



ODDO BHF

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The French risk: memories of the euro crisis might not be a good benchmark



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Do you remember the euro crisis? It was a time of late-night crisis summits, last-minute bailouts and speculation about a break-up of the EU. Ultimately, the eurozone was stabilised and economic cooperation was even strengthened. With global bond yields rising, memories of that crisis are resurfacing. This time, however, the focus is not on a peripheral country but on France, one of the eurozone's core economies. In early October, the risk premium on French government bonds relative to German Bunds exceeded 140 basis points, a level last seen during the euro crisis. The move has been driven by concerns over France's fiscal discipline and fears that higher yields could significantly tighten financing conditions across the eurozone. As a result, the euro has recently come under pressure.

A difficult starting point for France

The pressures on global bond markets are hitting France at a particularly challenging fiscal and political moment. Structural weaknesses are underpinning the rise in risk premiums. Compared with Germany, the French economy is losing momentum. At the same time, the national budget remains deeply in deficit. For decades, government spending in France has exceeded revenue. The government expects total debt to reach 121.7 per

cent of gross domestic product next year. France is already more heavily indebted than any other EU country.

Budget and elections in the markets' spotlight

For investors, the first key question is whether the government manages to pass a budget. The draft budget for 2027 includes savings of 43 billion euros. Through this austerity programme, the government aims to reduce the budget deficit of 5.4 per cent and restore confidence among financial markets. However, passing such an austerity budget is a challenge, as the government has not had a majority of its own in parliament since the snap elections in 2024. If it manages to secure a majority for the budget with the help of individual opposition parties, this could calm the markets in the short term and reduce risk premiums.

However, with the presidential election approaching in spring 2027 and widespread protests against the planned spending cuts to be expected, opposition parties appear unlikely to make significant concessions. It is therefore more likely that Article 49.3 will be invoked once again and a budget passed by decree, as was the case in 2026. Moreover, adopting the budget by 49.3 decree, already politically contentious last year,



could trigger a vote of no confidence and bring down the government. If that were to happen, no budget would be passed, and spreads could rise sharply. A new government will have to restart the budget discussion. A “special law” will be needed to avoid default. In that case, revenues and expenditures would largely be rolled over, potentially worsening the public finance balance. Even if an immediate financial crisis were avoided, the spread over German government bonds would likely continue to widen in this scenario.

There is another alternative, which relies in triggering Article 47 of the constitution allowing to pass the budget through executive orders (“ordonnances”). In that case, there’s no way of blocking the government after 70 days of debate in Parliament. Once the article 47 is triggered, Lecornu’s draft budget becomes law. Conversely, this has never been done. The opposition parties, from LFI to RN, will likely unite to bring the government down – but at least a budget will have been passed.

Following the budget crisis, the markets’ attention will turn to the presidential elections in April. Marine Le Pen of the Rassemblement National is clearly in the lead in the polls, with figures of over 30 per cent. It cannot be ruled out that she will face Jean-Luc Mélenchon, the representative of the far-left La France insoumise, in the decisive run-off. His recent proposal to simply write off 20 per cent of France’s national debt is unlikely to have reassured investors. Pressure from financial markets is therefore likely to intensify even before the election. Any signs that leading candidates are not committed to fiscal consolidation could prompt a market reaction. As a result, the election campaign in the first quarter may be accompanied by heightened volatility.

This is because France relies heavily on international investors to finance its national debt. 57 per cent of French national debt is held by foreign investors. If they lose confidence in France’s budgetary performance, the widening of risk premiums could be further exacerbated by sell-offs. Furthermore, government bonds are competing with the rapidly increasing bond issues from US technology giants, some of which offer higher interest rates. Nor is intervention by the European Central Bank by any means certain. To combat inflation, it has in fact embarked on a course of interest rate rises, which is further exacerbating

France’s situation. It is also reducing its holdings of securities. Any intervention via the Transmission Protection Instrument – which has never been used before – would be subject to conditions. These include compliance with the European fiscal framework, a sustainable debt trajectory, and sound and sustainable economic policy measures. A widening spread alone therefore does not necessarily trigger intervention. Nevertheless, the markets expect the ECB to intervene should the situation escalate to the point of threatening the eurozone. This limits the downside risks for French government bonds.

How high is the French risk?

French government bonds are the most direct transmission channel of the French risk. Rising yields put pressure on existing bond holdings, depending on their duration, while also increasing the government’s future refinancing costs. Caution therefore appears warranted about French sovereign debt. From a global perspective, corporate bonds are preferable to government bonds due to solid fundamentals and attractive current yields. This also applies to French bonds. The key factors here are the issuer, the business model, liquidity and dependence on the French market. Financial stocks are particularly sensitive to rising government bond yields and political risks.

A nuanced approach is also required when it comes to equities. Domestically focused companies tend to suffer more from weaker growth, higher inflation, potential special taxes and rising financing costs. Large French companies with an international presence and exporters, on the other hand, are often significantly less dependent on the domestic economic environment and can also benefit from a weaker euro. Accordingly, the preference is for large companies over small caps and exporters over predominantly domestically focused business models.

Against a backdrop of improved global economic prospects, stable corporate profits and ongoing investment in the expansion of energy and AI infrastructure, equities continue to offer considerable potential. Whilst the depreciation of the euro could strengthen the competitiveness of European exporters, it could simultaneously increase imported inflationary pressure. Gold, as well as copper and aluminium, offer potential: gold due to sustained high demand from central banks,



and industrial metals because of electrification, grid expansion and limited supply.

A renewed euro crisis cannot be ruled out, given the long-term fiscal challenges facing a major eurozone member such as France. However, it is far from inevitable. The experience of 2010 to 2012 demonstrated that crises can also become catalysts for deeper European integration. Looking ahead, market pressure may encourage policymakers across the political spectrum to recognise the seriousness of the situation and support a credible fiscal consolidation programme in highly indebted countries such as France. Although that outcome may not seem especially likely at present, investors should remain clear-eyed while retaining a sense of optimism. Ultimately, investing is an investment in future value. But always, timing is key.

Positioning

We maintain an overall cautious stance on equities, while continuing to favor emerging markets, where we see more attractive valuation and growth opportunities. Following the recent sharp increase in interest rates, we have moved to a neutral

duration stance. Within fixed income, we continue to prefer Investment Grade credit, which offers a compelling balance between yield and quality. We are also strengthening portfolio diversification through selective exposure to commodities, including gold and industrial metals, as well as through currencies such as the Japanese yen and local emerging market currencies. Looking ahead, markets are likely to be driven by two key catalysts over the coming months: the electoral cycle and the upcoming corporate earnings season. Given the uncertainty surrounding both factors, we believe it is prudent to remain patient and await clearer signals before making significant allocation changes.

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Past performance is not a reliable indicator of future returns and is subject to fluctuation over time. Performance may rise or fall for investments with foreign currency exposure due to exchange rate fluctuations. Emerging markets may be subject to more political, economic or structural challenges than developed markets, which may result in a higher risk

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