



Sovereign debt – The risk of rising rates

Yields on European government bonds have risen noticeably in recent months. This is further exacerbating the situation for public finances. Even a de-escalation in the Middle East is unlikely to calm the markets in the long term. Rather, a high supply of government bonds and political uncertainties are likely to weigh on bonds. In the long term, higher market interest rates are also likely to worsen financing conditions for companies.

Dr. Vincent Stamer^{AC}

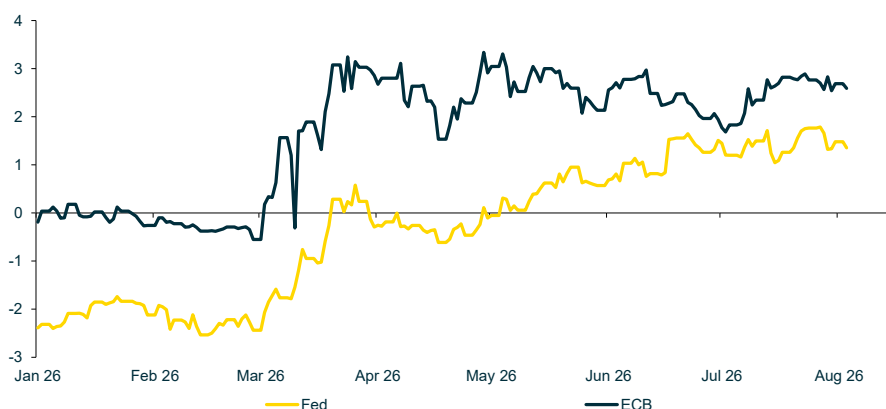
Inflation and interest rate expectations drive yields

Yields on European government bonds have risen steadily in recent years (title chart). In the last three years alone, yields on 10-year German government bonds and comparable French government bonds have climbed by more than one percentage point. As a result, the French yield recently broke through the 4% mark for the first time since 2008. At first glance, this development is surprising. After all, since 2024, the European Central Bank has significantly lowered its key interest rates, which are crucial for the bond markets.

However, this factor is more than offset by other aspects: Governments continue to issue debt and the ECB has stopped its bond purchases. This increases the supply of government bonds, lowers the demand and requires higher interest rates to attract investors. In addition, the war in Iran has put noticeable pressure on the bond market because energy prices – and thus inflation – in Europe have risen again. Furthermore, financial markets expect central banks to (further) raise their key interest rates in response to rising inflation. While financial markets had anticipated two Fed rate cuts earlier this year, they are now pricing in at least one rate hike by the end of the year (Chart 1).

Chart 1 - Expectations for key interest rate hikes have increased

Number of expected 25bp-interest hikes in the current year in total, calculated from overnight interest swaps (OIS)



Source: Bloomberg, Commerzbank Research

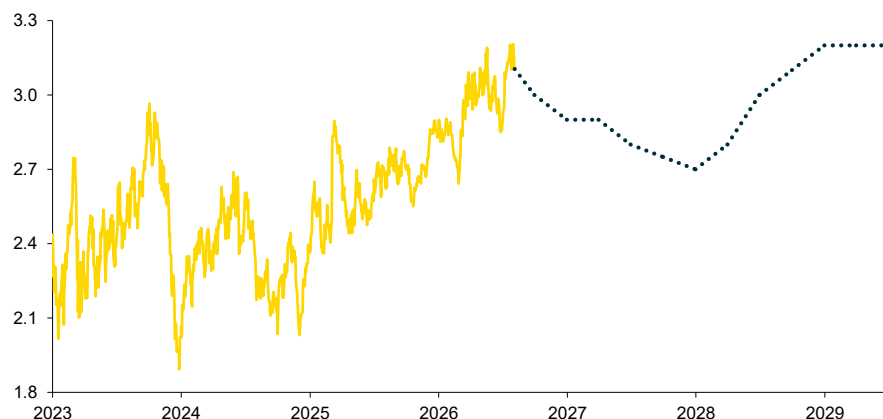
What's Next?

In the short term, developments in the bond markets will depend on how the conflict in the Middle East unfolds. If the tension eases, inflation is likely to fall again, allowing central banks to roll back the key interest rate hikes they have implemented so far. We expect the yield on 10-year German government bonds to fall back below 3% by the end of next year (Chart 2). In the medium to long term, however, the enormous supply of bonds resulting from loose fiscal policy – including in Germany – will cause yields to rise again. We therefore expect interest rates to rise again over the longer term. In the worst-case scenario, investors could begin to doubt the sustainability of government debt, which could trigger a vicious cycle of even faster-rising yields and spiraling government debt.



Chart 2 - The government bond yields will rise

The German government 10-year bond yield at the end of the quarter, in percent; Commerzbank forecasts as of 2026



Source: Bloomberg, Commerzbank Research

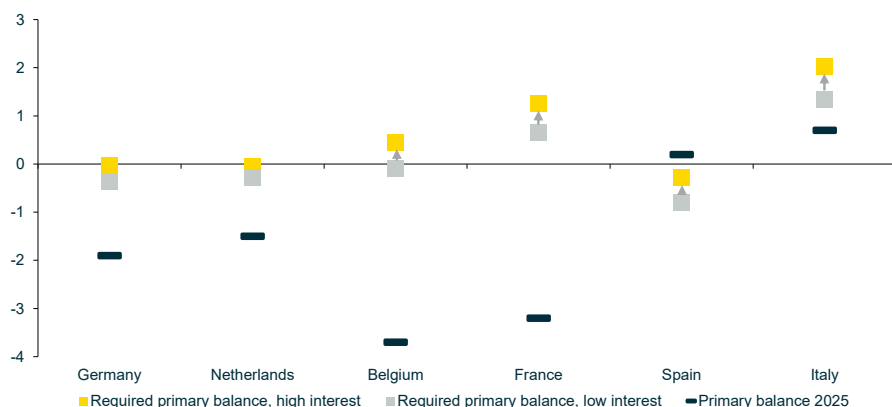
The pressure on public budgets rises

Even before the rise in interest rates in recent years, countries like Italy and France were heavily indebted. The additional percentage point in government bond yields has further exacerbated the situation. Because of this, governments must not only take on new debt at higher interest rates, but also refinance existing debt at higher coupon rates. This has serious consequences: In Italy, the government's interest payments will rise to over 5% of GDP. In France, yields now exceed the economy's growth rate – meaning the country fails to meet a key condition for sustainable debt. [1]

To prevent government debt from spiraling out of control, many governments would actually need to take countermeasures and improve their budget balance increasing revenue or reducing spending. Even without the rise in interest rates in recent years, all major euro area countries except Spain would have had to significantly improve their budget balance net of interest payments (primary balance) in order to stabilize their debt-to-GDP ratio. Rising yields on government bonds have made this target even more ambitious (Chart 3). For example, with interest rates as low as they were three years ago, France would have had to improve its primary budget balance to 0.7% of gross domestic product. Now, the target has risen to 1.3%. Given the high level of political instability and a primary balance of -3% (i.e., a significant deficit), there is now, more than ever, a huge gap between reality and sustainability. Italy's budget is already in surplus after deducting interest payments, but this is no longer sufficient.

Chart 3 - The budget situation in many countries is increasingly dire

Primary budget as % of GDP; Required budget for a stabilization of the debt levels by interest levels



Source: Commerzbank Research

What does this mean for the real economy?

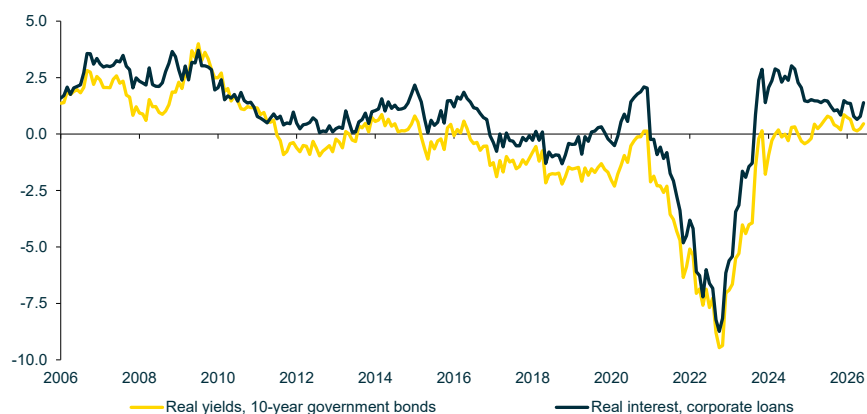
Higher yields on government bonds don't just put a strain on the public sector. After all, governments must either significantly reduce their spending over the long term or substantially increase their revenue (usually through taxes) in order to pay the interest without allowing debt to rise even further. This, in turn, dampens demand and slows growth. Furthermore, higher yields on government bonds generally also make loans more expensive for the private sector. Since governments must offer higher interest rates, investors and banks also demand a correspondingly higher real rate of return from companies (Chart 4).



Higher real corporate interest rates make refinancing existing corporate debt more expensive and drastically raise the barriers to new investments. Since less profitable or capital-intensive projects can no longer be carried out as a result, the economy's propensity to invest declines, which in turn noticeably slows down the entire real economy. Economic studies estimate that a one-percentage-point increase in real interest rates reduces private investment by one percent. This could noticeably slow down the economic recovery in many European countries.

Chart 4 - Rising government bond rates support real loan interests

Real 10-year government bond yields and real loan interest of company loans with a term of at least five years, in %



Source: Bundesbank, Bloomberg, German Statistical Office, Commerzbank-Research

[1] If the interest rate exceeds the growth rate of nominal gross domestic product, the country's debt-to-GDP ratio will rise unless the government takes countermeasures by maintaining a positive primary balance – that is, a budget surplus before interest payments. ([back](#))



Analysts

Dr. Jörg Krämer^{AC}
Chief Economist
+49 69 136 23650
joerg.kraemer@commerzbank.com

Bernd Weidensteiner^{AC}
Senior Economist
+49 69 9353 45625
bernd.weidensteiner@commerzbank.com

This report was completed 7/8/2026 07:24 CEST and disseminated 7/8/2026 07:24 CEST.

This document has been created and published by the Group Research department (GM-R) within the Group Management division of Commerzbank AG, Frankfurt/Main or Commerzbank's non-US branch offices mentioned in the document.

Analyst Certification (AC): The author(s), denoted by AC at the beginning of this report, individually certifies that the views expressed in this report accurately reflect their personal views about the subject securities and issuers; and no part of their compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or views expressed by them contained in this document.

It has not been determined in advance whether and in what intervals this document will be updated. Unless otherwise stated current prices refer to the most recent trading day's closing price or spread which may fluctuate.

Conflicts of interest

Disclosures of potential conflicts of interest relating to Commerzbank AG, its affiliates, subsidiaries (together "Commerzbank") and its relevant employees with respect to the issuers, financial instruments and/or securities forming the subject of this document valid as of the end of the month prior to publication of this document*:

Please refer to the following link for disclosures on companies included in compendium reports or disclosures on any company covered by Commerzbank analysts: <https://commerzbank.bluematrix.com/sellside/Disclosures.action>*

*Updating this information may take up to ten days after month end.

Disclaimer

This document is for information purposes only and has been prepared for recipients who, like professional clients according to MiFID II, have the experience, knowledge and expertise to understand information related to the financial markets. The document does not take into account specific circumstances of any recipient and the information contained herein does not constitute the provision of investment advice. It is not intended to be and should not be construed as a recommendation, offer or solicitation to acquire, or dispose of, any of the financial instruments and/or securities mentioned in this document and will not form the basis or a part of any contract or commitment whatsoever. Investors should seek independent professional advice and draw their own conclusions regarding suitability of any transaction including the economic benefits, risks, legal, regulatory, credit, accounting and tax implications.

The information in this document is based on public data obtained from sources believed by Commerzbank to be reliable and in good faith, but no representations, guarantees or warranties are made by Commerzbank with regard to accuracy, completeness or suitability of the data. Commerzbank has not performed any independent review or due diligence of publicly available information regarding an unaffiliated reference asset or index. The opinions and estimates contained herein reflect the current judgement of the author(s) on the date of this document and are subject to change without notice. The opinions do not necessarily correspond to the opinions of Commerzbank. Commerzbank does not have an obligation to update, modify or amend this document or to otherwise notify a reader thereof in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate.

In order to address potential conflicts of interest Commerzbank's Research department operates independently of other business units of the bank. This is achieved by way of physical and administrative information barriers and separate reporting lines as well as by written internal policies and procedures.

This communication may contain trading ideas where Commerzbank may trade in such financial instruments with customers or other counterparties. Any prices provided herein (other than those that are identified as being historical) are indicative only, and do not represent firm quotes as to either size or price. The past performance of financial instruments is not indicative of future results. No assurance can be given that any financial instrument or issuer described herein would yield favourable investment results. Any forecasts or price targets shown for companies and/or securities discussed in this document may not be achieved due to multiple risk factors including without limitation market volatility, sector volatility, corporate actions, the unavailability of complete and accurate information and/or the subsequent transpiration that underlying assumptions made by Commerzbank or by other sources relied upon in the document were inapposite.

Commerzbank and or its affiliates may act as a market maker in the instrument(s) and or its derivative that has been mentioned in our research reports. Employees of Commerzbank and or its affiliates may provide written or oral commentary, including trading strategies, to our clients and business units that may be contrary to the opinions conveyed in this research report. Commerzbank may perform or seek to perform investment banking services for issuers mentioned in research reports.

Neither Commerzbank nor any of its respective directors, officers or employees accepts any responsibility or liability whatsoever for any expense, loss or damages arising out of or in any way connected with the use of all or any part of this document.



Commerzbank may provide hyperlinks to websites of entities mentioned in this document, however the inclusion of a link does not imply that Commerzbank endorses, recommends or approves any material on the linked page or accessible from it. Commerzbank does not accept responsibility whatsoever for any such material, nor for any consequences of its use.

This document is for the use of the addressees only and may not be reproduced, redistributed or passed on to any other person or published, in whole or in part, for any purpose, without the prior, written consent of Commerzbank. The manner of distributing this document may be restricted by law or regulation in certain countries, including the United States. Persons into whose possession this document may come are required to inform themselves about and to observe such restrictions. By accepting this document, a recipient hereof agrees to be bound by the foregoing limitations.

Additional notes to readers in the following countries:

Germany: Commerzbank AG is registered in the Commercial Register at Amtsgericht Frankfurt under the number HRB 32000. Commerzbank AG is supervised by both the German regulator, Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), Graurheindorfer Strasse 108, 53117 Bonn, Marie-Curie-Strasse 24-28, 60439 Frankfurt am Main and the European Central Bank, Sonnemannstrasse 20, 60314 Frankfurt am Main, Germany.

United Kingdom: This document is not for distribution to retail customers and has been issued or approved for issue in the United Kingdom by Commerzbank AG, London Branch, which is authorised and regulated by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) and the European Central Bank. Authorised by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request.

United States: This research report was prepared by Commerzbank AG, a company authorized to engage in securities activities in Germany and the European Economic Area (EEA). Commerzbank AG is not a U.S. registered broker-dealer and is therefore not subject to U.S. rules regarding the preparation of research and associated rules pertaining to research analysts. This document is not for distribution to U.S. retail customers. Any distribution of this research report to U.S. investors is intended for "major U.S. institutional investors" in reliance on the exemption from registration provided by Rule 15a-6(a)(2) of the U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act"). Any U.S. recipient of this research report seeking to effect transactions to buy or sell securities, or related financial instruments based upon the information provided in this research report, may only do so through a Financial Industry Regulatory Authority (FINRA) registered broker-dealer. Commerz Markets LLC (CMLLC) is a U.S. registered broker-dealer and wholly owned subsidiary of Commerzbank AG. Commerzbank AG is a registered derivatives swap dealer with the Commodity Futures Trading Commission (CFTC), in accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act. U.S. Person(s) and related Dodd-Frank relevant investors seeking to effect transactions in non-security based swaps based upon the information provided in this research report, may only do so through a CFTC registered swap dealer.

Canada: The information contained herein is not, and under no circumstances is to be construed as, a prospectus, an advertisement, a public offering, an offer to sell securities described herein, solicitation of an offer to buy securities described herein, in Canada or any province or territory thereof. Any offer or sale of the securities described herein in Canada will be made only under an exemption from the requirements to file a prospectus with the relevant Canadian securities regulators and only by a dealer properly registered under applicable securities laws or, alternatively, pursuant to an exemption from the dealer registration requirement in the relevant province or territory of Canada in which such offer or sale is made. Under no circumstances is the information contained herein to be construed as investment advice in any province or territory of Canada and is not tailored to the needs of the recipient. In Canada, the information contained herein is intended solely for distribution to Permitted Clients (as such term is defined in National Instrument 31-103) with whom Commerzbank AG and/or Commerz Markets LLC deals pursuant to the international dealer exemption. The information contained herein is not permitted to reference securities of an issuer incorporated, formed or created under the laws of Canada or a province or territory of Canada, as Commerzbank AG and Commerz Markets LLC operates under the international dealer exemption pursuant to National Instrument 31-103. No securities commission or similar regulatory authority in Canada has reviewed or in any way passed upon these materials, the information contained herein or the merits of the securities described herein and any representation to the contrary is an offence.

European Economic Area: Where this document has been produced by a legal entity outside of the EEA, the document has been re-issued by Commerzbank AG, London Branch for distribution into the EEA. Commerzbank AG, London Branch is authorised and regulated by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) and the European Central Bank. Authorised by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request.

Switzerland: This document is generally not for distribution to retail clients. Neither this research report nor the information contained herein should be regarded as personal recommendations for transactions in financial instruments within the meaning of the Financial Services Act.

Singapore: This document is furnished in Singapore by Commerzbank AG, Singapore branch. It may only be received in Singapore by an institutional investor, an accredited investor or an expert investor as respectively defined in section 4A of the Securities and Futures Act, Chapter 289 of Singapore ("SFA") pursuant to section 274 or section 275 (as applicable) of the SFA. Nothing in this document constitutes accounting, legal, regulatory, tax, financial or other advice and/or recommendations to the recipient of this communication. Further, the communication/information provided herein does not constitute a "financial advisory service" within the meaning of the Financial Advisers Act, Chapter 110 of Singapore ("FAA") and therefore, the regulatory requirements and duties that may be owed to a client pursuant to or in connection with the FAA are not applicable to the recipient in connection with this communication. Recipients are advised to seek independent advice from their own professional advisers about the information contained discussed herein.

Japan: This information and its distribution do not constitute and should not be construed as a "solicitation" under the Financial Instrument Exchange Act (FIEA) of Japan. This information may be distributed from Commerzbank international branches outside Japan solely to "professional investors" as defined in Article 2(31) of the FIEA and Article 23 of the Cabinet Ordinance Regarding Definition of Article 2 of the FIEA. Please note that Commerzbank AG, Tokyo Branch has not participated in its preparation. Not all financial or other instruments referred to in this document are available within Japan. Any instruments referred in this report cannot be introduced by the Branch. You should contact the Corporate Clients division of Commerzbank AG for inquiries on availability of such instruments.

Australia: Commerzbank AG does not hold an Australian financial services licence. This document is being distributed in Australia to wholesale customers pursuant to an Australian financial services licence exemption for Commerzbank AG under Class Order 04/1313.



Commerzbank AG is regulated by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) under the laws of Germany which differ from Australian laws.

People's Republic of China (PRC): This document is furnished by Commerzbank AG and is only intended for eligible entities in the PRC. No-one else may rely on any information contained within this document. The products and services in this document only apply to entities in the PRC where such products and services are permitted to be provided by PRC laws and regulations. For any person who receives this document, the information in this document shall neither be regarded as promotion or solicitation of the business nor accounting, legal, regulatory, tax, financial or other advice and/or recommendations to the recipient of this communication, and the recipient is advised to seek independent advice from its own professional advisers about the information contained herein and shall understand and abide by PRC laws and regulations while conducting any related transactions.

© Commerzbank AG 2026. All rights reserved. Version 26.02

Frankfurt

Commerzbank AG
DLZ - Gebäude 2, Händlerhaus
Mainzer Landstraße 153
60327 Frankfurt
Tel: + 49 69 136 21200

London

Commerzbank AG
PO BOX 52715
30 Gresham Street
London, EC2P 2XY
Tel: + 44 207 623 8000

New York

Commerz Markets LLC
225 Liberty Street, 32nd floor,
New York,
NY 10281-1050
Tel: + 1 212 703 4000

Singapore

Commerzbank AG
128 Beach Road
#17-01 Guoco Midtown
Singapore 189773
Tel: +65 631 10000