And then there were four…

After the French downgrade, things could start to go downhill in Europe Five top-rated European countries outside EMU – and only four inside

by David Marsh

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Seldom in monetary history will an event so frequently forecast and so intrinsically banal have triggered such far-reaching consequences. Standard & Poor’s downgrading of France from Triple A status is of monumental significance. From now on, things could start to go downhill in a big way.

Forget the ringing declarations of Franco-German solidarity, the ritual denunciation of rating agencies as Anglo-Saxon dark forces and the stalwart Parisian affirmations of 'business as usual'. Put to one side, too, any comparison with the US downgrade in August (since when American Treasury yields have been in free fall).

Developments in Europe are (and have been for 150 years) the result not of absolute rankings, but of relative positions, especially between Germany, Britain and France. Much will change as the result of Friday's S&P ratings drop for France and eight other countries. Probably, very little of it for the better.

The movie we're watching is actually an old one. Each country is reverting to type. S&P’s stripping of France and Austria from the top notch list, the downgrading of Spain, Italy and five other members of economic and monetary union (EMU) and the maintained top credit rating for Germany and the Netherlands confirm the 'winner takes all' polarisation of the euro area. The Germans will become not more generous, but more self-righteous, because they fear that, if they stray from the path of orthodoxy, France's fate will be theirs.

There are now five top-rated European countries outside EMU – Denmark, Norway, Sweden, Switzerland and the UK – and only four within – Germany, Finland, Luxembourg and the Netherlands. The first group (because of Germany’s preponderance) still has a higher population – 104m against 90m. All the same, at a stroke, EMU’s claim to represent the best of Europe in strength and stability has been washed away.

Turning the EFSF rescue fund into a useable financing vehicle will become immeasurably more challenging now that its Triple A rating is all but gone.

Watching from the side-lines, knowing that they may be caught up in the debacle but will not themselves be in the midst of the wreckage, the British and Americans raise supercilious eyebrows and say, 'Sorry, but we told you so.'

The strongest shockwaves are rippling across France, only slightly more than three months ahead of the presidential elections. Even though kindly old S&P made sure the news was not a surprise - two months ago it helpfully released a precursor of the downgrade announcement - the loss of the Triple A accolade brings to a halt France's decades-long effort to achieve sustainable parity in its monetary and financial relationship with Germany.

Germany is in the ascendancy - and looks like staying there. Up to the events of the last few days, recent developments looked relatively satisfactory. The new Spanish and Italian governments were knuckling down to austerity programmes. The European Central Bank was dispensing liquidity to problem-hit banks. Leading French officials openly welcomed the tilt to German-style discipline by Madrid and Rome, saying this could make Berlin more compliant in other areas of European policy. Now the room for optimism is fading fast.

Marine Le Pen, the leader of France’s ultra-right National Front and François Hollande, the Socialist candidate, slightly ahead of President Nicolas Sarkozy in the opinion polls, will reap considerable political capital from the S&P decision. As a result, the whole of French politics will move towards the nationalist end of the spectrum. Not good news for anyone who still thinks EMU can hold together without major disruptive changes in coming months.