



PERSPECTIVES Memo

France – Summer déjà vu

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Key takeaways

- The French prime minister François Bayrou is seeking a vote of confidence on September 8 to support austerity plans, but his chances of success are low.
- France's fiscal and political strains are driving up OAT yields and prompting spreads to widen, with credit rating downgrades a key risk.
- French financials are underperforming, hit by the rising cost of equity, tax uncertainty, and weak loan growth; 30% of CAC 40 stocks may face earnings downgrades.
- European banks remain strong – with limited exposure to France – benefitting from earnings momentum and favourable rate dynamics.

What happened?

French assets have been roiling recently with French 10Y bond (OAT) spreads to German 10Y (Bunds) climbing to their highest level since January at 82bps. French 10Y bonds now yield only 6.7bps less than their Italian counterparts, their lowest level since 2005. Spreads on French credit default swaps have jumped from 33.6bps to 37.6bps since last Friday. The equity benchmark CAC 40 had lost 3.26% as of Tuesday before paring back some of the losses to a current week-to-date loss of 1.97%. Banks have taken the hardest hit with a loss of -8.8% by yesterday's close.

The financial market movements are largely a reflection of the increase in political uncertainty that has been building over time in the background. After months of disputes, the government of François Bayrou managed to pass the 2025 austerity budget through parliament and is delivering the promised savings.

Throughout the summer, Bayrou repeatedly emphasised that France must make massive spending cuts.

Unusually early the prime minister presented the key points of next year's budget back in July. It includes savings of around EUR44bn.

Otherwise, acute over-indebtedness threatens to render the country, economically and politically, incapable of action. This year, interest payments will become the largest item in the budget, Bayrou stressed. He also proposed abolishing May 8 (Victory Day) and Easter Monday as public holidays.

However, the budget plans are facing resistance – not only politically, but also from civil society. For weeks, a movement called *Bloquons Tout* (in English: Block Everything) has been forming, aiming to paralyze the country on September 10. Bayrou has chosen his own departure date, according to the far-left party LFI, which has called for a general strike.

La France Insoumise (LFI) parliamentary leader Mathilde Panot emphasised that the party would certainly not express confidence in the government. The Greens and Communists who along with LFI form the so-called New Popular Front, the left-wing alliance in parliament, have also announced they will not support Bayrou in the confidence vote. The far-right *Rassemblement National* (RN) plans to do the same. RN parliamentary spokesperson Thomas Ménagé stated that supporting this government would be a betrayal of the voters.

This puts the Socialists in a difficult position. They must choose between ensuring the political survival of an unpopular government and deepening divisions within the left or joining forces with the far right to bring down Bayrou – thus exposing the country to major challenges. Socialist Party leader Olivier Faure left little doubt about his party's intentions not to express confidence in Bayrou. Instead, the party plans to present its "counter-budget" over the next days. Bayrou knows the uphill task he faces but has nevertheless opted for a confidence vote.



He has presented a budget that is apparently attracting little support from the parliamentary opposition, the unions or the general public.

Although the government is receiving backing from Gabriel Attal, parliamentary leader of President Macron's Renaissance party, the responsibility now lies with the members of Parliament, who will vote on September 8. If Bayrou and his government fall, the question arises: who can still govern France with the current composition of Parliament? And will President Macron dissolve the National Assembly once again given that the constitutional restriction that at least one year must have elapsed between the previous parliamentary elections and the dissolution no longer applies? There is also a bigger issue at play, that by toppling government after government, both parties aim to pressure the President into resigning and force early presidential elections.

What does it mean for investors?

From an **economic** perspective, the government's aim to reduce the deficit to 4.6% by 2026 appears increasingly optimistic. To prevent further expansion of the deficit, France must identify annual savings equivalent to approximately 0.5% of GDP. Although the current absence of fiscal austerity measures may bolster short-term growth, it simultaneously contributes to a rising debt burden, which conflicts with EU fiscal requirements. This situation is reflected in rising French OAT yields, which account for both fiscal dynamics and prevailing political uncertainty. Considering the broad spectrum of possible scenarios outlined above, we do not anticipate a significant narrowing of the OAT-Bund spread soon.

Bond investors are not only concerned with the prevailing political instability but are also attentive to the upcoming review by the rating agency Fitch scheduled for September 12, just four days after the parliamentary vote. Subsequent reviews by other rating agencies will follow, with Moody's on October 24 and Standard & Poor's on November 28. France currently maintains an AA- sovereign rating from Fitch; however, the ongoing political uncertainty introduces additional risk to this rating. Should two of the three major agencies implement a downgrade, it may limit banks' ability to use OATs as collateral, thereby reducing an essential source of demand for French sovereign bonds. Since one-third of all maturing French government bonds (OATs) are held by the ECB – which is in the process of decreasing its bond holdings – OATs are becoming increasingly reliant on alternative sources of demand.

A downgrade may also lead to increased costs for CDS protection as the market responds to heightened perceptions of default risk. Furthermore, with Italy scheduled for a ratings review on September 19, the outlook for OATs remains uncertain. In this scenario, the spread between OATs and Bunds could widen further. Should France experience a downgrade while Italy receives an upgrade, it is possible that additional capital may flow into Italian bond markets at the expense of French bonds.

From a **foreign exchange** perspective, barring significant changes in the political environment, the EUR is expected to experience limited impact. Current market conditions have already incorporated considerable risk premium, as evidenced by the OAT-Bund spread, and have taken into account the previously mentioned downgrades.

Regarding potential deterioration of the situation, France faces two primary scenarios: the appointment of a new prime minister backed by the existing parties, or, should elections be held, the emergence of another fragmented parliament – both outcomes would largely mirror the status quo. Provided that France refrains from materially increasing its debt levels and continues efforts toward fiscal consolidation, even if it does so at a somewhat slower pace, currency markets are unlikely to factor in a notable additional risk premium for the EUR.

On the **equity** front, the initial decline in the CAC 40 that we saw this time around was about half the size of last summer's drop following snap election news, when the index lagged the broader European market by 4ppts for two weeks before stabilising. French stocks may continue to underperform in the short term. We do not expect weakness to spill over to the broader European stock market.

We highlight that the CAC 40 has underperformed the broad European market by around 5ppts year-to-date, driven by weaker relative earnings dynamics. Nevertheless, the index is trading at an NTM P/E ratio of 14.7x, which is 7% higher than the 10Y average. Furthermore, compared to the STOXX Europe 600 the index's valuation is close to its 10Y-high.

This week, banking and insurance equities experienced the most pronounced declines across sectors. Several factors contributed to this trend. Firstly, rising OAT yields have led to losses on sovereign holdings, as OATs comprise 12–30% of bank portfolios; nonetheless, these exposures are typically hedged, which mitigates the negative impact.



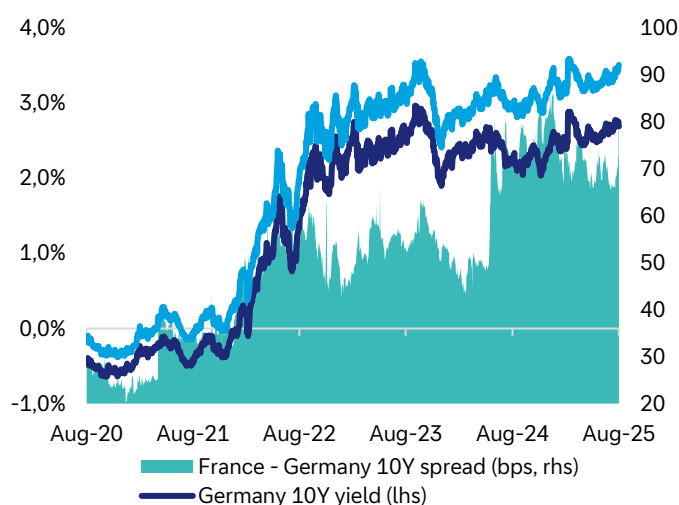
Additionally, widening spreads on French government bonds may result in increased equity costs for financial institutions, an effect that would be exacerbated by any downgrade of France's credit rating. Political uncertainty also poses risks, particularly if it dampens lending demand. Although loan growth has rebounded from 0% year-on-year last November to 1.8% in June, it remains subdued relative to historical standards.

Furthermore, the financial sector could be adversely impacted should the 10ppts tax surcharge on large corporations with revenues exceeding EUR3bn be extended into 2026, rather than reduced as previously anticipated. Analysts estimate this would reduce earnings at major banks by up to 3%.

It is noteworthy, however, that companies facing potential earnings declines of more than 5% due to such an extension represent nearly 30% of the CAC 40 index. Accordingly, we anticipate possible EPS downgrades and some underperformance in this scenario.

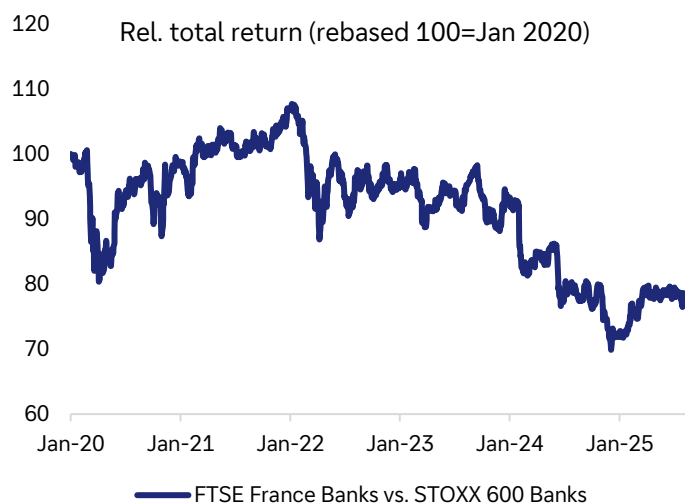
Weakness in French banks is having minimal impact on the broader European banking sector, which we still favour as one of our preferred sectors, as French banks account for just 10% of the STOXX 600 Banks index. Accordingly, we consider periods of continued weakness as potential buying opportunities. We highlight that the sector continues to experience a strong earnings upgrade cycle, unparalleled by other sectors. Additionally, the sector stands to benefit from the steepening yield curve and remains insulated from direct tariff risks.

France is France – And Germany is Germany



Source: LSEG Datastream, Deutsche Bank AG; Data as of August 28, 2025

European politics – French banks feeling the heat



Source: LSEG Datastream, Deutsche Bank AG; Data as of August 28, 2025



Appendix

Historical performance

	28.8.2020 - 28.8.2021	28.8.2021 - 28.8.2022	28.8.2022 - 28.8.2023	28.8.2023 - 28.8.2024	28.8.2024 - 28.8.2025
10 year French Government Bonds	0,6%	-14,3%	-6,1%	4,8%	-2,2%
10 year German Government Bonds	0,6%	-14,6%	-7,3%	5,3%	-1,5%
STOXX 600 Banks	47,8%	-2,8%	34,3%	34,8%	-4,9%
CAC 40	36,7%	-3,1%	20,4%	6,7%	-1,2%
FTSE France Banks	53,6%	-9,0%	37,0%	7,9%	-82,7%

Source: Deutsche Bank AG, Bloomberg Finance L.P., LSEG Datastream; Data as of August 28, 2025.



Appendix

Glossary

The **CAC 40** is a price index, which includes the 40 most valuable French companies that trade on the Euronext Paris exchange.

Credit default swaps (CDS) are credit derivatives that aim to offer some protection against credit defaults.

The **European Central Bank (ECB)** is the central bank for the Eurozone, meaning European Union countries who have adopted the euro.

The **Federal Reserve (Fed)** is the central bank of the United States. Its Federal Open Market Committee (FOMC) meets to determine interest rate policy.

Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.

NTM stands for next twelve months in the context of earnings and thus price/earnings ratios.

Price/earnings (P/E) ratios measure a company's current share price relative to its per-share earnings. In this context, LTM refers to last twelve months' earnings.

The National Rally (French: Rassemblement national, RN), known as the National Front from 1972 to 2018 (French: Front national, FN), is a French far-right political party, described as right-wing populist and national conservative.

OATs - in full, Obligation assimilable du Trésor - are French government bonds.



Appendix

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