Flash Economics

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The deterioration of financial markets in France is hindering the French economy

Budgetary challenges and political risk in France have led to a deterioration in both the French bond market and the French equity market. This will further weaken the economy through:

- the impact of higher long-term interest rates on public debt accumulation, housing investment, and corporate investment
- the effect of lower stock prices on household consumption and corporate financing capacity

This results in a further deterioration of public finances, driven by rising long-term interest rates and slowing economic growth.

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Deterioration of the financial market situation in France

France is currently facing:

- **budgetary difficulties**, with a public deficit of 5.8% of GDP in 2024 and 5.4% of GDP in 2025, and an inability to pass a budget that includes a significant reduction in public spending starting in 2026
- **political instability**, due to the absence of a parliamentary majority
- **political uncertainty** related to the outcome of the upcoming presidential election in April 2027

This situation—characterized by high public deficits and political uncertainty—has led to **a deterioration in France's financial markets** compared to other Euro area countries, affecting both **the public debt market** (**Charts 1A/B**) and **the equity market** (**Charts 2A/B**).

Chart 1A
France: Yield spread on 10-year and 30-year government bonds vis-à-vis Germany (in percentage points)

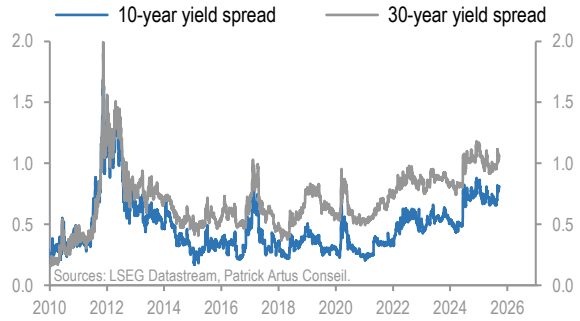


Chart 1B
France: Yield spread on 10-year and 30-year government bonds vis-à-vis Germany (in percentage points)

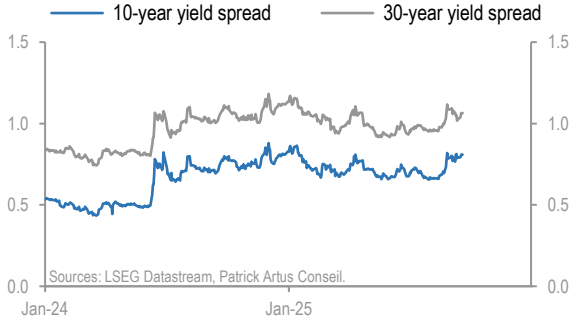


Chart 2A
Stock market indices (01.01.2010 = 100)

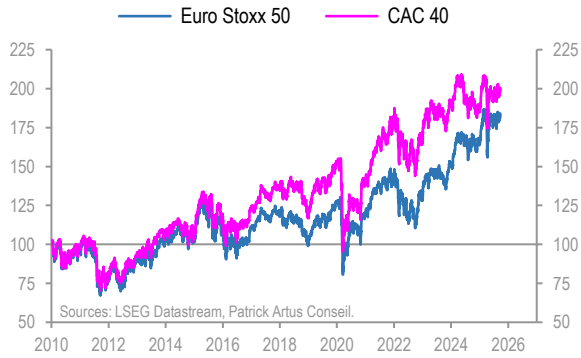
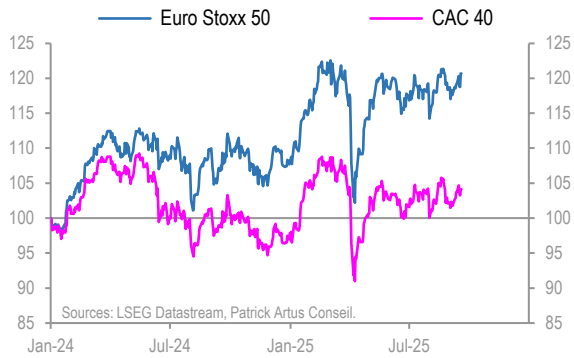


Chart 2B
Stock market indices (01.01.2024 = 100)

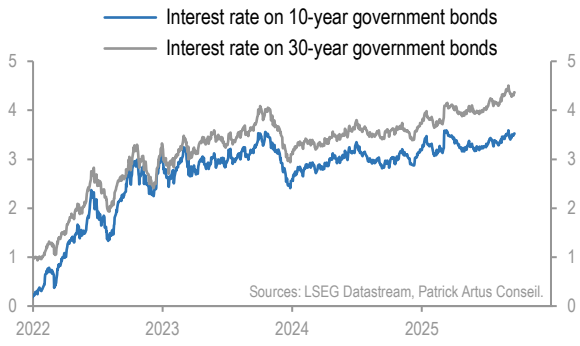


This deterioration in financial market conditions will lead to a **further weakening of the economic situation**.

Negative effects of rising long-term interest rates

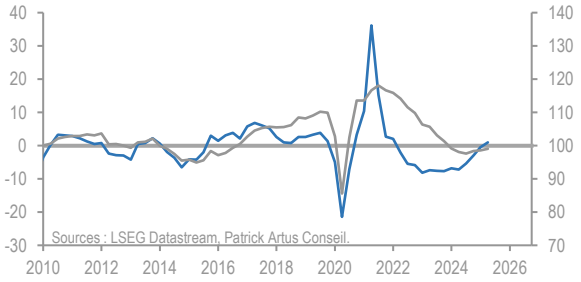
The increase in long-term interest rates (**Charts 1A/B** above, **Chart 3**) triggers several adverse mechanisms:

Chart 3
France: Interest rates on 10-year and 30-year government bonds (as %)



- **a long-term interest rate higher than the long-term growth rate** (approximately 2.5% annually, composed of 1% real growth and 1.5% inflation), which implies that in order to offset this gap between the interest rate and the growth rate, **a primary budget surplus** (excluding interest payments on public debt) **of 1.1% of GDP** is required (equal to the product of the public debt-to-GDP ratio and the interest-growth differential). This increases the risk of a rise in the public debt ratio.
- **a slowdown in household investment in housing** (**Chart 4**), due to the inevitable rise in mortgage interest rates;

Chart 4
France : Changes in household residential investment



- **a slowdown in corporate investment**, driven by the increase in interest rates on business loans (**Chart 5**).

Chart 5
France: Investment of non-financial corporations



Negative Effects of Falling Stock Market Indices

The decline in French stock market indices compared to those of other euro area countries:

- **reduces household consumption** (**Chart 6**) and leads to an increase in the household savings rate (**Chart 7**);

Chart 6
France: Household consumption (in volume terms)

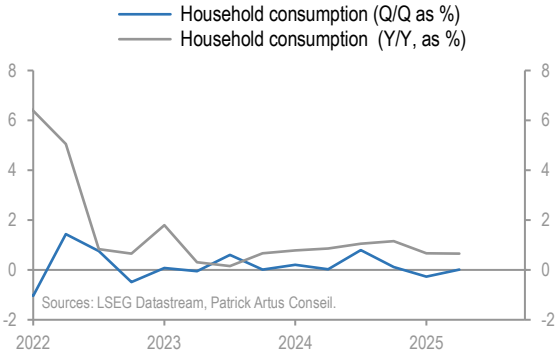
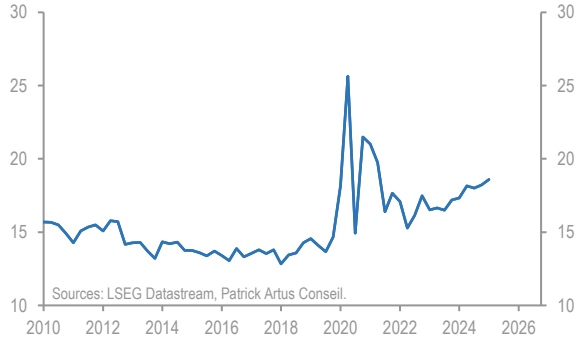


Chart 7
France: Gross household saving rate (as %)



- **reduces the ability of companies to raise equity financing**, thereby contributing to weak investment levels (see **Chart 5** above).

Summary: a low-growth trap

The difficulty in reducing the public deficit and ongoing political uncertainty have led to a rise in long-term interest rates and a decline in stock market indices in France compared to other European countries.

This has resulted in a further slowdown in growth potential, due to the impact of financial market developments on the need for fiscal consolidation, on housing investment, household consumption, and corporate investment.

The cumulative effect on the public deficit is particularly concerning. It is estimated that:

- an additional 30 basis points on long-term interest rates stem from economic and political uncertainty;
- a 0.4 percentage point loss in GDP growth results from this uncertainty

In total, the combined effect of higher interest payments on public debt and lower tax revenues is estimated to increase the public deficit by 0.55 percentage point of GDP.

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