Winds of Change: DM Safe Haven No Longer to Be Taken for Granted

Bill Campbell, Portfolio Manager, Global Sovereign Debt | December 2025

Since at least the 1990s, analysts of emerging markets (EM) have not only eyed market risk through the lens of those nation-states' economic positions. They also have weighed those countries' governmental fiscal accountability, social stability and popular acceptance of state policies, and the acumen and independence of their central banks. On occasion, market analysts have applied this second set of risks to developed markets (DM), the European sovereign debt crisis of 2011 being one example. However, to a large extent, DM issuers of sovereign debt securities have enjoyed the luxury of an investor base focused on economic factors to the exclusion of these other considerations. But that is ceasing to be the case. Market participants are coming to the realization that the time has come to hold the so-called developed markets to the same standards. DM countries, including some of those representing the Group of Seven economies, no longer can claim to be the adults in the global fiscal-monetary room. The tension, if not a brewing collision, between managing a country's fiscal position and social demand is here for us to see in the forms of political agitation and rudderless budgets. Markets are starting to reflect these realities via steeper yield curves, high long-end interest rates and currency volatility.

What follows is not a doomsday forecast but a call for active allocation among sovereign risks to DM countries' monetary promises. I will lay out the developed sovereign borrowers whose fiscal-political positions appear to be at greatest risk: France, the United Kingdom and Japan. I also will review similar market warning signs for the United States.[1] Then I will share an allocation strategy for navigating these emerging risks in the developed world.

France

France's previous three governments each failed due to escalating conflicts over urgently needed fiscal reforms, persistent political fragmentation and mounting opposition to deficit-cutting measures. Most recently, on Oct. 6, 2025, Sébastien Lecornu resigned as France's prime minister, less than 24 hours after President Emmanuel Macron named a new cabinet stacked with centrist loyalists, ignoring threats from opposition parties. Just four days later, President Macron reinstated Mr. Lecornu as prime minister, making him France's third PM in just a year. His immediate challenge is passing a 2026 budget with a deficit projected at 5.4% of gross domestic product (GDP) and public debt at €3.4 trillion (about 114% of GDP).

This budget turmoil did not appear out of nowhere but has been festering since late 2024. In December of that year, the administration under then-Prime Minister Michel Barnier fell after attempting to pass a budget with €60 billion in tax increases and spending cuts in a failed effort to reduce France's deficit to 5% in 2025 and comply with European Union (EU) fiscal targets by the end of the decade. Prime Minister Barnier's successor in the Hôtel de Matignon, François Bayrou, another centrist, took office promising to tackle France's "unsustainable" deficit and bring the annual shortfall under 3% of GDP by 2029. Prime Minister Bayrou proposed €40 billion in spending cuts, elimination of public holidays and wage freezes. His efforts were undone by deep opposition to public-sector austerity and his lack of coalition-building with other parties – essential under France's fragmented Parliament. On Sept. 8, 2025, Parliament passed a vote of no confidence, sending Mr. Bayrou packing.

Lack of popular and parliamentary support – along with growing fatigue over "permanent crisis"[2] – continues to vex President Macron's efforts to form – or hold together – a government. This has meant ongoing ministerial fragility and a sense of political paralysis. France finds herself in a very difficult fiscal position with a current deficit greater than 5.4% of GDP and debt greater than 114% of GDP. This situation requires the government to take serious steps to either cut spending, raise revenues via taxes or implement both.

Spending cuts that are targeted toward reducing pension benefits and raising the retirement age from 62 to 64 have been some of the more contentious reforms facing the nation. In September and October 2025, tens of thousands protested nationwide. France's largest unions such as the *Confédération générale du travail* (General Confederation of Labor) and the *Confédération française démocratique du travail* (French Democratic Confederation of Labor) called for strikes across more than 240 locations, demanding higher wages, increased funding for public services and reversal of retirement-age increases. In addition, a grassroots campaign, *Bloquons Tout* (Let's Block Everything), organized shutdowns and strikes targeting ring roads, major cities (Paris, Bordeaux, Rennes, Nantes) and various infrastructure points. On Oct. 14, Lecornu proposed suspending these pension reforms in order to cut a deal with the Socialist Party in an attempt to avoid losing yet another confidence vote. These events underscored the broad, persistent opposition to austerity as well as the depth of frustration within French society regarding the current political impasse and future of social protections.

France's recurring government collapses reflect a broader struggle to reconcile fiscal discipline with attempts to align the country with EU fiscal rules. These goals have crashed into electoral and parliamentary realities, leaving critical long-term reforms unresolved. Increased social unrest around the proposed budget cuts will only further exacerbate the fiscal and debt outlook as politicians remain afraid to make difficult decisions to address these issues, creating a vicious loop that will be difficult to break. In recognition of this imbroglio, markets have sent the French government bond curve steepening, with the spread between the two- and 30-year bonds widening from about 150 basis points (bps) at the beginning of 2025 to 217 bps as of this writing. *(Figure 1)*

France OATs* 30-to-2-Year Yield Spread

Figure 1
Source: DoubleLine, Bloomberg
December 31, 2024 - December 19, 2025
**Obligations assimilables du Trésor* (OATs), or fungible bonds of the French Treasury

United Kingdom

On Sept. 23, 2022, the U.K. became the first among the DM sovereign states to run aground on the rocks of the market's recalibration of DM debt fundamentals. Then-Chancellor of the Exchequer Kwasi Kwarteng submitted to the House of Commons a "mini-budget" whose fiscal imbalances unleased such havoc on the pound and the Gilts market that the Bank of England was compelled to intervene and soon after Prime Minister Liz Truss to resign. The fiasco, I noted at the time, was a bellwether of secular change not only for the U.K. but also the rest of the G-7 countries.[3]

With the Truss-Kwarteng comeuppance fresh in everyone's memory, the U.K. faces a fiscal crisis characterized by rising debt, stagnant growth and increasing welfare costs. The country is running a fiscal deficit of around 5% of GDP and carrying debt over 95% of GDP. On Nov. 26, 2025, Prime Minister Keir Starmer and his chancellor of the exchequer, Rachel Reeves, announced a tax-heavy budget, with about £26 billion of tax increases proposed to cut energy bills and child poverty. The November outlook for the Office for Budget Responsibility (OBR) indicates that the budget package raises borrowing in the next few years but then reduces it later in the forecast, with the government still judged to be on track to meet its fiscal rules. However, the buffer to stay on the right side of the fiscal rules is narrow and heavily reliant on tax receipts and restrained spending, with additional help from the OBR increasing its estimates of real GDP growth from 1.4% to 1.5% a year through the second half of the decade. These assumptions are of questionable reliability. The increased tax burden of the proposed budget could weigh on growth, and continued public pressure against the fiscal policy mix could constrain revenues over the projected period.

A wealth divide has left many new and younger voters in a more vulnerable economic position. Wealthy voters want neither their savings to be eroded via taxes nor their benefits cut. But younger voters have seen benefits reduced and do not see a similar path to financial independence from which the prior generation benefited. Political polarization has turned the government from Tory conservative to Labor center-left with a possible return to the right again, under a populist Reform Party leading in the polls, as an unhappy electorate stymies cooperation across party lines to resolve these issues.

Polling indicates the public view takes a dim view of the updated overall package of proposed tax increases and perceived squeeze on living standards. In late November, a YouGov survey reported that far more Britons see the budget as unfair and unaffordable (48% unfair) than people who don't (21% fair), polling the second-worst fairness rating for a U.K. budget since 2010.[4] (The worst fairness rating went to the ill-fated Kwarteng-Truss budget.)

In 2025, the U.K. experienced significant social unrest, driven mainly by protests and violent disorder related to immigration and asylum accommodation amid economic strain and rising asylum claims. The core issue fueling unrest has been the government's practice of housing a growing number of asylum seekers in hotels across the country, often for extended periods, while their applications are processed. Concerns about free speech and job availability have been additional issues among some protesters.

Similar to their risk-pricing for France, markets have taken notice, with the yield curve in the U.K. steepening in line with a perception of growing fiscal/social risks. The spread between the two- and 30-year government bond yields increased from 75 bps at the beginning of 2025 to 150 bps as of this writing. *(Figure 2)*

United Kingdom Gilt 30-to-2-Year Yield Spread

Figure 2
Source: DoubleLine, Bloomberg
December 31, 2024 - December 19, 2025

Japan

In Japan, the ruling Liberal Democratic Party (LDP) lost its majority in both chambers of the National Diet following historic setbacks in the October 2024 general election and July 2025 House of Councillors election. These events marked the LDP's first loss of parliamentary dominance since the party's founding in 1955.

Japan has been running very high fiscal deficits, currently around 6% of GDP, which have ballooned the national debt load to 250% of GDP. A large aging population has consumed the majority of the fiscal benefits. The younger population faces reduced economic prospects with higher-costing goods and services. The growing dissatisfaction of the electorate likely will weigh on the Japanese economic outlook for the foreseeable future. This social anxiety will make addressing the fiscal position extremely difficult. Over the past year, Japan has seen an uptick in street demonstrations and vocal protests, particularly in response to economic hardship and government corruption scandals.

In the LDP's most recent leadership contest on Oct. 4, 2025, Sanae Takaichi won the party presidency and became Japan's first female prime minister at an extraordinary Diet session on Oct. 21. Prime Minister Takaichi's platform is characterized by a hawkish defense stance, an emphasis on fiscal stimulus and focus on economic and national security. The LDP's loss of its parliamentary majority triggered a major political realignment, leading to a new generation of leadership in the party, while steep challenges remain around fiscal management, social cohesion and political stability.

Japan's fiscal outlook remains precarious: Inflation, rising living costs and a depreciating currency have contributed to widespread public dissatisfaction and have been major campaign issues for both the LDP and opposition parties. Budget gridlock and contentious fiscal negotiations under the minority LDP government have fueled continued political divisiveness in the Diet. In the past year, these economic pressures have been linked to rising social unrest, with protests over living standards and government scandals. Trade unions and labor groups organized large May Day and related rallies framing wage demands around the rising cost of living. In Tokyo, tens of thousands of participants called for pay hikes that keep up with inflation. Cost-of-living pressures also surfaced in the 2025 electoral and party political arena as well as in street protests. Parties across the spectrum campaigned on tax cuts, cash transfers and other relief, with analysts describing a "material populism" rooted in frustration over inflation and taxes.

Recently, the Takaichi government announced a supplemental budget for fiscal 2025 that totals about ¥18.3 trillion in general account spending. That is roughly 3.0% to 3.5% of Japan's GDP. More than 60% of this supplementary budget will be financed through new Japanese government bond issuance. Again, the markets are taking notice. The spread between the two- and 30-year government bonds has steepened from about 170 bps at the beginning of the year to about 232 bps as of this writing. *(Figure 3)*

Japan Government Bonds 30-to-2-Year Yield Spread

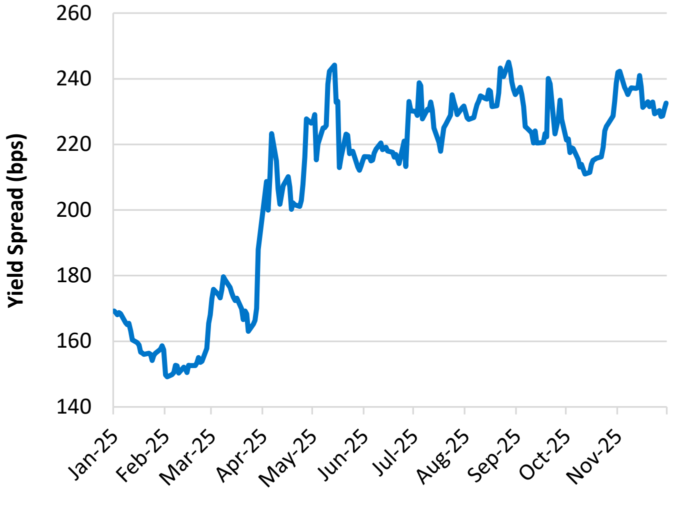

Figure 3
Source: DoubleLine, Bloomberg
December 31, 2024 - December 19, 2025

Back in the U.S.A.

The United States is not immune to the effects of declining fiscal space, notably in the form of social tensions and potential headwinds to growth also being experienced by the country's DM peers.[5] The U.S. continues to run one of the largest deficits outside of recession in wartime (currently over 6% of GDP). This spending gap has raised the national debt to over 100% of GDP. The spread between the two- and 30-year government bonds steepened across the year from about 54 bps to 134 bps as of this writing. *(Figure 4)* Americans should take heed of France, the U.K. and Japan, whose societies and political classes are further down the road of political impasse amid ever-increasing fiscal pressure.

U.S. Treasury 30-to-2-Year Yield Spread

Figure 4
Source: DoubleLine, Bloomberg
December 31, 2024 - December 19, 2025

Allocation Strategy

This story has played out many times in emerging markets. A vicious loop starts between embedded benefits and rising fiscal costs, hurting an EM country's growth and fiscal trajectories. Unfortunately, this scenario often has unleashed a devastating combination of currency depreciation and rising interest rates, ratcheting up social tensions and political instability. Until recently, the developed markets had been largely immune to such doom loops, but the tide has changed. Already, DM countries such as France, the U.K. and Japan have run into walls in their struggles to strike the delicate balance of managing social expectations against the reality of limited fiscal coffers and deepening indebtedeness.

Over the next several years, in developed as well as emerging markets, DoubleLine's sovereign debt team must navigate these troubled policy waters. One implication of the fiscal-social divide is our outlook for continued curve steepening. Longer-term borrowing costs for developed nations under the fiscal-social gun will likely continue to increase, so positioning in the shorter-term tenors and underweighting longer-term interest rates in strategies that allow for this activity make sense. In addition, we are looking for currency weakness in the U.S. dollar. International investors are likely to become more aware of the spread of fiscal/social-divide risks to the U.S. and hedge their dollar risk accordingly. In fact, they might reallocate some of their capital away from the U.S.

I expect the dollar to move lower in fits and starts. Consequently, currency positioning will need to be actively managed in line with the unfolding balance of risk among the U.S. and its DM counterparts.

Finally, DoubleLine continues to favor select emerging markets, in particular local currencies and local government bonds. Many emerging markets have improved their fiscal positions and policies over the past several decades. I believe such EM credits are well positioned vis-à-vis their DM peers with the potential to offer higher returns in the coming years. ■

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Endnotes

1. For examples of past DoubleLine advisories on the fiscal position and trajectory of the U.S. government, see Ryan Kimmel, "[Debt Spiral Watch: A Scenario Survey as Washington Drifts Toward a Reckoning]," July 2024, and Jeffrey Gundlach, "[America's debt cannot keep stacking up]," The Economist, Dec. 13, 2024

2. Variants of the phrase *crise permanente* (permanent crisis) cropped up during protracted periods of political impasse or turmoil in 20th century France. Mentions of the 21st century expression surged in French news media in 2020-2025. That period, which began with COVID-19 lockdowns, coincided with the last of the mass *gilet jaune* (yellow vest) protests, electoral gains by populist political parties *Rassemblement National* (National Rally) on the right and *La France Insoumise* (France Unbowed) on the left, the end of clear parliamentary majorities since legislative elections in June 2022 and the collapse of the Barnier and Bayrou governments in 2024 and 2025, respectively.

3. Bill Campbell, "Commentary: Debt, currency and inflation crises – the U.K.'s object lessons for the G-7," Pensions & Investments, Oct. 18, 2022.

4. "How have Britons reacted to the 2025 Budget?," YouGov, Nov. 27, 2025

5. See also Bill Campbell, "Yield Curve Steepening in the Near Term, Risk of Higher Term Premium Further Out," October 2025

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