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Macro Picture
France and the Return of
the Bond Vigilantes
By
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9 October 2025

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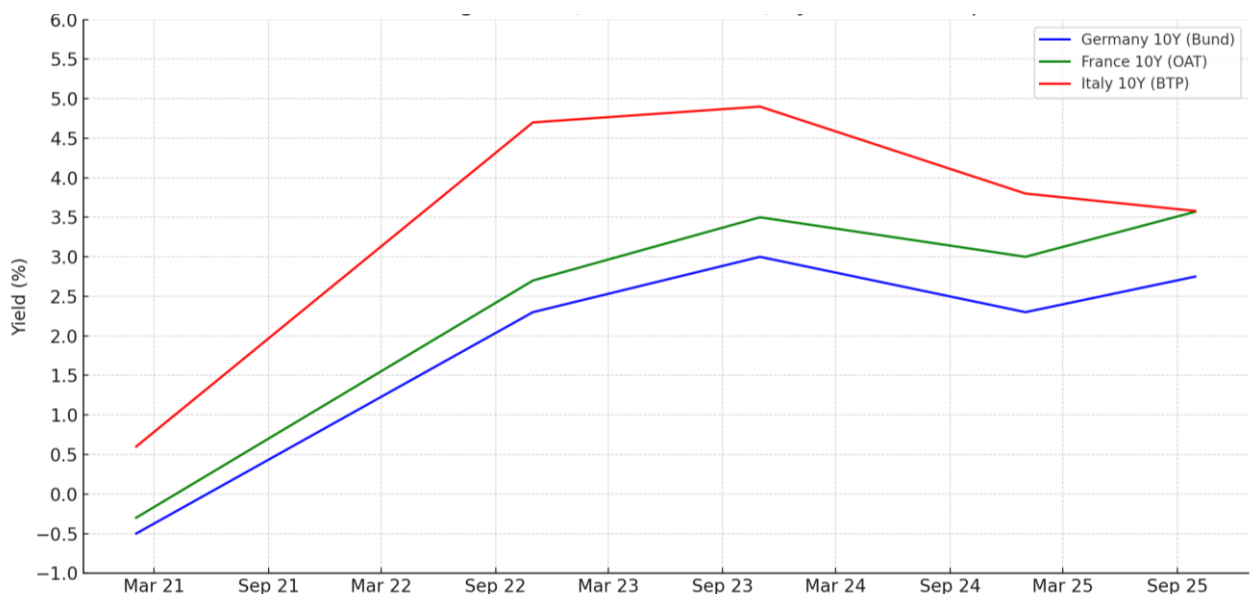
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Executive Summary

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- ✦ Bond markets have a way of enforcing discipline when politics and policy fall short. France is now learning this lesson the hard way. OAT–Bund spreads have blown out to multi-year wides, at times brushing Italian levels; A development once unthinkable for the Eurozone’s second-largest economy.
- ✦ The reasons are clear: deficits entrenched above 5% of GDP, debt ratios drifting toward 120%, and a fractured political system unable to deliver consolidation.
- ✦ The fiscal indulgence of the “quoi qu’il en coûte” era has lingered even as the ECB has stepped back, forcing investors to reassess sovereign risk in a world of record issuance and diminished central bank support.
- ✦ Yet the market’s verdict, while understandable, is exaggerated. France is not Italy or Greece. Its debt market is among the deepest and most liquid in Europe; maturities are long, the economy is large and diversified, and institutions remain robust.
- ✦ The inversion where corporate giants like LVMH trade tighter than the sovereign reflects mispricing rather than existential weakness. The ECB’s backstop, while less visible, still anchors against disorderly fragmentation.
- ✦ For investors, the challenge is to distinguish noise from signal. This volatility is best viewed as an opportunity: relative value trades long Spain vs short France, curve steepeners in the 10s–30s segment, and carry in the OAT belly.
- ✦ The broader message, however, goes beyond France. In today’s world of heavy issuance and less forgiving markets, fiscal credibility carries a price and advanced economies no longer enjoy a free pass.
- ✦ **Scenario analysis:** *Base case:* Spreads should stabilise in a 70–90bp range, compensating for structural weakness without equating OATs to periphery risk. *Stress case:* 110–120bp is possible if fiscal slippage accelerates or ratings pressure intensifies.

Key Picture: 10y Sovereign Yields (Bund, OAT, BTP) – Jan 2021 to Sep 2025



Source: [Borsa Italiana](#)

1. Introduction: The Market's Verdict

Bond markets have a way of humbling governments. In the 1990s, it was the United States, as deficit concerns forced [Bill Clinton's White House to tack to fiscal discipline](#). In 2022, it was Britain, when Liz Truss's "mini-budget" triggered a gilt market revolt that toppled a prime minister. Today, the eurozone's second-largest economy finds itself in the crosshairs.

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France's sovereign bonds—Obligations assimilables du Trésor (OATs)—have sold off sharply. Spreads over German Bunds are at multi-year wides; at times, French risk has traded uncomfortably close to Italian BTPs. That convergence, once unthinkable, has become the market's shorthand for a sobering question: has France joined the ranks of the periphery?

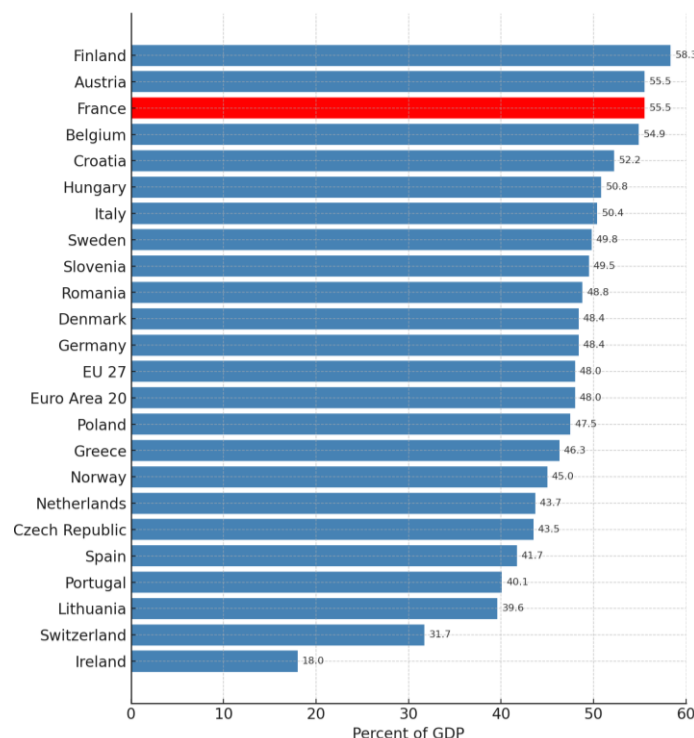
The case against Paris looks strong. [Deficits are running near six per cent of GDP, the highest in the eurozone. Debt is projected to climb toward 120 per cent. The country has not produced a balanced budget since the 1970s.](#) Meanwhile, a fractured National Assembly and recurring no-confidence threats have weakened the government's ability to deliver consolidation. Ratings agencies have responded in kind: [Fitch cut France to A+, DBRS followed.](#)

Markets are right to be uneasy. But they are also overreacting. France is in rough seas, but still afloat. Its debt market is deep and liquid, its institutions remain strong, and its bonds sit under the protective umbrella of the European Central Bank. Vigilantes are right to demand a premium, but wrong to assume OATs belong in the same category as Italian paper. Volatility in French bonds should be seen not as a systemic alarm, but as an opportunity.

2. Anatomy of a Panic

The arithmetic is unforgiving. [The deficit reached 5.8 per cent of GDP in 2024 and is projected to remain above five per cent in 2025—well in breach of the EU's three per cent ceiling. Public debt, already about 113 per cent of GDP, is drifting higher \(Figure 1\).](#)

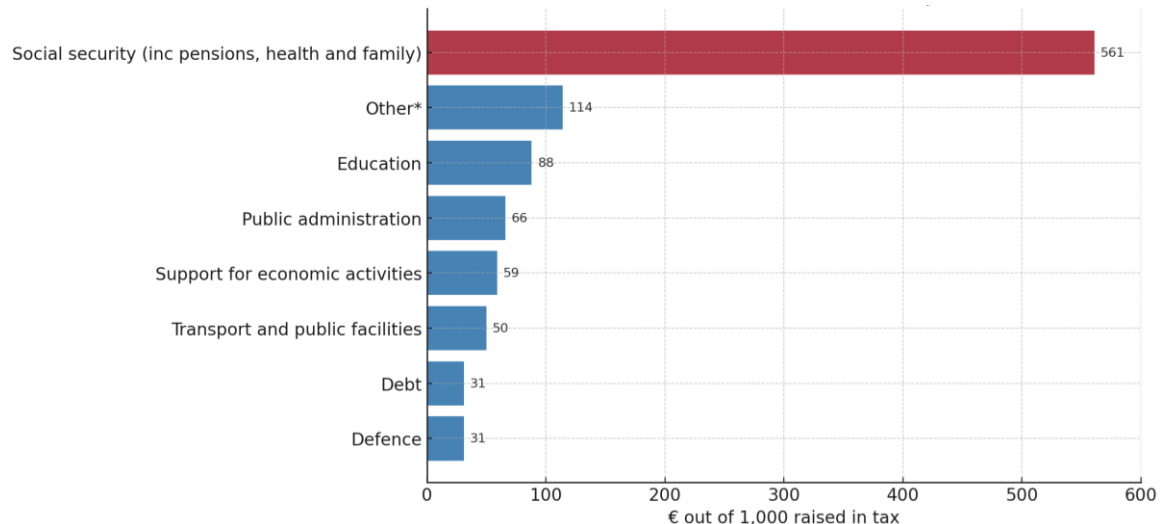
Figure 1: General Government Expenditure as a Percentage of GDP



Source: [Macrobond](#)

The drivers are structural. Government spending absorbs around 56 per cent of GDP, the highest share in the OECD. Social transfers alone consume a third of national income (Figure 2). [The tax-to-GDP ratio is already 45.6 per cent](#), leaving little space for additional revenue. The “quoi qu’il en coûte” mentality of the pandemic has lingered, while Macron’s permanent tax cuts have eroded the fiscal base.

Figure 2: Where Does French Taxpayers’ Money Go?



Source: [FT](#). Note: Breakdown of what EUR 1,000 raised in tax paid for in 2023

Overlaying these rigidities is political fragility. The National Assembly is fractured, with no clear majority. Governments have been brought down by repeated no-confidence votes, most recently [François Bayrou’s resignation over a contested €44bn fiscal plan](#). His replacement, Sébastien Lecornu, who inherited the unenviable task of reconciling deficit reduction with a hostile parliament and a restless electorate, had to renounce his mandate as well and resigned, thus precipitating France in a deeper political turmoil.

3. The Return of the Bond Vigilantes

What makes this moment so treacherous is the global backdrop. France’s fiscal stumbles coincide with the return of bond vigilantes across developed markets.

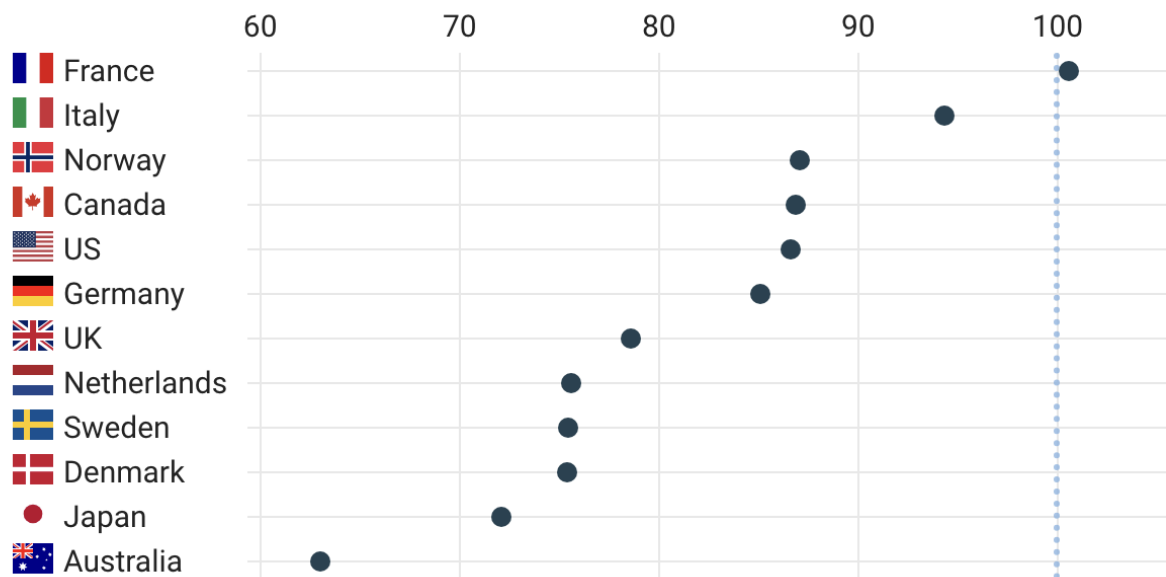
[In the United States, ten-year Treasury yields have tested five per cent](#), levels not seen in decades, as investors digest record issuance and the Federal Reserve’s retreat from quantitative easing. [In Britain, gilt yields remain volatile two years after the Truss debacle](#), a reminder that fiscal policy missteps in advanced economies can still trigger violent market moves. Bund yields are materially higher than in the negative-rate era, reflecting ECB policy and balance-sheet normalization; intermittent rallies have accompanied periods of [weak German growth](#) and shifting rate expectations.

Into this storm steps France. Its deficits, tolerated for years when rates were low and the ECB was a relentless buyer, now look toxic. Its political churn, once a domestic story, now matters for global investors recalibrating sovereign risk. The vigilantes, dormant for a decade of monetary repression have returned and for Paris, the free ride is over.

4. Why the Bears Have a Point

The market’s scepticism is not irrational. France is structurally constrained in ways that make fiscal repair difficult. Spending is politically entrenched, taxes are maxed out, and [demographics point to rising pension and healthcare costs](#). Unlike Spain or Portugal, which endured external bailouts and used them to enforce reform discipline, France has never been forced into consolidation. Evidently, its fiscal history often drifts but rarely consolidates.

Figure 3: Pensioners Income – Relative Income of Over 65s in Developed Nations



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Source: *FT and Sunday Times*

Politics compounds the problem. A president without a parliamentary majority faces an opposition ready to block but not to govern. Policy is made in short bursts of improvisation, not long-term strategy. Investors, looking for signals of credible reform, see only paralysis.

Debt dynamics underscore the risk. At a debt/gdp ratio of around 113 per cent, and growth estimated at 0.8% this year, France is vulnerable to shifts in the relationship between its effective funding cost (r) and nominal GDP growth (g). For years, $r-g$ was comfortably negative; debt was sustainable by default. Now, with higher rates and weaker growth, the margin has narrowed. A one-percentage-point shift in $r-g$ materially alters the debt trajectory. Vigilantes understand this arithmetic, and they demand compensation.

5. Why the Market is Still Wrong

And yet, treating France as if it were Greece or Italy is a mistake. The structural buffers are too significant to ignore.

First, market depth. OATs are among the eurozone's most liquid sovereign instruments, widely used as collateral and reference assets. Investors may sell them aggressively, but it would not make sense to abandon them.

Second, maturity. With an average debt life of 8.5 years, France is not rolling over its stock in panic. Higher yields bite gradually, not suddenly.

Third, the economy. France remains a high-income, diversified economy, home to global corporate champions. The fact that LVMH, Airbus, and AXA trade tighter than the sovereign is a striking inversion, but it reflects mispricing more than existential weakness (Figure 4).

Figure 4: LVMH Bond Yield Falls Below That of French Government Bond

Yield on 2033 LVMH bond versus comparable sovereign bond



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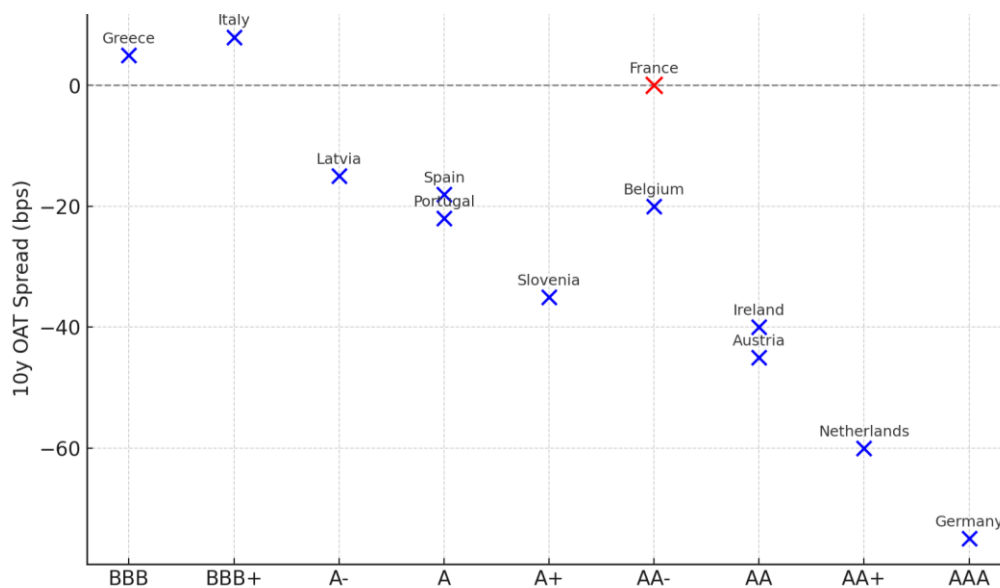
November 2023, 3.5% coupon OAT versus September 2023, 3.5% coupon LVMH bond
Source: LSEG

Source: [FT](#)

Fourth, [the ECB. Net purchases under PEPP ended in 2022 and reinvestments are being phased out in 2024](#), but the ECB has equipped itself with the Transmission Protection Instrument (TPI), designed to counter unwarranted fragmentation. While politically less visible than OMT, its very existence serves as a deterrent against disorderly spread widening.

Finally, contagion. Spain and Portugal have been upgraded even as France was cut. Italy trades where it has always traded. The idea of a new eurozone crisis, sparked by OATs, does not match the evidence. This dynamic is more akin to idiosyncratic repricing than systemic fracture (**Figure 5**).

Figure 5: Euro Area 10y – OAT Spreads vs Sovereign Ratings



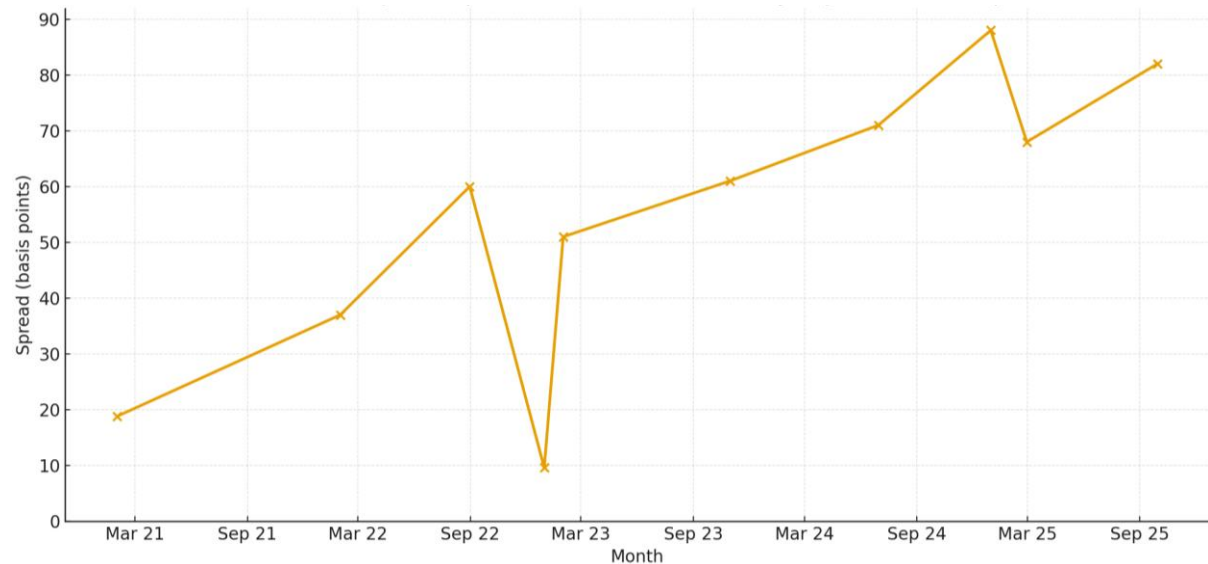
Source: [Macrobond](#)

6. Implications for Investors

France deserves a risk premium, but not Italian pricing. In a base case, OAT–Bund spreads should settle in the 70–90 basis point range (currently 80–85bps), reflecting structural weakness but also core status. In a stress scenario, spreads could test 110–120bp if deficits surprise to the upside or ratings agencies turn more aggressive (Figure 6).

Figure 6: France-Germany 10y Spread (OAT-Bund), Monthly – Jan 2021 to Sep 2025

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Source: [Borsa Italiana](#)

For a rates desk, this volatility is tradable. Relative value trades “long Spain, short France” capture divergence in fiscal credibility. On the curve, heavy issuance argues for steepening in the 10s-30s segment, where supply pressure will be most acute. Positioning data suggest real money accounts underweight OATs while overweight Iberia, exaggerating the dislocation. That sets up attractive carry-and-roll opportunities in the OAT belly, where valuations look stretched.

Cross-asset, fiscal noise will keep French banks’ funding costs wider than peers and could cap CAC 40 performance. But systemic eurozone risk is not the trade. The opportunity lies in helping clients monetise volatility intelligently.

Figure 7: A Scenario Analysis

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Scenario	Probability	Spread Range	Catalysts	Trades	Risk to View
Base	High	70-90 bps (current 80-85)	Fiscal noise; heavy issuance; PEPP reinvestments phasing out; no systemic contagion	RV: Long SPGB 10y vs Short OAT 10y (target 15-20bp compression, stop +10bp). Curve: OAT 10s-30s steepener (enter 55-60bp, target 70bp, stop 50bp). Carry: Prefer OAT 5-7y belly vs Bunds.	Unexpectedly hawkish ECB; risk-off into Bunds; Spain weakens vs France.
Tightening	Medium	60-70 bps	Credible fiscal plan; benign auctions; ECB easing tone; EU fiscal enforcement bites evenly	Reduce RV Spain>France; consider tactical Long OAT vs Bund; take profits on steepener if curve converges.	Growth shock to France; downgrade chatter returns.
Stress	Low	110-120 bps	Budget slippage >6% of GDP; ratings action; supply indigestion; political gridlock	Flip RV (hedge Spain risk), fade longs; consider flatteners if front-end reprices ECB later-for-longer.	ECB anti-fragmentation signalling; auctions clear well.

Source: Author's Estimations

7. Conclusion

France's fiscal trajectory is troubling, and its politics are noisy, but equating it with Italy is misplaced. OATs are not BTPs. They are benchmark instruments with deep liquidity, structural buffers, and ECB protection.

For markets, the task is to cut through the panic. Investors need to understand that vigilance is warranted, yet mispricing is rife. France will remain a magnet for volatility, and that is an opportunity to trade spreads, curves, and cross-asset dislocations but not a reason to flee.

The bond vigilantes have returned, and France is their first target. But the real story is broader: advanced economies no longer get a free pass. Fiscal credibility now carries a market price. France is the test case, others may follow.