Flash Economics

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Rating agencies do not take a long-term view

We illustrate our point with the case of the rating of the four largest countries in the euro area. Germany has a AAA rating from all rating agencies, France has a rating between AA- and A+, Spain has a rating between A and A+, and Italy has a BBB+ rating. We believe that if rating agencies took a long-term view, they would rate Germany and France significantly lower, and Spain higher.

The rating should normally result from the public debt level and its expected evolution; that is to say:

- the gap between long-term interest rates and long-term nominal growth;
- the political situation and its impact on fiscal policy;
- long-term growth and its determinants.

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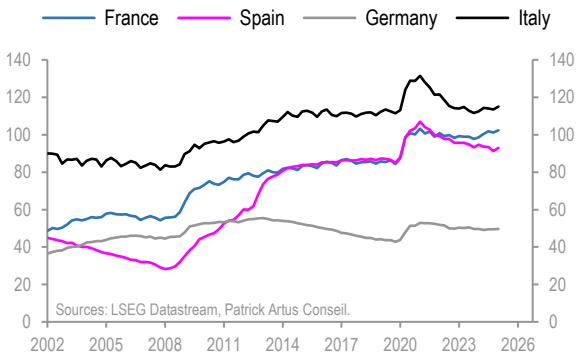
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A clear hierarchy in the rating of major euro area countries by rating agencies

Rating agencies currently rate **Germany AAA, France between AA- and A+, Spain A or A+, and Italy BBB+**. According to the rating agencies, financial strength decreases as we move from Germany to France, then to Spain, and finally to Italy.

We believe that **this judgment by the agencies is too static**, reflecting primarily the current public debt level (**Chart 1**), and not sufficiently accounting for economic and fiscal prospects.

Chart 1
Public debt (as % of nominal GDP)



What factors should the agency rating depend on?

The agency rating should depend on the level and expected evolution of public debt (Chart 1), that is to say:

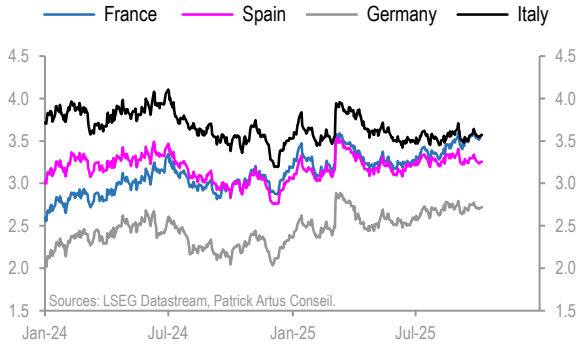
- the gap between **long-term interest rates** and long-term nominal growth;
- the **political situation** and its effect on fiscal policy;
- **long-term growth** and its determinants.

Gap between long-term interest rates and long-term nominal growth

The 10-year long-term interest rate is currently (**Chart 2**):

- 2.7% in Germany;
- 3.5% in France;
- 3.25% in Spain;
- slightly above 3.5% in Italy.

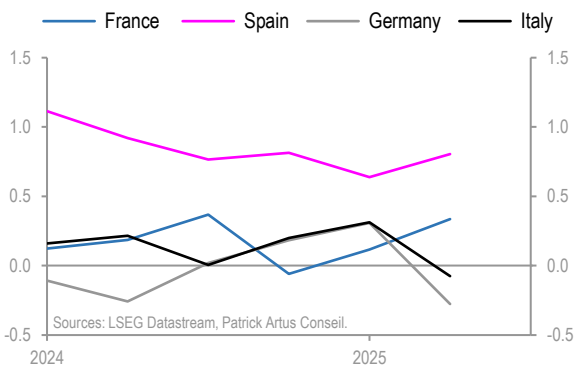
Chart 2
Interest rate on 10-year government bonds (as %)



The volume growth for the first half of 2025, annualized (**Chart 3**), is:

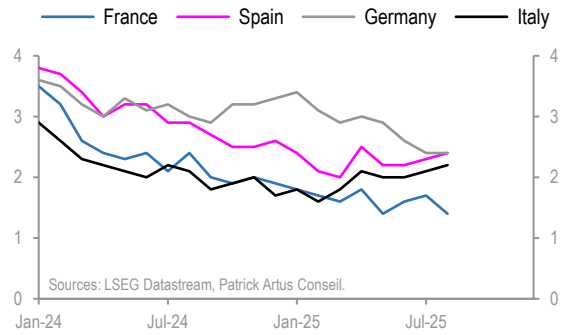
- 0% in Germany;
- 0.8% in France;
- 2.6% in Spain;
- 0.4% in Italy.

Chart 3
Real GDP growth (Q/Q, as %)



Finally, **core inflation** (excluding energy and unprocessed food, **Chart 4**) in August 2025 is 2.4% in Germany; 1.4% in France; 2.2% in Italy; 2.4% in Spain.

Chart 4
Core inflation
(HICP excl.unprocessed food and energy, Y/Y as %)



We can see that **the gap between long-term interest rates and long-term nominal growth** (with long-term growth likely being close to that observed in the first half of 2025) is:

- close to 0% in Germany;
- 1.3% in France;
- 0.9% in Italy;
- -1.75% in Spain (growth exceeds the long-term interest rate).

This gap therefore has the effect of:

- increasing the public debt ratio in France and Italy spontaneously (by 1.7 percentage points of GDP per year in France, 1.4 percentage points of GDP per year in Italy);
- reducing the public debt ratio in Spain spontaneously (by 1.7 percentage points of GDP per year).

Political situation and fiscal policy

In Germany, Chancellor Friedrich Merz and the SPD-CDU coalition have a clear majority in the Bundestag; the German government has decided to implement an investment plan in infrastructure and an increase in military spending, which will lead, **by 2027, to a public deficit of nearly 4% of GDP** (the public deficit was 2.8% of GDP in 2024). The primary public deficit (excluding interest payments on public debt) in 2024 was 2.3% of GDP, and **Germany's public debt ratio will increase continuously**.

In France, political instability is high. It is very likely that the public deficit (5.8% of GDP in 2024, 5.4% of GDP in 2025) will remain close to 5% of GDP in 2026. The primary public deficit in 2025 is 3.2% of GDP, and **to stabilize the public debt ratio, a primary surplus of 1.7% of GDP would be required. Therefore, we will see a rapid increase in France's public debt ratio**.

Italy has a primary budget surplus, and it is expected to reach 1.1% of GDP in 2026. The public debt ratio will therefore remain relatively stable.

The projected public deficit in Spain is 2.8% of GDP in 2025, with a primary public deficit of 0.4 percentage points of GDP. Given that the long-term interest rate is significantly lower than the growth rate, this will lead to **a continuous reduction in the public debt ratio**.

Long-term growth

Long-term growth primarily depends on productivity gains (**Chart 5**) and **immigration** (**Chart 6**).

Chart 5
Real labour productivity per hour worked (2010.Q1 = 100)

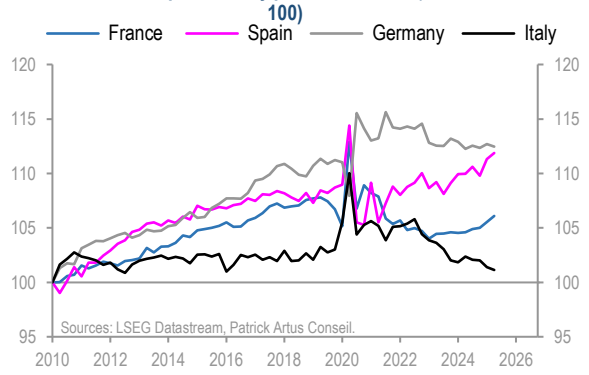
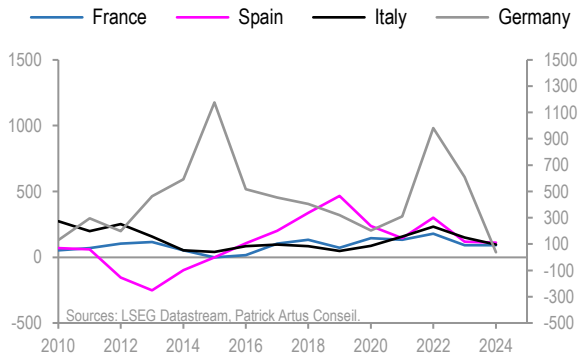


Chart 6
Net migration (thousands of people, annual data)



We can see that **productivity has declined** since the late 2010s in Germany, France, and Italy.

Immigration, considering public opinion trends, is likely to decrease in both Germany and France.

We can also examine **the recent GDP growth in volume** (**Chart 7**) and industrial production growth (**Charts 8A/B**).

Chart 7
Real GDP growth (Q/Q, as %)

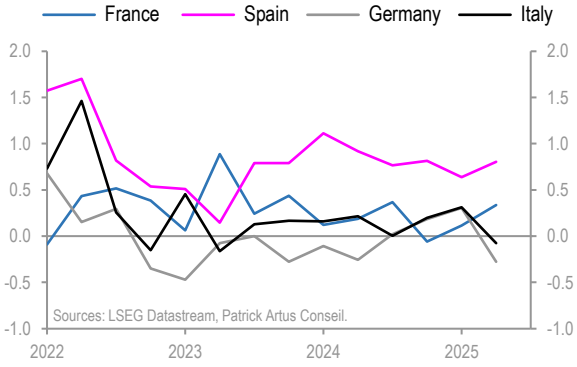


Chart 8A
Manufacturing production (100 : 2010.M1)

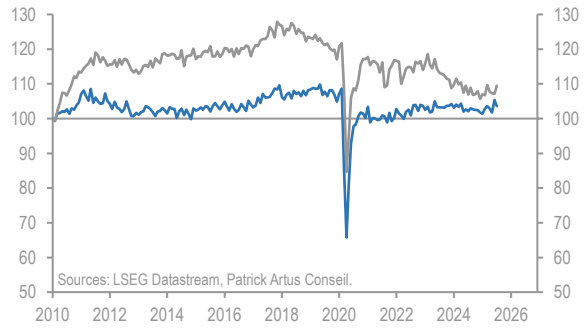
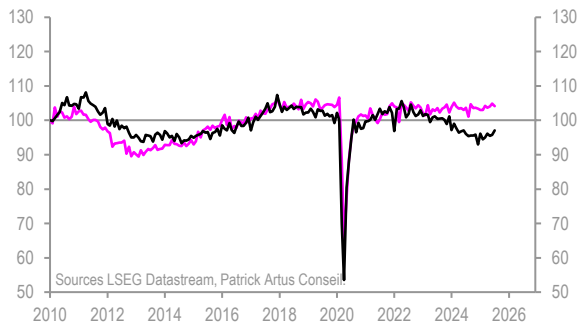


Chart 8B
Manufacturing production (2010.M1 = 100)



We observe that:

- GDP and manufacturing production have declined since 2023 in Germany;
- GDP has shown slow growth in France and Italy; in France, manufacturing production is stagnating, while in Italy, manufacturing production has declined;
- GDP has grown rapidly and manufacturing production has grown slowly in Spain.

Summary: A difficult situation in Germany and France, a somewhat more favorable situation in Italy, and much more favorable conditions in Spain.

When we examine the gap between long-term interest rates and growth rates, as well as the evolution of the primary public deficit, we see that **the public debt ratio will**:

- increase very rapidly in France;
- increase in Germany;
- remain stable in Italy;
- decrease in Spain.

When we look at **productivity gains and immigration prospects**, we see that potential growth will be very low in Germany and France, slightly higher in Italy, and significantly higher in Spain.

Finally, when we consider **the recent developments in GDP and manufacturing production**, we observe very negative trends in Germany, rather negative trends in France and Italy, and quite positive trends in Spain.

Overall, if the agency rating incorporated these various observations, it would be much more unfavorable for Germany and France, remain largely unchanged for Italy, and be much more favorable for Spain.

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