



Sovereign debt crisis – is this time different?

French government bonds are likely to remain under pressure in the coming months. We analyze the parallels with the sovereign debt crisis of 15 years ago, but also highlight what has improved.

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Anxiety surrounding French government bonds remains high

French government bonds have been on a roller-coaster ride. Last Friday, the yield spread relative to 10-year German government bonds had reached nearly 160 basis points, only to fall since then to 140 basis points – the latter move also supported by Marine Le Pen, who has promised a significant reduction in France's high budget deficit should she win the election. In any case, anxiety surrounding France's high and rising public debt, along with fears of contagion to other highly indebted countries, is likely to persist in the coming months. We therefore analyze the parallels to the sovereign debt crisis of 15 years ago. But we also highlight what is better today than it was back then.

What reminds us of the sovereign debt crisis back then, and what is even worse today?

Let's start with the negative aspects—that is, what today reminds us of the sovereign debt crisis from 15 years ago.

- **High public debt-to-GDP ratio:** The most striking parallel to that time is the fact that public debt remains high today. On average across the eurozone, it currently stands at around 90% of GDP. The public debt-to-GDP ratio thus significantly exceeds the Maastricht Treaty's upper limit (60%). Furthermore, it is higher than in 2009 (80%), the year before the outbreak of the sovereign debt crisis at that time. With the exception of Germany, this applies to all other major eurozone countries –namely France, Italy, and Spain (Chart 1).

Chart 1 - Public debt in many cases higher than before the sovereign debt crisis

Public debt in percent of GDP, 2026: forecast of the EU commission



Source: Ameco, Commerzbank Research

- **Debt sustainability called into question:** Another troubling parallel to the sovereign debt crisis is that investors today, just as they did back then, have begun to question the debt sustainability of a member state of the monetary union. Furthermore, there were contagion effects at the end of last week, as the spreads of other countries also increased – such as those of heavily indebted Italy. For now, France's risk premiums and the contagion effects are much smaller than they were back then with regard to Greece, the other Southern European countries, and Ireland, but doubts about the sustainability of government debt have begun to surface. There is a danger that this genie can no longer be forced back into the bottle.
- **France is systemically important:** Greece is a small country. Nevertheless, it brought the monetary union to the brink of collapse back then – in part because many foreign investors and banks held Greek government bonds. This systemic importance is even more evident when it comes to France.
- **Weak willingness to reform:** The willingness to reform is likely even weaker today than it was back then. Ireland, Portugal, and Spain cooperated with lenders from the EU and the International Monetary Fund and implemented many of the conditions attached to their bailout packages. With the exception of the left-wing Syriza government under Prime Minister Alexis Tsipras, this even applied to the Greek governments. However, with regard to France, such cooperation would be difficult to imagine. For instance, the European Commission turned a blind eye to France's repeated budget violations and granted the country multiple extensions to meet its budget deficit reduction targets – a decision that then-Commission President Jean-Claude Juncker justified with the famous phrase, "Because it's France."



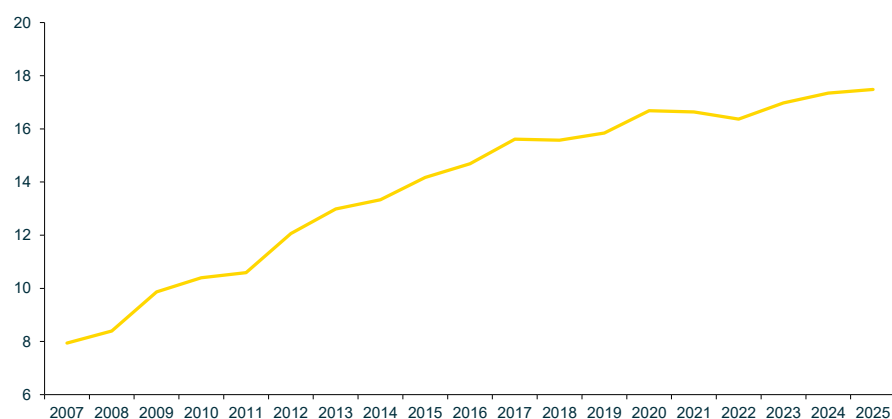
But some things are also better than they were back then

So there are troubling parallels to the sovereign debt crisis of that time, and the willingness to reform is even weaker than it was back then. But some things are also better:

- **France is a highly developed country:** The sovereign debt crisis in Greece exposed serious institutional shortcomings that were plain for all to see. The lack of functioning land registry offices was symptomatic of this. In contrast, France is a highly developed country with stable, functioning institutions. It has far more financial strength than Greece did back then.
- **Stable banks:** Even before the outbreak of the sovereign debt crisis back then, many banks in the eurozone had been weakened by the preceding real estate and subprime crises. This fueled fears of costly bank bailouts, which in turn intensified concerns about the sustainability of sovereign debt. In contrast, there is no crisis looming over the banks today. Instead, in recent years – partly due to stricter regulatory requirements – they have significantly increased their capital ratios. They are much more resilient than they were back then (Chart 2).

Chart 2 - Banks are better capitalised now

Tier 1 capital ratio of euro area domestic banks, in % of risk weighted assets



Source: ECB, Commerzbank Research

- **ECB Rescue Mechanisms Are in Place:** If a central bank is willing to purchase any number of Treasury bonds, a country can never formally become insolvent. With the help of its central bank, the government can settle any bill using newly created electronic money. Before the outbreak of the sovereign debt crisis, the situation was different, as the ECB initially still adhered to the prohibition set forth in the Maastricht Treaty. Although it had purchased Greek government bonds in 2010 under then-President Jean-Claude Trichet, it was not prepared to acquire government bonds in large or even unlimited quantities. Investors therefore saw an opening after the eurozone finance ministers failed to mobilize sufficient aid funds for member states under pressure, such as Greece or Italy. Since Mario Draghi's famous statement, "Whatever it takes," in 2012, the situation has changed. At that time, the ECB adopted the so-called OMT bond-purchase program, which allowed it to buy bonds on a large scale from affected member states under fairly lenient conditions. In the summer of 2022, the ECB also adopted the TPI purchase program, under which the ECB can acquire bonds from individual countries if their yields are, in the ECB's view, fundamentally too high. Here, too, the conditions are loosely defined and allow the ECB a great deal of discretion. At the very latest when the existence of the monetary union were threatened, the ECB would activate its instruments – even if such a rescue operation were to have serious side effects.

Conclusion: No sovereign debt crisis in the baseline scenario, but risks are rising

There are troubling similarities to the sovereign debt crisis of 15 years ago when one considers the high levels of government debt. There are additional problems when one considers the resistance to reform in France and other countries. But some things are better than they were back then, especially the ECB's multi-layered defense system. Therefore, in the base case scenario, we do not expect a new sovereign debt crisis with strong contagion effects on other countries, although the risk that things could turn out differently is rising.



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