Deutsche Bank
Chief Investment Office

PERSPECTIVES Memo

France: Fiscal concerns driving OAT spreads

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Authors:

Dr. Dr. Ulrich Stephan, Chief Investment Officer Germany

Dr. Dirk Steffen, Chief Investment Officer EMEA

Wolf Kisker, Senior Investment Strategist

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Key takeaways

- The spread of OATs over German Bunds widened to more than 110 bps in September.
- The French government is yet to devise properly funded proposals for the EUR54 billion of fiscal austerity measures required to meet its 2027 deficit target and could find it difficult to gain parliamentary approval for any such proposals.
- Risks seem largely priced in; OAT-Bund spreads are likely to remain elevated and volatile in the near term, with attractive carry potential over the medium term.

What happened?

The spread between ten-year French government bonds (OATs) and German Bunds widened sharply in September, increasing from around 85 bps at the start of the month to more than 110 bps on September 29, with 10y French bond yields at 4.75% compared with 3.63% for Bunds. The 100-basis-point threshold was breached intraday on September 18 for the first time since 2012.

The main driver was a deterioration in France's fiscal outlook. The budget adopted in February projected a general government deficit of 5.0% of GDP for 2026. However, fiscal data through July already pointed to mounting risks: the cumulative central government deficit widened to EUR145.9 billion, compared with EUR142.0 billion in the first seven months of 2025, as expenditure increased faster than revenues. The government of Prime Minister Sébastien Lecornu now expects the deficit to reach 5.4% of GDP in 2026, following 5.1% in 2025 and 5.8% in 2024. At the same time, it cut its 2026 growth forecast from 1.0% to 0.5%, while still expecting growth to return to 1.0% in 2027.

The greater challenge lies in the 2027 budget. According to government estimates, the deficit would rise to around 6.5% of GDP in the absence of corrective measures. Higher spending on interest payments, pensions, and social benefits is coinciding with the expiry of temporary tax measures and weaker revenue growth. Debt-servicing costs alone are expected to increase by around EUR10 billion. To limit the deficit to 5.0% of GDP and keep fiscal consolidation on track in 2027, the government has identified spending cuts and additional revenues amounting to EUR54 billion. So far, however, only part of this package has been specified. Proposed measures include a nominal freeze of central government spending outside defence, tighter constraints on local governments, a freeze of public-sector pay scales, smaller increases in selected pensions and welfare benefits, and EUR2 billion in savings on sickness benefits. Additional measures include an extension of the corporate tax surcharge at a reduced rate, stronger anti-fraud efforts, and a review of tax expenditures.

What does it mean for investors?

Markets are reacting not only to the higher projected deficit for 2026, but more importantly to the gap between the fiscal adjustment required in 2027 and a politically credible plan to deliver it. Without a parliamentary majority, the government must either secure legislative support or once again rely on Article 49.3 of the Constitution, thereby risking a vote of no confidence. For now, the EUR54 billion figure reflects the scale of the challenge rather than a package of measures that has already been approved. Even if the government succeeds in achieving its 5.0% deficit target for 2027, public debt would continue to rise. According to official projections, the debt-to-GDP ratio would increase from 115.7% at the end of 2025 to 119.3% in 2026 and 121.7% in 2027.

Weak growth is compounding France's fiscal challenges. The Banque de France expects real GDP to grow by 0.4% in 2026 and 0.9% in 2027, slightly below the government's forecasts of 0.5% and 1.0% respectively. Estimates compiled by the central bank put France's potential growth, the rate the economy can sustain without generating inflationary pressure, at around 1% per year over 2026–28. Growth alone is therefore unlikely to stabilise the public debt ratio. Even if the planned fiscal consolidation is delivered, it would slow rather than halt the rise in debt. Government expenditure is projected to decline only marginally, from 57.1% of GDP in 2026 to 56.9% in 2027, while the tax burden is expected to rise from 43.9% to 44.2%.

The spring 2027 presidential election is adding to France's fiscal uncertainty and OAT risk premia. As the vote approaches, parties have little incentive to support cuts to pensions, benefits or local-government spending, making it harder for the minority government to pass a credible budget. Election programmes could also affect France's external position, potentially exacerbating its twin deficit. France recorded a current-account deficit of EUR11.6 billion in 2025 and, based on monthly data, around EUR8.2 billion in the first seven months of 2026. Debt-financed measures to support household consumption could widen both the budget and current-account deficits if some of the additional demand flows into imports rather than higher domestic output. By contrast, measures that boost productivity and export capacity could support growth and hence improve the outlook for debt sustainability.

A further constraint comes from the EU fiscal framework, which limits the scope for any renewed fiscal slippage. France has been subject to the EU's Excessive Deficit Procedure since July 2024. The European Council requires the country to correct its excessive deficit by 2029 and has capped nominal growth in EU-defined net expenditure at 1.2% per year between 2026 and 2028. Investors will therefore focus not only on the 2027 deficit target itself, but also on whether the government's measures are durable and consistent with the agreed European fiscal path.

Credit ratings also argue against a rapid return to historically tighter spreads. Fitch and S&P rate France A+ with a stable outlook, while Moody's assigns an Aa3 rating with a negative outlook. At the same time, Eurosystem bond holdings are gradually declining as maturing securities purchased under asset-purchase programmes are no longer reinvested. With fiscal deficits remaining elevated, France will continue to depend on market funding.

France's importance to the euro area provides a counterweight to its fiscal risks. Former European Commission President Jean-Claude Juncker's remark that France was given leeway on fiscal rules "because it is France" illustrates the political reluctance to let tensions around a major member state escalate unchecked. In a period of severe market stress, European policymakers would likely explore ways to preserve stability, while the ECB has instruments – e.g. the Transmission Protection Instrument (TPI) – to address disorderly moves that threaten monetary-policy transmission. Although such support would neither eliminate fiscal risks nor resolve France's structural challenges, the prospect of a European response could help stabilise markets during periods of acute stress.

While a substantial share of fiscal and political risks appears already priced in, we see limited potential for a sustained decline in OAT-Bund spreads or their volatility in the near term. Uncertainty over the 2027 budget, fiscal consolidation, compliance with EU rules and the presidential election is likely to remain a source of market caution. Over a medium-term horizon, however, current OAT yields may offer attractive carry opportunities for bond investors, particularly if France succeeds in stabilising its fiscal position.

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Glossary

Article 49.3 is a French constitutional mechanism that allows the government to pass legislation without a parliamentary vote unless a no-confidence motion succeeds.

A **basis point (bp or bps)** equals 0.01 percentage point, so 100 basis points equal one percentage point.

A **budget deficit** occurs when a government spends more than it receives in revenue during a given period.

A **Bund** is a bond issued by the German federal government and commonly used as a euro-area benchmark.

A **corporate tax surcharge** is an additional tax imposed on top of the standard corporate income tax.

A **credit rating** assesses a borrower's ability to repay debt, with higher ratings generally indicating lower credit risk.

The **debt-to-GDP ratio** compares a country's public debt with the annual value of the goods and services its economy produces.

Disorderly fragmentation occurs when borrowing costs across euro-area countries diverge sharply for reasons that may disrupt the ECB's monetary policy.

The **EU Excessive Deficit Procedure** is the European Union's process for requiring countries to correct deficits or debt levels that breach agreed fiscal rules.

The **EU fiscal framework** comprises the European rules used to promote sustainable government deficits, expenditure and debt.

EU-defined net expenditure is a measure of government spending adjusted for selected items and used to monitor compliance with EU fiscal rules.

The **Eurosystem** consists of the European Central Bank and the national central banks of countries using the euro.

Fiscal consolidation means reducing a government deficit through spending cuts, higher revenues or both.

A **fiscal outlook** is an assessment of how government revenue, expenditure, deficits and debt are expected to develop.

Fiscal slippage occurs when a government's finances perform worse than its agreed targets or forecasts.

Fitch, Moody's and S&P are major credit-rating agencies that evaluate the creditworthiness of governments and other borrowers.

Gross domestic product (GDP) is the total value of goods and services produced within a country over a specified period.

Monetary policy transmission is the process through which central-bank decisions influence borrowing costs, financial markets and the wider economy.

A **nominal freeze** keeps an amount unchanged in cash terms, meaning its purchasing power may fall when prices rise.

An **OAT (Obligations Assimilables du Trésor)** is a medium- or long-term bond issued by the French government.

The **OAT–Bund spread** is the difference between French and German government-bond yields and indicates the additional return investors demand for holding French debt.

A rating **outlook** indicates whether a credit-rating agency may raise, maintain or lower a borrower's rating over time.

A **risk premium** is the additional return investors demand for accepting greater uncertainty or potential loss.

A **spread narrowing** means the yield difference between two bonds has decreased, while a **spread widening** means it has increased.

Tax expenditures are government revenues forgone through tax exemptions, deductions, credits or preferential rates.

The **Transmission Protection Instrument (TPI)** is an ECB tool intended to counter unjustified market pressures that disrupt monetary policy across euro-area countries.

Appendix

Historical performance

	28.9.2021 - 28.9.2022	28.9.2022 - 28.9.2023	28.9.2023 - 28.9.2024	28.9.2024 - 28.9.2025	28.9.2025 - 28.9.2026
2y German government bonds	-3,15%	-2,09%	0,49%	-0,34%	-1,54%
10y German government bonds	-16,48%	-7,02%	4,67%	-4,19%	-6,04%
30y German government bonds	-35,38%	-23,45%	9,84%	-15,71%	-10,83%
2y French government bonds	-4,54%	-1,96%	3,88%	1,69%	-1,48%
10y French government bonds	-16,74%	-6,91%	4,06%	-4,07%	-6,82%
30y French government bonds	-36,30%	-19,60%	5,41%	-14,78%	-12,28%

Source: Deutsche Bank AG, LSEG Datastream; Data as of September 28, 2026.

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