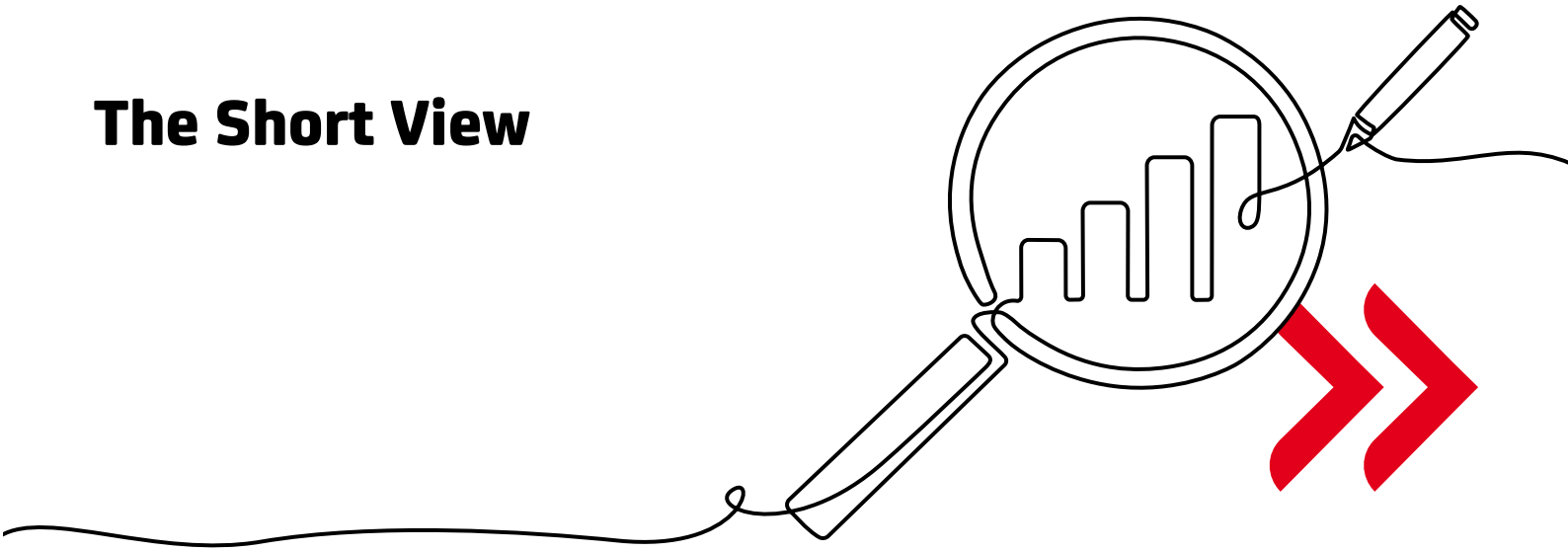
The Investment Institute
by UniCredit

The Short View



The Short View offers insights on key macro and market stories and is designed to promote discussion and debate.

EU bonds shrug off French jitters: what could challenge this?

2 November 2026

Despite the sharp repricing in French government bonds (OATs), EU debt has remained comparatively resilient, suggesting investors still view France's challenges as primarily domestic rather than systemic. We assess the key risks to this view and discuss alternative investment options.

1. EU bonds have held up remarkably well despite the sharp repricing in OATs. Their spread to Bunds has widened only modestly, underscoring the market's view that EU debt benefits from the collective backing of its member states. Around half of the widening reflects investor preference for more liquid assets, mainly Bunds, and half reflects higher credit risk.
2. Investors continue to view France's fiscal and political challenges as largely idiosyncratic. With a busy electoral calendar ahead, developments regarding the European agenda will be key to monitor. Any deterioration in political cohesion could translate into wider EU spreads.
3. For investors seeking to reduce exposure to EU political risk, Bunds are the cleanest option, albeit also the most expensive one in terms of missed carry. For investors seeking to reduce forgone carry, switching into EIB debt offers an attractive risk-reward trade-off among high-quality alternatives.

EU bonds have held up well amid France tensions

A commonly cited weakness of the euro area's architecture is the absence of a fully developed common safe asset. EU bonds are the closest equivalent, but it is not built on central fiscal power, at around EUR 800bn, their market size remains relatively small and their long-term developments uncertain. Yields of EU bonds typically trade above Bunds and have never traded much lower than the average of euro countries 10Y yields, symptomatic of the fact that EU bonds cannot be seen as a genuine form of continental safe asset. Further expansion of joint funding would strengthen European integration, yet the current political backdrop remains challenging. Political uncertainty in several member states, combined with an intense electoral calendar in 2027, limits the scope for further fiscal and funding integration.

Against this backdrop, it is worth examining how EU bonds have performed amid the recent bout of sovereign spread widening.

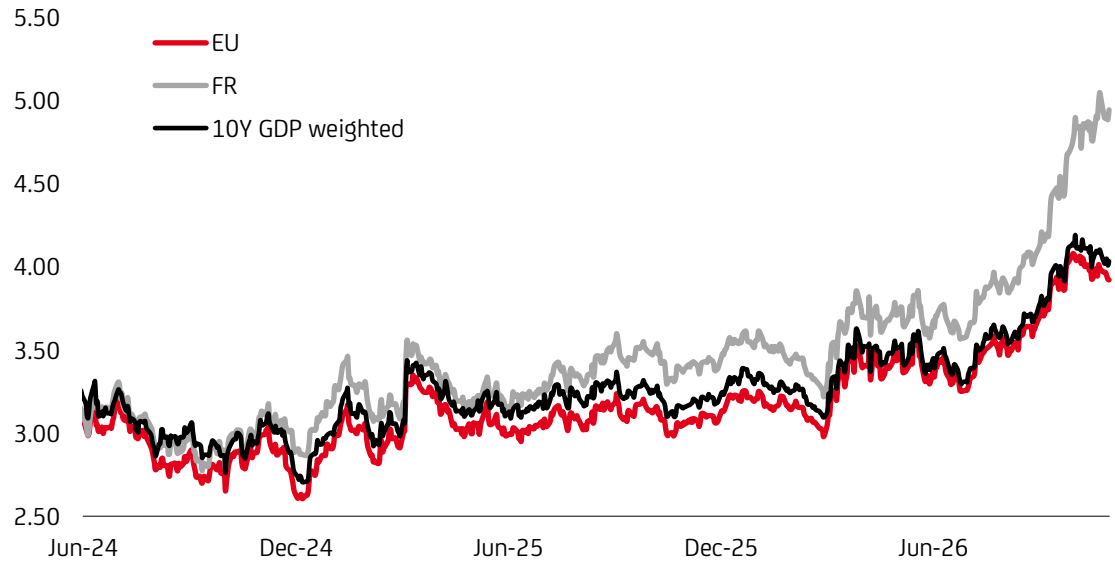
OATs have been especially hit: concerns over weak fiscal fundamentals, political uncertainty ahead of next year's presidential and parliamentary elections, and social tensions pushed OAT spreads to their widest levels since 2010. The move has attracted significant attention: as France accounts for around 20% of euro area GDP, a sustained deterioration in market sentiment could have implications well beyond its domestic bond market.

The interesting finding is that EU bonds have proved remarkably resilient so far. Since the beginning of September, the EU-Bund spread has widened by around 20bp, roughly one-quarter of the move seen in the 10Y OAT-Bund spread.

As the chart below shows, the 10Y EU yield has moved in line with the GDP-weighted average yield of euro area countries.

EU BONDS HAVE BEEN RESILIENT TO FRANCE JITTERS

10Y YIELD (%)



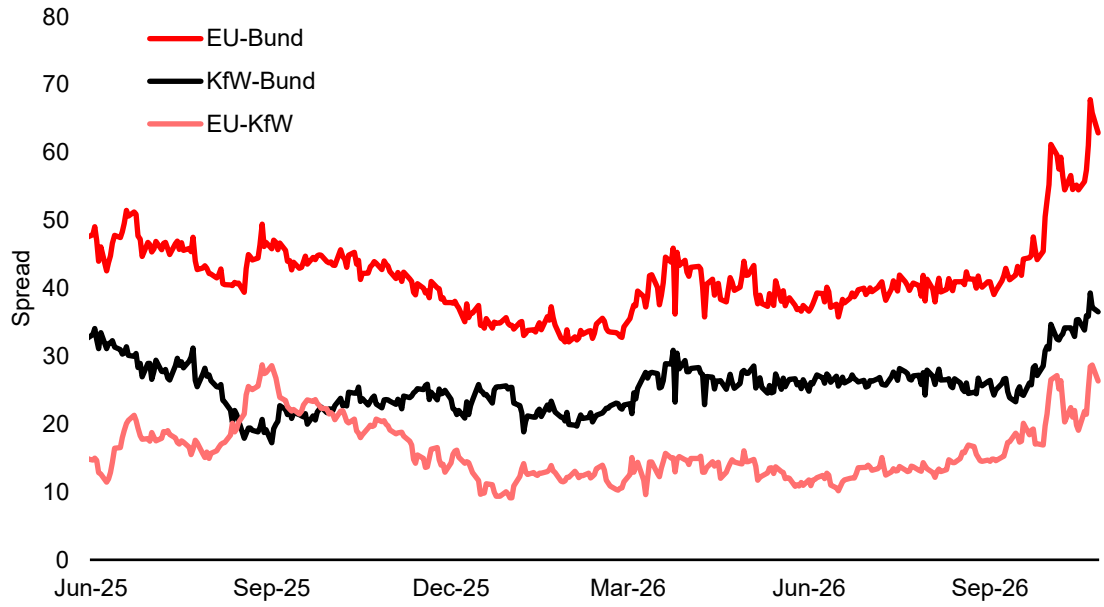
Source: Bloomberg, The Investment Institute by UniCredit

A useful way to analyse the EU-Bund spread is to decompose it into two components: the KfW-Bund spread and the EU-KfW spread. Since both KfW and Bunds share the same German sovereign anchor, the KfW-Bund spread primarily reflects liquidity considerations. By contrast, the EU-KfW spread is more likely to capture changes in the market's assessment of EU-specific credit risk.

Interestingly, the widening in the EU-Bund spread since early September has been split broadly evenly between these two components. Only about half of the move reflects higher credit-risk concerns while the remainder appears to be compensation for stronger preference for liquid assets. Overall, investors appear confident that France's fiscal challenges will neither undermine the euro area's institutional framework nor materially weaken the EU's credit profile.

BREAKING DOWN EU-BUND SPREAD IN LIQUIDITY PREMIUM AND CREDIT RISK

YIELD SPREADS (BP)



Source: Bloomberg, The Investment Institute by UniCredit

Reasons for the resiliency

The more contained reaction of EU bonds reflects a few factors. **First**, EU bonds are backed by the EU budget and therefore benefit from the support of all member states. While France is an important one, the framework does not rely on any single country and was designed to be resilient. **Second**, investors view the French situation primarily as a domestic issue rather than a threat to the broader European project. Strong commitment by member countries to provide additional funding to the EU budget, if needed, is not under question. **Third**, a full-fledged euro crisis remains unlikely given that, should tensions intensify materially, the ECB would likely act to prevent wide-spread contagion and market fragmentation. **Fourth**, EU bonds benefit from a stable investors base, with central banks accounting for around 20% and insurance companies for 16.5%. This has likely reduced volatility in the last weeks. **Fifth**, the EU has a regular and predictable issuance path, which also contributes to price stability.

What could challenge this?

EU bonds have so far performed well, showing limited widening relative to other SSAs. For example, at the 10Y maturity, EU has widened moderately versus KfW and the EIB. An interesting question, also from a risk management perspective, is what could challenge this constructive assessment by investors.

The resilience of EU bonds relative to French government debt rests largely on investor's view that France's difficulties remain a national rather than a European issue. In this respect, the main risk factor is political cohesion in the eurozone. Any sign that support to political integration is weakening could prompt investors to demand a higher risk premium for holding EU bonds.

With important elections coming up next year, a rise in popularity of parties that are tepid versus European policies would be detrimental for EU bonds. Marine Le Pen suggestions to reduce France contributions to the EU budget do not bode well in this respect. Moreover, EU bonds find an important element of support from larger States. With France now navigating increasingly difficult waters, it will be particularly important to monitor how the political debate in Germany evolves.

Investors could become concerned that member states may prioritise domestic fiscal agendas over deeper fiscal integration. In this respect, the decision to launch new projects of common funding and give the asset class a more permanent role would be a good signal of political commitment.

Deterioration in France credit rating could matter, but to a lesser extent. Moody's recently noted that the creditworthiness of highly rated net contributors to the EU budget, such as Germany, France and the Netherlands, remains an important rating consideration but the EU's Aaa rating has a degree of resilience to such changes, particularly if they are limited. A moderate downgrade of France alone would be unlikely to trigger a reassessment of EU ratings, which are supported by the collective fiscal capacity of member states and extensive budgetary safeguards. The rating improvement of some periphery countries is also a supportive factor.

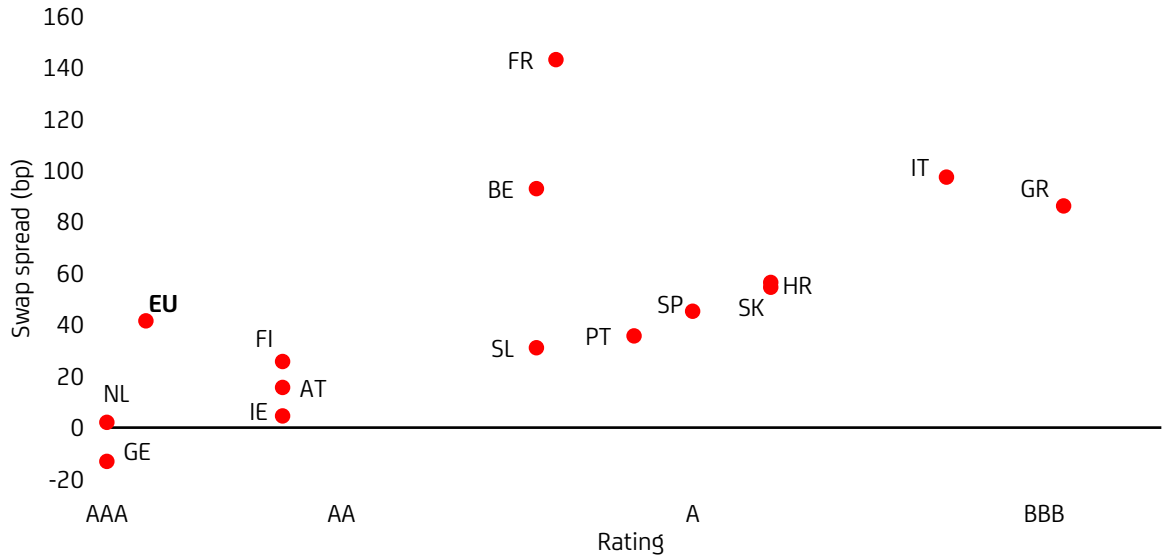
Investment implications

EU bonds offer an attractive carry, higher than that offered by most other top-rated issuers. EU credit spread is comparable to Spain, which has the pros of being a large market but has a much lower rating. As we have discussed, the pick-up offered by EU bonds is in part a remuneration for their lower liquidity and in part reflects inherent credit risk, in particular related to the EU political project.

The chart below suggests that France's credit spread already reflects a significant amount of negative news. OATs spread should have room to retrace over a sufficiently long horizon. In the short term, however, risks are for more widening as political uncertainty remains high and the bar for ECB intervention is probably well above current market spreads.

EUROZONE ISSUERS MENU: CREDIT SPREAD AND RATING

10Y SWAP SPREAD (BP) AND RATING



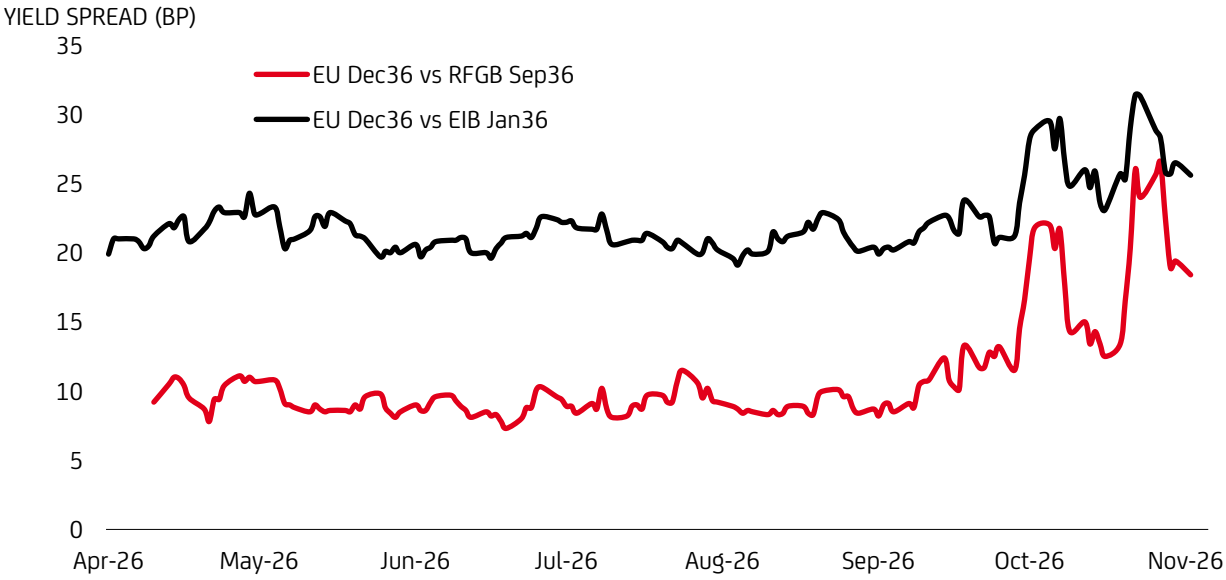
Source: Bloomberg, The Investment Institute by UniCredit
Note: Rating is defined as the average rating of Moody's, Fitch and S&P

As discussed above, EU bonds have remained resilient in recent months, behaving broadly like a proxy for the average euro-area yield level. They have not been fully immune to developments in OATs, however.

A negative view on France does not necessarily call for a reduction of exposure to EU: as recent market action suggests, wider OAT spreads would likely spill over into EU bonds with a beta well below one. That said, investors wanting to reduce their exposure to EU politics have a few options. One is to forego the carry and buy Germany, which would attract safe-haven demand in a crisis scenario. This, however, comes with an elevated 60bp yield give-up at the 10Y maturity. Finland represents an intermediate option, with a smaller yield give-up (20bp) and a rating still elevated. With less than EUR 150bn outstanding, the Finnish bond market is much smaller than that of EU bonds.

Another option to diversify from Europe political risk would be to switch into EIB. Yield give-up is approximately 25bp. The market size is lower than for EU bonds but comparable to Finland, and yield dynamics are likely to be relatively immune to European political developments as the institution should benefit from its own capital structure.

TWO ALTERNATIVE OPTIONS TO EU BONDS



Source: Bloomberg, The Investment Institute by UniCredit

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