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Markets focus on French debt amid government upheaval

France's fiscal concerns return to the spotlight as President Macron appoints a new prime minister – the fifth in under two years.

Markets are monitoring a political crisis in France after the collapse of Prime Minister François Bayrou's government.

Mr Bayrou fell on 8 September in a confidence vote over his plans to cut the budget deficit involving a EUR 44 billion package of tax increases and spending cuts.

French President Emmanuel Macron moved quickly to appoint defence minister Sébastien Lecornu as his new prime minister, the fifth of President Macron's second term.

Mr Lecornu, a close ally of President Macron, faces the difficult task of securing parliamentary approval for a new budget. He will not form a government until the discussions are agreed, the Elysée palace said.

Key takeaways

- With France's debt exceeding 114% of GDP, ratings agency Fitch will announce on 12 September whether to downgrade the French rating to single-A.
- We think it is possible that France will continue to muddle through until the 2027 presidential election, but that the country's risk assets will continue to underperform.
- Despite the turmoil, demand for French government bonds is robust, with some investors viewing rising yields as an attractive entry point.
- The current disruption in equity valuations may create opportunities to gain exposure to stocks that are unexposed to domestic dynamics.

France's debt ratio has climbed to above 114% of GDP¹ and the country's fiscal concerns have returned to the forefront of investors' attention at a time when European neighbours such as Italy are making comparative progress in taming deficits.

MACRO



Christian Schulz
Chief Economist

We expect market focus to now turn to the European Central Bank (ECB) and the ratings agencies in the coming days. We think ECB President Christine Lagarde will maintain pressure on French politicians by ruling out any financial support. Ms Lagarde may also signal that the ECB monitors contagion to the wider euro zone financial system and especially fiscally more prudent member states. Above all, we expect Ms Lagarde to avoid any statements which would accelerate any widening in spreads between France's sovereign bonds and those of other euro zone countries. Ratings agencies are also closely monitoring the situation, and we anticipate downgrades to France's sovereign debt rating.

Consensus among commentators seems to be that the new prime minister will – under the pressure of protests and strikes – make concessions to the Socialists to get a budget over the line with some minor fiscal adjustment, tax hikes and some watering down of the pension reform.

A budget compromise would “kick the can down the road” and fall far short of the around 3% of GDP fiscal adjustment necessary to stabilise France's public debt ratio, yet should not come as a surprise to markets. However, it sets up a struggle with the European Commission (and by extension the ECB) and could antagonise the French centre-right, triggering more confidence votes.

Snap election scenarios

Although a snap parliamentary election looks less likely at this stage, if it does materialise, anything is possible due to France's two-round first-past-the-post system. The most recent Harris poll for parliamentary elections (4-5 September) sees the far-right ahead with 33% of voting intentions. The left-wing alliance NFP comes second with 26%. In the centre, President Macron's centrist ENS polled 16% (-5pp compared to last year's election) and the centre-right LR at 10% (+3pp). It is possible that the far right or the left win outright majorities, but also that the three-way gridlock is repeated. We will also watch out for any changes to the electoral law, as a concession to get the budget over the line.

A snap presidential election would occur if President Macron eventually yielded to pressure to step down. In that case, the far-right would stand a good chance of winning, albeit not guaranteed. The most recent poll (Ifop from 19-20 May) sees far-right leader Jordan Bardella in the lead in the first round with 31%, ahead of centrist Edouard Philippe at 21% and far-left Jean-Luc Mélenchon at 13%. Mr Philippe and Mr Bardella would then be tied at 50% each in a second round (although Mr Philippe would likely defeat Marine Le Pen if she was cleared to run). The far-right would comfortably win in the event of a run-off between it and the far-left.

We think it is possible that France continues to muddle through until the 2027 presidential election and that a centrist defeats the extreme parties again. This scenario would return France to an economically more sustainable path. But “muddling through” has weakened the political centre and may continue to do so. The time window for a stable political outcome is running out, with numerous event risks ahead.

We continue to expect underperformance in French risk assets, including a widening in French sovereign spreads. French instability could prove a stumbling block for the drive to strengthen European sovereignty, providing headwinds to the euro.

GOVERNMENT BONDS



Matthieu de Clermont
CIO Insurance & Regulatory
Strategies

Despite political gridlock in Paris, and France's debt ratio climbing above 114% of GDP, French government bonds – Obligations assimilables du Trésor (OATs) – have recently continued to attract robust demand. One explanation lies in the timing and context of recent issuance on 4 September; market participants were already pricing in the likelihood of a government collapse, so when the auction was held, the absence of drama became itself a surprise. For some, this uncertainty offered a tactical entry point, particularly with yields at striking levels.

Currently, 10-year OATs at around 3.50% are near their highest in three years, returning to the territory last seen in 2011-2012. The 30-year benchmark, trading in the 4.50% range, exceeds the previous 2023 peak and similarly harks back to 2011.² These elevated yields, coupled with a strong presence of local investors, underpin demand despite headline risks.

Looking ahead, several factors could shift investor appetite for French government bonds. Ratings agency Fitch will announce on Friday 12 September whether to downgrade France from AA to single-A; however, we do not expect this decision to significantly impact sentiment given that pricing already reflects a credit profile close to single-A. More important is the political landscape, which remains pivotal. The emergence of a caretaker government would renew doubts about the administration's durability, while parliamentary dissolution and new elections risk perpetuating a hung parliament and prolonging uncertainty. In our view, such scenarios could heighten the perception of political risk and test the market's tolerance.

Euro zone fragmentation, though currently considered a low-probability event, remains a distant but consequential tail risk. Ultimately, continued investor confidence in French OATs will hinge not just on local yield appeal, but on the evolution of France's political stability and its broader euro zone context.

CREDIT



Vincent Marioni
CIO Credit

The announcement of the vote of confidence on 25 August impacted the credit market for the most sensitive companies. Additional Tier 1 bonds (AT1s) and subordinated corporate hybrid issues lost 2 and 1.5 percentage points respectively.² But, with the likely censure of the government already factored into markets, the prime minister's subsequent resignation did not have a significant effect. The market is accustomed to political instability, and the French risk is not systemic. France carries a risk premium, but it is fairly low. The market is focusing instead on other major issues, notably the US Federal Reserve and the US macroeconomy.

EQUITIES



Virginie Dubois
Product Specialist

Political uncertainty is back in the spotlight, but it should not obscure the opportunities that are emerging. Prime Minister Bayrou's fall had been widely anticipated by the markets when the confidence vote was announced. What matters now is what happens next.

With Mr Lecornu's appointment, the market focus turns to a search for compromise, particularly with the left-wing parties, and the most widely accepted scenario is some concessions on tax and/or pension reform.

The key challenge for the country is to curb its debt level, which at 114% of GDP is valued at EUR 3.3 trillion – the third highest in the euro zone behind Greece and Italy. The debt trajectory remains a key factor for the markets. A full-blown, self-perpetuating financial crisis, with higher yields meaning higher deficits and therefore even higher costs, is unlikely at this stage.

² Source: Bloomberg, 8 September 2025

From an equity perspective, the situation must be approached with caution. We have reduced our positions in sectors that are most sensitive to domestic dynamics, such as utilities, infrastructure and certain banks and insurance companies with significant exposure to the French market.³ Our view is that these segments could still experience turbulence.

However, our outlook remains positive. Most CAC 40 companies generate most of their revenue internationally, which means they are largely unaffected by local political turmoil. Furthermore, the declines in valuations do not reflect a deterioration in fundamentals. On the contrary, they may offer attractive entry points for quality stocks that have been unfairly penalised. We will be paying particular attention to this in the coming weeks.

³ This is for guidance only and not indicative of future allocation.

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