



Hendrik Willem Mesdag, *Fishing Pinks in Breaking Waves*, c. 1875–85. Rijksmuseum, Amsterdam (SK-A-2670). Public domain. "In calm water, the mooring limits you. In a storm, it protects you."

The Privilege of Being Constrained

Why assets that once priced off a sovereign can now trade through it — France as the case study

28 September 2026

In 2026 the French state has been outperformed by the assets that used to price off it. French covered bonds and EU-Bonds — for which France is the second-largest contributor — now trade through the OAT, and EDF has compressed 37bp against it. Each of them historically traded at a spread to France and was anchored by it. That anchor has come loose, though not evenly, and where it still holds turns out to be as informative as where it has gone.

The mechanism itself is not new. It is what happens to the domestic complex of a sovereign under stress, and in 2011 it happened in Spain: *cédulas* tightened hard into bonos, the covered bond outperforming the state that stood behind the banks issuing it. At the height of the stress in November 2011, Santander and BBVA *cédulas* traded through Bonos by around 100bp at the short end, narrowing to roughly 60bp further out — where, on outright yields, investors accepted about 4.3–4.4% to own a Spanish bank's covered bond against 4.9% for the sovereign. What has changed is the address. The European sovereign question has moved off the periphery and into the semi-core, and this behaviour has travelled with it — which is why the case study is now France rather than Spain.

The distance travelled shows in the yield hierarchy: France now trades wider at ten years than Greece, Italy, Portugal and Spain. The fiscal trajectory and the absence of a political route to reform explain that journey, and we set them out in our previous note; this piece takes them as established and examines the consequence. When a sovereign stops being the floor under its own credit complex, the hierarchy every euro portfolio is built on stops holding.

The question is therefore not where France sits among sovereigns. It is what happens to everything priced off it.

How far France has travelled

Start with the measure of the journey. Sorted by leverage, the spread to Bunds should ascend down the table.

	Debt/GDP	2 Jan	25 Sep	Spread to Bund, Jan (bp)	now (bp)	change (bp)
Netherlands	44.4%	3.015	3.673	10.8	6.7	-4.1
Germany	63.5%	2.907	3.606	—	—	—
Portugal	89.7%	3.210	3.990	30.3	38.4	+8.1
Spain	101.6%	3.348	4.077	44.1	47.1	+3.0
Belgium	109.1%	3.409	4.253	50.2	64.7	+14.6
France	117.6%	3.618	4.675	71.1	106.9	+35.8
Italy	138.9%	3.573	4.503	66.6	89.6	+23.0
Greece	143.5%	3.524	4.407	61.7	80.1	+18.4

Yields are weekly closes, week ending 2 January 2026 against week ending 25 September 2026. Debt ratios are Eurostat's Q1 2026 vintage, except Germany, the Netherlands and Portugal (Q4 2025, no Q1 figure in the release).

It does, Germany aside — the benchmark, so its spread is zero by construction — all the way to France, and then it breaks. France is the widest name in the sample. Italy and Greece carry 21 and 26 more points of debt and trade 17.2bp and 26.8bp through it; Portugal, at 89.7%, trades 68.5bp through. The year's move has the same shape: France widened 35.8bp and Italy 23.0bp, the two largest issuers after Germany, against 18.4bp for Greece, 14.6bp for Belgium, 8.1bp for Portugal and 3.0bp for Spain, with the Netherlands 4.1bp tighter.

The table measures the distance travelled. It is not the argument. The argument is vertical.

What the risk-free asset became

The core sovereign was never one thing. It bundled three functions in one instrument, and those functions have come apart.

The discount curve for valuation has largely gone to swaps and OIS. The collateral function is now defined by eligibility rules — central bank schedules, CCP haircuts, LCR treatment. Flight to quality is still Bunds and Treasuries.

Only the third has stayed put. That is the change this note is about: not that the sovereign became risky, but that it stopped doing two of the three jobs it used to do, and the assets priced off it noticed before the league tables did.

This matters before any of the numbers. A corporate trading tight to its sovereign is not making a credit statement; it is what you see when a bond is priced off a benchmark that has stopped being the valuation benchmark. The same applies to covered bonds financing better than the sovereign of a weaker state — eligibility is an administrative fact, not a credit judgement.

That raises the question of what to measure against, and for this argument the answer is the sovereign itself. The claim concerns the relationship between an asset and the state it used to price off, so the pairwise difference is the object of interest rather than a distortion to be benchmarked away. Every comparison in this note is therefore a direct yield differential against France, or against the matched French tenor.

One caveat comes with that, and it concerns what swaps are. A tightening swap spread means Germany is cheapening against swaps; SSAs quoted at a spread to mid-swaps then cheapen too. That is not a credit signal. It is the sovereign complex moving and everything priced alongside it moving with it, and it only looks surprising if swaps are treated as an absolute measure of value. They are not. Every asset here is

arbitraged relative to every other, and the swap curve is the common measuring stick rather than the anchor — an SSA's value is as tied to sovereigns and to other SSAs as it is to swaps. Nor is the swap curve still a bank credit curve: collateralisation and OIS discounting took that content out of it. Which is why this note compares each asset directly with its sovereign, and leans on changes over the year and on betas rather than on the absolute level of any single spread.

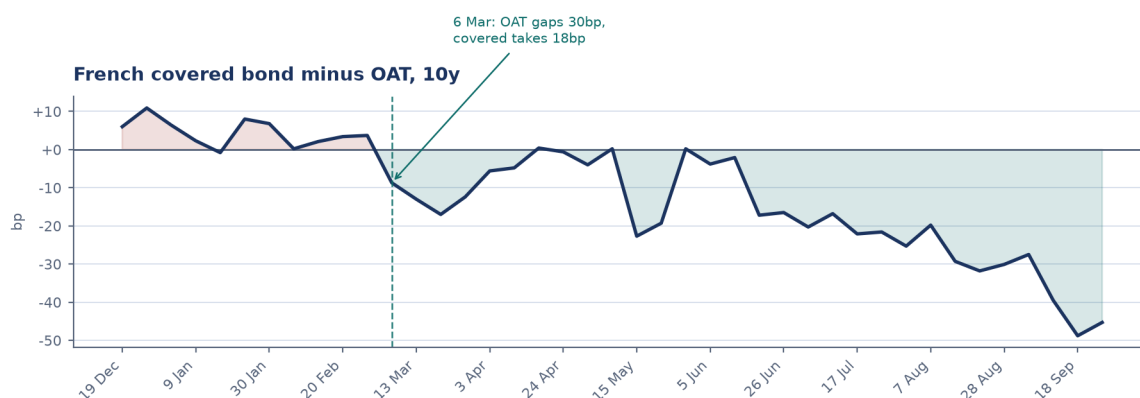
A French covered bond crossed through the OAT in March

Start with the purely domestic case. A French covered bond is a French bank's obligation, secured on French mortgages, under French law — no mutualisation, no European institution, nothing outside the jurisdiction. It never depended on the French state, since dual recourse is precisely the absence of that dependence, but it was always priced off it. That makes it the cleanest test of whether the pricing convention still holds.

Taking Credit Agricole Home Loan SFH 1.5% February 2037 — almost the same maturity as the EU line below — and computing yields from clean prices:

	2 Jan	25 Sep	change
Covered YTM	3.682	4.222	+54.0bp
France 10y	3.618	4.675	+105.7bp
Covered vs France	+6.4bp	-45.3bp	-51.7bp
Covered vs Bund	+77.5bp	+61.6bp	-15.9bp

It began the year 6bp over the OAT and now trades 45bp through it, a swing of 52bp.



Weekly closes. Credit Agricole Home Loan SFH 1.5% Feb-2037, yield computed from clean price, against the generic French 10-year.

The crossing is datable. The spread oscillated around zero through January and February, then went decisively through France in the week to 6 March — the week the OAT gapped 30bp, from 3.222 to 3.525. The covered bond took 18bp of that. It touched zero twice more in the spring and has traded continuously through the sovereign since early June.

That single week is the argument in miniature, and the full year confirms it. Regressed on weekly yield changes, the covered bond runs a beta of about a half to France, and it falls as the shock gets larger: the bigger the French selloff, the less of it the covered bond absorbs. That is the signature of recourse that does not run back to the sovereign, and it is the same signature *cédulas* showed against bonos in 2011. What is new is not the behaviour but the issuer it is being measured against.

One last point on what a crossing is, and is not. Forty-five basis points is not a claim that a covered bond has become safer than the French state by that amount; a threshold event depends heavily on where the instrument started. What it marks is the moment a convention stopped binding, and the closest precedent is the zero bound. Both barriers rested on arbitrages that proved imperfect — the zero bound on holding physical cash, the sovereign floor on the claim that a state can always tax and always print. Inside the euro, France can do neither unilaterally. It gave up the printing leg in 1999 and the taxing leg is what the fiscal trajectory puts in question, so the theoretical basis for a French floor was removed twenty-seven years ago. The market went on applying it out of habit.

What followed the zero bound is why this matters: the question stopped being whether rates could go below it and became how far, and mandates, models and index rules had to be rewritten around a bound that no longer existed. Two differences keep the analogy honest. Negative rates were imposed by a central bank that wanted them, whereas this is market-driven. And rates did return above zero — at -45bp with a beta of a half, an ordinary French rally would put this covered bond back above the OAT. That would not rebuild the floor. It would mean the barrier is no longer where anyone is looking.

EDF: where the floor still holds

The covered bond has independent recourse. A wholly state-owned company does not, and it behaves differently.

EDF 4.25% January 2032 against the matched French 5-year (the 8-year EDF line has no quotes and the 2034 line is too sparsely traded to use):

	2 Jan	25 Sep	change
EDF	3.407	4.214	+80.7bp
France 5y	2.892	4.070	+117.8bp
EDF vs France	+51.5bp	+14.4bp	-37.1bp

EDF outperformed the sovereign by 37bp over the year but has never crossed through it. It is now 14bp over, having touched +11.4bp a week earlier — close enough that the distinction this section rests on may not survive much longer.

It would be easy to over-read that, and the ratings show why. Credit Agricole Home Loan SFH's covered bonds carry the top rating from all three of Fitch, Moody's and S&P, with a 10% risk weight under CRR and Level 1 LCR treatment. EDF's senior unsecured is BBB+ / Baa1 / BBB+, stable at all three. France itself was cut to A+ by both Fitch and S&P in October 2025.

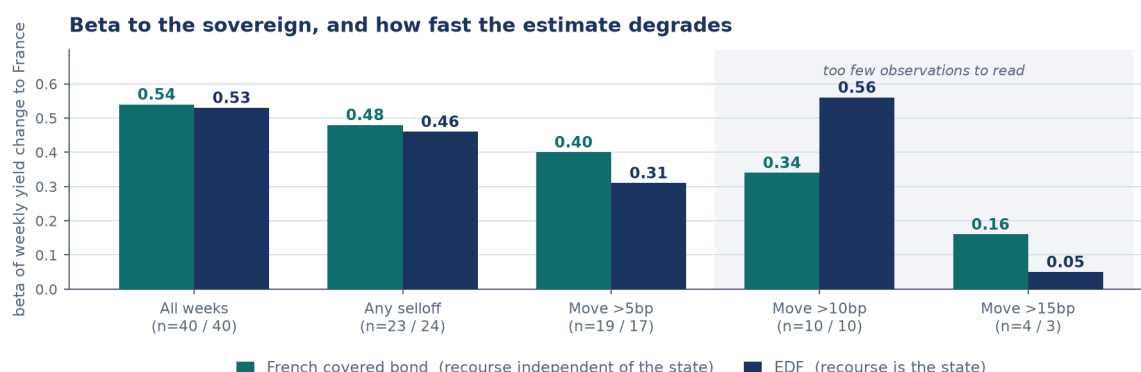
So the stack is AAA covered, A+ sovereign, BBB+ corporate, and the spread ordering follows it: the covered bond began the year 6bp over France and EDF 52bp over. Within the French complex, rating order and spread order agree, so the crossing is not a credit surprise.

But ratings do not govern spreads, and this paper's own first table proves it: France is rated three to four notches above Greece and trades 27bp wider. A rating assesses where an issuer stands; a spread prices where it is going. France was downgraded twice in the autumn of 2025 and Greece upgraded repeatedly through 2025 and 2026 — the market is not disagreeing with the agencies, it is ahead of them. Which makes the covered crossing over-determined rather than explained: rating and trajectory pointed the same way, and it still took until March.

And on raw compression both moved the same way, the covered bond by 52bp and EDF by 37bp. The one thing ratings do not predict is the tail behaviour, which is where the two instruments part company.

What survives those objections is the beta, because it is scale-free, does not depend on the starting level, and is not something a rating predicts. Weekly yield changes against the matched French tenor, cut at several thresholds so the reader can see how stable the estimate is:

Sovereign move	Covered	n	EDF	n
All weeks	0.54	40	0.53	40
Any selloff week	0.48	23	0.46	24
More than 5bp	0.41	19	0.31	17
More than 10bp	0.34	10	0.56	10
More than 15bp	0.16	4	0.05	3



Beta of weekly yield changes to the matched French sovereign, 2026, by size of the sovereign move. Sample sizes shown as covered/EDF.

The stable result is the top of the table and it is the one worth having: both instruments absorb roughly half of a French sovereign move, and both sit far below one. A French covered bond and a wholly state-owned French corporate each taking about 50bp of a 100bp French selloff is the decoupling, stated as a coefficient rather than a level.

The tail is a different matter. It is tempting to read the 0.34 against 0.56 at the 10bp cut as recourse showing up under stress — the instrument with an independent claim decoupling further, the company the state owns re-coupling. The thresholds either side refuse that reading. At 5bp EDF's beta is the lower of the two; at 15bp both collapse on three or four observations. The divergence is not robust, and this note does not claim it.

The reason is arithmetic rather than economics. Forty weekly observations contain fewer than ten large French moves, which is not enough to estimate tail behaviour for any instrument. Whether recourse asserts itself in stress remains a reasonable hypothesis — it is what the Spanish episode suggests and what the structure implies — but it is not something this dataset can test.

So the floor has weakened, and it has weakened for both — for the instrument with independent recourse and for the company the state owns outright. Where the two differ is in level, and the ratings explain that. Whether they differ in stress is the interesting question and the one this note leaves open.

The EU started pricing like a sovereign

On 10 March 2026 the European Commission priced a new EU-Bond line against the EU's own curve for the first time. That is a change of convention, and it is the one that matters. Supranationals are priced and marketed off mid-swaps — MS plus a spread — and the EU had always been no exception. Pricing a

new line off your own secondary curve is what sovereigns do. The issuer has begun quoting itself the way a government does.

This is not the French anchor failing, but nor is the EU becoming the new anchor. There is no such post to inherit — that is the whole point of the three functions coming apart. An issuer that prices off its own curve and settles as central-government collateral has picked up part of one and most of another. Flight to quality has not moved and nothing here suggests it will; it remains with Bunds. What is ending is the concentration of all three roles in a single issuer, which is why the euro area increasingly resembles a system with several near-safe reference assets rather than one unquestioned benchmark.

Two qualifications on that, one about timing and one about smoothness. It did not start in 2026: already back in 2024, EU bonds beyond ten years were trading through France across the curve, and some investors — official institutions and bank treasuries among them — had begun treating EU-Bonds as sovereign rather than supranational holdings. No one has announced a reclassification; it shows in behaviour rather than in policy. And it has not been a one-way re-rating: when swap spreads ballooned the EU cheapened sharply against Germany, and at the widest EU paper traded around Portuguese levels while Portugal itself was well off France. An SSA quoted against swaps takes the full force of a swap-spread regime change whatever its credit is doing. Read the EU's position as a structural re-rating carried on a volatile spread, not a smooth ascent.

None of which changes the direction of travel this year. Measured on the same weekly anchor as the sovereign table:

	2 Jan	25 Sep	change
EU 0.875% Mar-37	3.389	3.934	+54.5bp
Germany 10y	2.907	3.606	+69.9bp
France 10y	3.618	4.675	+105.7bp
EU vs France	-22.8bp	-74.1bp	-51.2bp
EU vs Bund	+48.2bp	+32.8bp	-15.4bp

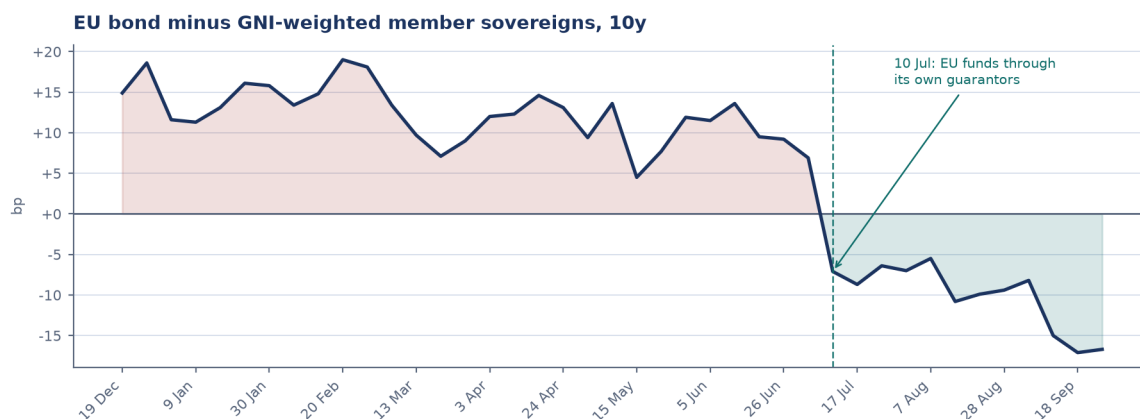
The EU has richened 51bp against France this year and now trades 74bp through it. It also tightened 15bp to Bunds, while every euro sovereign in the first table except the Netherlands widened.

The harder test holds the guarantor pool constant. Build a synthetic sovereign yield weighted by each member's share of the EU budget, and compare the EU's own cost of funds against it. The weights come from the Council's 2025 own-resources table, renormalised across the eight euro members with quoted 10-year curves.

	2 Jan	25 Sep	change
Synthetic, GNI-weighted	3.273	4.101	+82.8bp
EU 0.875% Mar-37	3.389	3.934	+54.5bp
EU minus synthetic	+11.6bp	-16.7bp	-28.3bp

Basket and weights: Germany 33.3%, France 22.3%, Italy 16.2%, Spain 11.7%, Netherlands 8.1%, Belgium 4.6%, Portugal 2.1%, Greece 1.7% — shares of 1% of GNI per the Council's 2025 own-resources table, renormalised over the eight. Together they are 88% of euro-area GNI. Austria, Ireland and Finland are excluded for want of a matched quoted series.

The EU began the year funding 12bp wide of its own guarantors and now funds 17bp through them. The crossing came in the week to 10 July and has not reversed since. The path is a grind rather than an event: wide through the winter, narrowing across the spring, then stepping through in early July and widening from there. The basket covers 88% of euro-area GNI and the main omissions are low-yielders, so it runs slightly rich — on a full basket the gap is a few basis points narrower than shown.



Weekly closes. EU 0.875% Mar-2037 against a GNI-weighted basket of eight euro-area sovereign 10-year yields.

The result looks impossible on a pass-through view of the credit — the joint issuer beating the weighted average of the states that stand behind it. It is possible because EU credit was never the average of its members. It rests on the budget and on the headroom guarantee under the own-resources ceiling, and that ceiling is itself GNI-proportional, which is what makes the GNI key the right weighting rather than merely a convenient one. What the series shows is the market moving from pricing the EU as a basket of its members towards pricing it as an issuer in its own right.

Four things underwrite it, and none is a market opinion. EU-Bonds are Level 1 HQLA with a 0% risk weight under Basel, ECB-eligible, moved to haircut category I — the central government category — on 29 June 2023, and CCP-eligible at Eurex, LCH and ICE. They carry a legal obligation under Article 323 of the Treaty on the Functioning of the EU. On the Commission's own figures, outstanding stock is around €790bn and heading for €1trn by the end of 2026 — which the EU puts at close to two-fifths of outstanding AAA-rated government debt — with secondary turnover above the EGB market average.

The collateral point is the one that matters for the framing above. The EU was granted central-government haircut treatment in 2023 by administrative decision — nothing about its credit changed that day, the eligibility rules did. That is what it looks like when the collateral function detaches from sovereign identity.

The index question is the one still open, and it is where the limits of the analogy show. EU-Bonds are not in the government bond indices: both MSCI and ICE declined to include them, and the reason is structural rather than technical — the EU is not a state, levies no taxes, and is funded by contributions from its members. What ICE did instead was build a variant of its Euro Government Index containing EU-Bonds, and the arithmetic of that variant is itself the argument for inclusion: adding EU-Bonds raises the index rating by a notch and lifts its AAA share by several percentage points, while leaving effective yield unchanged and duration barely moved. Better credit at the same yield and duration is not a trade-off an index committee can refuse forever, and the alternative — leaving the EU in SSA — eventually breaks the SSA indices instead.

Meanwhile the infrastructure a sovereign market rests on is being assembled. The EU joined Eurex's repo market; cash-settled futures on an 8–13 year EU index have traded at ICE since December 2024, and physically deliverable contracts at Eurex since September 2025. Cash, repo and futures — the triangle is complete. Who is buying says the same thing: bank treasuries take roughly a quarter of EU syndicated allocations and central banks and official institutions around a fifth, the two buyer types whose mandates define what counts as a government bond.

And the supply does not stop: around €180bn of EU-Bonds is indicatively expected in 2026 against roughly €700bn of funding needs across 2026–30, including €150bn of SAFE defence lending and a €90bn Ukraine Support Loan. Rising supply alongside an improving relative standing is the same shape the covered market has shown this year, and it settles one thing: whatever is being paid for here, it is not scarcity of paper.

The mooring is tied to the quay: what would reactivate the floor

Being moored protects you only if the thing you are moored to holds, and the risk runs precisely through the assets this note recommends. Banks are the one entity whose own constraint is contingent on the sovereign having none, and they sit under both legs of dual recourse; domestic government bonds are also repo collateral, so the link between sovereign valuation and bank funding is direct rather than an accounting artefact. A covered bond is a rope to a quay standing in the same storm.

The sharper version of the risk is about correlation rather than level — but the old rule was never as universal as it is usually stated. Dual recourse decoupled in 2011 as well: *cédulas* outperformed bonos through the worst of the Spanish sovereign stress, redenomination fears included. A covered bond running a beta below one in a sovereign selloff is not a 2026 invention, and this note does not claim it is. Nothing in rating methodology stood in the way either; the sovereign ceiling was relaxed by S&P in 1997, by Fitch in 1998 and by Moody's in 2001.

The Spanish evidence is worth setting out, because it is contemporaneous rather than retrospective. A December 2011 regulatory filing with the Spanish securities commission carries market curves plotting BBVA and Santander *cédulas* directly against Spanish government bonds across maturities. Readings at 8 November 2011, approximate from the published curve rather than terminal closes:

Maturity	Spain govt vs swaps	BBVA <i>cédula</i>	Santander <i>cédula</i>	<i>Cédula</i> vs Bonos
~2012/13	~235bp	~130bp	~110bp	–105 / –125bp
~2014	~270bp	~180bp	~160bp	–90 / –110bp
~2015	~295bp	~225bp	~205bp	–70 / –90bp
~2016	~315bp	~260bp	~250bp	–55 / –65bp

Two features matter. It is not an asset-swap optical effect — the same document plots outright yields, with Spanish government debt at the long end around 4.9% against roughly 4.4% for BBVA and 4.3% for Santander. And the gap decays with maturity, from about –115bp at the front to –60bp by 2016, because the cover pool protects against the sovereign event only for as long as the bank is there to service it. The obvious objection is official-sector distortion, and the dates settle it the other way: CBPP2 had barely begun in November 2011 and bought only €16.4bn against a €40bn target across a full year, while the SMP had been buying Spanish and Italian government bonds since August and took €9.5bn in the week of 7 November alone. The larger official bid sat under the sovereign. The decoupling happened despite it.

That history tells you where the real risk sits, and it is not where the doom-loop framing puts it. A covered bond decouples from the sovereign because its recourse is independent. It re-couples when the independent leg stops being independent — when the banking system issuing it and the collateral securing it come under stress in their own right. That is what eventually caught Spanish covered bonds, and it is the correct thing to watch in France: not the OAT, but French bank capital and funding, and French residential collateral. A widening OAT on its own does not touch the cover pool.

EDF fails the other way, and the distinction is clean: its recourse is the state, so there is no independent leg to protect it. That converts into a position rather than a warning. Long the French credit complex

against the OAT is short a correlation option, but the trigger is not the one usually named — redenomination risk by itself did not break the cédulas trade. What breaks it is the sovereign's stress reaching the banks: capital, funding, and the quality of the pool. Size the covered leg off French bank health and the housing market rather than off the OAT spread, and the corporate leg off how much of the issuer's recourse runs back to the state.

Who owns the paper matters as much as who guarantees it, and here the big issuers differ sharply. On the European Stability Mechanism's figures, domestic investors hold around three quarters of euro area government bonds overall, but foreign holdings run 35–40% in France and Germany against roughly 15% in Spain and Italy. France therefore carries by far the largest footloose investor base among the major issuers, which is a plain mechanical reason for it to reprice faster than Spain on the same news — and a reason the reallocation out of it has to land somewhere smaller.

There is some good news: the ECB finds bank sovereign portfolios have grown but diversified, with a rising share of non-domestic European government bonds, though larger portfolios still expose banks to valuation shocks. Home bias has not gone, and is far more pronounced among insurers than banks — average domestic shares of roughly 73% for Spain, 68% for Italy and 63% for France, against 45% for Germany and 21% for the Netherlands. So the question is not whether the doom loop returns in its 2011 form. It is narrower: if investors are escaping sovereign risk by moving into banks and covered bonds, how much have they actually escaped?

What it changes

What changes is less a trade than a reference point. For thirty years the sovereign curve was where everything in its jurisdiction began: you priced from it, financed against it, and ran to it when frightened. It now does only the last of those reliably. The assets that used to sit above it have been repricing against what actually backs them — a cover pool, a budget and a treaty, a balance sheet — rather than against the flag on the prospectus.

That process is slow and uneven, which is the part worth holding on to. It took five months from France's downgrade before a covered bond crossed the OAT. The EU has the collateral treatment, the repo facility and the futures, and still not the index inclusion — and may not get it while it is not a state. Conventions of this kind do not break on a date. They stop binding quietly, and the market notices afterwards.

So the question this leaves is not which spread to own. It is which reference point a portfolio is actually built on, whether that reference point still does the job it is assumed to do, and what a mandate will say counts as a government bond by the time the answer matters.

Disclaimer

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