

ECOCHARTS

PUBLIC FINANCES

Under the pressure of rising interest rates

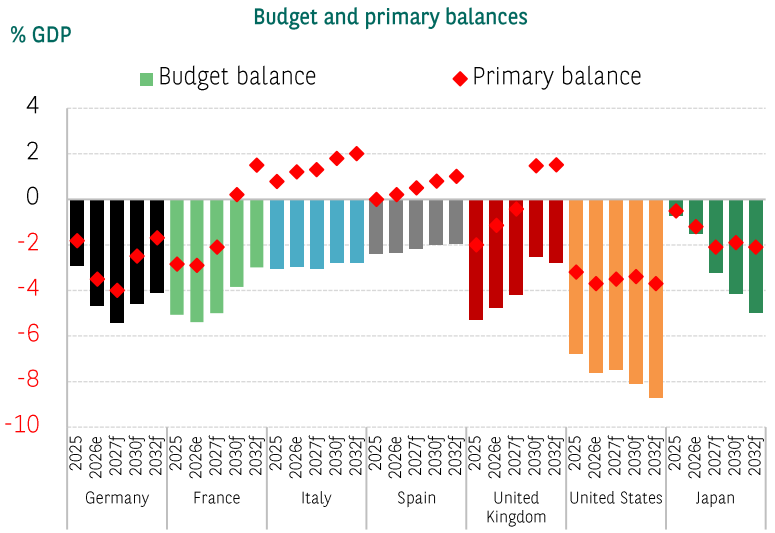
November 2026

BNP PARIBAS

The bank for a changing world

Summary: Rising interest rate pressure does not prevent several countries from reducing their debt

Consolidation in Europe but not in Japan or the United States

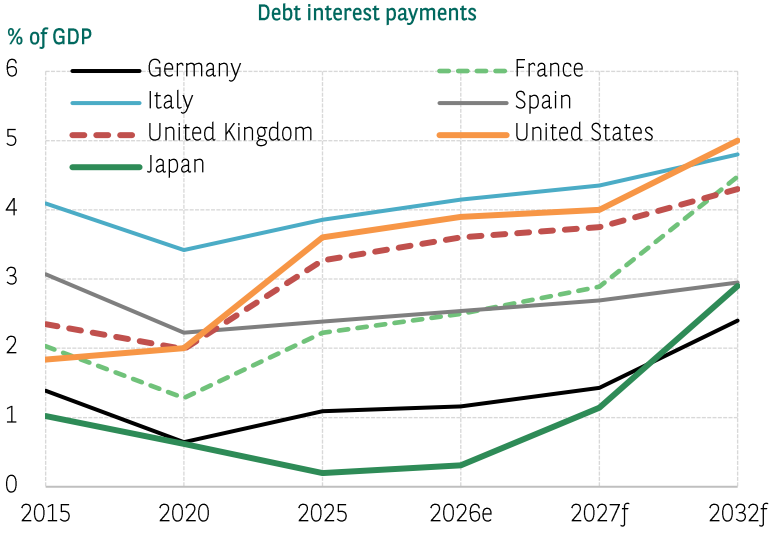


Source: IMF, BNP Paribas

Fiscal policies are heading in opposite directions. In the United States, the public deficit is set to continue widening, reaching nearly 9% of GDP by 2032 (including a federal deficit of 7.2%), due to a lack of effort to improve the primary balance.

The public deficit is also set to rise in Germany (investment plans) and Japan (pro-growth policies). Conversely, the United Kingdom and France (with a greater risk of deviation from the central scenario in France) are expected to continue their fiscal consolidation and return to a primary surplus before 2030. The budget deficit in Italy and Spain is expected to remain below 3% of GDP. In Italy, the primary surplus is expected to be largely absorbed by interest payments.

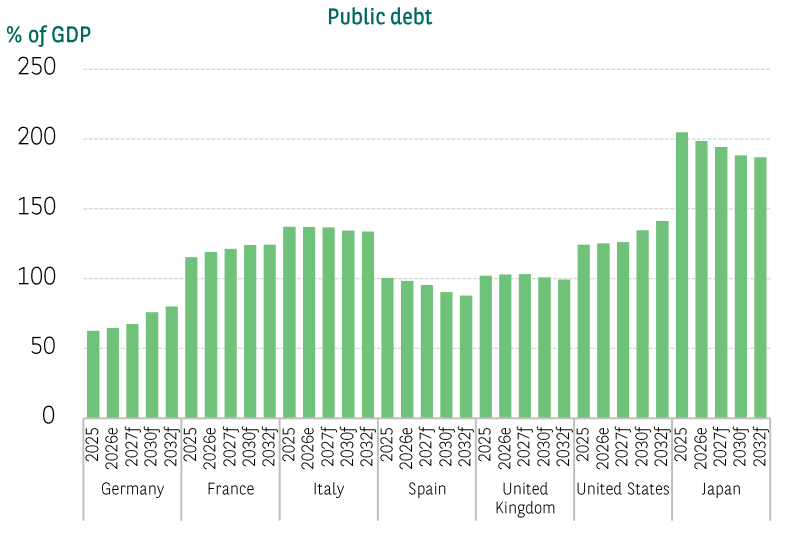
A generalised rise in interest payments by 2032



Source: IMF, BNP Paribas

Interest payments are set to rise in all countries, as debt issued at low rates gradually matures and must be refinanced on current terms. France would experience the sharpest rise: its interest payments would double by 2032 and approach the Italian level. Germany and Japan would also see their interest payments more than double from low levels. The United States would reach the highest level in the sample (5% of GDP). Signalling a shift in the economic regime, the gap between the apparent interest rate and nominal growth would become unfavourable in most European countries. As growth alone cannot, under these conditions, guarantee a reduction in debt ratios, primary surpluses will be necessary.

Rising debt ratios in the United States, Germany and France, but a decline elsewhere

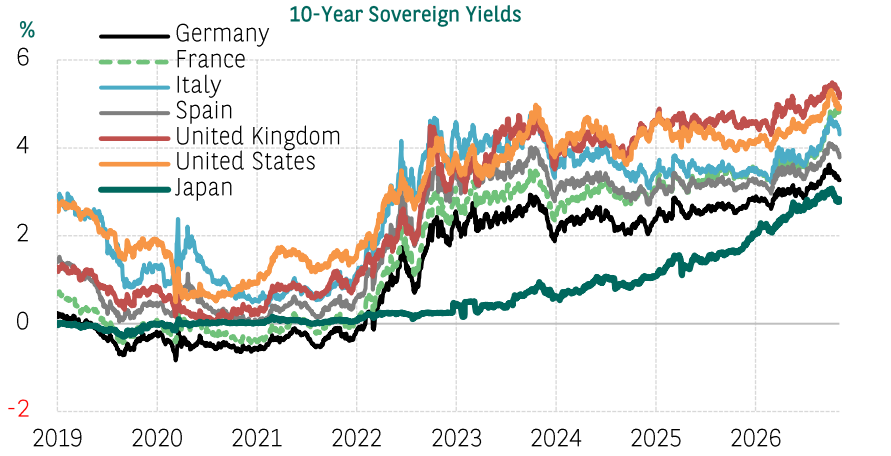


Source: IMF, BNP Paribas

By 2032, debt trends will remain mixed. Debt is set to rise sharply in Germany and the United States, where it would exceed Italy's level as early as 2030. In France, it is expected to rise further before stabilising in 2032 at around 124.5% of GDP. Conversely, Spain and Japan are projected to reduce their debt levels significantly, thanks to sustained nominal growth and a more moderate rise in their interest burden. Italy and the United Kingdom would see a slight decline in their debt levels. Risks remain skewed to the upside: a combined shock to interest rates and growth would weigh heavily, particularly on countries with the highest financing needs, starting with the United States and Japan.

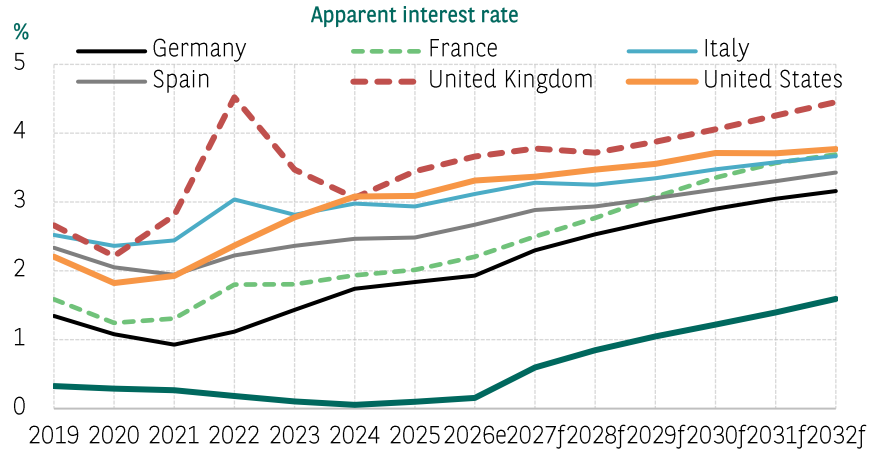
The cost of debt will continue to rise

A return to market rates not seen for 25 years



Source: IMF, European Commission, BNP Paribas

The rise in market rates is feeding through to nominal rates



Source: IMF, European Commission, BNP Paribas

	Date	Germany	France	Italy	Spain	UK	US	Japan
Average residual maturity (years)	Sept. 2026	8.3	8.1	7.0	7.6	13.1	5.8	8.6
	Dec. 2019	8.0	7.8	6.9	7.6	15.7	5.7	8.0
Net debt[1] (% of GDP)	2025	47.1	108.4	127.7	86.0	93.6	96.7	132.4
% short-term debt (< 1 year)	2025	3.4	5.7	4.3	4.7	2.9	17.1	12.2
% held by non-residents	-	51.3	59.7	34.3	48.9	33.6	31.9	13.1
% inflation-indexed	2025	2.1	8.9	8.8	5.4	22.3	5.6	0.0
% debt held by the Central Bank	Sept. 2026	28.1	18.5	18.2	23.9	23.3	23.8	41.2
	Dec. 2019	33.3	21.4	18.1	24.9	23.0	15.0	43.7
Primary expenditures (% of GDP)	2025	49.0	55.0	47.3	42.9	40.2	34.0	36.8
Revenues (% of GDP)	2025	47.2	52.2	48.1	42.9	38.2	30.5	36.3

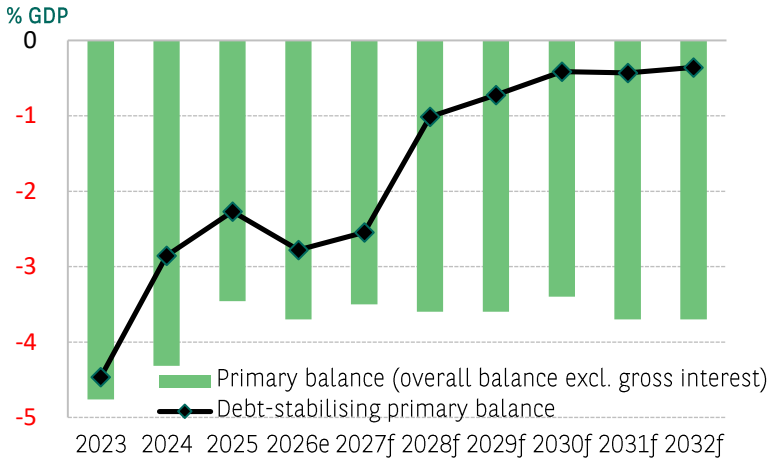
[1] *Net debt: the sum of all liabilities minus financial assets that are debt instruments (IMF)*

Source: IMF, European Commission, national Source

United States: Public debt on an upward trajectory, with no turnaround in sight (1/2)

Persistent primary deficits, with no fiscal consolidation in prospect

Primary balance and debt-stabilising primary balance

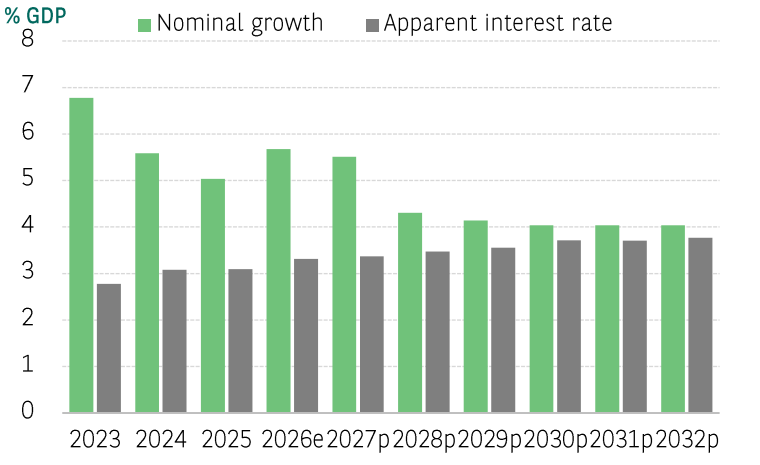


Source: IMF, BNP Paribas

The US primary deficit is projected to remain sizable through to 2032. Population ageing exerts structural pressure on mandatory health and pension spending, while fiscal consolidation does not appear to be on the policy agenda. The primary deficit is estimated to have widened to -4.2% of GDP in 2026, from -3.2% in 2025. This primarily reflects a shortfall in tariff revenue, as reciprocal-tariffs are being refunded and gradually replaced. This volatility is expected to dissipate in 2027, with the primary deficit narrowing modestly to -3.5% of GDP.

An increasingly unfavourable interest rate-growth differential

Apparent interest rate vs. nominal growth

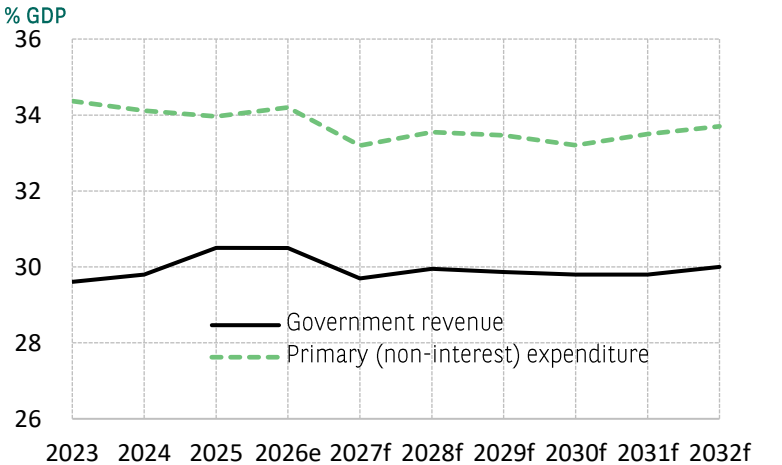


Source: IMF, BNP Paribas

The interest rate-nominal growth (r-g) differential remains favorable for now, but the gap is expected to close almost entirely by 2032. Two factors are at play. First, real growth and inflation should normalize towards their long-term levels, bringing nominal growth down from nearly 6% to about 4%. Second, the effective interest rate is rising as maturing debt is refinanced at a higher rate. The larger share of short-term issuance accelerates the pass-through of market rates to debt service costs.

A revenue-expenditure gap that is unlikely to narrow

Revenue and primary (non-interest) expenditure



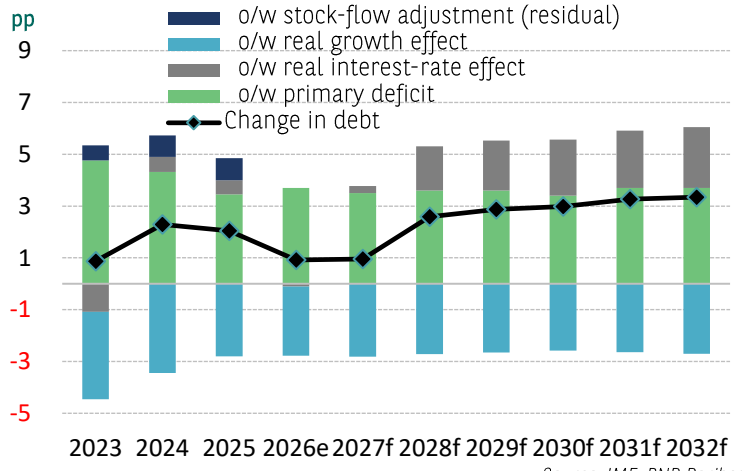
Source: IMF, BNP Paribas

Primary spending is subject to structural upward pressure over the medium term. Population ageing raises mandatory outlays on healthcare and pensions. Scope for savings on federal discretionary spending is limited. On the revenue side, tax increases appear unlikely at this stage.

United States: Public debt on an upward trajectory, with no turnaround in sight (2/2)

Debt growth set to accelerate from 2028

Contributions to the change in debt, baseline scenario

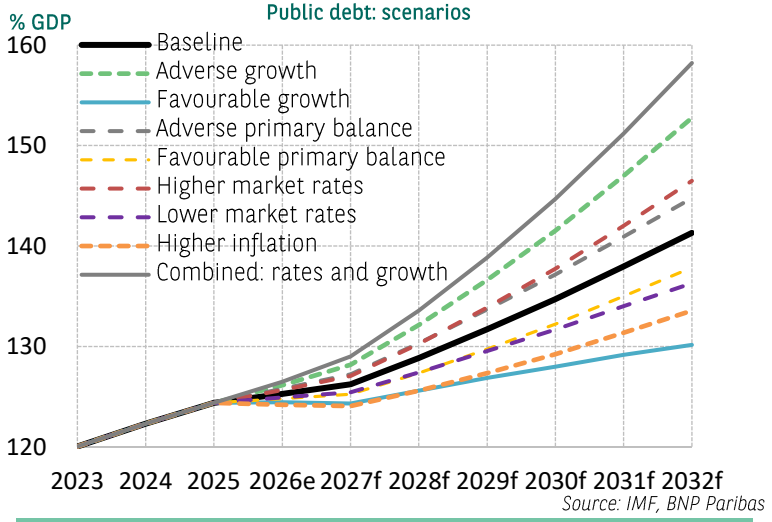


Source: IMF, BNP Paribas

The debt-ratio is set to keep rising throughout our projection horizon, and at an accelerating pace. From less than 125% of GDP in 2025, it is projected to exceed 140% in 2032. Limited to 1pp per year in 2026 and 2027, the annual rise in the ratio is expected to exceed 3pp from 2030 onwards. Persistent primary deficits would be the main driver, while the offsetting contribution of growth would fade. Higher real interest rates, as inflation normalizes and the cost of debt rises, would add further to the ratio.

Rising debt in all scenarios

Public debt: scenarios



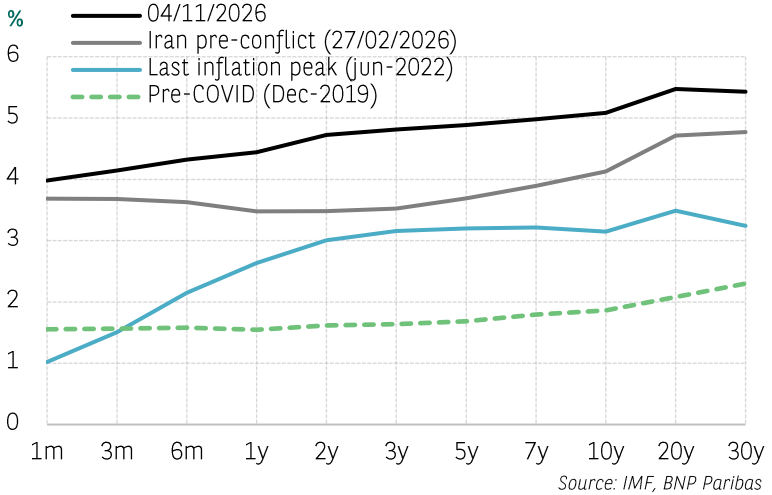
Source: IMF, BNP Paribas

Note: the 'growth' and 'primary balance' scenarios incorporate, respectively, a negative shock to growth and to the deficit of 0.5 percentage points of GDP per year compared with the baseline scenario; the 'interest rate' scenario incorporates a 1 percentage point rise in the apparent interest rate.

The US debt ratio is clearly exposed to upside risks; it rises under every scenario considered. Even the most favorable growth and inflation scenario would push debt above 130% of GDP by 2032. At the other end, a combined growth and interest rate shock would push it towards 160% through lower nominal GDP and a weaker primary balance. Debt is also highly sensitive to interest rates, exceeding 145% under a rate shock. The relatively short maturity of US debt speeds up the transmission.

Long-term rates pushed higher by multiple factors

US yield curve



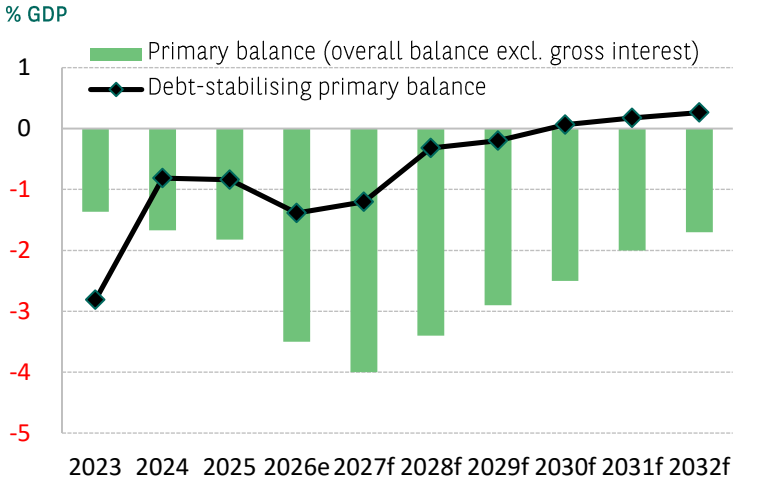
Source: IMF, BNP Paribas

The yield curve has shifted sharply upwards and is now positively sloped across all maturities. At the short end, the 2-year reflects expectations of tighter monetary policy fueled by the conflict in Iran. Further out, several factors, not all of them fiscal, are pushing long-term yields higher. Strong US growth is one. Another is intensifying competition for capital, with the AI boom creating large investment needs. Finally, a shift investor base, with institutional investors giving way to short-horizon buyers, is amplifying the trend.

Germany: The fiscal shift is fuelling rising debt (1/2)

A primary deficit exceeding the debt-stabilising level

Primary balance and debt-stabilising primary balance



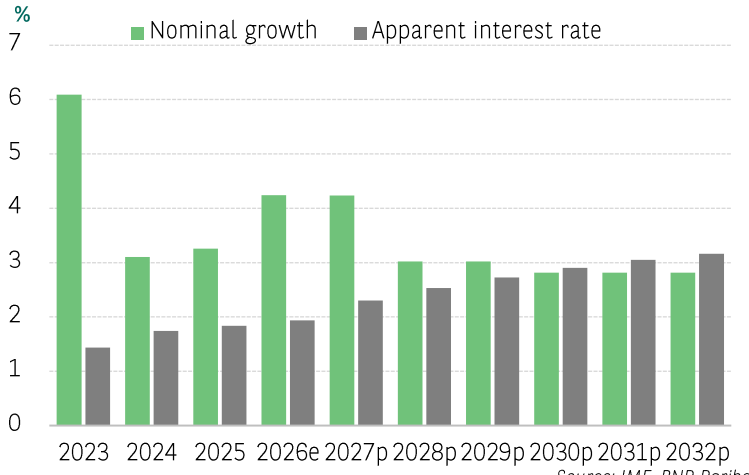
Source: IMF, BNP Paribas

Germany's primary deficit is expected to widen significantly in 2026 and 2027, driven by rising infrastructure and defence spending, made possible by the relaxation of fiscal rules. The primary balance will continue to exceed the debt-stabilising level in the coming years, despite a gradual reduction in the deficit from 2028 onwards.

Given the gradual rise in the implicit interest rate on debt over the forecast horizon, the improvement in the primary balance will need to accelerate to allow debt to stabilise.

An unfavourable interest rate-growth differential from 2030 onwards

Apparent interest rate vs. nominal growth



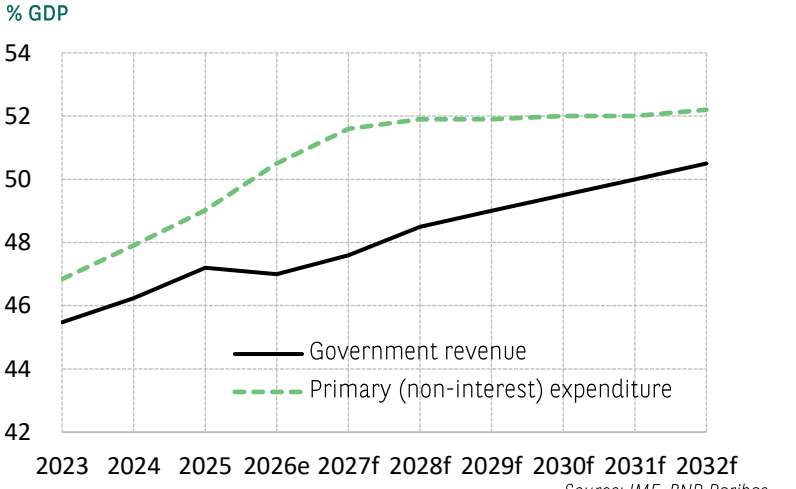
Source: IMF, BNP Paribas

Having benefited from nominal growth that was significantly higher than the apparent interest rate on its debt, Germany is expected to see this situation reverse from 2030 onwards.

The apparent interest rate is projected to rise from 1.93% in 2026 to 3.16% in 2032, driven by the gradual refinancing of debt on less favourable terms. At the same time, nominal growth is expected to slow, falling from 4.2% in 2026 to 2.8% in 2032 due to a slowdown in real growth (from 1.3% in 2026 to 0.7% in 2032). Consequently, the interest-growth differential would gradually become unfavourable, contributing to a sharper rise in the public debt ratio towards the end of the period.

In the short term, a sharp rise in primary expenditure

Revenue and primary (non-interest) expenditure



Source: IMF, BNP Paribas

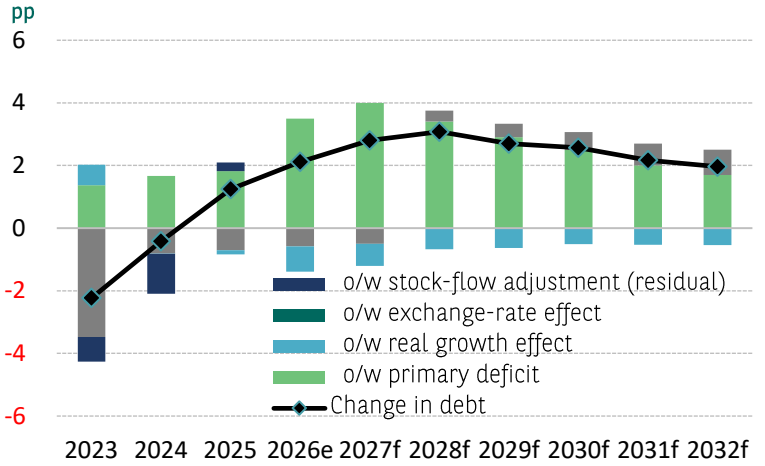
Driven by infrastructure investment and increased defence spending, primary public expenditure (excluding interest) is expected to rise sharply from 2026 onwards.

Whilst public revenue is also expected to rise, particularly due to the acceleration in GDP growth, this increase would remain insufficient to offset the rise in expenditure, leading to a widening of the primary deficit.

Germany: The fiscal shift is fuelling the rise in debt (2/2)

The primary deficit: the main driver of rising public debt

Contributions to the change in debt, baseline scenario



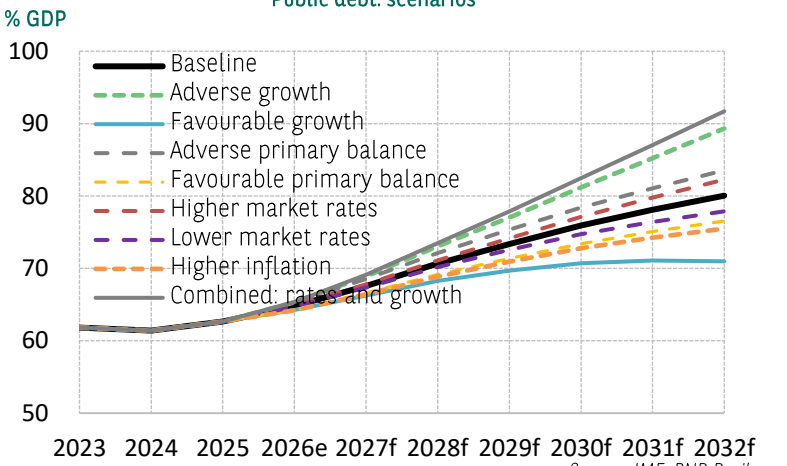
Source: IMF, BNP Paribas

The rise in public debt is expected to remain moderate. The increase in the public debt ratio is likely to be driven mainly by the primary deficits resulting from the new fiscal stance. The favourable effect of GDP growth would help to partially mitigate this impact, though without fully offsetting the positive contribution from the deficits and the interest burden.

German public debt is expected to reach 80% by the end of the forecast period (2032), compared with 62.7% in 2025.

Debt will rise even under a favourable scenario

Public debt: scenarios



Source: IMF, BNP Paribas

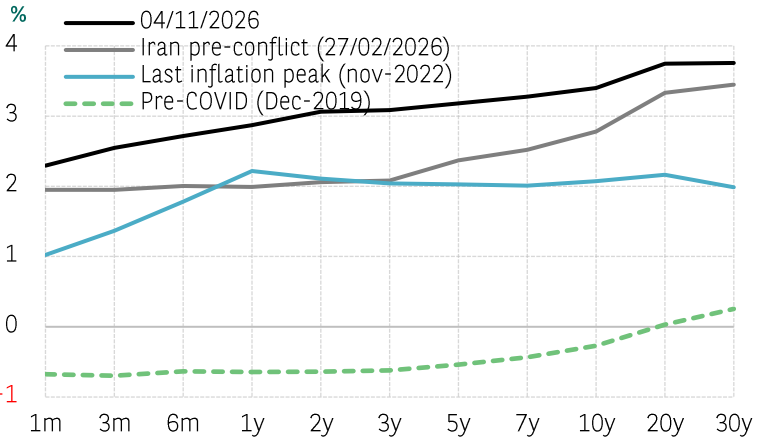
Note: the 'growth' and 'primary balance' scenarios incorporate, respectively, a negative shock to growth and to the deficit of 0.5 percentage points of GDP per year compared with the baseline scenario; the 'interest rate' scenario incorporates a 1 percentage point rise in the apparent interest rate.

The debt trajectory is sensitive to macroeconomic and financial assumptions. In our alternative adverse scenarios, it is the combination of lower growth and a rise in market interest rates that would have the most adverse impact. This scenario remains unlikely, as we consider German growth to be robust.

Conversely, more favourable assumptions regarding growth, the primary balance and rates would limit the rise in debt, but would not stabilise the debt-to-GDP ratio.

A significant tightening of financing conditions

Germany yield curve



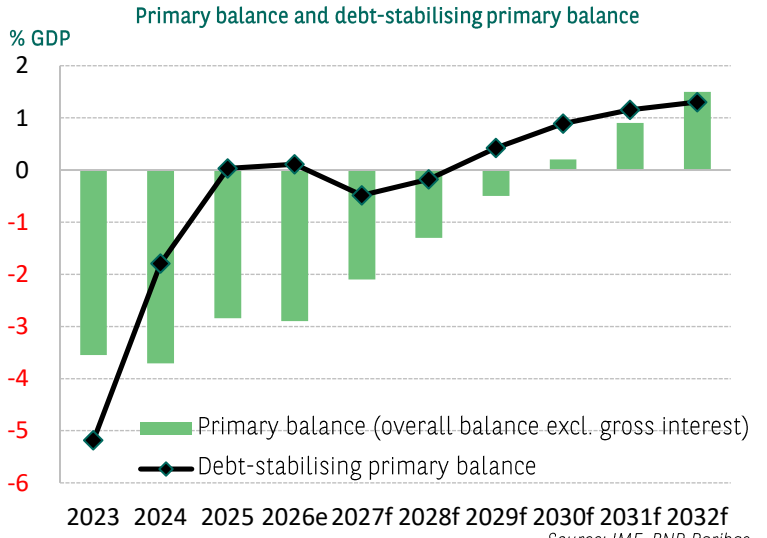
Source: IMF, BNP Paribas

The yield curve has shifted significantly upwards from its previous levels, particularly for long-term maturities.

This development, combined with rising public borrowing requirements, is likely to contribute to a gradual increase in the interest burden as existing debt matures and is refinanced at higher rates.

France: Public finances hampered by weak growth (1/2)

A primary deficit too high to stabilise the debt

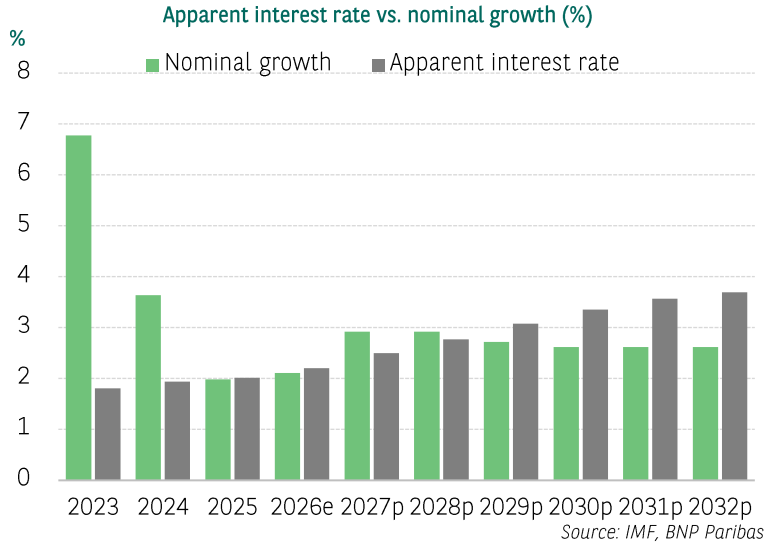


Source: IMF, BNP Paribas

The reduction in the primary budget deficit remains very limited compared with the level observed in 2024. It came to a halt in 2026, and the gap between the actual balance and the balance required to stabilise the debt has even widened.

In the coming years, the primary balance is expected to remain worse than the debt-stabilising balance. The public debt ratio is therefore likely to continue rising. By 2032, the effort required to stabilise the debt ratio is expected to reach nearly 4 percentage points of GDP (*i.e.* EUR 140 billion). To achieve this, France will need to generate a primary surplus.

The effective interest rate will exceed growth from 2028 onwards

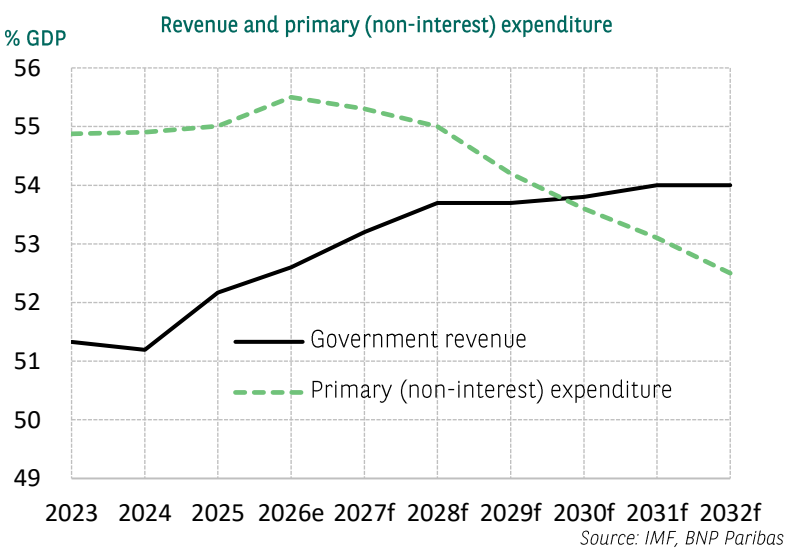


Source: IMF, BNP Paribas

The low level of real GDP growth in 2026 (0.3%) does not prevent nominal growth from remaining above the effective interest rate (due to inflation). Furthermore, the rise in the effective interest rate is very gradual (reaching 2.2% in 2026) because part of the debt was issued at very low interest rates.

The rise in the effective interest rate is set to accelerate. Debt currently being issued carries a rate of close to 5%, whilst maturing debt carries a rate of less than 1%. Consequently, the effective interest rate will continue to rise and exceed nominal GDP growth from 2028 onwards.

Fiscal consolidation is relying in increased revenues



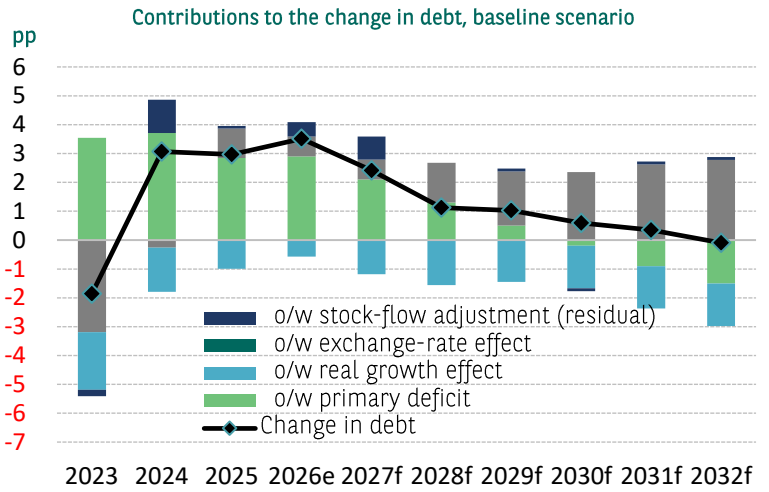
Source: IMF, BNP Paribas

So far, the consolidation of public finances has relied on increased revenue. This was the case in 2025, when the government managed to meet its deficit target. Revenue is expected to continue rising in 2026 and 2027. Expenditure is expected to remain virtually unchanged, due to rising defence spending and the indexation of social expenditure to inflation, which has been in place to date.

A reduction in the share of public expenditure in GDP appears necessary to cut the public deficit more significantly. However, we do not anticipate this happening before 2028, as the current government does not have the necessary majority in the National Assembly to push through such a policy.

France: Public finances hampered by weak growth (2/2)

A rise in debt caused by deficits



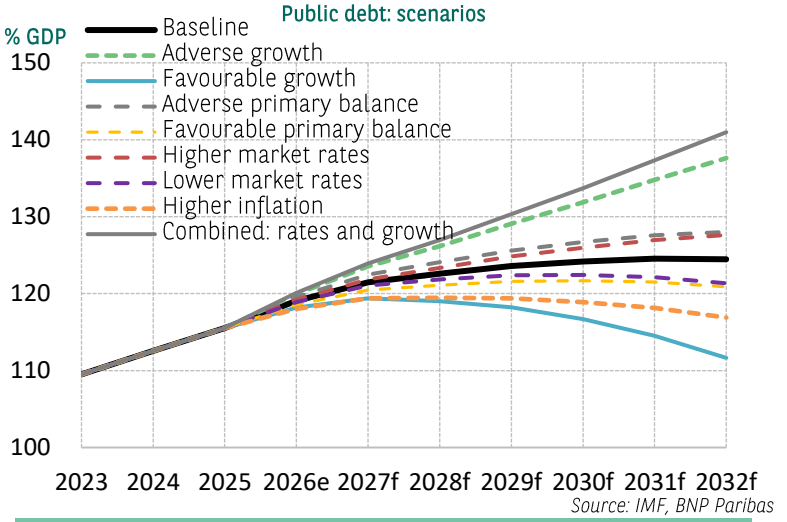
Source: IMF, BNP Paribas

The high primary deficit is the main driver of the rise in the public debt-to-GDP ratio (+3.3 percentage points of GDP in 2026). This is expected to remain the case in 2027.

The slowdown in growth is also having an impact, as, since 2025, growth has been doing significantly less to mitigate the rise in the public debt-to-GDP ratio.

The effective real interest rate still plays a relatively minor role in debt dynamics. Its role will strengthen from 2028 onwards (with the expected decline in inflation) and will eventually become the primary driver of the rise in the public debt ratio. From 2030 onwards, primary surpluses will therefore be a necessary condition for stabilising public debt.

Public debt ratio: upside risks predominate

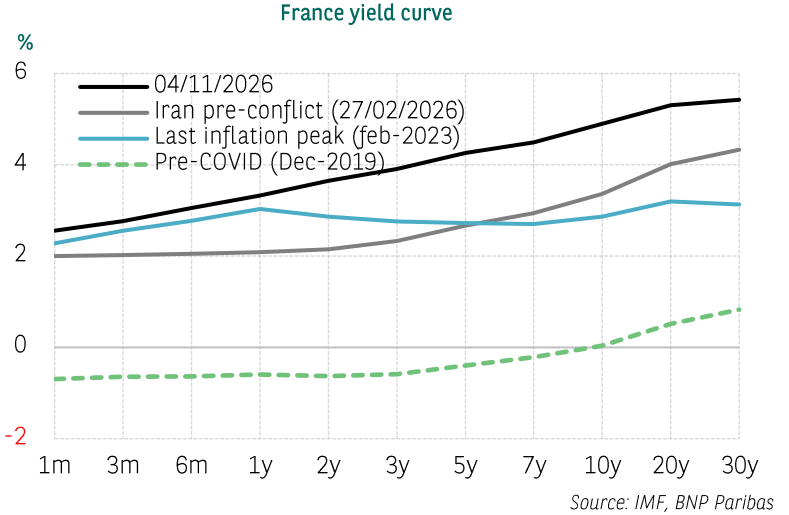


Source: IMF, BNP Paribas

Note: the 'growth' and 'primary balance' scenarios incorporate, respectively, a negative shock to growth and to the deficit of 0.5 percentage points of GDP per year compared with the baseline scenario; the 'interest rate' scenario incorporates a 1 percentage point rise in the apparent interest rate.

Our baseline scenario anticipates an increase in public debt to 124.5% of GDP in 2032, at which point it would stabilise. However, this scenario assumes a significant reduction in the public deficit in the meantime, with a primary surplus of 1.5% of GDP in 2032. According to our calculations, **postponing this consolidation by one year** (as in 2026, when the public deficit did not fall) **would result in an additional 2pp rise in the public debt ratio by 2032.** Whilst higher growth would help stabilise the debt ratio more quickly, the risks appear to be moderately skewed to the downside in the short term.

The rise in interest rates is substantial and has accelerated



Source: IMF, BNP Paribas

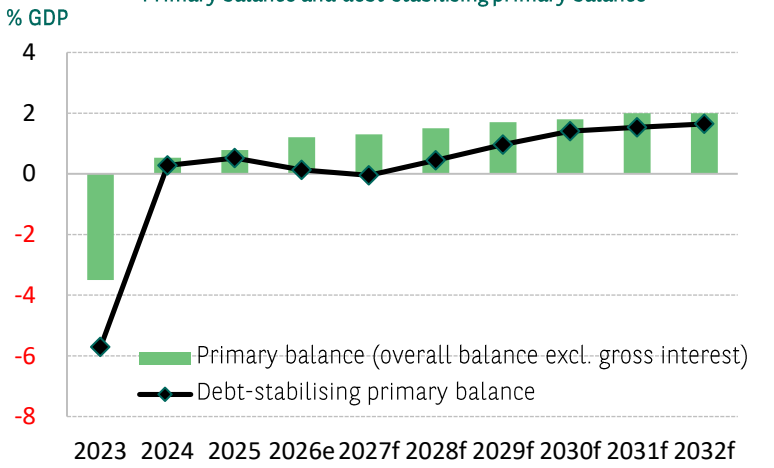
The rise in interest rates has accelerated further since the outbreak of the conflict in the Middle East. This trend is partly common to all advanced economies due to the rebound in inflation expectations. However, France has seen its *spread* widen to 160 basis points by the end of October (175 basis points at its peak) relative to Germany.

The rise in short-term rates remains moderate due to the ECB's gradual rate hikes. The rise in long-term rates is more pronounced, highlighting market concerns regarding the government's stated fiscal consolidation target. This rise will only be gradually passed on to the effective interest rate due to the relatively long average maturity of public debt (just over 8 years).

Italy: Debt stabilisation remains fragile (1/2)

A growing primary surplus

Primary balance and debt-stabilising primary balance

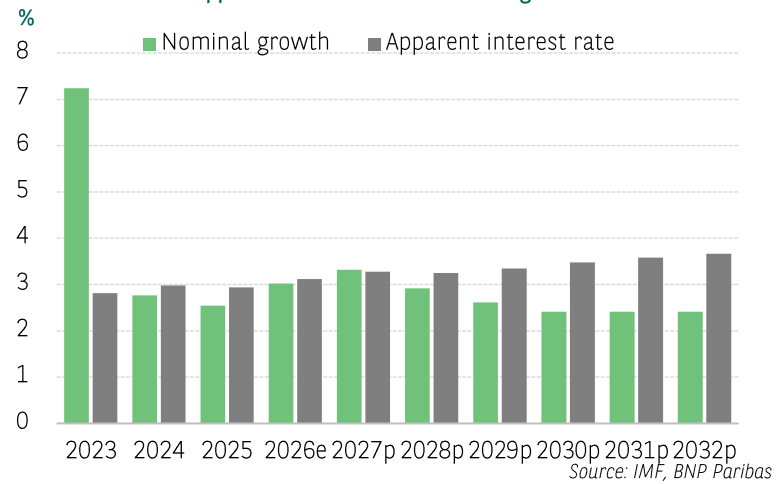


Source: IMF, BNP Paribas

Having returned to positive territory since 2024, Italy's primary balance is expected to continue improving. It has moved from a deficit of 3.5% in 2023 to a surplus of 1.2% expected this year, thanks to the phasing out of the support measures introduced after the pandemic, the basic income scheme and the '*Superbonus*' scheme. The primary surplus is projected to widen further, reaching 2% by 2032.

Towards growth insufficient to offset rising interest rates

Apparent interest rate vs. nominal growth



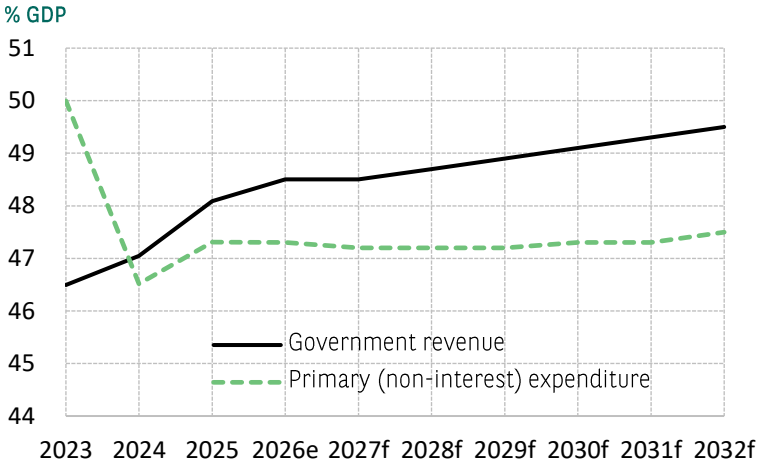
Source: IMF, BNP Paribas

Weak nominal growth and the gradual rise in the apparent interest rate on debt would continue to weigh on Italy's public finances. Following a temporary improvement in 2026 and 2027, nominal growth is projected to slow, falling from 3.3% in 2027 to 2.4% in 2032. At the same time, the effective interest rate is projected to rise gradually, reaching 3.67% in 2032 (compared with 3.12% in 2026).

This unfavourable gap from 2028 onwards would make it necessary to maintain significant primary surpluses in order to stabilise the public debt ratio.

Rising revenue, prudent spending

Revenue and primary (non-interest) expenditure



Source: IMF, BNP Paribas

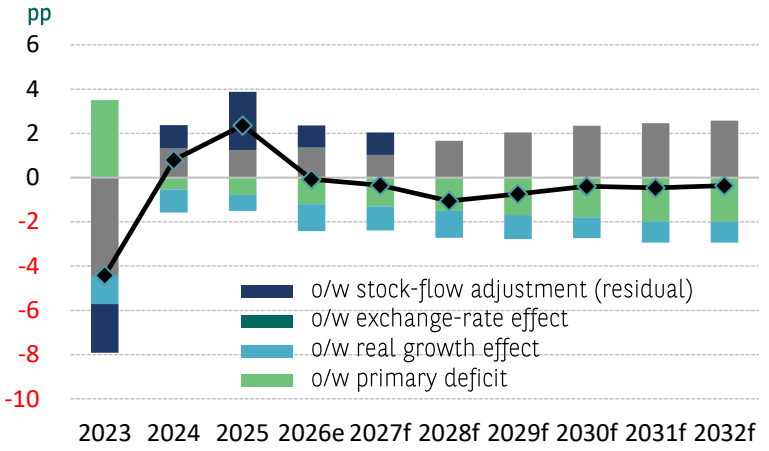
The growth in public revenue, which is outpacing expenditure (excluding interest payments), will enable Italy to gradually consolidate its primary surplus and contain the rise in public debt.

Public revenue will remain higher than expenditure excluding interest payments as part of fiscal consolidation efforts and compliance with European rules, despite pressures, notably from pension and defence spending.

Italy: Debt stabilisation remains fragile (2/2)

Primary surpluses offset the impact of high interest rates

Contributions to the change in debt, baseline scenario



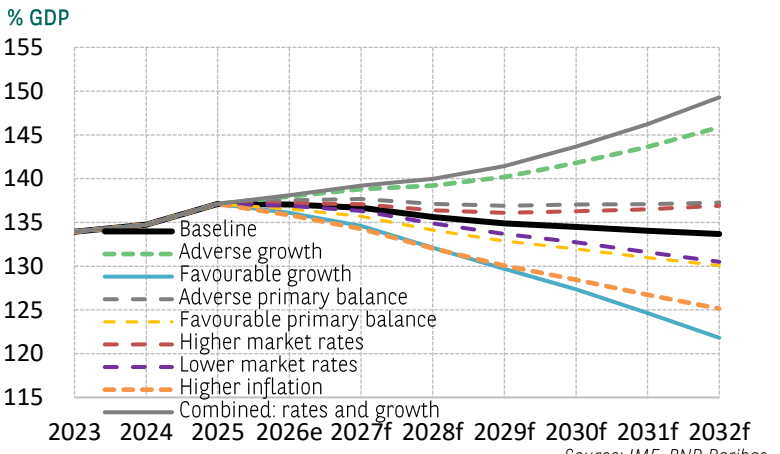
Source: IMF, BNP Paribas

Following a rise in the debt-to-GDP ratio in 2024 and 2025, driven in particular by significant stock-flow adjustments linked to the *'superbonus'* scheme, **Italy's public debt is expected to stabilise gradually.**

The debt-to-GDP ratio is projected to reach 137% of GDP in 2026, before falling to 133.7% by the end of our forecast horizon (in 2032), driven by nominal growth and primary surpluses offsetting the interest burden, which will, however, increase from 2029 onwards.

Debt stabilisation depends on macroeconomic assumptions

Public debt: scenarios



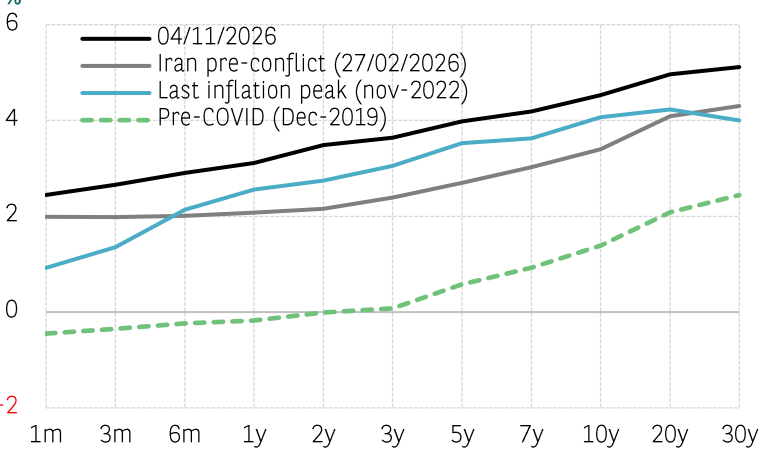
Source: IMF, BNP Paribas

Note: the 'growth' and 'primary balance' scenarios incorporate, respectively, a negative shock to growth and to the deficit of 0.5 percentage points of GDP per year compared with the baseline scenario; the 'interest rate' scenario incorporates a 1 percentage point rise in the apparent interest rate.

Despite its gradual stabilisation over our forecast horizon, **Italy's public debt is expected to remain one of the highest in the Eurozone.** The trajectory of our baseline scenario remains particularly sensitive to the assumptions made: a slowdown in growth, a larger-than-expected rise in interest rates or a deterioration in the primary balance could lead to a further increase in Italy's debt. Conversely, more favourable conditions would allow for a more marked reduction in the debt-to-GDP ratio.

Sustained rise in borrowing costs

Italy yield curve



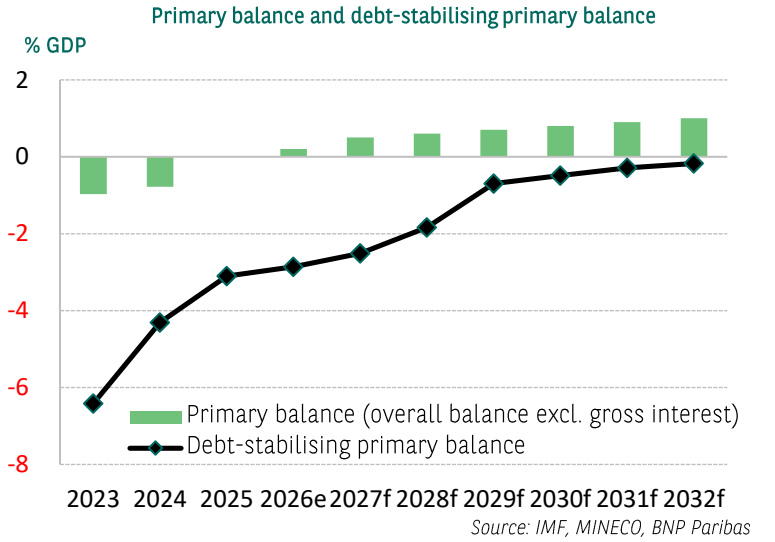
Source: IMF, BNP Paribas

Since the start of the year, interest rates have risen and the yield curve has steepened. The current slope is close to that observed in the pre-Covid period, albeit at a significantly higher level.

The gradual refinancing of debt at higher rates is expected to continue to increase the interest burden, limiting fiscal manoeuvre.

Spain: Debt reduction supported by growth (1/2)

The primary surplus is driving down the public debt ratio

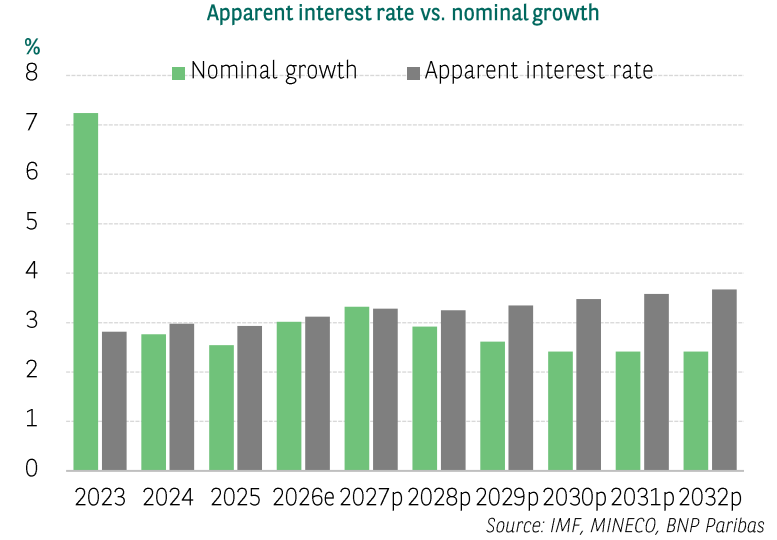


Source: IMF, MINECO, BNP Paribas

Primary surpluses are expected to rise steadily until 2032 (reaching +1% of GDP by then). Beyond the temporary impact of the 2026 energy support measures, fiscal discipline would enable this surplus to be maintained.

This primary balance should stay above the stabilising balance, ensuring a continuous reduction in the public debt ratio. From 2029 onwards, the gap between the two will narrow, which would result in a slowdown in debt reduction over the medium term.

Interest rates are expected to keep pace with growth without exceeding it

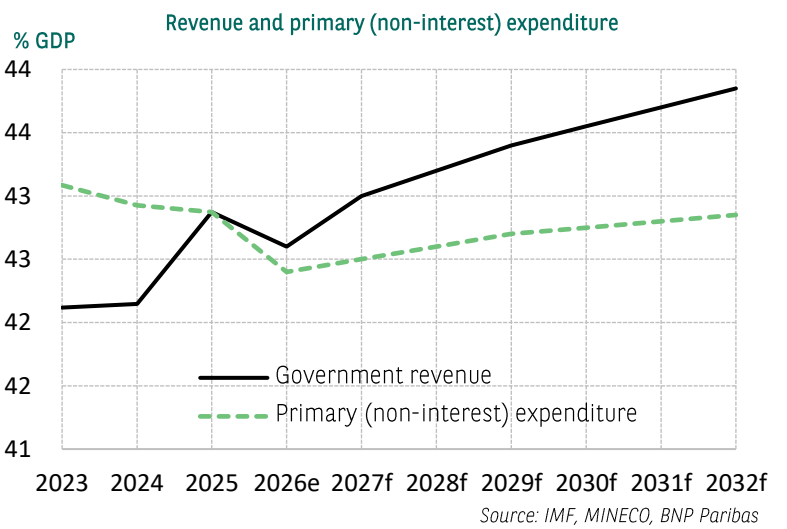


Source: IMF, MINECO, BNP Paribas

Nominal growth is expected to remain above the apparent interest rate on public debt throughout the forecast horizon. Despite its gradual slowdown, from 5.7% in 2026 to 3.6% in 2032, it would continue to benefit from robust real growth (1.9% on average) and inflation above 2%. At the same time, the apparent interest rate is expected to rise gradually as a result of debt refinancing at higher rates.

Maintaining a positive spread between nominal growth and the apparent interest rate will help to reduce the public debt ratio, although this effect will diminish over time.

Growth underpins public revenue



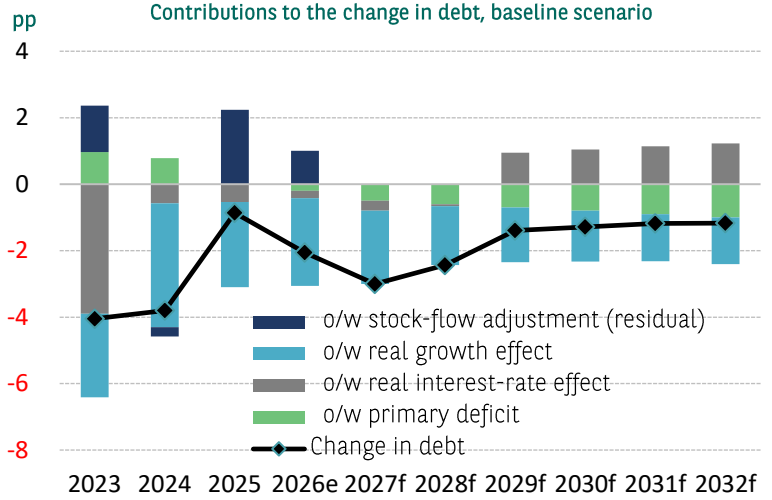
Source: IMF, MINECO, BNP Paribas

Public expenditure excluding interest payments is set to rise slightly to around 42.9% of GDP through to 2032. At the same time, revenue is expected to grow, supported by a strong labour market, resilient consumption and effective tax collection.

The lack of a parliamentary majority has restricted room for manoeuvre on the spending front. The 2023 budget has been deferred to the 2024–2026 period, leading to a reduction in discretionary spending. The rise in defence spending remains contained as Spain has secured an exemption from NATO's 5% target; it is maintained at 2.1% of GDP, a level reached in 2025. However, these constraints will be eased if the higher spending ceiling, provided for in the 2027 budget, is implemented.

Spain: Debt reduction supported by growth (2/2)

Debt reduction driven by growth

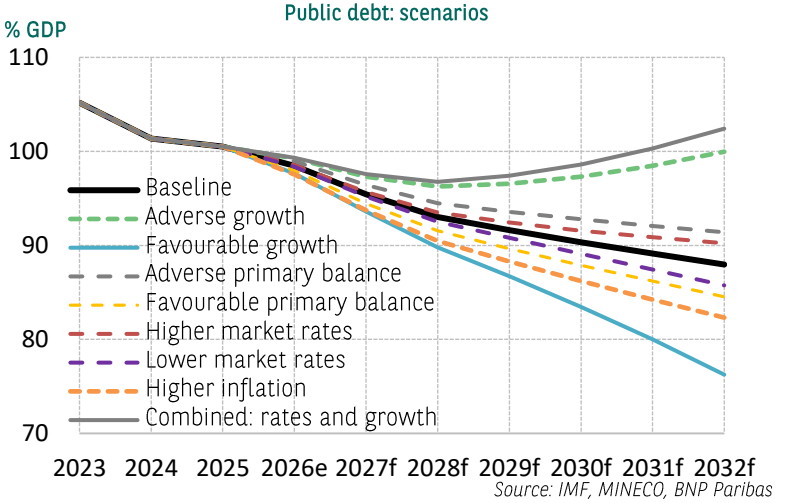


Source: IMF, MINECO, BNP Paribas

Strong growth, combined with a favourable trend in the primary balance, is facilitating a continuous reduction in public debt throughout the forecast period. However, this decline is expected to slow from 2027 onwards.

From 2029 onwards, real interest rates are expected to become a drag. Despite higher financing costs, the primary balance will remain positive and continue to support debt reduction.

Debt will fall unless there is a very negative surprise regarding growth



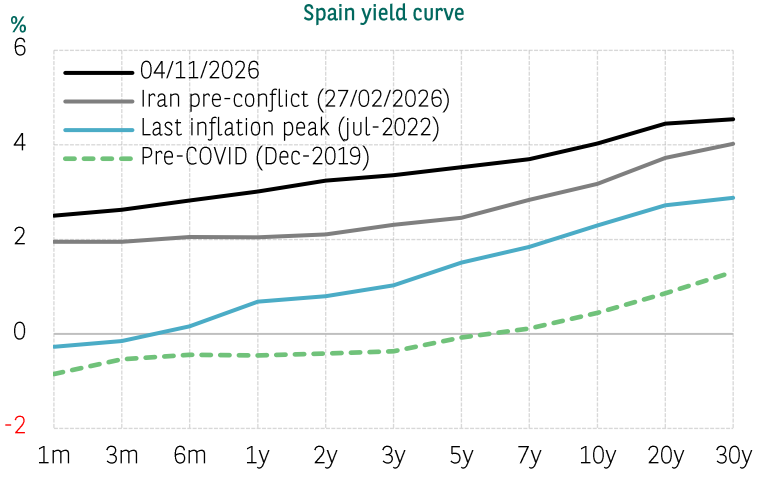
Source: IMF, MINECO, BNP Paribas

Note: the 'growth' and 'primary balance' scenarios incorporate, respectively, a negative shock to growth and to the deficit of 0.5 percentage points of GDP per year compared with the baseline scenario; the 'interest rate' scenario incorporates a 1 percentage point rise in the apparent interest rate.

According to our central scenario, public debt will fall below 90% of GDP as early as 2030 , after reaching 100.5% in 2025, to stand at 88% in 2032. This trend confirms the persistence of a downward trajectory, even as macroeconomic conditions evolve.

Growth momentum remains the key factor : both the main risk and a source of opportunity for the debt trajectory. In the majority of scenarios, debt reduction would continue, whilst the most adverse scenario – combining a rise in market rates and unfavourable growth – is the only case in which public debt would once again exceed 100% of GDP from 2031 onwards.

A rise in market rates



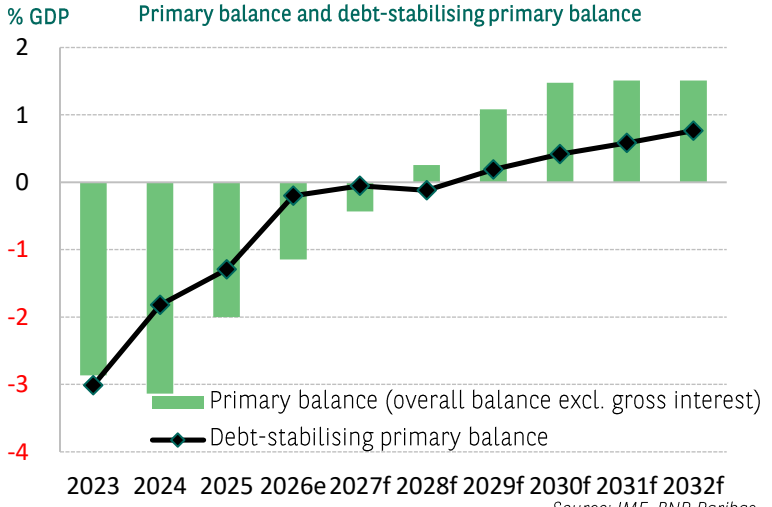
Source: IMF, MINECO, BNP Paribas

The yield curve has shifted upwards since the start of the conflict in Iran, with the sharpest rise in the 2–5-year segment.

Financing costs are coming under gradual pressure, with the rise in rates slowly but surely feeding through to the interest burden. The average cost of debt is expected to continue rising as maturing debt is rolled over at higher interest rates.

United Kingdom: Fiscal consolidation remains on track (1/2)

Return to a primary surplus from 2028

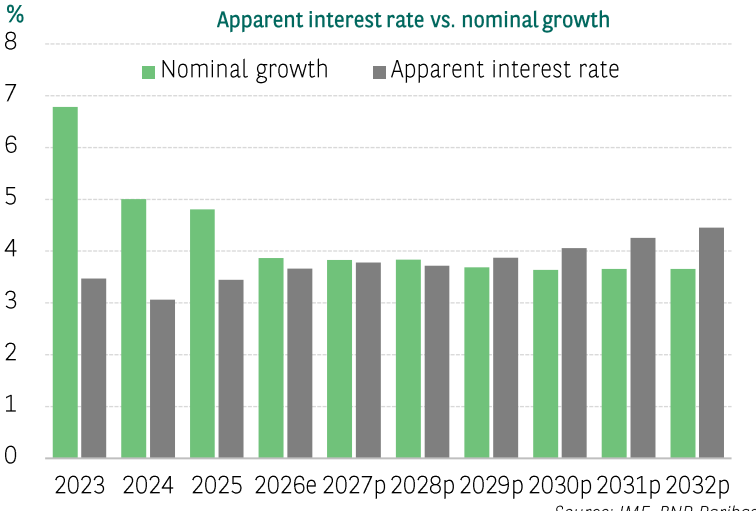


Source: IMF, BNP Paribas

The UK's primary balance is expected to return to surplus from 2028, continuing the path of fiscal consolidation initiated by the previous Labour government.

After improving by nearly 2 percentage points of GDP between 2024 (-3.1%) and 2026 (expected to be -1.1%), it is expected to remain in deficit in 2027, largely due to temporary support measures in response to the energy crisis. The primary surplus expected from 2028 onwards is projected to exceed the debt-stabilising balance from 2029, enabling a gradual decline in the debt-to-GDP ratio.

The apparent rate will rise above growth from 2029

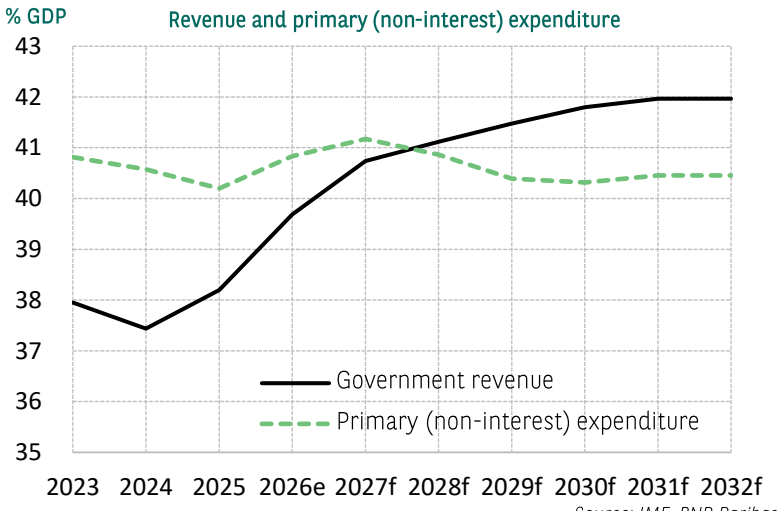


Source: IMF, BNP Paribas

The rise in interest rates is expected to gradually feed through to the apparent rate on UK public debt, which is projected to rise from around 3.5% in 2025 to nearly 4.5% by 2032.

From 2029 onwards, the apparent interest rate is expected to exceed nominal growth, contributing to an increase in the 'snowball' effect of the debt. In this context, maintaining the sustainability of public finances will depend on continued fiscal consolidation and the achievement of primary surpluses sufficient to offset this effect.

Consolidation relies primarily on higher revenue



Source: IMF, BNP Paribas

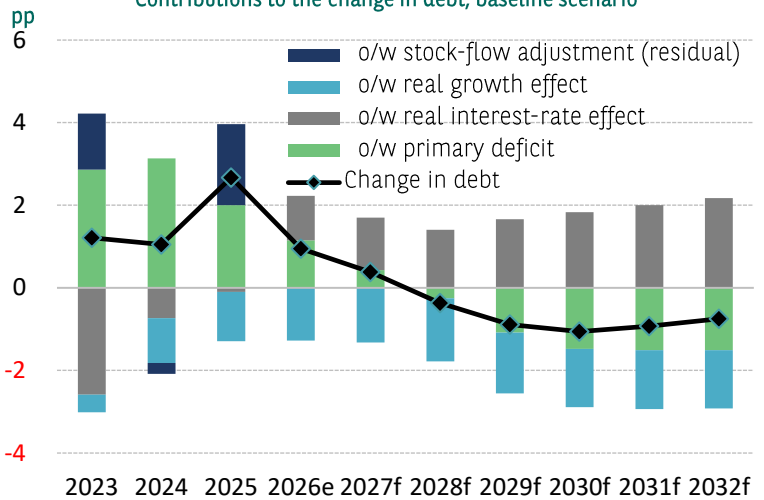
UK fiscal consolidation is expected to rely mainly on a structural increase in tax revenue, the share of which in GDP would reach a historically high level (42% in 2032), and on relative expenditure restraint after the middle of the decade.

The rise in revenue would be supported in particular by a freeze on tax thresholds and targeted tax measures. Welfare expenditure is expected to rise slightly as a share of GDP, driven by pensions and health-related benefits, but this increase would remain below the expected decline in departmental budgets.

United Kingdom: Fiscal consolidation remains on track (2/2)

Fiscal consolidation is essential to stabilise the debt ratio

Contributions to the change in debt, baseline scenario



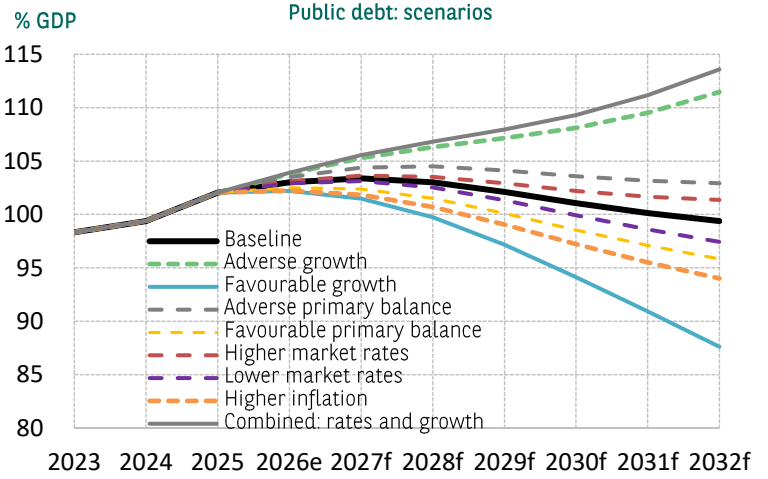
Source: IMF, BNP Paribas

The gross public debt-to-GDP ratio is projected to rise marginally in 2026–2027, driven by temporary fiscal support in response to the energy shock, slower growth and higher interest payments.

From 2028 onwards, fiscal consolidation is expected to resume, leading to a gradual decline in the debt ratio despite the increased burden of debt servicing, thereby ensuring compliance with the UK government's fiscal targets (which envisage a current account surplus and a reduction in the public sector's net financial debt as a percentage of GDP in 2029–2030).

A slowdown in growth is the main risk to public debt

Public debt: scenarios



Source: IMF, BNP Paribas

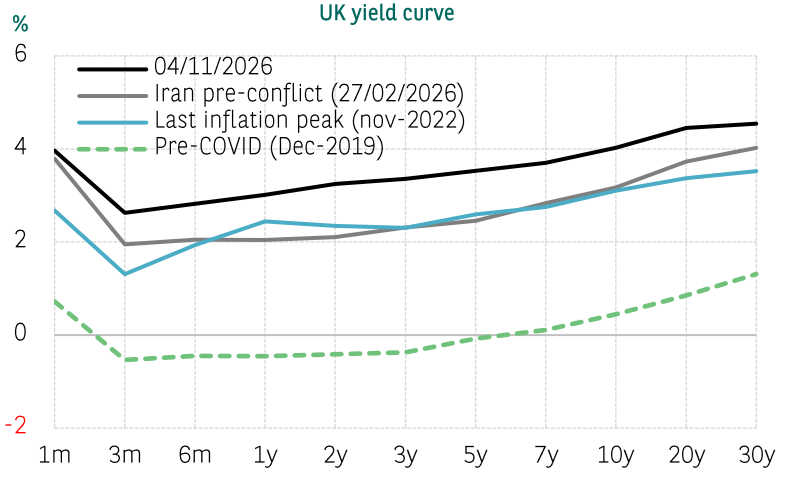
Note: the 'growth' and 'primary balance' scenarios incorporate, respectively, a negative shock to growth and to the deficit of 0.5 percentage points of GDP per year compared with the baseline scenario; the 'interest rate' scenario incorporates a 1 percentage point rise in the apparent interest rate.

The reduction in the debt-to-GDP ratio would remain relatively limited. It would fall from 103% of GDP in 2027 to 97% in 2032.

Its trajectory remains heavily dependent on macroeconomic assumptions, particularly regarding growth. Rising interest rates would also weigh on debt dynamics, but their effect would be gradual and mitigated by the long maturity (13 years). Conversely, growth lower than that anticipated in our central scenario would lead to a further rise in debt.

The rise in interest rates remains gradual

UK yield curve



Source: IMF, BNP Paribas

The rise in interest rates is expected to have a gradual impact on the interest burden, given the long average maturity of UK debt (around 13 years).

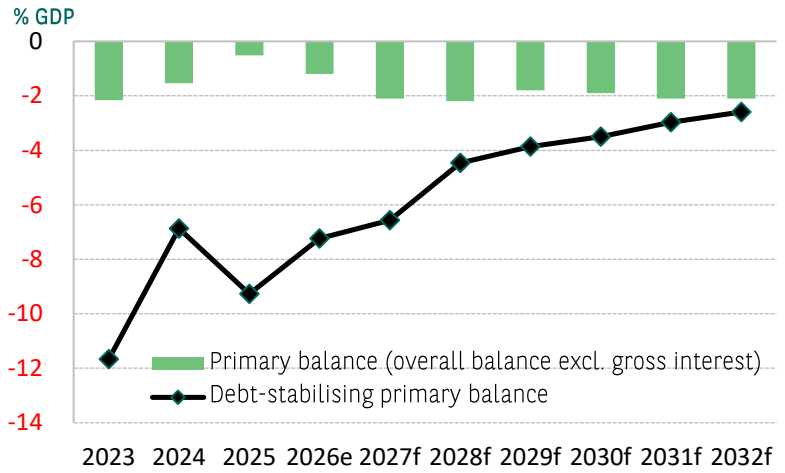
In the short term, however, this pass-through will be accelerated by the significant proportion of inflation-indexed debt (around 23%), which directly exposes the interest burden to energy shocks.

The rise in interest rates is accompanied by a steepening of the yield curve, against a backdrop of rising term premiums and persistent public financing needs despite fiscal consolidation.

Japan: A moderately expansionary fiscal stance (1/2)

A persistent but sustainable primary deficit

Primary balance and debt-stabilising primary balance



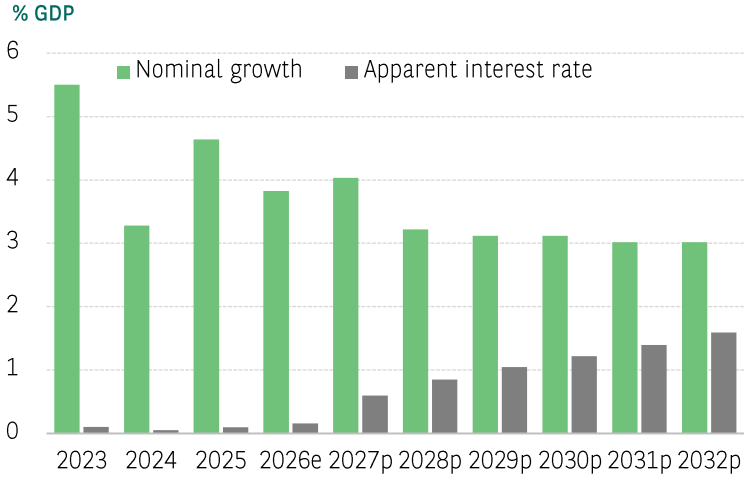
Source: IMF, BNP Paribas

Japan's primary balance deteriorated in 2026 to -1.2% of GDP, ending five consecutive years of improvement. The deficit is projected to widen further in 2027 to more than 2% of GDP, reflecting in particular the suspension of the consumption tax on food.

The government has shifted its fiscal anchor from a consolidation target (primary surpluses) to a sustainability target (no increase in the debt-to-GDP ratio). Beyond 2028, the primary deficit is projected to settle around -2% of GDP. It would remain below the debt-stabilising level, but by an increasingly narrow margin.

A favourable interest rate-growth differential

Apparent interest rate vs. nominal growth

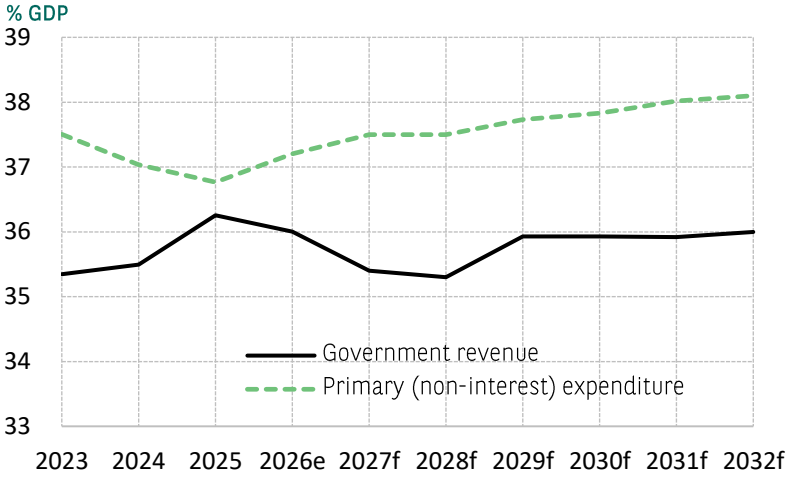


Source: IMF, BNP Paribas

Nominal growth would continue to exceed the apparent interest rate on Japan's debt, but this advantage would erode gradually. The apparent rate, close to zero through 2026, is projected to approach 1.6% by 2023 as debt is refinanced at higher rates amid monetary normalisation. Nominal growth is expected to remain robust, at around 3%, underpinned by the new growth and inflation regime. The r-g differential would therefore remain favourable, albeit to an increasing extent, narrowing the margin between the primary balance and its debt-stabilising level.

Structural and political pressures on expenditure

Revenue and primary (non-interest) expenditure



Source: IMF, BNP Paribas

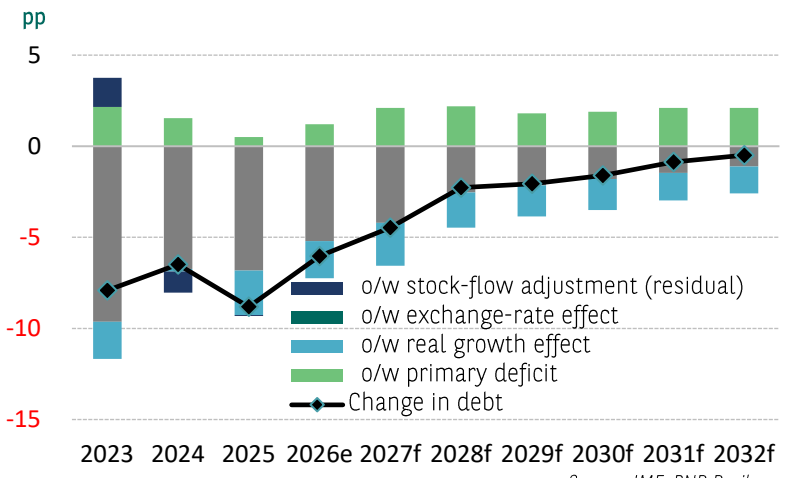
Revenue is projected to fall in 2027–2028 as a result of tax cuts (suspension of the tax on food products) before recovering thanks to nominal growth.

Revenue is projected to fall in 2027-2028 owing to the suspension of the consumption tax on food, before recovering on the back of nominal growth. Primary spending would rise steadily, driven by demographic pressure (healthcare, pensions), defence needs and an expansionary fiscal stance, with a particular emphasis on public investment.

Japan: A moderately expansionary fiscal stance (2/2)

Low interest rates drive the decline in the debt-to-GDP ratio

Contributions to the change in debt, baseline scenario

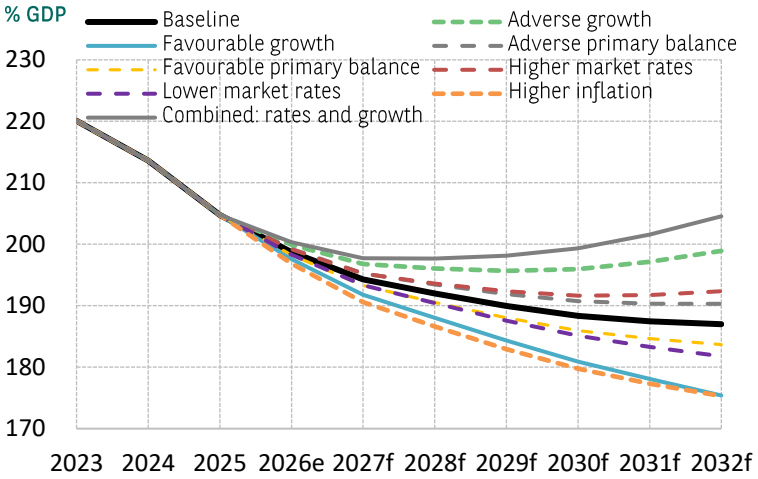


Source: IMF, BNP Paribas

Japan's public debt is projected to keep declining, from 205% of GDP in 2025 to 187% in 2032. The pace of decline is, however, set to slow markedly (from 6pp in 2026 to less than 1pp from 2030 onwards). This slowdown mainly reflects the fading of the favourable r-g differential – the main driver of debt reduction – and, to a lesser extent, persistent primary deficits.

The debt reduction trajectory relies on growth

Public debt: scenarios



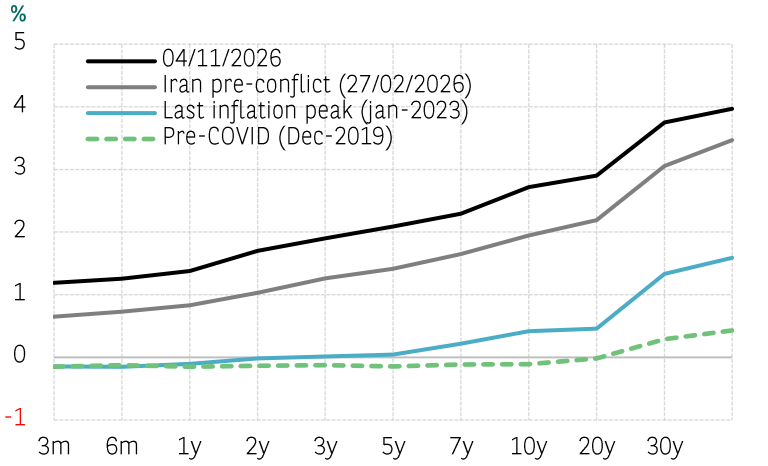
Source: IMF, BNP Paribas

Note: the 'growth' and 'primary balance' scenarios incorporate, respectively, a negative shock to growth and to the deficit of 0.5 percentage points of GDP per year compared with the baseline scenario; the 'interest rate' scenario incorporates a 1 percentage point rise in the apparent interest rate.

The reduction in Japan's debt-to-GDP ratio rests primarily on the favourable gap between nominal growth and the apparent interest rate. This leaves the debt path exposed to growth and interest rate shocks. A combination of weaker growth and higher interest rates would be enough to jeopardize the government's objective of reducing the ratio. Inflation, for its part, supports public finances through its effect on nominal growth. The potential for a fall in the debt-to-GDP ratio is similar in scenarios involving either strong growth or additional inflation.

A sharp rise in interest rates

Japan yield curve



Source: IMF, BNP Paribas

Japan's yield curve has shifted significantly upwards in recent years. Following years of ultra-accommodative monetary policy, the Bank of Japan has initiated a cycle of adjustment, including the end of negative interest rates, which is evident at the short end of the yield curve. The long end of the curve is influenced by a number of converging factors: reduced BoJ purchases of JGBs, concerns over fiscal sustainability, and rising inflation and growth expectations. However, the pass-through to interest expense is gradual due to an average maturity exceeding 8 years.

Glossary

- **Net public debt** : gross public debt from which deposits, negotiable debt securities and loans held by general government on other entities are deducted.
- **Primary balance** : the budget balance excluding interest payments. It measures the difference between public revenue and public expenditure, excluding interest payments from the latter.
- **Stabilising primary balance** : a primary budget balance that would stabilise the public debt-to-GDP ratio in year N at the same level as in year N-1.
- **Apparent interest rate** : the ratio of general government interest expenditure in year N to public debt in year N-1. The apparent interest rate can thus be interpreted as the average effective interest rate on public debt.

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