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The ECB May Already Be Captured by Fiscal Dominance

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Abstract: Recent developments in French sovereign debt markets have raised important questions about the evolving role of the European Central Bank (ECB) within the euro area. While much of the increase in government bond yields across advanced economies reflects global factors, France has experienced a notable widening in sovereign spreads relative to Germany. This paper argues that the significance of these developments extends beyond concerns regarding French public finances. Instead, they highlight a broader institutional transformation in which the ECB is increasingly required to make judgements with potentially significant fiscal consequences. The paper reviews recent developments in French fiscal policy and debt dynamics before examining the ECB's Transmission Protection Instrument (TPI), introduced in 2022 to address unwarranted fragmentation in sovereign bond markets. Particular attention is paid to the instrument's requirement that market movements be "not warranted by country-specific fundamentals", a criterion that is difficult to apply objectively in practice. The paper considers whether recent French yield movements can reasonably be explained by fiscal fundamentals and compares the experience with the United Kingdom's gilt market intervention in September 2022. It concludes that the growing expectation of possible ECB intervention risks blurring the distinction between monetary policy and fiscal policy. Although France does not currently require support, the episode raises questions about whether fiscal dominance may already be emerging through expectations rather than formal institutional arrangements.

Keywords: Fiscal dominance, European Central Bank, Transmission Protection Instrument, Sovereign Debt Markets

INTRODUCTION: IS HIGH DEBT A FRENCH PROBLEM, OR AN ECB PROBLEM?

Recent increases in advanced economy government bond yields have largely been interpreted as a global phenomenon. Higher US Treasury yields, persistent inflation concerns, and a reassessment of the likely path of policy rates have all contributed to a broad repricing of sovereign debt markets. Yet this global narrative only explains part of what has been occurring within the euro area. Increasingly, attention has focused on France, where government bond yields have risen relative to German Bunds and concerns about fiscal sustainability have become more prominent.

At first glance, this appears to be a conventional fiscal story. France has entered the current period with a public debt burden exceeding 115% of GDP, a fiscal deficit that remains large by historical standards, and a political environment that makes fiscal consolidation difficult. Debt sustainability is ultimately a matter of arithmetic rather than politics. Although the interaction between interest rates, economic growth and public debt has become the subject of renewed debate in recent years, investors must be persuaded

that government debt remains sustainable. If doubts emerge, borrowing costs tend to rise, potentially worsening the very fiscal dynamics that prompted concern in the first place.

However, the significance of recent developments extends beyond France itself. The euro area is not merely a collection of sovereign borrowers; it is a monetary union whose institutional framework has evolved considerably since the sovereign debt crisis. Over the past fifteen years, the European Central Bank (ECB) has acquired an increasingly prominent role in preserving financial stability and maintaining the functioning of sovereign debt markets. The introduction of the Transmission Protection Instrument (TPI) in 2022 (ECB, 2022a) represented another step in that evolution. The ECB argued that the TPI was necessary to safeguard the transmission of monetary policy across the euro area, permitting intervention when financing conditions deteriorate in ways that are not warranted by country-specific fundamentals (ECB, 2022b).

This raises an important question regarding the ongoing transformation of one of the world's most influential economic institutions. Determining whether market movements are justified by fundamentals is not a purely technical exercise. It requires judgement about fiscal sustainability, political developments and sovereign credit risk. Yet these are traditionally matters for governments and markets to resolve, rather than central banks. The more frequently such judgements are required, the more blurred the boundary becomes between monetary policy and fiscal policy.

The issue is particularly relevant in the French case. If current yield movements largely reflect concerns about French fiscal fundamentals, then any future intervention to restrain those movements risks appearing less like monetary policy and more like support for fiscal policy. Conversely, if markets are generating unwarranted fragmentation, intervention may be entirely consistent with the ECB's mandate. The distinction is straightforward in theory, but far less obvious in practice.

This paper argues that recent developments in France illustrate a broader institutional transformation taking place within the euro area. The ECB is increasingly being placed in a position where it may be required to make judgements that have significant fiscal consequences. After reviewing recent developments in French sovereign debt markets and the country's fiscal position, the paper discusses the design and objectives of the TPI and examines whether recent market movements can reasonably be considered warranted by underlying fundamentals. It then considers the institutional implications of intervention and asks a deliberately provocative question: is the ECB already operating under a form of fiscal dominance, even before the TPI has been activated?

WHY MARKETS ARE WORRIED ABOUT FRANCE

Recent Market Developments

The rise in sovereign bond yields observed across advanced economies during 2025 and 2026 has been driven by a combination of factors. Higher global term premia, persistent concerns over inflation, elevated debt issuance requirements, and uncertainty about the medium-term path of interest rates have all contributed to a broad repricing of government bonds. As a result, higher yields are not unique to France, nor are they unique to the euro area.

Nevertheless, viewing recent developments solely through a global lens risks missing an important country-specific story. While German Bund yields have risen alongside other global benchmarks (Figure 1), French government bond yields have increased by more, leading to a widening of the spread between French Obligations Assimilables du Trésor (OATs) and German Bunds. This spread is widely viewed as a market-based measure of France's relative credit and fiscal risk within the euro area.

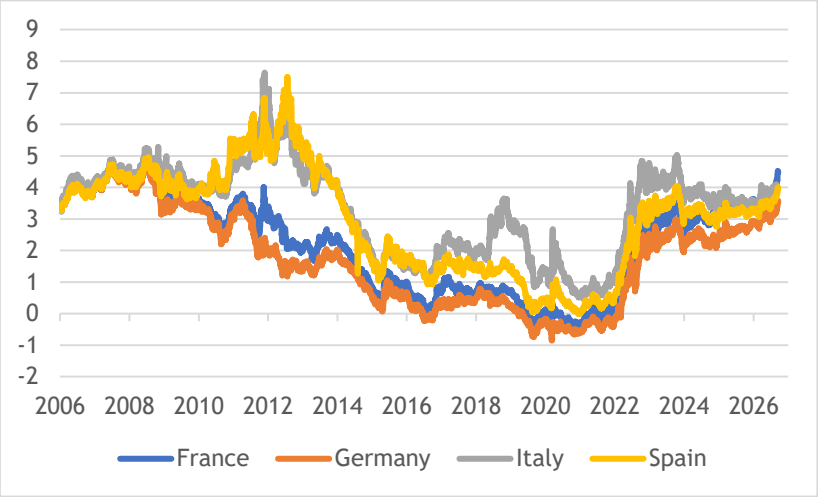


Figure 1: Euro area ten-year sovereign bond yields

Source: Data Buffet.

The widening of French spreads is notable for two reasons. First, it is unusual in historic terms. France has traditionally occupied a position close to the euro area's perceived "core", alongside Germany, with spreads generally much lower than those of Italy or other highly indebted member states. Second, the widening has occurred despite the absence of an acute banking crisis, recession, or external shock specific to France. Instead, market attention has increasingly focused on the country's fiscal outlook and the apparent lack of a credible political consensus around fiscal consolidation.

It is important to retain perspective here. Current French spreads remain well below the levels observed in Spain and Italy during the sovereign debt crisis. The euro area is not experiencing a rerun of 2011-12. The institutional architecture has also changed substantially since then, with the creation of new policy instruments and a greater willingness by the ECB to intervene when it believes monetary transmission is threatened. Yet market comparisons are rarely about absolute levels; they are about direction and relative performance. The key point is not that France faces imminent fiscal distress, but that markets appear increasingly uncomfortable with the trajectory of French public finances.

Indeed, the emergence of France as a focal point is perhaps one of the most striking developments in recent euro-area sovereign debt markets. During the sovereign debt crisis, concerns centred on smaller peripheral economies. Today, attention is increasingly shifting toward the euro area's second-largest economy, a country whose government debt market plays a systemically important role within European financial markets. This distinction

matters because market concerns regarding France have potentially larger implications for the ECB than similar concerns directed at smaller member states.

Fiscal Arithmetic

At the heart of these concerns lies a relatively simple question: can France stabilise its public debt trajectory without significant policy adjustment?

Recent forecasts from the European Commission (2026b) suggest that France's fiscal deficit will remain around 5% of GDP in 2026, while the public debt ratio is expected to continue rising, reaching approximately 118% of GDP in 2026 and around 120% by 2027. Growth is projected to remain modest, at around 1% per year. The Commission explicitly notes that rising debt levels are being driven by sizeable primary deficits and increasing debt-servicing costs.

The arithmetic of debt sustainability is well understood. Ignoring valuation effects, the evolution of the debt-to-GDP ratio can be approximated as:

$$\Delta d_t \approx (r_t - g_t)d_t - pb_t$$

where d_t is the debt-to-GDP ratio, r_t is the effective interest rate on government debt, g_t is nominal GDP growth, and pb_t is the primary budget balance expressed as a share of GDP. Blanchard (2019) provides a recent assessment of this simple framework.

This framework highlights two important points. First, high debt levels create vulnerability because even relatively small changes in borrowing costs can have significant effects on debt dynamics. Second, sustainability depends not only on the stock of debt but also on the interaction between interest rates, economic growth and future fiscal policy. Recent debate has emphasised that debt may be more sustainable when growth persistently exceeds interest rates, but even proponents of this view recognise that rising risk premia can rapidly alter the equation. And recent experience suggests that a fiscal policy that relies on growth to allow (modest) persistent deficits could well fail (Ellis, 2024a).

The challenge for France is that current fiscal policy appears inconsistent with debt stabilisation over the medium term. Precise estimates depend on assumptions regarding growth, inflation and future borrowing costs. However, with deficits remaining near 5% of GDP and debt already above 115% of GDP, stabilising the debt ratio would likely require a substantially stronger primary fiscal position than currently exists.

Both the European Commission (2025, 2026a) and the International Monetary Fund (2025) have highlighted the need for continued fiscal consolidation and structural reform. At the same time, recent political developments have demonstrated how difficult it has become to secure agreement on meaningful budgetary adjustment. Fiscal targets have repeatedly been revised, governments have struggled to assemble durable parliamentary majorities, and uncertainty surrounding future policy has remained elevated.

Financial markets are therefore increasingly confronted with a difficult question. If France's debt trajectory continues to worsen and domestic politics prevents a credible fiscal response, what mechanism will eventually restore discipline? In most countries, the answer would simply be higher borrowing costs. Within the euro area, however, the existence of ECB backstops and the possibility of intervention under the Transmission Protection

Instrument complicate that calculation. It is therefore necessary to examine the ECB's role more closely.

THE ECB'S DILEMMA: WHAT IS THE TPI FOR?

Understanding the Transmission Protection Instrument

The euro-area sovereign debt crisis transformed the ECB in several important respects. Prior to 2010, the ECB largely resembled other inflation-targeting central banks, focusing primarily on price stability through changes in policy rates and liquidity operations. The subsequent decade forced the institution to confront a different challenge: how to conduct a single monetary policy in a currency union where government borrowing costs could diverge sharply across member states. As a result, the ECB progressively expanded its toolkit through measures such as the Securities Markets Programme (SMP), Outright Monetary Transactions (OMT), the Public Sector Purchase Programme (PSPP), and the Pandemic Emergency Purchase Programme (PEPP). Although these initiatives differed significantly in design, they shared a common element, namely preserving the effective transmission of monetary policy across the euro area. The Transmission Protection Instrument (TPI), announced in July 2022, represents the latest stage in this institutional evolution.

The TPI has already generated a growing academic literature. Arnold (2023) examines the design of the instrument and its activation criteria, while Assenmacher (2023) discusses the role of the TPI within the ECB's broader monetary policy framework. A separate legal and economic assessment by Bernoth et al. (2022) places the instrument within the wider evolution of the ECB's unconventional policy toolkit. Collectively, these contributions illustrate both the importance of the TPI and the uncertainties surrounding its operation.

The official rationale for the TPI is straightforward. Monetary policy is intended to affect financing conditions across the entire euro area. If sovereign bond yields in one member state rise sharply relative to others for reasons unrelated to economic fundamentals, the ECB may find itself unable to transmit its chosen policy stance evenly throughout the currency union. In those circumstances, the ECB argues that intervention may be necessary to preserve the "singleness" of monetary policy. The TPI therefore allows the Eurosystem to purchase government securities issued by member states experiencing a deterioration in financing conditions that is judged not to be warranted by country-specific fundamentals.

The TPI differs from conventional asset-purchase programmes. The stated objective is not to ease monetary policy or provide macroeconomic stimulus. Indeed, the instrument was announced at the same meeting at which the ECB began raising interest rates in response to elevated inflation. Instead, the purpose of the TPI is to ensure that a given monetary policy stance is transmitted smoothly across member states. In principle, therefore, activation of the instrument should not alter the intended stance of monetary policy itself, provided any purchases are “sterilised” in monetary terms, for instance in a similar manner to the ECB’s previous SMP (see Sinclair & Ellis, 2012).

The ECB also established a series of eligibility criteria intended to distinguish transmission concerns from fiscal problems. These include compliance with the European Union's fiscal framework, the absence of severe macroeconomic imbalances, and a judgement that public debt remains sustainable. In assessing debt sustainability, the ECB

explicitly notes that it may draw upon analyses produced by the European Commission, the European Stability Mechanism, the International Monetary Fund, and other institutions.

At first glance, these safeguards appear sensible. No independent central bank wishes to be accused of financing government spending or monetising public debt. Yet the practical challenge lies not in setting out broad principles, but in applying them to specific countries and specific market episodes.

The Problem of "Warranted" Movements

The most important phrase in the entire TPI framework may also be the least precise. According to the ECB, intervention is intended to address a deterioration in financing conditions that is "not warranted by country-specific fundamentals".

In theory, this distinction is compelling. Financial markets are not always efficient. Investors can overreact, liquidity can evaporate, and self-fulfilling dynamics can emerge. The euro-area sovereign debt crisis demonstrated how concerns regarding sovereign solvency can themselves contribute to higher borrowing costs, thereby increasing the probability of the adverse outcomes that markets fear. Under such circumstances, central bank intervention designed to restore orderly market functioning can plausibly be justified as a monetary rather than fiscal operation.

In practice, however, identifying a market movement that is genuinely divorced from fundamentals is extraordinarily difficult. As Arnold (2023) notes, the activation criteria embedded within the TPI are difficult to apply in a fully objective or transparent manner, inevitably requiring the exercise of policy discretion. The challenge is that sovereign bond yields reflect a combination of fiscal policy, economic growth, inflation, political uncertainty, liquidity conditions, risk appetite and expectations regarding future monetary policy. There is no observable measure of "fundamental value" against which actual yields can be compared directly.

Indeed, the problem becomes particularly acute when concerns are themselves related to fiscal sustainability. Suppose investors become increasingly sceptical about a government's willingness or ability to stabilise public debt. Higher yields may then reflect a perfectly rational reassessment of sovereign risk. Yet those higher yields may simultaneously worsen debt dynamics and increase financing pressures. At what point does a justified market reaction become excessive fragmentation? The TPI framework offers no precise answer.

This ambiguity is not accidental. The ECB almost certainly wished to preserve room for judgement when designing the instrument. A rigid rule could encourage markets to test the limits of intervention or prevent policymakers from responding to unforeseen events. As Bernoth et al. (2022) observe, the instrument was deliberately designed to provide flexibility while remaining consistent with the ECB's legal mandate. From an operational perspective, this flexibility is clearly valuable.

However, flexibility also carries institutional costs. The more discretion the ECB exercises in distinguishing warranted from unwarranted market developments, the more it risks becoming an arbiter of sovereign creditworthiness. Decisions regarding fiscal sustainability, debt dynamics and appropriate risk premia have traditionally been made by

investors, governments, credit rating agencies and international institutions. Under the TPI framework, they increasingly become questions on which the ECB may need to form and act upon its own judgement.

This shift matters because the distinction between monetary policy and fiscal policy depends critically on why intervention occurs. If market developments genuinely threaten monetary transmission, intervention is entirely consistent with the ECB's mandate. If the same developments primarily reflect concerns about fiscal sustainability, intervention begins to look rather different. As Assenmacher (2023) notes, the TPI is intended to safeguard monetary policy transmission, not to shield governments from market discipline. The difficulty is that both interpretations may be plausible simultaneously.

The French case illustrates the issue particularly clearly. Few observers would dispute that France remains capable of funding itself in capital markets. Equally, few would deny that debt levels are elevated, deficits remain large, and the political commitment to fiscal adjustment is uncertain. As a result, determining whether recent spread widening reflects deteriorating fundamentals, excessive market pessimism, or some combination of the two is ultimately an exercise in judgement rather than measurement.

That judgement sits at the heart of the fiscal dominance debate. Before turning to the broader institutional implications, it is necessary to examine whether the recent behaviour of French government bond markets can reasonably be explained by underlying fundamentals.

ARE FRENCH YIELD MOVES "WARRANTED"?

A Market-Based Assessment Versus Agencies

The central challenge posed by the TPI is that the ECB must ultimately distinguish between sovereign yield movements that are justified by fundamentals and those that are not. While this sounds conceptually straightforward, there is no universally accepted measure of what a "warranted" sovereign spread should be. The ECB itself does not provide a formal model, nor does it specify a numerical threshold that would trigger intervention. As a result, any assessment inevitably requires the use of benchmarks.

One potential benchmark is sovereign credit ratings. Ratings are far from perfect, and they adjust relatively slowly compared with financial markets. Nevertheless, they provide a structured assessment of a sovereign's underlying creditworthiness, incorporating fiscal metrics, debt dynamics, institutional strength and political factors. If sovereign spreads widen significantly relative to what would normally be associated with a country's rating, one could argue that markets are becoming excessively pessimistic. Conversely, if spreads remain broadly consistent with underlying credit quality, market developments appear more difficult to dismiss as irrational.

A useful way of formalising this comparison is through the use of market-implied ratings (MIRs). Rather than asking whether credit ratings are correct, the MIR framework asks what rating markets appear to be assigning, based on observed prices and spreads. Differences between agency ratings and market-implied ratings provide a measure of disagreement between investors and more traditional assessments of credit risk. In earlier work, Ellis, Kanthan and Zheng (2018) showed that such gaps can persist for considerable

periods, but also demonstrated that they provide a useful framework for comparing market signals with underlying credit assessments. Ellis (2025) also uses the gap between MIRs and ratings to assess investors' evolving views of emerging markets. Importantly for current purposes, MIRs provide a practical way of asking whether markets are behaving consistently with broader measures of sovereign risk or moving significantly beyond them. For this paper, we convert ratings and MIRs into integers, based on Moody's global rating scale, with 1 being the best rating (Aaa) and 21 being the lowest (C); so a bigger number indicates a lower rating. We then subtract the rating integer from the MIR integer; so a negative number here implies markets are more optimistic than rating agencies, and a positive number implies markets are more pessimistic. With 'unwarranted' movements in yields, we would expect to see large positive numbers for the MIR-ratings gap.

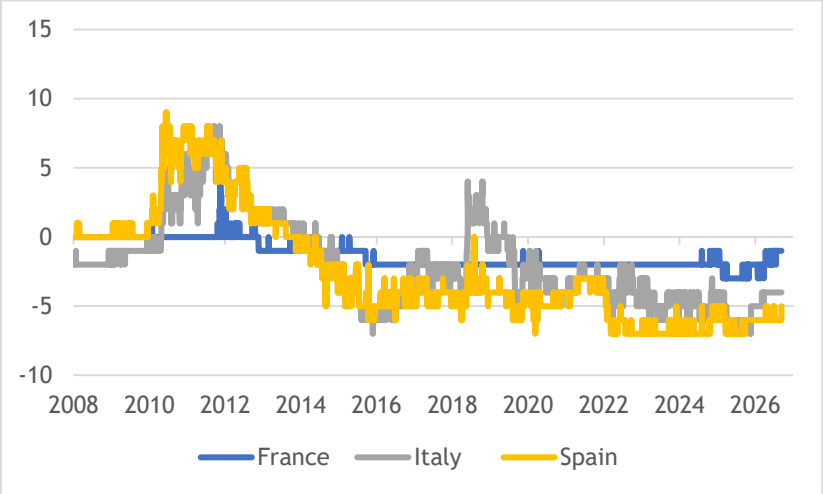


Figure 2: Gaps between market-based and agency-based sovereign credit ratings

Source: Moodys.com, Data Buffet and author's calculations. Note: MIRs and ratings converted to integers, then the latter is subtracted from the former as described in the main text.

Viewed through this lens, the recent widening of French spreads appears less obviously disconnected from fundamentals than some proponents of intervention might suggest. France enters this period with high debt levels, persistent budget deficits, weak trend growth and significant political uncertainty surrounding fiscal consolidation. But, at the moment, the gap is negative (Figure 2), so the market-implied rating for France is higher than the Moody's rating. That means that French yields would have to jump very significantly from current levels for the market signal to be as negative – and potentially unwarranted – as was seen for Italy and Spain in 2012. Of course, markets are not always right. Financial history provides numerous examples of excessive pessimism and excessive optimism. However, the burden of proof becomes important. If bond spreads can be broadly explained by observable fiscal and political developments, the argument that markets are generating "unwarranted" fragmentation becomes considerably harder to sustain.

Lessons from the United Kingdom

A second benchmark is provided by the United Kingdom's experience during September 2022.

Markets reacted sharply to the fiscal package announced by the government of Liz Truss and Kwasi Kwarteng, driving a rapid increase in gilt yields (Figure 3) and creating significant stress for liability-driven investment funds. The Bank of England subsequently intervened in gilt markets to restore financial stability. However, that intervention was explicitly temporary, narrowly targeted, and accompanied by no suggestion that fiscal concerns themselves were invalid. Indeed, the market reaction ultimately contributed to a reversal of the government's fiscal plans. The episode is often characterised as an example of market discipline operating successfully, albeit through a highly disruptive adjustment process.

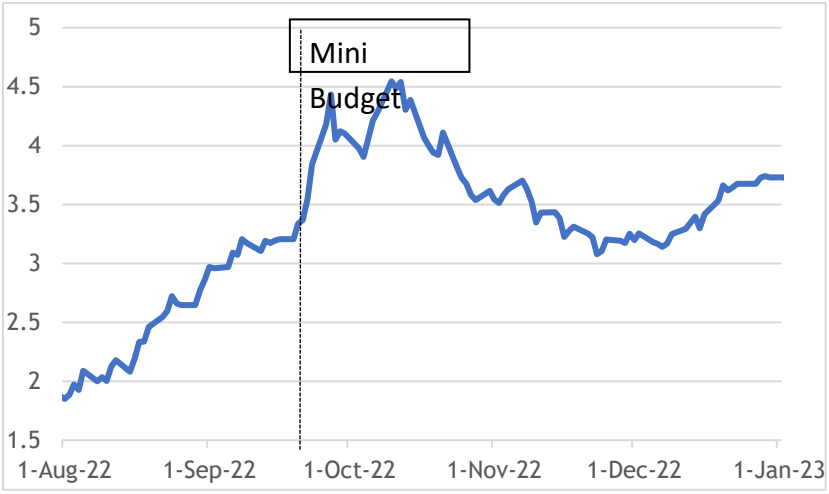


Figure 3: Ten-year gilt yields around the Truss-Kwarteng 2022 mini-budget

Source: BBC.

The comparison with France is not exact, in no small part because the institutional settings are very different. The United Kingdom possesses its own currency, its own central bank and a long-established sovereign debt market. France operates within a monetary union, where sovereign spreads have implications for the transmission of a common monetary policy. Nevertheless, the Bank of England's response to the September 2022 gilt market turmoil is instructive. Faced with severe dysfunction in the long-dated gilt market, the Bank announced temporary and targeted purchases of government bonds with the explicit objective of restoring orderly market conditions and safeguarding financial stability. Importantly, the intervention was presented as distinct from the stance of monetary policy. The Bank emphasised that the purchases were intended as a backstop to market functioning rather than support for the government's fiscal programme (Bank of England, 2022).

Yet the UK episode highlights an important principle. A rise in sovereign borrowing costs does not automatically indicate market dysfunction. Sometimes markets are responding to fiscal developments that investors regard as unsustainable. In such cases, suppressing market signals risks delaying rather than solving the underlying problem.

This distinction matters because the TPI is intended to address problems in monetary transmission, not adverse market reactions to fiscal policy. The more French developments resemble a reassessment of fiscal risk, the more difficult it becomes to justify intervention solely in terms of transmission.

France Today: An Ambiguous Assessment

Today, France remains one of Europe's largest economies, possesses deep and liquid financial markets, and continues to borrow at rates that remain low by historical standards. It is entirely possible that markets could become excessively focused on fiscal concerns, creating self-reinforcing dynamics similar to those observed during earlier episodes of euro-area fragmentation. Moreover, markets are not obliged to move gradually. If investors conclude that public debt trajectories are becoming less sustainable, repricing can occur rapidly and overshoot fundamentals.

This is precisely why the ECB has consistently resisted establishing mechanical intervention thresholds. Flexibility allows policymakers to exercise judgement when confronting unique situations. Indeed, the history of euro-area crisis management contains numerous examples where policymakers adapted existing frameworks in response to changing circumstances. The development of OMT, large-scale asset purchases and pandemic-related interventions all reflected a willingness to reinterpret existing tools when judged necessary.

Nevertheless, a reasonable observer examining current French developments could also reach a different conclusion. Debt levels are high and rising. Fiscal deficits remain substantially above levels consistent with long-run debt stabilisation. Political fragmentation has complicated efforts to establish a credible medium-term fiscal adjustment strategy. International institutions, including the European Commission and International Monetary Fund, have repeatedly highlighted the need for stronger fiscal consolidation. Under such circumstances, higher risk premia are not obviously irrational. Instead, they may simply reflect markets updating their assessment of sovereign risk.

The practical implication is that both interpretations remain plausible. Yield movements may partly reflect changing fundamentals and partly reflect market dynamics. The difficulty is that the TPI ultimately requires policymakers to decide which factor dominates. That judgement cannot be delegated to a formula, nor can it be derived directly from market prices. Instead, it inevitably relies upon institutional discretion.

The French case therefore exposes a fundamental tension within the TPI framework. The instrument was designed to separate transmission concerns from fiscal concerns. In practice, however, the two may be impossible to disentangle completely. If recent French spread widening is largely a response to deteriorating fiscal fundamentals, intervention risks resembling support for fiscal policy. If the movements are primarily the product of self-reinforcing market dynamics, intervention may be entirely appropriate. The challenge is that there is no objective test capable of resolving the issue conclusively.

That ambiguity is not merely a technical problem for monetary policy. It raises deeper questions about the relationship between fiscal authorities and central banks. It is to those questions that we now turn.

FISCAL DOMINANCE BY STEALTH?

The concept of fiscal dominance has a long history in macroeconomics. In its simplest form, fiscal dominance arises when fiscal policy constrains the actions of the monetary authority, rather than the other way around. Under such circumstances, a central bank may be unable

to pursue its preferred monetary objective because doing so would create unsustainable consequences for government finances. The classic statement of this argument comes from Sargent and Wallace (1981), who demonstrated that monetary policy cannot always determine inflation independently of fiscal policy. In their framework, attempts by a central bank to reduce inflation may ultimately fail if fiscal policy does not adjust accordingly.

Subsequent research formalised these interactions. Leeper (1991) distinguished between "active" and "passive" monetary and fiscal policies, arguing that macroeconomic outcomes depend critically on which authority ultimately adjusts to stabilise the government's intertemporal budget constraint. In regimes where fiscal policy is effectively active and monetary policy accommodates fiscal outcomes, the influence of fiscal decisions over monetary policy becomes much more pronounced.

More recently, Sims (2013) argued that modern monetary systems cannot be understood without recognising the interaction between fiscal and monetary authorities. Writing in the aftermath of the global financial crisis and euro-area sovereign debt crisis, Sims noted that large central bank balance sheets, elevated public debt levels and evolving institutional arrangements have made fiscal-monetary interactions increasingly important for both policymakers and researchers.

While these contributions differ in emphasis, they share a common insight: the independence of monetary policy ultimately depends on the existence of a fiscal framework that does not force the central bank to accommodate government financing needs. Fiscal dominance therefore need not involve explicit political pressure on a central bank. It can emerge whenever fiscal realities begin to shape the set of feasible monetary policy choices.

For much of its history, the ECB appeared relatively insulated from such concerns. Unlike a national central bank, it does not operate on behalf of a single sovereign government. Nor does it normally face direct pressure to facilitate deficit financing. Indeed, the institutional architecture of the euro area was explicitly designed to separate monetary policy from fiscal policy. National governments retained responsibility for taxation, spending and public debt, while the ECB was assigned a narrow mandate centred on price stability. The introduction of the TPI potentially complicates that separation.

In formal terms, the TPI is not a fiscal instrument. Its stated purpose is to safeguard the transmission of monetary policy, not to lower borrowing costs for governments. The ECB has also established eligibility criteria intended to prevent countries with unsustainable fiscal positions from benefiting automatically from intervention. Moreover, activation remains entirely at the discretion of the Governing Council. These safeguards are important and should not be dismissed. The existence of a mechanism through which government bond yields can be influenced does not automatically imply fiscal dominance.

Yet there is another way of viewing the issue. Suppose investors increasingly lose confidence in French fiscal policy. Rising debt levels, persistent deficits and political paralysis lead to a widening of sovereign spreads. Over time, market participants begin to ask whether the ECB will tolerate further increases in borrowing costs or whether the TPI will eventually be deployed. If investors expect intervention, market pricing itself may begin to reflect that expectation. Equally, politicians may begin to assume that sufficiently adverse market outcomes will ultimately trigger some form of ECB response. It can also be argued that past crises have been needed to foster public support for fiscal consolidation in several advanced economies (Ellis, 2024b).

At that point, fiscal dominance need not take an explicit form. No finance minister needs to issue instructions to the ECB, and no formal request for support is required. Instead, the central bank becomes constrained by the consequences of fiscal decisions taken elsewhere. The weaker fiscal adjustment becomes, the greater the likelihood that monetary policymakers will face pressure to act. Fiscal policy therefore begins to shape the choices available to the supposedly independent central bank.

The French case is particularly significant because of the country's scale. During the sovereign debt crisis, market pressure fell most heavily on smaller peripheral members of the euro area. Countries such as Greece, Ireland and Portugal ultimately faced varying degrees of adjustment imposed by markets, governments and European institutions. In several cases, ECB support was conditional and limited. The experience of Greece is especially notable. The ECB demonstrated a willingness to maintain pressure on both the government and the banking system during periods of acute crisis, despite the severe economic consequences that followed.

France presents a different challenge. As the euro area's second-largest economy and one of its largest sovereign debt issuers, France occupies a fundamentally different position within the monetary union. A prolonged disruption in French bond markets would have materially greater implications for euro-area financial stability than a comparable episode in a smaller member state. This reality may create an implicit asymmetry within the system. Markets may reasonably ask whether a country the size of France will ever be permitted to experience the same degree of market discipline faced by smaller economies in earlier crises.

The issue extends beyond France itself. If investors conclude that some governments benefit from an implicit ECB backstop while others do not, incentives inevitably change. Fiscal consolidation becomes politically easier to postpone. Difficult fiscal decisions can be deferred. Market signals become weaker as a mechanism for encouraging policy adjustment. In economic terms, this is the classic problem of moral hazard.

There is also a broader institutional concern. The more frequently the ECB is required to determine whether sovereign spreads are justified by fundamentals, the more it becomes involved in questions that are fundamentally fiscal in nature. Judgements regarding debt sustainability, fiscal credibility and appropriate risk premia are no longer merely inputs into monetary policy. They become central to operational decisions regarding intervention. In extremis, the ECB risks evolving into an institution that effectively determines which governments face market discipline and which do not.

This is why the fiscal-dominance question matters. The concern is not that the ECB has already abandoned its price-stability mandate. Nor is it that activation of the TPI would automatically constitute monetary financing. Rather, the concern is that expectations matter. If governments, investors and policymakers increasingly assume that serious fiscal stress will ultimately provoke ECB intervention, then any boundary between monetary policy and fiscal policy is already eroding.

There is a further reason why the French case is instructive. At the time of writing, the TPI has never been activated. Yet this arguably strengthens, rather than weakens, the concern outlined above. If fiscal dominance can only emerge after a central bank has intervened, then it will usually be easy to identify. More challenging are situations in which expectations alone begin to influence behaviour. Investors may assume that sufficiently

severe market stress in a large member state would ultimately trigger ECB action, while governments may take comfort from the existence of such a backstop even if it is never used. The critical point is that expectations can affect market pricing, policy choices and institutional incentives without a single bond ever being purchased under the TPI. If so, the question is not whether the ECB has already intervened in support of France, but whether the mere existence of a potential intervention has begun to alter the behaviour of markets and policymakers.

The most important consequence would be a weakening of institutional credibility. An independent central bank derives much of its authority from the perception that its actions are guided by macroeconomic objectives rather than fiscal considerations. Once that perception begins to change, restoring it can prove difficult. The risk, therefore, is not simply fiscal dominance in the traditional sense, but fiscal dominance by expectation and by anticipation. In that respect, the debate surrounding France represents an important test of the ECB's continued independence. If expectations of future TPI use already exist, that will limit the central bank’s future room for manoeuvre; and that is a form of fiscal dominance.

CONCLUSIONS

The recent widening of French sovereign bond spreads has focused attention on a question that extends well beyond the outlook for the French public finances. At its heart, the issue concerns the continuing evolution of the ECB's role within the euro area's institutional framework. Since the sovereign debt crisis, the ECB has acquired an increasingly important function in preserving the transmission of monetary policy across member states. The introduction of the Transmission Protection Instrument represents the latest stage in that evolution, providing the Governing Council with a mechanism through which it can respond to sovereign market fragmentation when financing conditions are judged not to be warranted by country-specific fundamentals.

This paper has argued that France presents a particularly challenging test case for that framework. Fiscal deficits remain elevated, public debt continues to rise, and political constraints have complicated the implementation of credible medium-term fiscal consolidation. These developments provide a plausible explanation for at least part of the increase in French borrowing costs. Recent market movements therefore appear difficult to dismiss as wholly disconnected from economic fundamentals. At the same time, the distinction between a justified repricing of sovereign risk and excessive market fragmentation is inherently subjective. The TPI was designed precisely to address that type of situation, yet its effectiveness ultimately depends upon a judgement that cannot be reduced to a simple formula.

The resulting ambiguity creates an important institutional challenge. If the ECB intervenes when markets are reacting to deteriorating fiscal fundamentals, the intervention risks appearing less like monetary policy and more like fiscal support. If it does not intervene, it risks allowing financial conditions to diverge across the monetary union in a manner that may impede the transmission of monetary policy. The tension exists because, in practice, monetary transmission and fiscal sustainability cannot always be cleanly separated from one another.

This brings us to the broader question of fiscal dominance. Traditional discussions typically focus on situations in which fiscal pressures eventually force a central bank to accommodate government financing needs. The issue raised here is subtler. France does not require ECB financing, nor has the TPI been activated. Yet expectations themselves may matter. If investors, governments and policymakers increasingly assume that market stress in a large member state will ultimately provoke ECB intervention, then fiscal policy may already be influencing the choices available to the central bank. In that sense, fiscal dominance can emerge gradually, not through formal institutional change, but through changing expectations regarding the behaviour of monetary authorities.

The purpose of this paper has not been to argue that the ECB is already under fiscal dominance in any definitive sense. Rather, it has sought to highlight an important transformation occurring within the euro area. The ECB increasingly finds itself required to make judgements that carry significant fiscal consequences, particularly when sovereign market developments and monetary transmission become intertwined. Whether or not the TPI is ever deployed in France, the growing expectation that the ECB may be required to arbitrate such questions represents a significant shift from the original vision of the monetary union.

Ultimately, the most important question may not be whether the TPI succeeds in stabilising sovereign bond markets. It is whether the ECB can use the TPI to contain market dynamics while preserving a clear distinction between monetary policy and fiscal policy. As pressures on public finances increase across many advanced economies, that challenge is only likely to become more important.

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