ROSA & ROUBINI
ASSOCIATES

MACRO PICTURE

Europe's Fiscal Divide:

France Now Lags Its Peers

By

Nato Balavadze

1 October 2025

Nato Balavadze

Europe's Fiscal Divide: France Now Lags Peers

1 October 2025

Table of Contents

Rosa & Roubini Associates Ltd is a private limited company registered in England and Wales (Registration number: 10975116) with registered office at 118 Pall Mall, St. James's, London SW1Y 5ED, United Kingdom.

For information about Rosa&Roubini Associates, please send an email to info@rosa-roubini-associates.com or call +44 (0)20 7101 0718.

***Analyst Certification**: I, Nato Balavadze, hereby certify that all the views expressed in this report reflect my personal opinion, which has not been influenced by considerations of Rosa & Roubini Associates' business, nor by personal or client relationships. I also certify that no part of my compensation was, is or will be, directly or indirectly, related to the views expressed in this report.*

Nato Balavadze

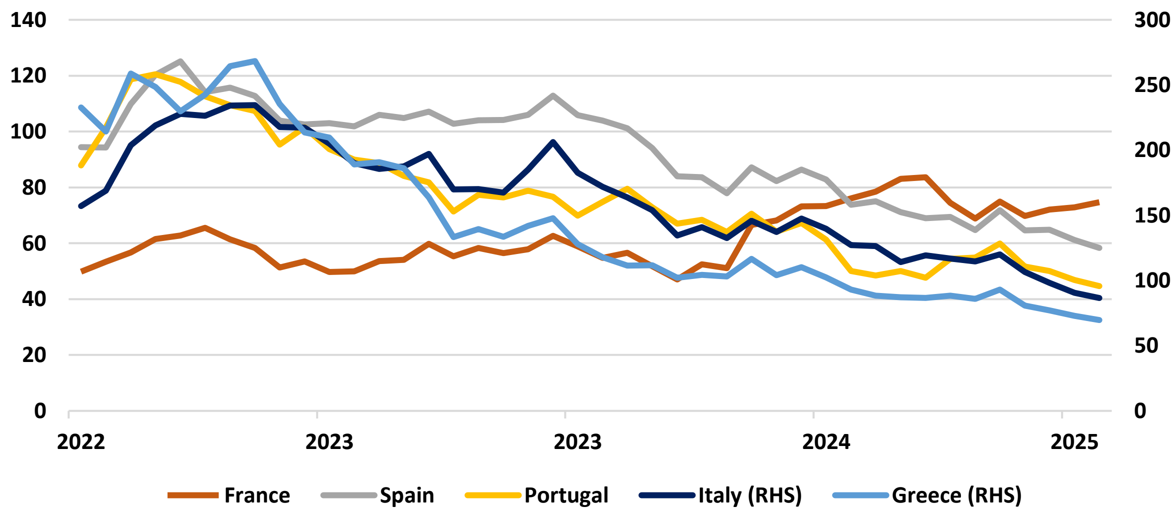
Europe's Fiscal Divide: France Now Lags Peers

1 October 2025

Executive Summary

- France posted the eurozone's largest deficit in 2024 (5.8% of GDP) and remains in negative primary balance, pushing debt above 114% and on course toward 125% by 2029.
- Exceptionally high spending (57% of GDP, driven by pensions and healthcare) and a weak consolidation record leave little room for adjustment, despite already high taxes.
- Fitch cut France to A+ citing persistent deficits and political instability, though market reaction was limited, with OAT–Bund spreads stabilizing near 80bp.
- With the largest deficit, unsustainable debt dynamics, entrenched spending, and political fragmentation, France has become the Eurozone's fiscal laggard, underscored by its recent downgrade.
- French 10-year yields briefly hit 3.6%, narrowing the gap with Italy, while higher borrowing costs are weighing on equities, prompting investors to shift toward Italy and Germany.
- Spreads remain below past crisis peaks, but France's lack of a credible reform path, combined with the ECB's nearing end of easing, leaves risks tilted toward further widening and volatility.
- Markets treat France as an isolated case, with limited contagion to peers. The CAC 40 has underperformed since Macron's June 2024 snap election, and OAT–Bund spreads have widened to ~80bp.
- Portugal and Greece are leading on consolidation with surpluses and falling debt, Italy has regained stability with primary surpluses, and Spain is holding steady but risks debt stagnation near 100% of GDP.
- In Italy, deficit consolidation is on track, falling to 3.4% of GDP in 2024 with projections below 3% by 2025; however, debt remains high at 135% and is set to rise slightly before resuming a gradual decline.
- Spain's deficit narrowed to 2.7% and debt fell to 103.5% of GDP, but structural imbalances risk keeping debt stuck near 100% without deeper adjustment.
- Portugal's debt dropped to its lowest since 2009 (93.6% of GDP) with strong consolidation momentum, while Greece posted a surplus and the eurozone's sharpest debt reduction, marking a striking turnaround from its crisis-era position.

Key Picture: European Government Bond Spreads to 10-Year German Bunds



Source: Fred

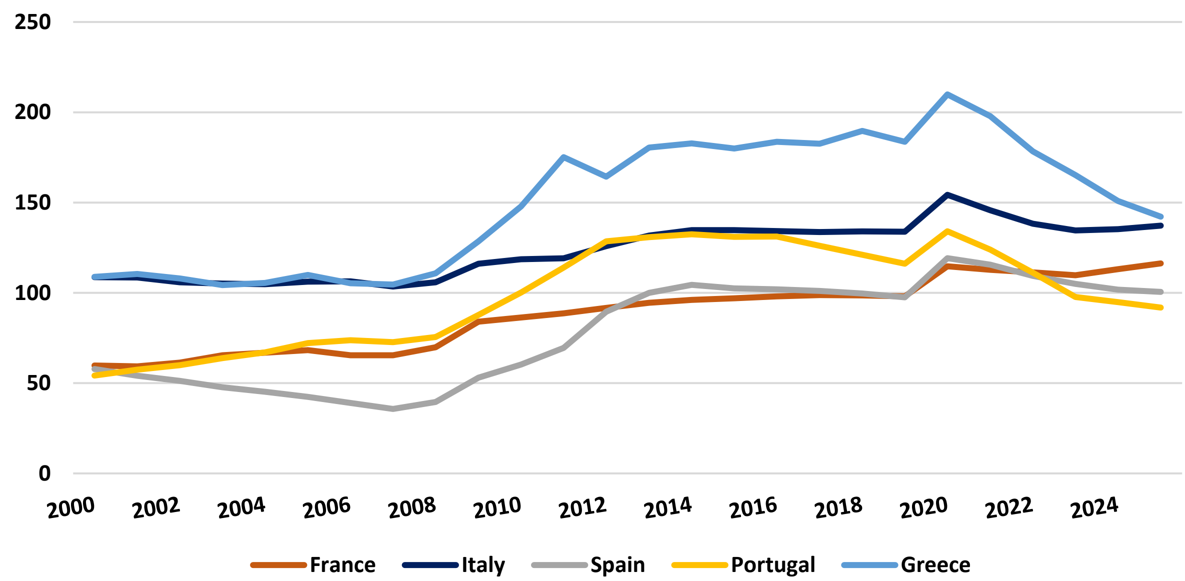
Introduction

Markets are closely watching the political turmoil in France following the collapse of Prime Minister François Bayrou's government. Bayrou was ousted on 8 September after losing a confidence vote on his proposal to reduce the budget deficit through a €44 billion mix of tax hikes and spending cuts. In response, President Emmanuel Macron swiftly appointed Defence Minister Sébastien Lecornu as the new prime minister — the fifth to serve during his second term.

The fiscal landscape across Southern Europe has shifted markedly. Portugal and Greece, once at the epicentre of the eurozone crisis, are now leading on consolidation, posting surpluses and cutting debt ratios. Italy has moved onto a more stable footing, with a return to primary surpluses and improved external balances, even as debt remains high. Spain, though avoiding EU sanctions, risks stagnating with debt stuck near 100% of GDP and progress reliant on favorable macro conditions.

Against this backdrop, France stands out as the laggard. Its deficit is the deepest in the group, its debt trajectory the least sustainable, and its political environment the most fragmented (**Figure 1**). Unlike Portugal and Greece, which are steadily reducing debt, or Italy, which is gradually consolidating under a stable government, France faces entrenched structural spending pressures and weak consolidation momentum. The country's persistent primary deficit, reliance on temporary revenue measures, and political instability undermine credibility and have already led to a sovereign downgrade.

Figure 1: French Debt Burden Third Biggest in the EU (General Government Gross Debt as % of GDP)



Source: IMF WEO

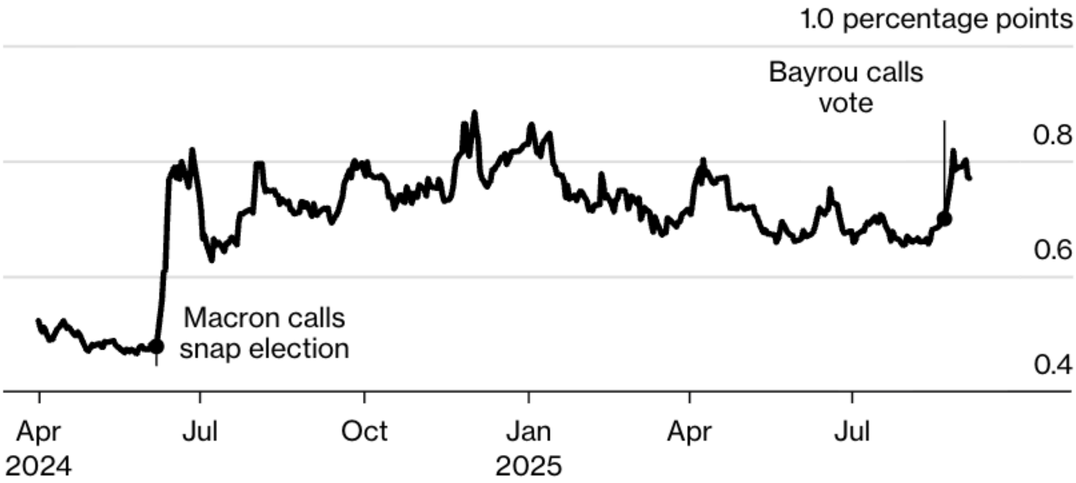
Market Reaction

Markets so far have treated France as an idiosyncratic case: spreads remain contained, and contagion into other sovereigns has been minimal. It seemed that markets have already priced in Bayrou's likely exit, with the CAC 40 underperforming peers and OAT–Bund spreads widening since late August. [Since Macron's snap election in June 2024 plunged France into stalemate](), the CAC 40 has dropped 4.1%, while the Stoxx Europe 600 gained 4.9% and Germany's DAX surged 24%.

The spreads remain near levels last seen during Macron's snap election in July 2024. Furthermore, risks are tilted toward further widening, especially as the ECB's easing cycle nears its end and quantitative tightening keeps pressure on yields. French 10-year yields briefly touched 3.6% after Bayrou called the vote, narrowing the gap with Italy before easing to 3.45%. The OAT–Bund spread widened to around 80bp, about 10bp higher than before the turmoil (**Figure 2**). Italian and French 10-year bond yields converged, shrinking the spread to zero from roughly 50bps in April and nearly 200bps at the height of the 2020 Covid crisis (**Figure 3**). Higher borrowing costs weigh on equities, especially smaller indebted firms, prompting investors to shift exposure toward Italy and Germany.

While current spreads are below the peaks seen during Barnier's collapse last year or Italy's 300bp blowout a decade ago, France lacks a credible fiscal reform path, leaving it more exposed. The ECB's backstop (TPI) limits the risk of disorderly moves, but uncertainty around ratings and politics could still drive volatility and sustain elevated spreads.

Figure 2: France vs Germany 10-Year Yield Spread



Source: Bloomberg

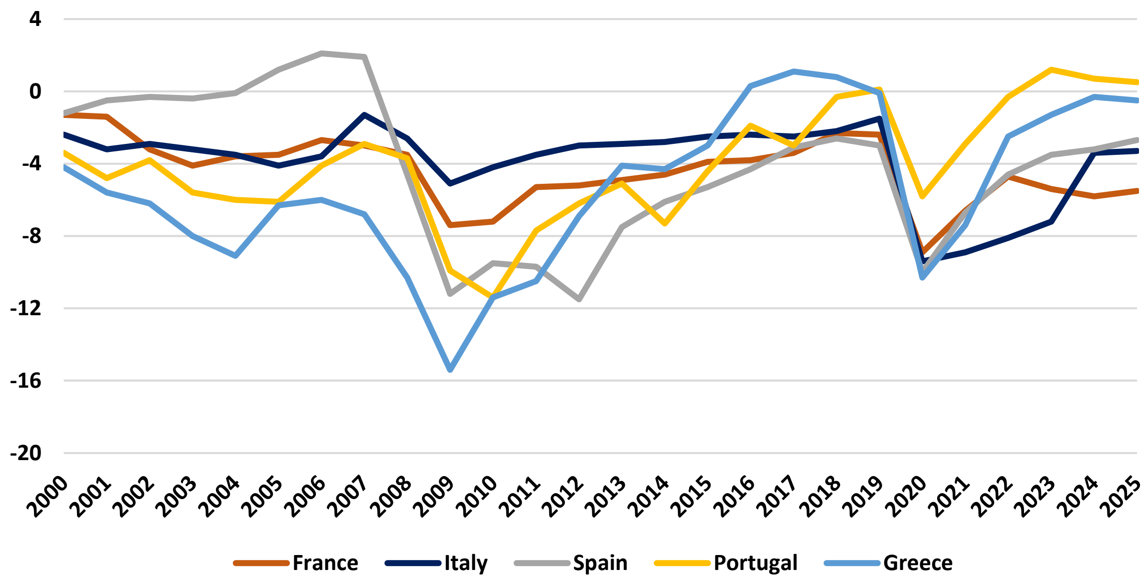
Figure 3: France vs Italy 10-Year Yield Spread

Source: Bloomberg

France Is a Fiscal Laggard

France has emerged as the fiscal laggard among Europe's large economies. The deficit widened to 5.8% of GDP in 2024, the largest in the group, while debt climbed above 114% of GDP (**Figure 4**). Importantly, Paris continues to run a negative primary balance, signaling that debt dynamics remain on an unsustainable path (**Figure 5**).

Figure 4: General Government Net Lending/Borrowing (Percent of GDP)



Source: IMF WEO

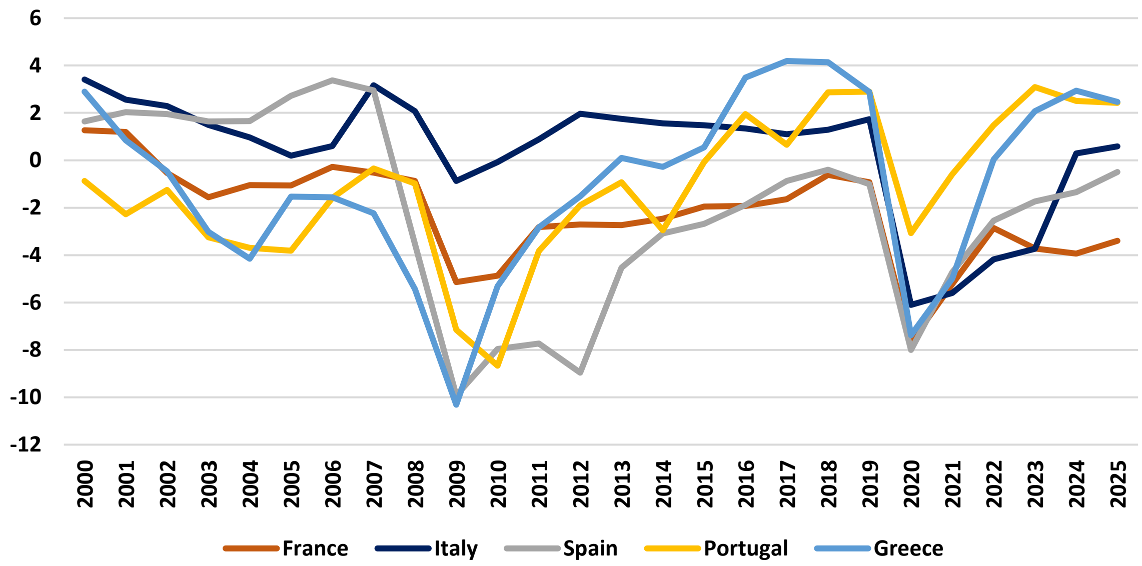
Fitch's downgrade of France from AA- to A+ on September 12 reflects these structural weaknesses. According to the Finance Ministry, public spending is set to rise by €51.1bn in 2025, which—absent corrective measures—would push the deficit to 6.1% of GDP, above the 5.4% expected this year and far from the 4.6% target submitted to Brussels. On current policies, debt would climb from 113% of GDP in 2024 to 125% by 2029. Indeed, Fitch's agency pointed to persistently high deficits, debt projected to reach 132% of GDP by 2034, and political instability as key risks. The move brings France closer to Italy's debt profile, while countries like Spain and Belgium are on more stable trajectories.

France also suffers from a weak consolidation record: the deficit has exceeded 3% of GDP in all but three of the past two decades, and the country has not run a primary surplus since 2001. Underlying rigidities make adjustment harder. France's tax-to-GDP ratio (45.6%) is already the EU's highest, leaving little room to raise revenues further, while structural spending—particularly pensions, healthcare, and welfare—remains entrenched at 32% of GDP versus a 26% EU average. Previous reform efforts have yielded only modest savings and faced stiff political opposition.

Since 2017, tax revenues have fallen by over 2 percentage points of GDP, while public spending has remained exceptionally high—57% of GDP versus a eurozone average of 50%. The excess is driven primarily by pensions (2.2 percentage points above peers) and healthcare (1.5 points). With the primary deficit below the stabilization threshold, France lacks the fiscal anchor needed to put debt on a sustainable trajectory.

The downgrade triggered little market reaction. A brief widening in the 10-year OAT–Bund spread quickly reversed, leaving it near 80bp, on par with Italy's, suggesting investors had already priced in the move.

Figure 5: Primary Net Lending/Borrowing (Also Referred As Primary Balance) (% of GDP)



Source: IMF WEO

Italy's Deficit Falls, Debt Lingers

Italy's credit profile has strengthened considerably, underpinned by fiscal prudence, reform progress, and political stability. The deficit fell to 3.4% of GDP in 2024, from 7.2% a year earlier, helped by the phase-out of pandemic and energy support measures and buoyant revenues. For the first time in years, the primary balance turned positive (0.4% of GDP), though interest costs rose close to 4% of GDP.

Looking ahead, Fitch projects a shortfall of 3.1% of GDP in 2025, below the government's 3.3% target, supported by strong tax revenues, improved compliance, and strict expenditure control. Italy's deficit could drop below the EU's 3% ceiling as early as 2025, Economy Minister Giancarlo Giorgetti said, citing stronger-than-expected tax revenues—up 5.3% year-on-year in the first seven months, or €16bn. The government aims to reduce the deficit further to 2.6% in 2027 and under 2% by 2029, with the primary surplus rising to 2.4**%** by then.

Despite these improvements, the debt ratio rose to 135.3% of GDP in 2024 and is expected to climb to 138.2% by 2026. After falling by more than 20 points between 2020 and 2024 to 135% of GDP, debt is projected to edge up temporarily due to one-off measures (the superbonus scheme) before resuming a gradual decline toward 134% by 2030. With long average maturities, strong market liquidity, and ECB backstop support, refinancing risks remain limited.

External accounts also provide support. Italy recorded a current account surplus of 1.1% of GDP in 2024, aided by a better energy balance, and maintains a record-high net international investment surplus of 15% of GDP. Net external debt has dropped to a two-decade low, reducing vulnerability to external shocks.

Spain Nears the EU Targets

While debt remains the fifth highest in the eurozone, Spain has avoided the EU's excessive deficit procedure thanks to steady progress: its 2024 deficit of 3.6% was deemed temporary and expected to fall below the 3% threshold without new measures. Spain posted a 2.7% deficit and cut debt to 103.5% of GDP in Q1 2025, with both indicators improving on the previous quarter, according to Eurostat. The decrease in deficit is driven by stronger revenues from the reversal of VAT cuts and new regulations, stable expenditure as a share of GDP, and favorable macro conditions.

Debt is expected to decline only slowly, hovering close to 100% of GDP for the foreseeable future. Much of the decline from above 120% five years ago was due to temporary tailwinds: rapid post-pandemic recovery, high inflation, and favorable financing costs. With inflation converging to 2% and growth slowing, the gap between growth and borrowing costs is narrowing, limiting automatic debt reduction.

BBVA Research estimates Spain's structural primary deficit at around 1.5% of GDP. Without stronger adjustment, the risk is that debt stagnates at a high level, even if the deficit converges toward EU thresholds.

Portugal's Fiscal Outperformance

Portugal has emerged as a fiscal outperformer. Public debt fell to 93.6% of GDP in 2024, the lowest since 2009 and well below government forecasts. The Finance Ministry highlighted this as proof of a "prudent and responsible trajectory," which has already earned successive rating upgrades.

Debt is projected to fall further to 90.2% in 2025, with the government targeting annual reductions of 3-4 percentage points. The 2024 decline alone exceeded 4 points. Even though 2026 will be more challenging due to EU recovery loans, Portugal's consolidation momentum is strong.

Growth is expected to slow to around 1.9% in 2025 and 1.8% in 2026, reflecting weaker investment and exports, but fiscal discipline is offsetting macro headwinds. Portugal's post-crisis trajectory now stands in sharp contrast to its peers from a decade ago.

Greece's Fiscal Turnaround

Greece delivered one of the sharpest fiscal improvements in the EU. It recorded a 1.3% budget surplus in 2024, up 2.7 percentage points from the year before. This places Greece among the very few EU countries in surplus, in contrast with France's 5.8% deficit.

At the same time, Greece achieved the largest debt reduction in the bloc, cutting its ratio by more than 10 points to 153.6% of GDP—still the highest in the EU, but on a clearly declining path. Strong growth, buoyant revenues, and spending restraint, supported by EU funds, underpinned the adjustment.

High interest costs—about 7% of government spending—remain a constraint, but Greece has shown that sustained primary surpluses can anchor debt reduction even under very high debt levels. Its fiscal trajectory now places it among the eurozone's leaders, a stark reversal of its crisis-era position.