French banks' model of combined retail and investment banking intact. One of the most controversial reforms from the bill was the creation of a resolution fund. The law now requires French banks to collectively contribute 2 billion euros, rising to 10 billion euros by 2020, to a fund that will pay out if a bank begins to fail. They may be obligated to increase their contribution if a bank bailout becomes necessary. Some argue that this is an excellent way for banks to protect themselves against failures without depending on the French government, while others argue that this places a financial burden on the already struggling banks and requires them to help their competitors. Nevertheless, with the changes made, the law has put "France in the leading position in Europe in regulating banking activity." (Daneshkhu & Carnegy, 2012)

France is currently the second largest economy in Europe with a GDP of 2.17 trillion euros ($2.77 trillion) in 2011; Germany is the largest economy with a 2011 GDP of 2.76 trillion euros ($3.57 trillion). (The World Bank Group, 2012) After seeing negative growth (-2.7%) in 2009, the French economy experienced positive growth (1.7%), albeit very slow, in 2010 and 2011. (Eurostat, 2012) Growth dropped off even more in 2012, with the economy expanding only 0.5%. GDP is predicted to bounce back slightly with an estimated growth of 1.3% in 2013. (Eurostat, 2012) In the third quarter of 2012, France's GDP increased by a mere 0.2%, barely avoiding a recession as the country has not recorded any economic growth since 2011. (Di Lorenzo, 2012) Because of its size and economic position, France is considered a core country of the Eurozone and of Europe as a whole. As the debt crisis worsens and European economies become more unstable, a lot of focus has turned to protecting and strengthening France.

By the summer of 2012, the unemployment rate in France had risen to its highest level in thirteen years. "The rise in unemployment to 10.2 percent, measured according to the International Labour Organisation's (ILO) criteria, comes as the Eurozone's second-largest economy has posted three consecutive quarters of zero growth." (Reuters, 2012) Unemployment increased even more by the third quarter, rising to 10.8%. This drop in employment is a major contributing factor to Hollande's unpopularity. Furthermore, according to the French Finance Ministry, France's high trade deficit (approximately 5 billion euros) and the sharp decline in the country's competitiveness has diminished exports and caused around 750,000 factory jobs to be lost over the past decade. (Reuters, 2012)

Other factors that are hindering France's competitiveness are the rigid labor laws and high labor costs. Employees in France are only required to work thirty-five hours per week and receive several weeks of paid vacation time in addition to the many national holidays that the country celebrates. Labor unions are a major player in French politics so changing the 35-hour law would most likely be the demise of President Hollande. Because of the unions' influence, it is also very difficult to let go of senior employees and hire younger, fresher applicants, which is why youth unemployment has reached 22.7% for French citizens aged 15 to 24 years old.

## Conditions of the French Banking Industry

Since the Eurozone debt crisis began, France's three largest lenders, BNP Paribas, Société Générale, and Crédit Agricole, have received credit rating downgrades due to the interrelated risks between France (whose credit rating was downgraded in January and November of 2012) and the other euro area nations, particularly Greece, Spain, and Italy. BNP Paribas now has an A+ rating from Standard & Poor's, an A2 from Moody's, and an A+ from Fitch. (BNP Paribas Group, 2012) Société Générale has an A rating from Standard & Poor's, an A2 from Moody's, and an A+ from Fitch. (Société Générale Group, 2012) Crédit Agricole has an A rating from Standard & Poor's, an A2 from Moody's, and an A+ from Fitch. (Credit Agricole Group, 2012) In comparison, Germany's (and Europe's) largest bank by total assets, Deutsche Bank, has an A+ rating from S & P's, an A2 rating from Moody's, and an A+ from Fitch. (Deutsche Bank, 2012) The political and regulatory contingencies of the French Socialist government as well as their cross-border exposure to Italy, who is currently in a recession, have greatly influenced the credit agencies' decisions to either downgrade the banks' ratings or change the banks' outlook from "stable" to "negative." (Laurent, 2012) However, the downgrades typically generate short-term effects, such as a drop in stock price, rather than any long-term consequences.

In March of 2013, Moody's released a report that maintained the outlook for the top French banks' as negative. The ratings agency cited the banks' "continued reliance on wholesale funding[2]" as the primary reason for this outlook, as wholesale funds made up 35% of total cash on the balance sheets for the major banks at the end of 2012. (Plumb, 2013) Though the credit ratings agencies predict the banks' profits to recover in 2013, they still believe that France's exposure to countries like Italy and Spain present too large of a risk to change their outlook.

**Table 2. Bank Credit Ratings**

| Bank | Present Credit Rating |
|---|---|
| BNP Paribas | A+ (S&P's), A2 (Moody's), A+ (Fitch) |
| Société Générale | A (S&P's), A2 (Moody's), A+ (Fitch) |
| Crédit Agricole | A (S&P's), A2 (Moody's), A+ (Fitch) |
| Deutsche Bank | A+ (S&P's), A2 (Moody's), A+ (Fitch) |

*Note*. S & P's highest ratings: AAA, AA+, AA, AA- ; Moody's highest ratings: Aaa, Aa1, Aa2, Aa3; Fitch highest ratings: AAA, AA+, AA, AA-

The net income of BNP Paribas, the largest French lender, actually increased by 2 billion euros between 2009 and 2010, but the bank experienced a 1.7 billion euro loss between 2010 and 2011. In the third quarter of 2011 alone, the bank's "net income fell 72% because of Greek [debt] write-downs and losses from selling European government bonds." (Benedetti-Valentini, A Less Magnifique Era for French Banks, 2012) That year, BNP Paribas took a total loss of 3.2 billion euros in write-downs on Greek government debt. (Benedetti-Valentini, BNP Paribas Third-Quarter Net Doubles on Trading Gains, 2012) Though BNP Paribas' Greek debt holdings severely hurt their financial standings in 2011, they were able to reduce their net Greek sovereign debt exposure from 1 billion euros to 0.2 billion euros just in the first quarter of 2012. (BNP Paribas Group, 2012) According to the Fixed Income Presentation published by the bank, this was accomplished because the European Central Bank implemented a program that allowed the bank to exchange 15% of the face value of old Greek bonds for bonds issued by the ECB's emergency loan fund called the European Financial Stability Facility (EFSF). (BNP Paribas Group, 2012) In fact, BNP Paribas recently reported that their profits have more than doubled in the third quarter of 2012. However, at the end of the year, BNP Paribas performed a 298 million-euro "goodwill write-down" of its Italian unit, Banca Nazionale del Lavoro, resulting in a 33% decline in fourth-quarter profits. (Benedetti-Valentini, BNP Paribas Plans Cost Reductions as Fourth-Quarter Net Falls, 2013) Crédit Agricole has an Italian banking unit as well, and it is this deep-rooted exposure to Italy's suffering economy that has intensified investors' fears. It is also important to note that, despite the debt write-offs and haircuts, BNP Paribas still holds a substantial amount of Greek private debt as well as public and private debt from other Eurozone countries.

[2] Wholesale funding is a method of funding banks by short-term borrowing from other banks and financial institutions. (QFinance)

In 2011, Société Générale reported 2.4 billion euros in net income[3], marking a 2.5% decrease in net income from 2010. In an effort to reduce risks affiliated with Greece, Société Générale sold its Greek unit, Piraeus Bank SA, last quarter at a loss of 130 million euros. The bank also "booked an accounting charge of 389 million euros tied to the theoretical cost of buying back its own debt as market prices fluctuate." (Benedetti-Valentini, SocGen Quarterly Net Falls 86% on Debt Charge, Greek Sale, 2012) Because Société Générale was already reporting significant losses from the Greek sale and other bad assets, it can be speculated that the bank decided to record this theoretical cost to avoid having to do so in the future. Essentially, they could write off a lot of their debt and report one terrible quarter, and then focus on increasing profits and growth in the upcoming quarters. In the third quarter of 2012, Société Générale was able to reduce their risk-weighted assets by 5.4 billion euros and has sold 16 billion euros of assets since June 2011 in order to create a capital buffer for the banking group. (Benedetti-Valentini, SocGen Quarterly Net Falls 86% on Debt Charge, Greek Sale, 2012) The income losses from the third quarter led to the three main credit rating agencies changing Société Générale's outlook from "stable" to "negative." Société Générale reported a fourth quarter net loss of 476 million euros following a goodwill write-down of its share in Newedge Group, a derivatives brokerage firm, and allocating 300 million euros for undisclosed legal issues. (Benedetti-Valentini, SocGen Posts Fourth-Quarter Loss on Newedge, Legal Expenses, 2013) Despite the bank's significant profit decline, its stock price has been steadily increasing over the last few months indicating that investors have confidence in the growth prospects of the bank.

In addition to risky asset disposal, BNP Paribas, Société Générale, and Crédit Agricole made significant job cuts at the start of 2012. Combined, the banks cut about 10% of their staff in their corporate and investment banking (CIB) units; Crédit Agricole's CIB unit cut 550 jobs in France and 1,200 jobs abroad, while BNP Paribas laid off 373 employees in France. (Benedetti-Valentini, A Less Magnifique Era for French Banks, 2012)Société Générale notably laid off 14% of their French CIB unit employees and has continued to make cuts throughout the year.

## Conclusion

Salvaging the banking industry is the most direct way to repairing the situation in the euro area. Healthy banks facilitate growth by lending money to businesses, which allow them to hire more employees, expand operations, and even invest in the financial markets. Well-functioning banks also lend to individuals/households and therefore increase personal consumption and investment. A sound banking industry is crucial to maintaining effective financial markets which economists argue is the key to a healthy, progressive economy. While the recapitalizing of the banks by Eurozone nations has helped, simply injecting capital will not save the banks. The banks must restore investor confidence, improve their competitiveness, rebuild their personnel, and continue to reduce their risky assets.

[3] Comparatively, BNP Paribas reported a net income of 6.1 billion euros in 2011. (BNP Paribas Group, 2012)

France's three largest banks have been taking the necessary steps to improve their financial standings and, in turn, the investors' opinions of the banks. BNP Paribas, Société Générale, and Crédit Agricole have performed significant Greek debt write-downs, and the latter two have both sold their Greek banking units in an effort to reduce their exposure to Greek debt/assets. The French banks have been trimming their balance sheets over the last couple of years to dispose of toxic assets like subprime mortgages from the United States, Greek bonds, Italian bonds, and Spanish private loans. By November of 2012, French banks were able to "cut debt holdings in Europe's troubled periphery by more than 35 percent since the start of the euro-area crisis," but they continue to struggle to ditch their image as refuges for the euro area's troubles. (Benedetti-Valentini, BNP, SocGen Fight French Banks' Euro-Crisis Proxy Label, 2012) Because French banks have the largest exposure to Eurozone debt, they must tread very carefully throughout the remainder of the crisis so investors do not lose confidence in their ability to pay off their own debts.

An avenue that the banks and other French firms have begun to explore is that of American and Asian lenders. France's banks have been unwilling or unable to provide loans for small- and medium-sized companies so they have started to turn to the U.S. private debt market. (Plumb, 2012) As the American economy has begun to improve, lenders are more capable of offering funds to French firms. Asian lenders in progressive countries like China, Japan, and Singapore, have also shown their willingness to loan money to European banks and businesses. In fact, in April of 2013, Iceland, whose economy is on par with that of Portugal, Spain, Italy and Ireland, became the first European country to sign a free trade agreement with China. Iceland is not a member of the European Union or the Eurozone, but it is this kind of agreement that other European nations should consider to help mend their economies. The free trade agreement between China and Iceland will eliminate most tariffs over the next few years and will open doors to bilateral investments. (Jolly, 2013) By taking this first step, Iceland has created an opportunity for its financial institutions to find other sources of credit and funding. If the French banks continue to demonstrate their methods of facilitating growth and increasing revenues, foreign markets, like China, will become more accessible creating a larger capital buffer for French institutions.

The Eurozone debt crisis has developed into a prolific, global phenomenon that is becoming increasingly relevant to the United States and the impending debt crisis, which renders this a very important topic to investigate and understand. The Eurozone debt crisis evolves everyday so it is necessary to remain informed and up-to-date on the status of the euro area nations and their financial markets. The implications of a "debt crisis" for economies as large as the U.S. and the Eurozone are huge, and finding viable solutions for the Eurozone is necessary if the U.S. is to avoid a similar situation.

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