

The situation in France remains a concern for investors

The French 10-year sovereign yield reached a new high of 5.1% this morning, its highest level since 2002. While this increase comes against a generally challenging backdrop for bond markets, amid tensions in the Middle East and rising energy prices, it also reflects France-specific factors. The 10-year OAT-Bund spread has continued to widen, reaching 170 bps, its highest level since 2011, with a significantly more pronounced move than in other euro area sovereign bond markets.

This underperformance primarily reflects **the increase in the risk premium demanded by investors amid uncertainty surrounding the trajectory of France's public finances**. The weakening economic outlook is making the fiscal equation even more challenging: weaker growth mechanically reduces the government's room for manoeuvre at a time when restoring the public finances would require significant adjustment efforts. Against this backdrop, the government's 1% growth assumption, used to project a reduction in the public deficit to 5% of GDP in 2027, already appeared ambitious. By comparison, previous episodes of social unrest, including the Yellow Vest protests, transport strikes and protests against the pension reform, are estimated to have reduced growth by 10 to 20 bps, although INSEE highlights the difficulty of precisely quantifying their impact. Investors will therefore be closely monitoring the scale of the upcoming demonstrations, particularly those announced for 24 October and 5 November, and, more importantly, their potential political and fiscal consequences.

It is worth noting that, in the absence of the current social tensions and election-related uncertainty, the 10-year OAT-Bund spread should, when compared with other European countries in terms of fiscal deficit, cumulative deficit and credit rating, stand at around 90 bps.

In the absence of greater visibility on the political situation and on the government's ability to pass a budget capable of stabilising the trajectory of public finances, volatility is likely to remain elevated across French assets, leading us to maintain a cautious stance.

Nevertheless, **the risk of contagion to the euro area as a whole appears contained at this stage**, even though Italian and Spanish spreads have widened to 125 bps and 70 bps, respectively. This view is also consistent with our stress scenario, which is built around a **France-specific shock rather than a renewed systemic euro area crisis**, particularly given the backstops implemented by the ECB.

Finally, the risk of a French sovereign default should be distinguished from a scenario involving severe market stress. An OAT-Bund spread of 170 bps and an OAT yield of 5.1% would signal a very significant deterioration in the market's perception of French sovereign risk, but would not, intrinsically, imply a default scenario. At this stage, the key risk to monitor therefore appears to be less an imminent default rather than the emergence of a self-reinforcing dynamic between declining investor confidence, a higher risk premium, rising interest costs and reduced fiscal room for manoeuvre.

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