

The Price of Fiscal Credibility: Sovereign Risk and Dollar Paradox

- France's widening spreads signal rising fiscal pressure, not an immediate funding crisis.
- USD remains resilient despite US fiscal concerns, supported by relative yields, technology investment attraction, and global liquidity demand.
- Favour selective duration and quality assets; monitor financial contagion and signs of deteriorating dollar confidence.

France's Sovereign Repricing Signals Growing Fiscal Pressure

France has become a focal point of European sovereign risk, with its 10-year government bond yield touching 5.0%, the highest since 2002. The spread over German Bunds has widened to approximately 157bp, reflecting concerns over France's fiscal outlook and political uncertainty, alongside broader interest-rate pressures. France's proposed 2027 financing requirement rises to EUR339.7bn, while its state debt-service budget charge is expected to increase from EUR62.6bn in 2026 to EUR72.9bn. Although higher refinancing costs will increasingly constrain fiscal flexibility, continued bond issuance and investor demand suggest that France faces rising financing pressure rather than an immediate funding crisis.

Elevated US Treasury Yields Raise Global Financing Costs

US faces similar fiscal challenges, with persistent deficits and substantial government borrowing requirements. The 10-year Treasury yield stood at 5.12%, alongside a real yield of 2.77%. While increased debt supply could add upward pressure, monetary policy, inflation and economic conditions remain important drivers of yields. Elevated US rates increase borrowing costs globally, weigh on equity valuations and create refinancing risks for highly leveraged companies. The greater threat would come from a rapid, disorderly rise in yields that disrupts financial-market liquidity.

The Dollar Paradox: Fiscal Deterioration Has Not Undermined Dollar Demand

Despite growing US fiscal concerns, the dollar remains supported by relatively attractive returns, deep financial markets and its dominant role in international funding. DXY traded around 101.76, below earlier peaks but without evidence of a disorderly currency sell-off. The IMF's latest reserve data show the dollar's share declining to 56.70% in Q2 2026, while the value of dollar reserve claims remained broadly unchanged. Meanwhile, US Treasury data recorded USD199.8bn in net foreign TIC inflows in August. These developments suggest that gradual reserve diversification can coexist with continued demand for US assets. However, sustained Treasury yield increases alongside broad dollar weakness and deteriorating foreign demand would raise concerns about a potential shift in fiscal confidence.

Financial Contagion Remains a Downside Risk, Not Our Base Case

Higher sovereign yields do not automatically trigger a financial crisis. Risks become more serious when bond losses weaken banks, credit conditions tighten or leveraged investors are forced to sell assets. Recent European bond-market stress has raised concerns about these transmission channels, although stronger bank capital positions offer protection compared with the previous eurozone debt crisis. A deterioration in bank funding, credit spreads and market liquidity would provide stronger evidence that sovereign repricing is developing into broader financial instability.

Strategy: Remain Selective and Preserve Portfolio Flexibility

We expect continued sovereign repricing without a systemic crisis. Favour short- to intermediate-duration bonds, financially resilient companies and diversified protection through dollar liquidity and gold. Add duration if inflation eases; turn defensive if funding conditions deteriorate. A confirmed US confidence shock would warrant reducing concentrated dollar and long-Treasury exposure.

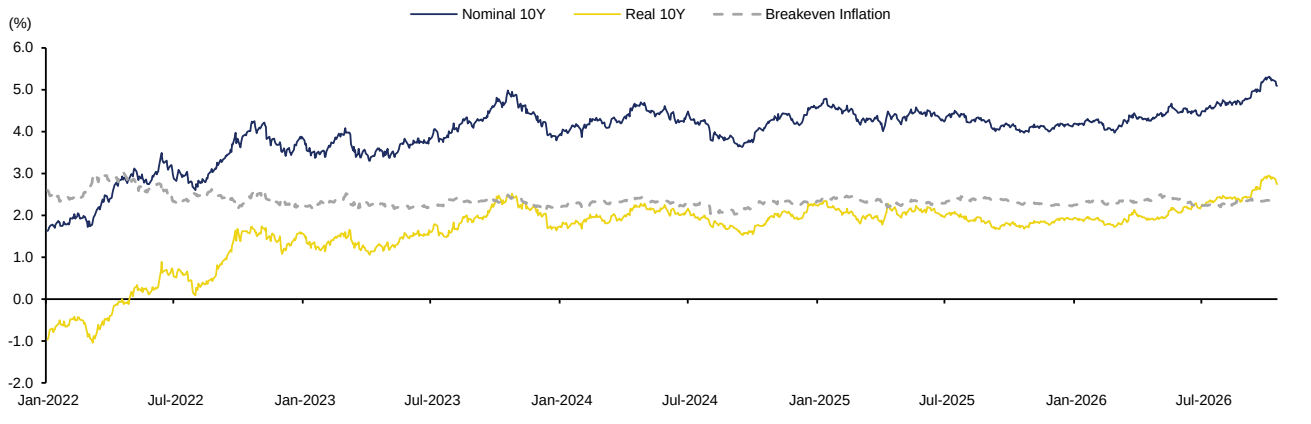
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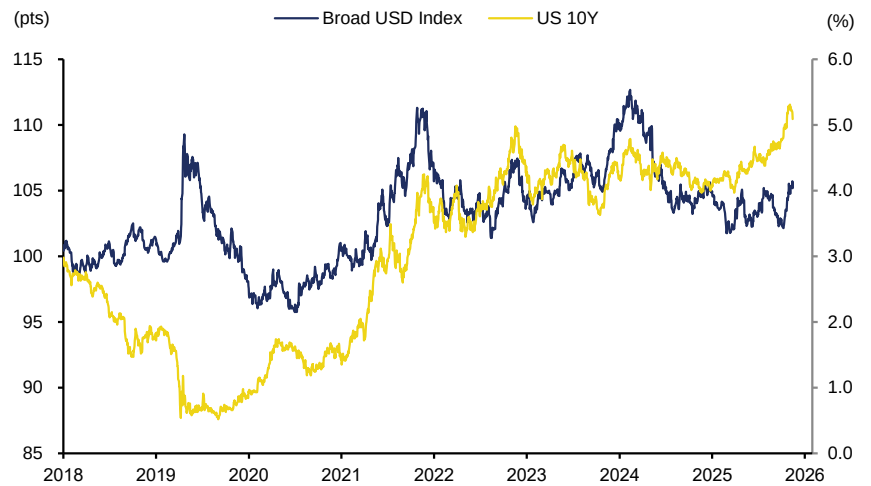
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Exhibit 1: US Treasury Yield – US 10Y Nominal Yield, TIPS Real Yield, Breakeven Inflation Percentage



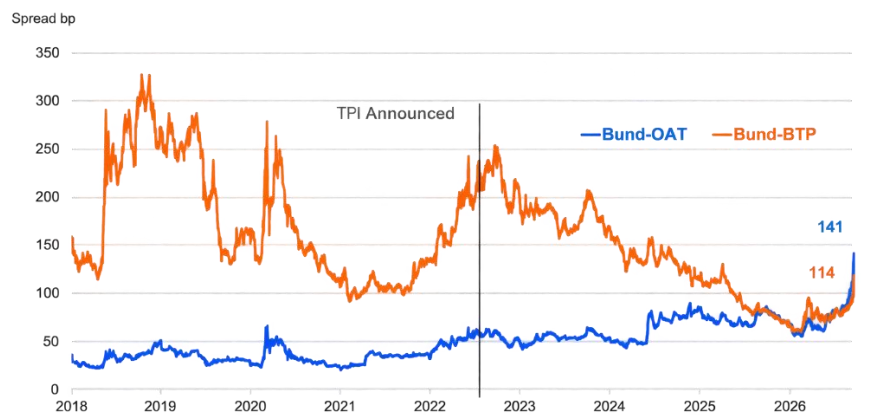
Sources: US Treasury, FRED, Globlex Research

Exhibit 2: Dollar Paradox – Broad USD Index vs US 10-Year Bond Yield



Sources: Federal Reserve Board, FRED, Globlex Research

Exhibit 3: France's Sovereign Risk Premium – France-Germany and Italy-Germany 10Y Gov Bond Yield Spreads 2018-2026



Sources: Bloomberg, ECB, Globlex Research

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Analyst Certification

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RECOMMENDATION STRUCTURE

Stock Recommendations

Stock ratings are based on absolute upside or downside, which we define as $(\text{target price}^* - \text{current price}) / \text{current price}$.

- BUY:** Expected return of 10% or more over the next 12 months.
HOLD: Expected return between -10% and 10% over the next 12 months.
REDUCE: Expected return of -10% or worse over the next 12 months.

Unless otherwise specified, these recommendations are set with a 12-month horizon. Thus, it is possible that future price volatility may cause temporary mismatch between upside/downside for a stock based on market price and the formal recommendation.

* In most cases, the target price will equal the analyst's assessment of the current fair value of the stock. However, if the analyst doesn't think the market will reassess the stock over the specified time horizon due to a lack of events or catalysts, then the target price may differ from fair value. In most cases, therefore, our recommendation is an assessment of the mismatch between current market price and our assessment of current fair value.

Sector Recommendations

- Overweight:** The industry is expected to outperform the relevant primary market index over the next 12 months.
Neutral: The industry is expected to perform in line with the relevant primary market index over the next 12 months.
Underweight: The industry is expected to underperform the relevant primary market index over the next 12 months.

Country (Strategy) Recommendations

Overweight: Over the next 12 months, the analyst expects the market to score positively on two or more of the criteria used to determine market recommendations: index returns relative to the regional benchmark, index sharpe ratio relative to the regional benchmark and index returns relative to the market cost of equity.

Neutral: Over the next 12 months, the analyst expects the market to score positively on one of the criteria used to determine market recommendations: index returns relative to the regional benchmark, index sharpe ratio relative to the regional benchmark and index returns relative to the market cost of equity.

Underweight: Over the next 12 months, the analyst does not expect the market to score positively on any of the criteria used to determine market recommendations: index returns relative to the regional benchmark, index sharpe ratio relative to the regional benchmark and index returns relative to the market cost of equity.