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French debt concerns rise as government falls.

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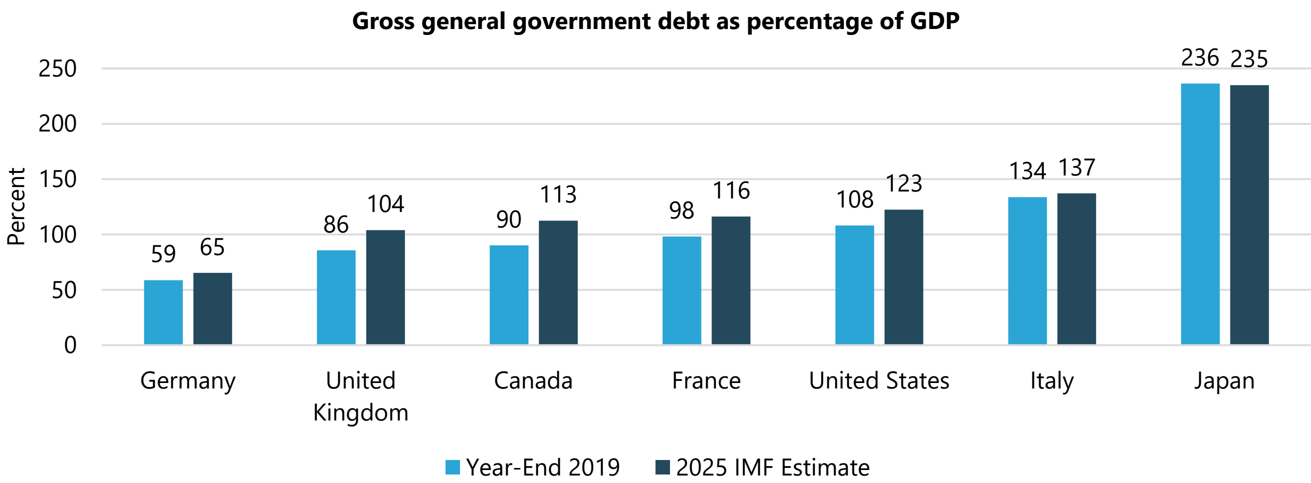
The French government has fallen…again. France's recent political instability—marked by four Prime Ministers in fewer than two years—is enough to make even the U.K. blush. François Bayrou's inability to secure buy-in for his plan to trim France's budget deficit removes the near-term prospect of a more sustainable trajectory for the country's public finances.

Other nations face similar challenges

France suffers from low economic growth and high taxes (as does the U.K.), which makes fixing its public finances a difficult task. Given the lack of political appetite to reduce government spending, the burden falls on higher taxes to address its fiscal woes. However, as depicted by the so-called Laffer curve, tax revenue increases with higher tax rates, but only to a certain point, after which tax receipts actually decrease. It is quite possible that France has already passed this point to the extent that further tax increases would be self-defeating from a revenue-generating perspective.

The government's other option is to attempt to grow its way out of the fiscal malaise by reducing taxes in the hope that this will stimulate economic activity and generate higher tax receipts. However, this would worsen the fiscal deficit in the short-term, and markets may not react well if the execution is clumsy—as evidenced by Liz Truss' short-lived government. With France's debt-to-gross domestic product (GDP) ratio currently near 115% and growing, the risk is that investors become increasingly restless by demanding ever-higher yields. And so, France finds itself in a fiscal bind—as do other nations (see Exhibit 1).

Exhibit 1: France is not alone.



Source: International Monetary Fund, SEI. As of 9/9/2025.

The spread on French 10-year government debt (relative to German government debt) is currently 79 basis points, almost double its recent 10-year average. Earlier this week, French government bonds (OATs) briefly traded wider than their Italian counterparts (BTPs). Moreover, with the all-in yield at 3.45% once again approaching the recent highs seen in March 2025, it is concerning that the bloc's second largest economy faces such relatively high borrowing costs.

What does this mean for investors?

European stocks have had a muted reaction thus far, with the broader global equity market unaffected. For bond markets on the other hand, as borrowing continues to rise, the risk remains that runaway government spending in France could lead concerned fixed-income investors (so-called bond vigilantes) to invest elsewhere, putting upward pressure on French yields. (Bond prices fall as yields rise.)

For investors and asset managers, the implications are clear:

- **Interest-rate volatility** will remain a key risk factor across sovereign debt markets.
- **Credit-quality divergence** between countries will create opportunities for selective exposure.
- **Policy credibility**—both fiscal and monetary—will be a critical determinant of long-term debt sustainability.

In this environment, active management and a disciplined approach to risk are more important than ever.

Our portfolios

The SEI Global Fixed Income Fund's positioning reflects the underlying managers' assessment that the current yields on French government bonds do not adequately compensate for political and fiscal risks. Our managers detected this risk early, and as a result the portfolio has been consistently underweight French bonds—a positive driver of year-to-date relative performance. French bonds have offered low real yields relative to other sovereign bond markets for some time, while France itself has continued on an unsustainable debt path matched by an apparent unwillingness by the public and politicians to change course.

In short, this means that from an active management perspective, we think that better choices are available elsewhere in the sovereign bond space. Accordingly, we currently have a 0.3 year underweight to France and are likely to remain strategically underweight French OATs for the foreseeable future (with the option to tactically neutralize or even overweight our position if we think that the market has overpriced these risks in the short-term).

Our view

Debt itself is not problematic—but ignoring its trajectory is. Just before the vote that led to his coup de grâce, French Prime Minister François Bayrou declared, "You have the power to bring down the government, but you do not have the power to erase reality. Reality will remain relentless: expenses will continue to rise, and the burden of debt, already unbearable, will grow heavier and more costly." Bayrou was speaking specifically about France, but his warning could easily apply to other countries should they prove unable to get their fiscal houses in order.

Important information