ECB Focus

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Could the ECB save France (if needed)?

- **The French 10Y spread is above 120bp; it has widened by more than 50bp in four months and by more than 30bp over the past three weeks. We are not constructive on the economic outlook, we are negative about the public finance outlook and we are worried by the political outlook.**
- **In this context, we have had several questions regarding the possibility that the ECB would intervene in the bond market if the French spread were to widen significantly.**
- **The simple answer is that the ECB has two tools ready: Outright Monetary Transactions and the Transmission Protection Instrument. If France needs them and if France deserves them, the ECB would happily implement them.**
- **The answer could be more complicated than that, as in the past the ECB adapted its "financial stability" framework during the sovereign debt crisis implementing five different tools and adapting these tools to the financial environment. The point here is that the ECB could easily create something new if warranted.**
- **In this paper, we review the legal framework that constrains the ECB's ability to intervene to preserve a country, we detail the different episodes of the sovereign debt crisis when the ECB intervened trying to infer a template and we review the two tools that are still active (the OMT and the TPI).**
- **We try to provide a conclusion on the situation in which the ECB would intervene if warranted, which is not the case currently, and which is not even expected in our main scenarios.**



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Introduction

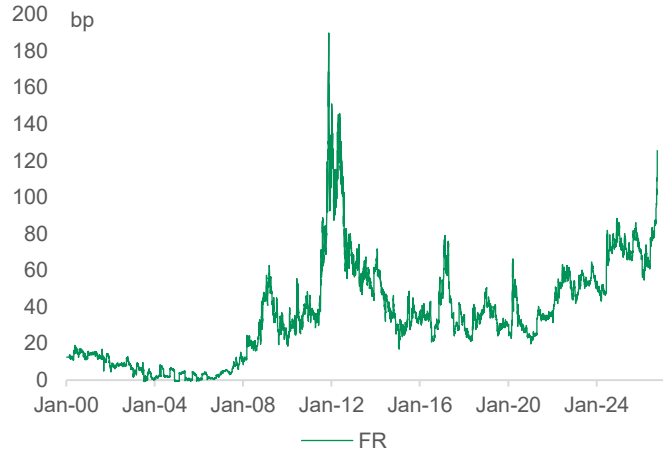
The French 10Y spread vs Germany is above 120bp at the time of writing, after a significant widening over the past few weeks. This level is not a record for France but it brings back memories of autumn 2011 and summer 2012 (although back then, France was far from being the problem child of the Eurozone).

10Y yields



Source: Bloomberg, Crédit Agricole CIB

10Y spread



Source: Bloomberg, Crédit Agricole CIB

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Our rates team still has a constructive view on the spread (with a maximum expected at 140bp by end-2027, even in the worst of their eight scenarios); in this context, there is absolutely no reason to discuss a potential ECB intervention.

Nevertheless, if the situation were to deteriorate more than expected, the question of an ECB intervention would be raised. And we will not deny that we already have several questions regarding the level at which the ECB would step in and the modalities of this intervention.

The ECB is constrained by a strict legal framework: the Treaty on the Functioning of the European Union (specifically Article 123, which prohibits monetary financing) and the jurisprudence of the European Court of Justice (and especially the conclusion of the case Peter Gauweiler and Others v Deutscher Bundestag).

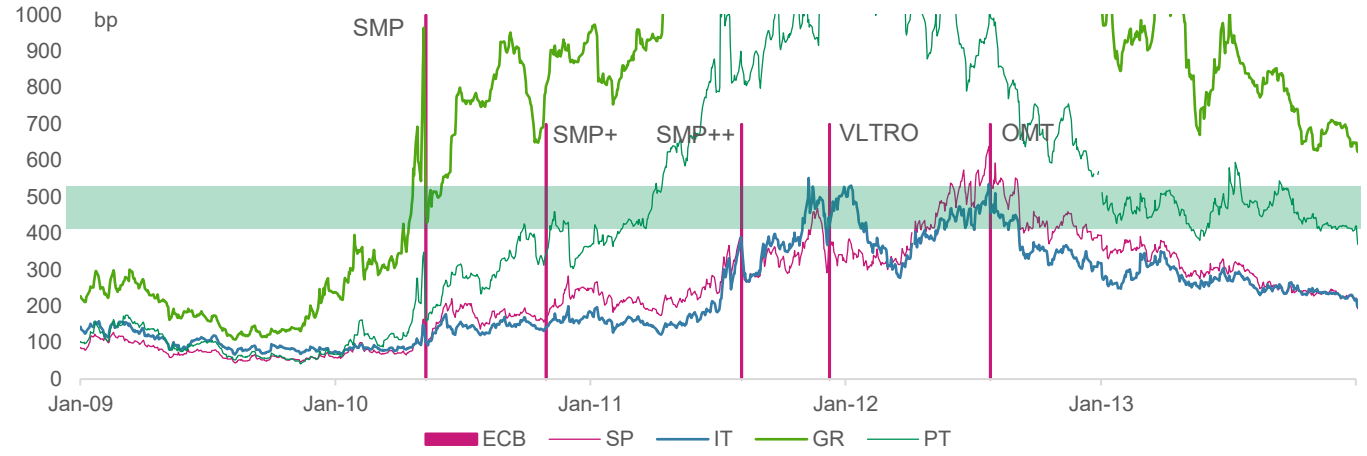
Due to this constraint, the ECB had to adapt its interventions and designed a series of complex programmes to address markets tensions (when warranted) while remaining in line with European law.

Today, two programmes are still ready to be used: the OMT and the TPI. None of them has been implemented so far; both of them can be implemented only after conditionalities have been met.

The ECB could easily create a new programme if needed. However, this new programme will have to remain within the ECB's mandate and legal framework, and consequently it would have to follow the same rules as programmes that have been implemented so far.

This is why in this paper, in addition to discussing the OMT and the TPI, we cover the legal framework and past ECB interventions to determine under which conditions the ECB would intervene on France, with the OMT, the TPI or any kind of new programme.

10Y sovereign spreads and ECB intervention – the green area is the range of spreads when the ECB intervened



Source: Bloomberg, ECB, Crédit Agricole CIB

Legal Framework

When discussing the ECB's intervention on the bond market, we have to start with the legal framework.

Prohibiting monetary financing

Article 123 of the Treaty on the Functioning of the European Union states that:

> *Overdraft facilities or any other type of credit facility with the European Central Bank or with the central banks of the Member States (hereinafter referred to as "national central banks") in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the European Central Bank or national central banks of debt instruments.*

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Which means that the ECB is prohibited from monetising public debt. Accordingly, this article is a key constraint for any ECB intervention: the ECB can intervene in the bond market, but only if it proves that this intervention is not monetary financing.

Jurisprudence

The questions regarding the ECB's purchases and monetary financing were addressed in the Peter Gauweiler and Others v Deutscher Bundestag case at the European Court of Justice. Peter Gauweiler challenged the legality of the OMT, which allowed the European Court of Justice to determine the reasons why the OMT is legal, and implicitly drawing the contours of an ECB intervention.

The conclusion from the European Court of Justice sets several conditions for an ECB's intervention, among which:

- **Monetary policy objective**: "*a programme such as that announced in the press release is appropriate for the purpose of contributing to the ESCB's objectives and, therefore, to maintaining price stability*".
- **Proportionality**: "*the principle of proportionality requires that acts of the EU institutions be appropriate for attaining the legitimate objectives pursued by the legislation at issue and do not go beyond what is necessary in order to achieve those objectives*"
- **Safeguards against fiscal financing**: "*a programme such as that at issue in the main proceedings is accompanied by a series of guarantees that are intended to limit its impact on the impetus to follow a sound budgetary policy*"

From these elements, it is clear that (1) the ECB could support French bonds only if financial tensions are strong enough to hamper monetary transmission; (2) the ECB cannot fully 'save' France, but only limit the tensions to ensure the proper transmission of its monetary policy; and finally (3) the ECB will ensure that its interventions will not encourage France to pursue its non-sustainable fiscal policy.

This means that an ECB intervention is possible only if financial tensions are extreme enough to disturb the transmission of its monetary policy and only if French public debt is sustainable without an ECB intervention.

Current situation

Currently, the ECB has two tools ready to be implemented, if warranted: the OMT (Outright Monetary Transactions) and the TPI (Transmission Protection Instrument).

Outright Monetary Transactions

The OMT was announced in September 2012 – following Mario Draghi's "Whatever it takes" speech of July 2012 – and putting a definitive end to the Eurozone sovereign crisis. This programme has never been implemented, but it is still live and can be implemented if needed.

Under the OMT, the ECB can buy an unlimited amount (*No ex ante quantitative limits are set on the size of OMT*) of sovereign bonds with a focus "*on the shorter part of the yield curve, and in particular on sovereign bonds with a maturity of between one and three years*".

But to benefit from the OMT, the country must be under an ESM programme and respect the rules attached to it (the EFSF is no longer active).

> *A necessary condition for Outright Monetary Transactions is strict and effective conditionality attached to an appropriate European Financial Stability Facility/European Stability Mechanism (EFSF/ESM) programme.*

The OMT has never been implemented, although Spain was eligible in H212 (under ESM financial assistance): the simple existence of the programme was enough to reduce extreme financial tensions and rebuild investors' confidence in most Eurozone countries.

Transmission Protection Instrument

The TPI was announced on 21 July 2022 – when the ECB started its hiking cycle of 2022-23.

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Under the TPI, the ECB can purchase "public sector securities with a remaining maturity of between one and ten years". Without explicitly saying it (contrary to the OMT) the ECB does not set limit to its purchases.

To be eligible to the TPI, the country must "pursue sound and sustainable fiscal and macroeconomic policies", and the ECB set outs four criteria:

1. Compliance with the EU fiscal framework: not being subject to an excessive deficit procedure (EDP) or not being assessed as having failed to take effective action in response to an EU Council recommendation under Article 126(7) of the Treaty on the Functioning of the European Union (TFEU).
2. Absence of severe macroeconomic imbalances: not being subject to an excessive imbalance procedure (EIP) or not being assessed as having failed to take the recommended corrective action related to an EU Council recommendation under Article 121(4) TFEU.
3. Fiscal sustainability: in ascertaining that the trajectory of public debt is sustainable, the Governing Council will take into account, where available, the debt sustainability analyses by the European Commission, the European Stability Mechanism, the International Monetary Fund and other institutions, together with the ECB's internal analysis.
4. Sound and sustainable macroeconomic policies: complying with the commitments submitted in the recovery and resilience plans for the Recovery and Resilience Facility and with the European Commission's country-specific recommendations in the fiscal sphere under the European Semester.

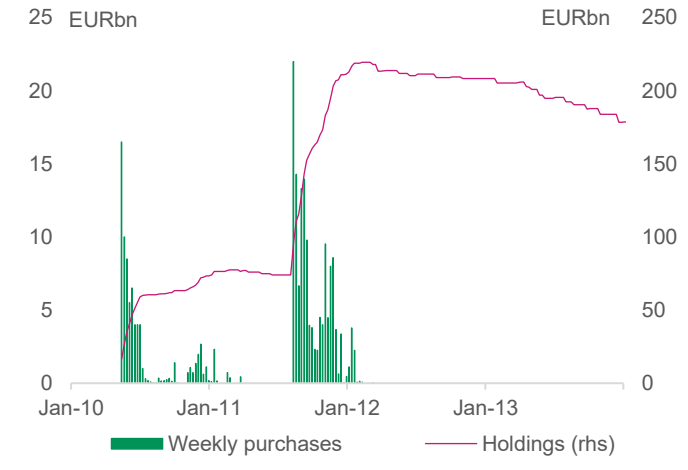
The third and fourth criteria can be assessed in a subjective manner, providing the ECB flexibility in the intervention; in contrast, the first and second criteria are more objective.

As regards to France, France is not subject to EIP (criterion 2), but it has been under Excessive Deficit Procedure since 2024. This procedure has been "held in abeyance" in June 2026, after the Commission assessed that France implemented "effective action".

To avoid a step up of the EDP, France must stick to the 2025 scenario, implying a public deficit at around 5.0% in 2026, 4.1% in 2027, 3.4% in 2028 and 2.9% in 2029, along with a limited increase in public expenditure (1.2% in 2026 to 2028 and 1.1% in 2029).

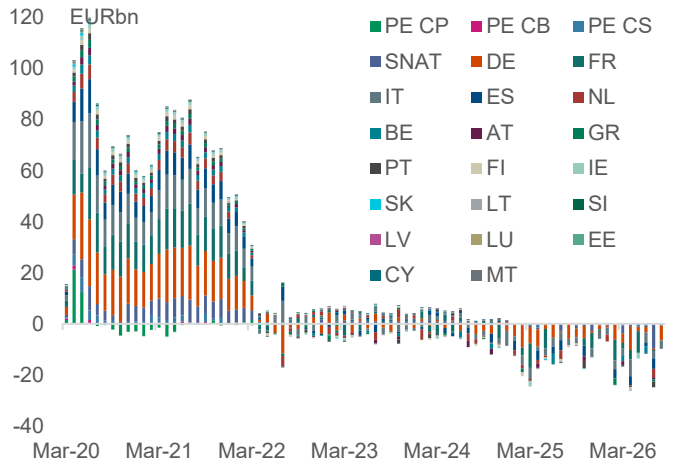
Terminated programmes

Securities Market Programme



Source: ECB, Crédit Agricole CIB

PEPP net purchases



Source: ECB, Crédit Agricole CIB

Securities Market Programme

The Securities Market Programme was launched in May 2010; it was officially terminated with the announcement of the OMT, in September 2012. Under the SMP, the ECB purchased sovereign bonds of Greece, Ireland, Portugal, Italy and Spain (the ECB could purchase other bonds, but it ended up only being sovereign

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bonds). Interestingly, the SMP had no conditionality attached: it was unilateral and discretionary purchases from the ECB.

Flexibility in the PEPP

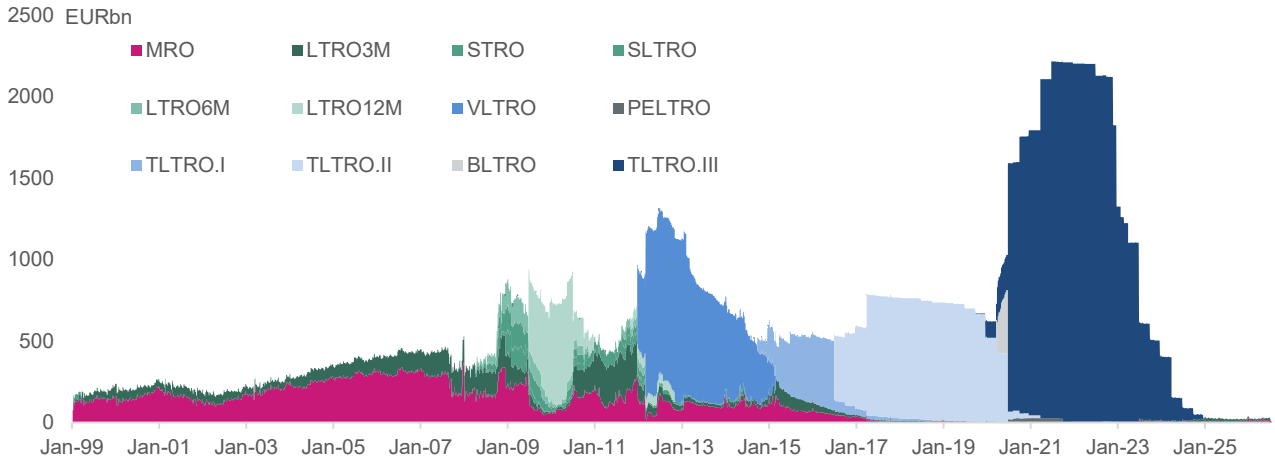
The flexibility in purchases of the PEPP (the possibility to deviate from the capital key in the purchase and reinvestments of public bonds) was implemented at the beginning of the PEPP, in March 2020 until August 2020. It was temporarily reimplemented in summer 2022, when the ECB started hiking its rates.

It is de facto terminated, as the ECB ended all reinvestments (and accordingly all purchases) in the PEPP. Some could argue that the ECB could restart reinvestments (or net purchases) in the PEPP; but for us, the bar is extremely high and would require a need for monetary accommodation (if inflation were to fall so low than even rates at the lower bound would not be accommodative enough).

36-month LTRO

As for VLTROs, they were one-shot operations. These operations were implemented in December 2011 and February 2012, allowing banks to borrow liquidity for 36 months at a fixed rate (1%) and buy sovereign bonds with this liquidity.

VLTRO – the first of the very long term refinancing operations



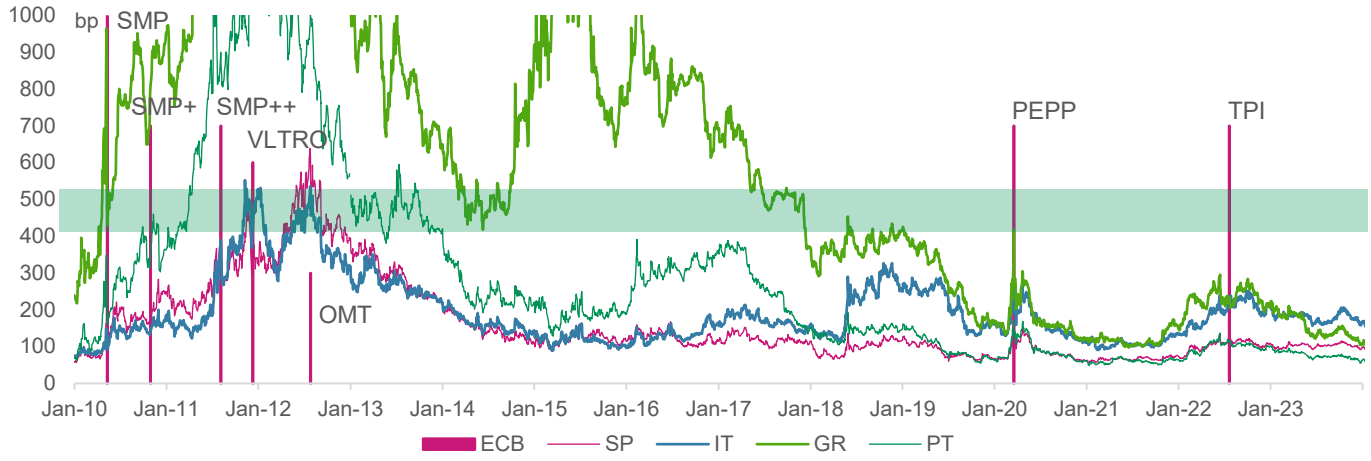
Source: ECB, Crédit Agricole CIB

The ECB will implement longer-term refinancing operations again under its new Monetary Framework, but the timing will not be dependent on financial tensions, and the modalities of these operations (still unknown) are unlikely to favour another "Sarko Trade" (the incentive for banks to borrow at the refinancing operations and buy bonds in the market).

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History of past ECB interventions

Sovereign spreads and ECB interventions



Source: Bloomberg, ECB, Crédit Agricole CIB

Schematically, the ECB has intervened seven times to ensure financial stability (to compress sovereign spreads). We take the broad definition of intervention (typically, we include the December 2011 VLTROs). We include all interventions implemented between 2010 and 2022, knowing that the 2020 and 2022 interventions were softer than those that happened during the sovereign debt crisis.

May 2010: Greece, Securities Market Programme

On 2 May 2010, after seven months of increasing tensions, Greece asked and received an international bailout. The IMF and Eurozone countries set up a EUR110bn bailout loan to avoid a sovereign default.

On 10 May 2010, the ECB decided

> *To conduct interventions in the euro area public and private debt securities markets (Securities Markets Programme) to ensure depth and liquidity in those market segments which are dysfunctional. The objective of this programme is to address the malfunctioning of securities markets and restore an appropriate monetary policy transmission mechanism.*

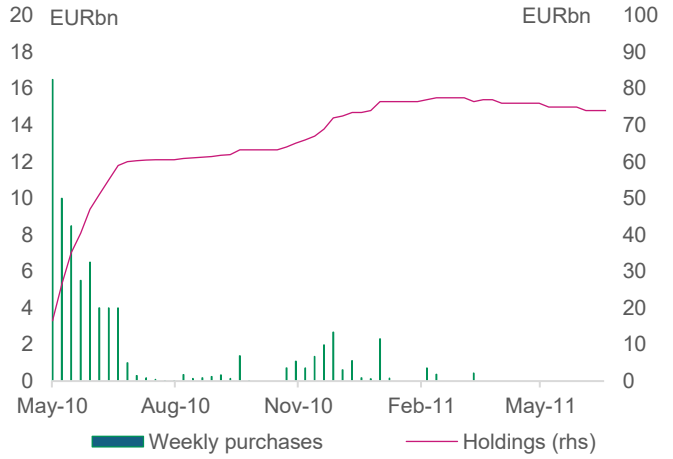
Under the Securities Market Programme, it purchased EUR60bn of bonds (mostly Greek bonds) between May 2010 and July 2010.

Greece 10Y spread vs Germany and beginning of the SMP



Source: Bloomberg, Crédit Agricole CIB

Securities Market Programme: a strong start for Greece, and two smaller reactivations for Ireland and Portugal



Source: ECB, Crédit Agricole CIB

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November 2010: Ireland, Securities Market Programme

After the bailout of Anglo Irish Bank, Ireland was pushed to ask for an international bailout programme. Negotiations started at the beginning of November 2010.

Before the actual signing of the programme, the ECB restarted the SMP, which had been put on pause since the summer, and purchased EUR13bn between November and December 2010.

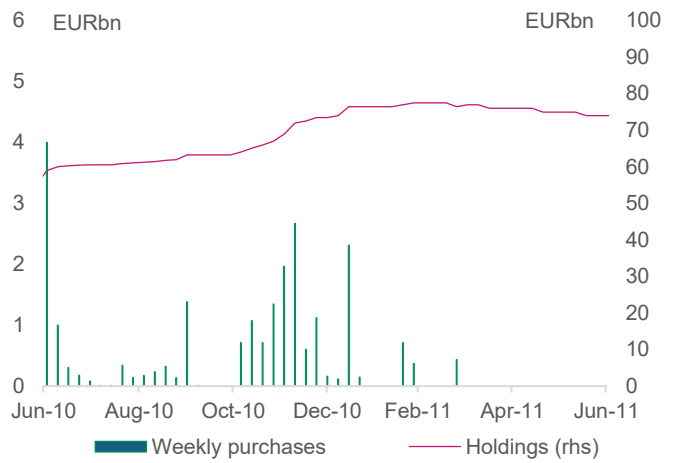
For Portugal, which asked for an international bailout in April 2011, the ECB's intervention was more erratic: the ECB temporarily supported the country's sovereign debt by ad-hoc purchases in the market, allowing the country more time to ponder the necessity of a bailout programme. We could even argue that the ECB did not really intervene to actually protect Portugal: it purchased only EUR1.5bn of bonds during that period, not even enough to compensate for redemptions of past purchases.

Ireland 10Y spread and reactivation of the SMP



Source: Bloomberg, Crédit Agricole CIB

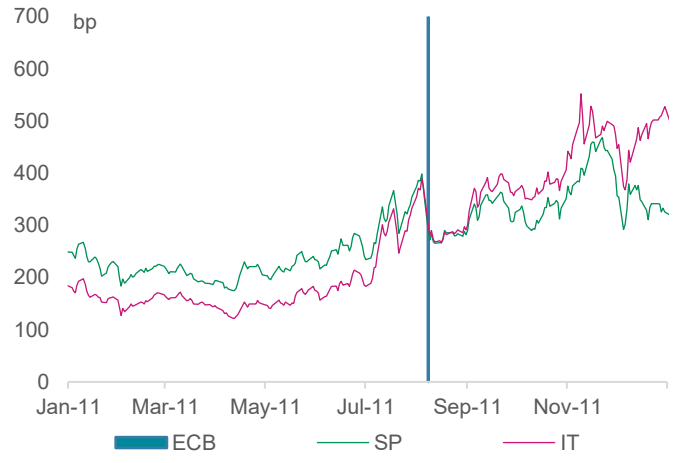
SMP: limited interventions ahead of the signing of the Irish programme



Source: ECB, Crédit Agricole CIB

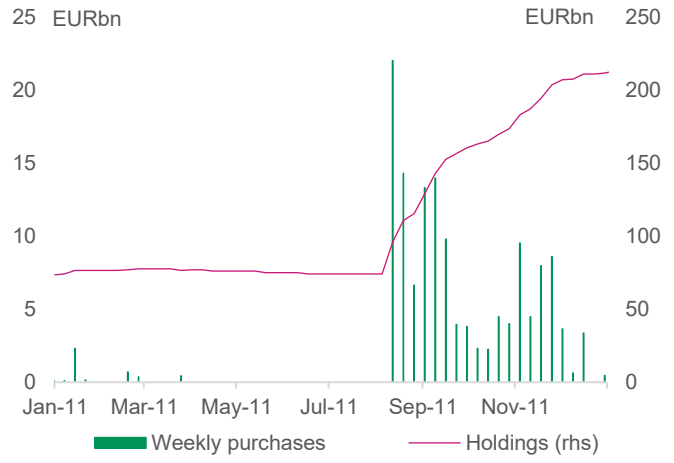
Summer 2011: Italy and Spain, Securities Market Programme

Spain and Italy 10Y spread and re-start of the SMP



Source: Bloomberg, Crédit Agricole CIB

Re-start of the SMP during summer 2011



Source: ECB, Crédit Agricole CIB

This episode is a bit specific: after the bailouts of Greece, Portugal and Ireland, the EGB market remained tense, especially regarding Italy and Spain. Different elements contributed to these overall tensions:

- Moody's downgrade of Portugal on 5 July 2011 (four notches, into junk category);
- S&P's downgrade of the US on 5 August 2011

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- The discussions on the Greek default (Private Sector Involvement that would be implemented in March 2012) that started at the beginning of summer 2011
- The overall feeling that the Eurozone had no solution to improve the situation

In this context, the ECB decided unilaterally to forcefully restart the Securities Market Programme and would continue its purchases as a faster or slower pace until the end of 2011.

December 2011: Italy, VLTRO

In December 2011, Italy was on the verge of losing its market access. The catastrophic G20 summit in Cannes (during which the Eurozone showed its dissensions and its lack of ability to address the crisis), the risk of a Greek referendum, and the lack of credibility of Italy's Prime Minister Silvio Berlusconi pushed sovereign spreads to unsustainable levels.

On 12 November, Berlusconi resigned and was replaced by Mario Monti supported by a broad coalition (all parties except Lega Nord). Monti started the first reforms on 6 December (with the law "Salva Italia" aimed at quickly improving public finances).

On 8 and 9 December 2011, the European Summit decided for stricter fiscal rules (the Fiscal Compact), with the support of all countries except the UK; this agreement would be signed on 2 March 2012: the Treaty on Stability, Coordination and Governance (by all EU countries, except the UK).

Then only, the ECB announced measures "measures to support bank lending and money market activity", including a reduction of the required reserves ratio to 1% (a topic that has been discussed recently), a broadening of the eligible collateral, but more importantly the two 36-month LTRO (VLTROs).

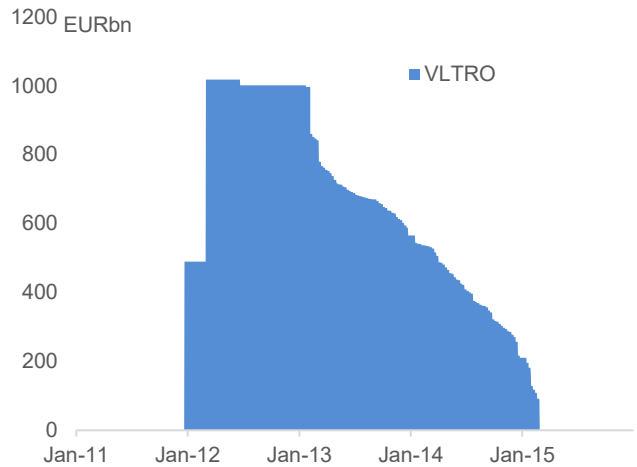
These operations, conducted at fixed-rate full allotment on 21 December 2011 and 29 February 2012, allowed banks to borrow EUR1,000bn, and, as suggested by French President Nicolas Sarkozy, buy sovereign bonds with this liquidity (and use the bonds as collateral at the ECB's operations): the "Sarko trade".

Spain and Italy 10Y spread and announcement of the VLTROs



Source: Bloomberg, Crédit Agricole CIB

Borrowing at the two 36-month LTROs



Source: ECB, Crédit Agricole CIB

Summer 2012: Spain (and all other): Outright Monetary Transactions

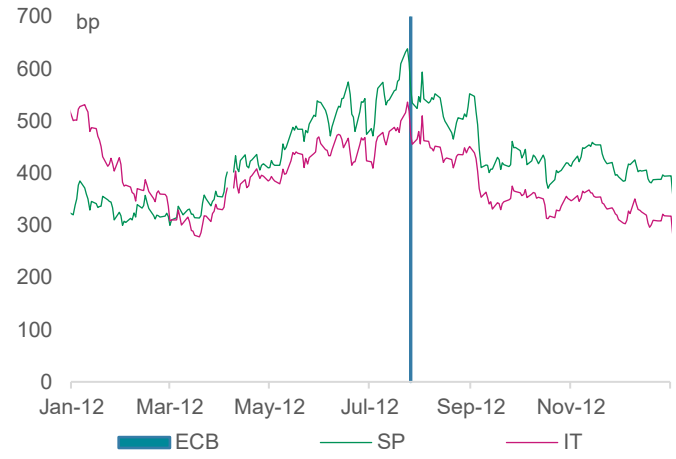
From March 2012 onwards, Spain had been facing increasing difficulties, both on its public finances (with a drift of the deficits of its autonomous regions) and its banking system (which was failing dramatically).

Until July 2012, when tensions became unsustainable and triggered a broad widening of all sovereign bonds, starting from Spain, obviously, but also Italy.

On 22 July 2012, Mario Draghi delivered his "Whatever it takes" speech that would be followed by the announcement of the OMT at the August Governing Council and detailed at the September 2012 meeting.

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Spain and Italy 10Y spreads and Mario Draghi's "Whatever it takes" speech



Source: Bloomberg, Crédit Agricole CIB

Mario Draghi on 26 July 2012 (as the ECB never implemented the OMT, there is no chart to show)



Source: YouTube, Crédit Agricole CIB

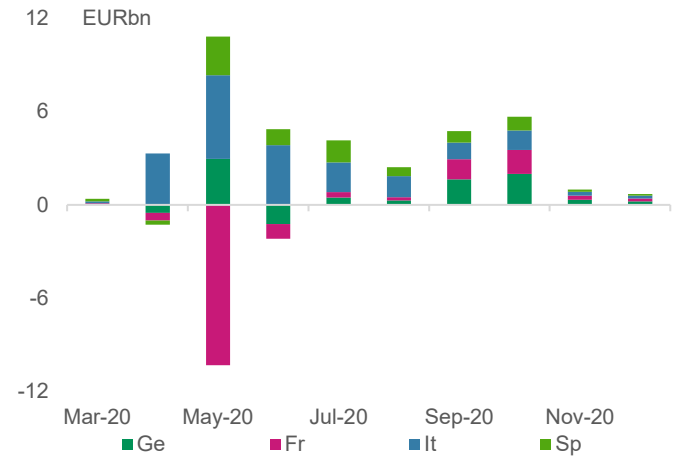
March 2020 (and July 2022): Italy, PEPP flexibility

We merge both ECB interventions, because they are really comparable. Italy was not the only country facing pressure – virtually all Eurozone countries were during the pandemic; several weaker countries were in 2022 – and this pressure was linked to an exogenous shock (pandemic in 2020, spike in inflation in 2022).

Of course, Italy suffered the most on financial markets because it was the weakest link before the crises, so one could argue that these tensions were not fully exogenous. Nevertheless, without these shocks, Italy would likely have continued improving its public finances and would not have suffered widening of its spread.

In 2020, the ECB implemented the PEPP, aimed both at easing further its monetary stance (via the size of the purchases) and at ensuring financial stability (via the possibility to deviate from the capital key in its purchases). This flexibility was used mostly for the first four months of the PEPP.

Deviation from the capital key (positive: overpurchases, negative: underpurchases) at the beginning of the PEPP



Source: ECB, Crédit Agricole CIB

Italy and Spain 10Y spread and announcement of the PEPP

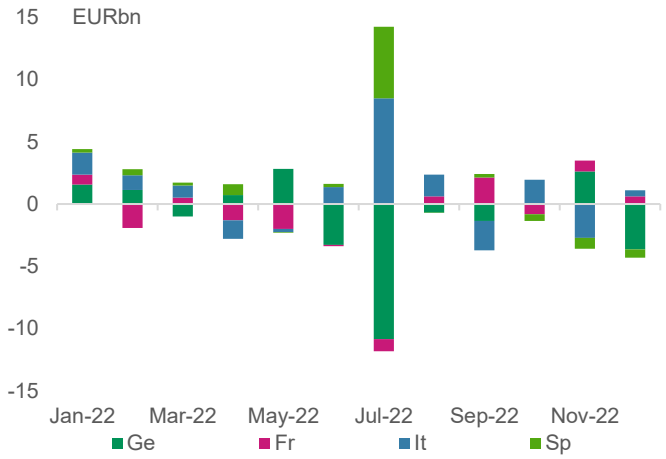


Source: Bloomberg, Crédit Agricole CIB

In 2022, the ECB applied again (temporarily and to a limited extent) flexibility under the PEPP in its reinvestments. More importantly, it announced the Transmission Protection Programme.

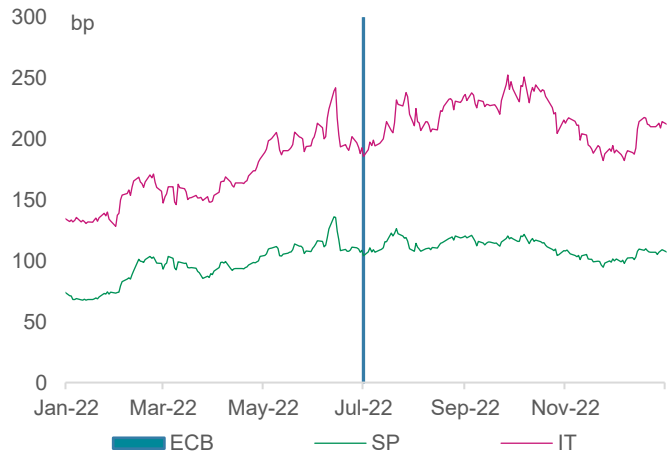
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Deviations in the reinvestments (during reinvestments, temporary deviations are normal, as the ECB cannot perfectly reinvest exactly what is maturing in a given month, but the July spike shows a proactive policy).



Source: ECB, Crédit Agricole CIB

Italy and Spain 10Y spread and beginning of deviations in reinvestments



Source: Bloomberg, Crédit Agricole CIB

July 2022: TPI announcement

In July 2022, the increase in yields (linked to the commodity crisis) triggered renewed uncertainties on debt sustainability, and consequently a limited widening of spreads. To ensure its ability to hike its rates as much as possible without triggering financial tensions, the ECB announced the TPI, Transmission Protection Instrument.

In our view, however, the announcement of the TPI is of different nature than other interventions, as it was more a pre-emptive decision, rather than a reaction one: the ECB wanted to ensure that it had no obstacle to tighten its monetary stance as much as needed. In a way, it was also a monetary policy announcement: to communicate on its readiness to hike rates, it put in place the tools that prevent financial tensions.

Conclusion on this history review

When the ECB intervened at each episode, the country that was helped had a spread above 400bp: Greece in May 2010, Ireland in November 2010, Portugal in April 2011, Spain & Italy in summer 2011, Italy in December 2011 and Spain in July 2012.

The only exception is 2020 and 2022: the ECB intervened whereas spreads were below 300bp.

For most episodes, the ECB intervened only after the country took adequate decisions to ensure its debt sustainability:

- In May 2010, the ECB purchased bonds under the SMP after Greece signed the MoU.
- In November 2010, it waited for a discussion between Ireland and the Troïka on an EFSF programme to have progressed enough before buying Irish bonds; the same occurred for Portugal at the beginning of 2011.
- In December 2011, it waited for Italy to appoint Mario Monti as prime minister and the first decisions of his government before announcing the VLTROs.
- Regarding the July to September 2012 episode ("Whatever it takes" speech and OMT programme), it explicitly required the country to be under an EFSF/ESM programme before any ECB intervention.
- And the same goes for the TPI: before buying bonds under the TPI, "*The Governing Council will consider a cumulative list of criteria to assess whether the jurisdictions in which the Eurosystem may conduct purchases under the TPI pursue sound and sustainable fiscal and macroeconomic policies*.". The

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TPI can be implemented only if the country applies sustainable fiscal and macroeconomic policies.

Past ECB interventions

	Country	Tool	Spread	Conditionality
May-10	Greece	SMP	500	International Bailout
Nov-10	Ireland	SMP	450	EFSF programme
Summer 2011	Italy	SMP	400	None
Dec-11	Italy	VLTRO	500	Mario Monti reforms
Jul-12	Spain	OMT	500	ESM programme
Mar-20	Italy	PEPP	280	None
Jul-22	*Italy*	*TPI*	*200*	EDP

Source: ECB, Crédit Agricole CIB

Historically, the ECB never intervened unilaterally: it waited for tensions to be high enough to threaten its monetary transmission (because legally, it can only address tensions if they hamper its mandate) and it waited for the countries to take the adequate reforms to ensure that their debt is sustainable (because legally, it cannot make monetary financing).

And before concluding this part, we would recall that in 2018, the Italian spread widened to more than 330bp when the Lega-M5S coalition went into power, and in this context, there was never any question of the ECB intervening; as long as the country did not decide to take adequate policies, the ECB did not consider intervening – and once the country went back on sustainable policies, an intervention from the ECB was no longer warranted.

Conclusion: back on France

If France eventually loses its access to market funding and needs an external bailout, it can always request an ESM programme. It would then have to apply the reforms required by the ESM (the Troïka), and then the ECB could implement the OMT. This option seems highly improbable, as an ESM programme is politically toxic, and for a country to ask for an ESM programme it needs to be in a catastrophic situation; let us hope that France would react before being in such a situation.

More likely, if needed, France would try to get the TPI. To get the TPI, the exact modalities are unclear; however, we believe that if France exits the Excessive deficit procedure (improbable in the coming years) or if it applies the recommendations of the European Commission, then the ECB would intervene.

In the current situation, however, even if the EDP has been paused since June 2026, the latest public finance figures and the outlook for the 2027 budget will likely encourage the European Commission to step up the Excessive Deficit Procedure, depriving France of its eligibility for the TPI.

Besides, as stated in the modalities of the TPI, the ECB would only intervene “to counter unwarranted, disorderly market dynamics that pose a serious threat to the transmission of monetary policy across the euro area”, meaning that the ECB would only intervene if the spread is wide enough to hamper monetary policy transmission.

Do not expect a unilateral intervention from the ECB because the spread is ‘too wide’: for the ECB to intervene, you need a significantly larger spread and you need the French government – whoever it is – to implement adequate fiscal policies, which we have not seen over the past 20 years, and which is not perceptible in the current presidential candidates’ platforms.

Yes, if needed the ECB will help France, but before that, France would have to help itself.

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- France 360° Monitors

Outlook and Forecasts:
A global view on the Developed Market economies and all our forecasts on Macro (up to extremely detailed components of growth and central banks).

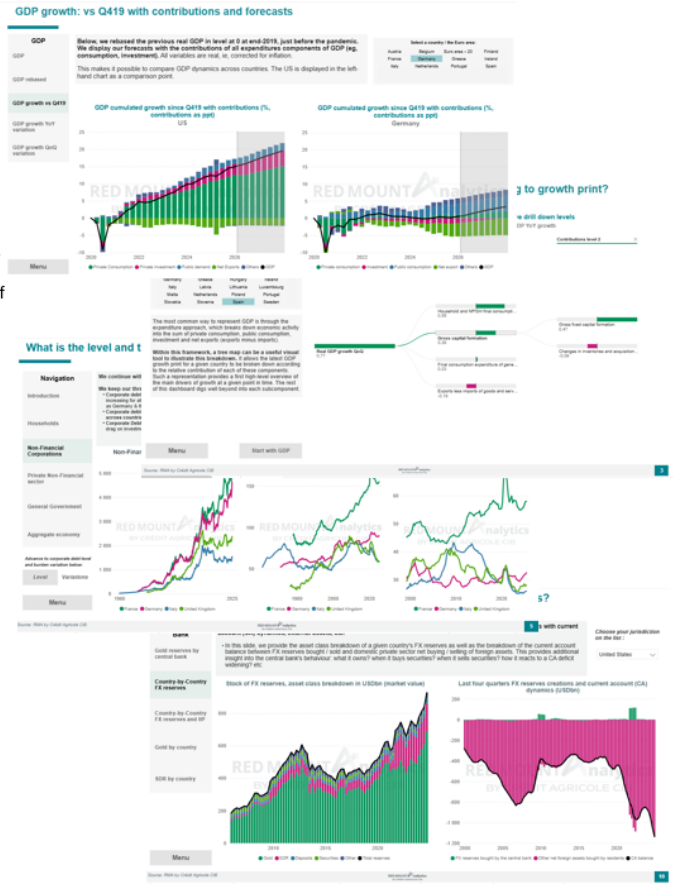
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Country by Country:
Only one topic for now, to be extended. France came to the brink of a crisis in 2024 – see how and why. This section will be expanded in the future as other countries come under the spotlight.



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