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RATES SPARK

Rates Spark: French spreads singed by violent protests

French spreads remain under pressure as protests reinforce concerns that any future government will struggle to deliver the reforms needed to stabilise public finances. At the same time, the ECB's hands are largely tied by energy prices still pressuring inflation



French government bond spreads continue to widen versus Germany on the fiscal situation and more recently the protests

France remains one of the focal issues in the eurozone. The spread of French government bonds over Germany has come under renewed widening pressure against the backdrop of violent protests grabbing the headlines.

The protests inject more uncertainty into the dynamics ahead of the presidential elections. On the right, Le Pen has jumped on public unrest to promote her law-and-order platform. Others have shifted the blame to the left. And indeed, if betting markets are to be trusted, the beneficiaries appear to be the right and centre candidates, while on the far left, Mélenchon's chances of winning the presidential race have been pared back of late. For bonds, that might be the only consolation, as his plans are viewed among the most controversial.

More importantly, the protests highlight that any government will struggle to implement the required reforms and savings against broader public resistance.

Tuesday will likely see more headlines around the 2027 budget, as Parliament is slated for a

first formal vote on the revenue section of the finance bill. From a flurry of proposed amendments, what remains is tax revenues being pared back and tax breaks expanded. It appears parties are still preoccupied with positioning themselves for the upcoming elections rather than tackling the fiscal issue.

It is not the end of the debate, though. Following the revenue section is the social security budget and then the expenditure part of the finance bill. All bills will be passed on to the Senate and eventually back to Parliament for a final vote. That is, in theory. The government still has the option to bypass Parliament to push through its fiscal consolidation plans, though at the risk of a no-confidence vote.

For now, a lack of will to make unpleasant but needed choices is likely to keep spreads over Bunds on a path towards testing recent intraday highs, with the 10y spread at 158bp. On an end-of-day basis, Monday's close at 147bp already marked a new high since the sovereign debt crisis. We have been looking for the spread to remain in the 125–150bp range. But negative headlines are piling up, and despite some dovish ECB remarks around the tightening of financial conditions, energy market pressures are tying the ECB's hands. A next test for French spreads awaits later this week with a scheduled rating review from Moody's.

Tuesday's events and market view

Following the UK jobs data in the morning, the next focus in European data is the German ZEW index, which is again expected to show an improving outlook for businesses. The US publishes housing data for September – building permits, housing starts and pending home sales. Central bank speakers scheduled for the day are the ECB's Rehn and the BoE's Greene. The National Assembly is slated for a first vote on an amended revenue section of the government's finance bill.

In primary markets, Germany reopens 2y and 27y green bonds (€1bn) while Finland auctions 4y and 10y bonds (€1.5bn). Italy is active in the retail segment this week, collecting subscriptions for the 5y BTP Valore and 5y BTP Valore Insieme. The UK will auction 10y gilts (£4.25bn).

Author

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroder@ing.com

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