

France: Negative rates shouldn't mean you ease up on debt reduction

French 10-year benchmark yields briefly went into negative territory after the ECB President, Mario Draghi's Sintra speech this week (and some tweets by President Trump). But being paid to take on more debt should not encourage reckless spending



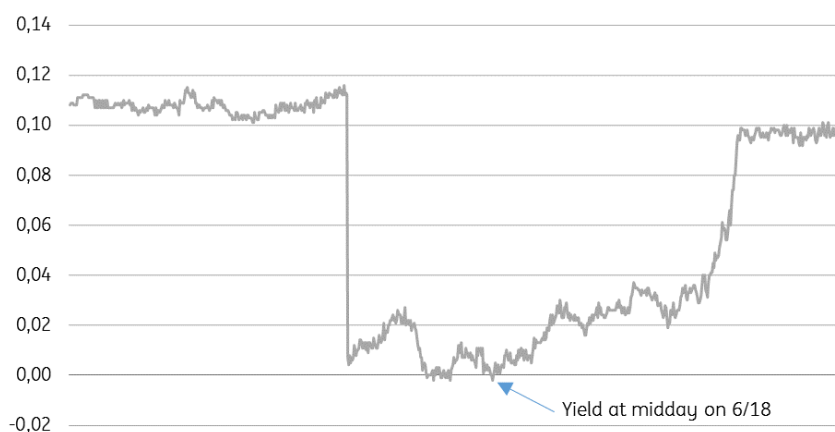
ECB President, Mario Draghi talks with the French President, Emmanuel Macron in 2018

Something of an historic event happened in France following Mario Draghi's speech in Sintra on 18 June: the benchmark rate on 10-year government bonds fell below 0%, following German bonds into negative territory. The speech went a little further than Mr Draghi's comments in Frankfurt (after the June monetary policy meeting) where he only mentioned, in response to a question, the fact that new easing measures had been discussed. By saying in Sintra that "in the absence of improvement, such that the sustained return of inflation to our aim is threatened, additional stimulus will be required", he boosted the likelihood of a further deposit rate cut (currently at -0.40%) starting in July.

French 10-year yields did not stay negative for long, merely minutes, but shorter maturities (up to 6 years) were already negative. The 0% threshold for 10-year government bonds is not just symbolic. Neither are the signs given by the ECB that rates will stay low for longer. These developments should indeed incentivise the French Government to continue to increase the general maturity of the public debt, in other words, to ensure that it is financed at low rates for a

longer time. The average maturity has already fallen from 8 to 10 years between 2011 and 2018, and that trend should continue.

24 hours of the French 10Y yield (starting 12:00pm on 17th of June - in %)



Source: Thomson Reuters Eikon

This also has the effect of easing the debt burden on public finances, giving some budgetary space for the projects announced by the Prime Minister, Edouard Philippe for the second half of the presidency. So far, most projections continue to see deficits close to 2% of GDP by 2022; lower interest rates should help reduce them.

Projects which boost potential growth must be a priority

There are those who believe now's the time to issue much more debt as it would actually bring in revenue. However, this ignores the fact that any new debt merely adds to the old one. So, when you're calculating public debt growth, it's not the current interest rate that counts but the implicit rate, that which is paid on the whole obligation. If this decreases, as it has been doing since 2008, it's clearly a good thing as you can gradually replace the old with new cheaper and longer debt and release the constraint on the primary deficit, but it doesn't remove the latter. To release it even further, you need economic growth.

If there's going to be spending, projects which boost potential growth must be a priority. It's wrong to say that negative rates suddenly allow the state to indebt itself forever. The 100% debt to GDP threshold remains as symbolic as negative rates. Putting this ratio on a downward trajectory should be France's main budget policy goal. Negative rates are there to help it, not to create the reverse.