

What to watch: Europe won't be fully electric before 2040, circular deals in AI and Eurozone growth takes a step forward

Ludovic Subran
Chief Investment Officer and Chief Economist
ludovic.subran@allianz.com

Maxime Darmet
Senior Economist for US-UK-France
maxime.darmet@allianz-trade.com

Guillaume Dejean
Senior Sector Advisor
guillaume.dejean@allianz-trade.com

Bjoern Griesbach
Head of Macro and Capital Market Research
bjoern.griesbach@allianz.com

Jasmin Gröschl
Senior Economist for Europe
jasmin.groeschl@allianz.com

Ano Kuhanathan
Head of Corporate Research
ano.kuhanathan@allianz-trade.com

Maddalena Martini
Senior Economist for Southern Europe and Benelux
maddalena.martini@allianz.com

In summary

Europe won't be fully electric before 2040. Europe's plan to ban sales of internal combustion engine vehicles by 2035 is caught in the clash between national industrial interests and regional green ambitions. But short-term concerns risk overlooking the big picture: The EU is likely to miss its target to turn fully electric by 2035, which in turn threatens the goal to become carbon-neutral by 2050. Though EV sales are the rare bright spot in Europe's muted car market this year (+24% sales ytd vs +1% overall; market share +3pps to 16%), the pace of adoption is still too slow as consumers prefer hybrid models and EV infrastructure falls short. By end-2025, the EU is expected to have around 1.1mn charging stations, less than one-third of the European Commission's 2030 target of 3.5mn, with the installation pace slowing to the weakest rate since 2019. Postponing the ICE ban could send the wrong signal, worsening the already fragile market confidence in Europe's automotive industry and widening the technology gap with global rivals that benefit from clearer strategies and stronger financial backing.

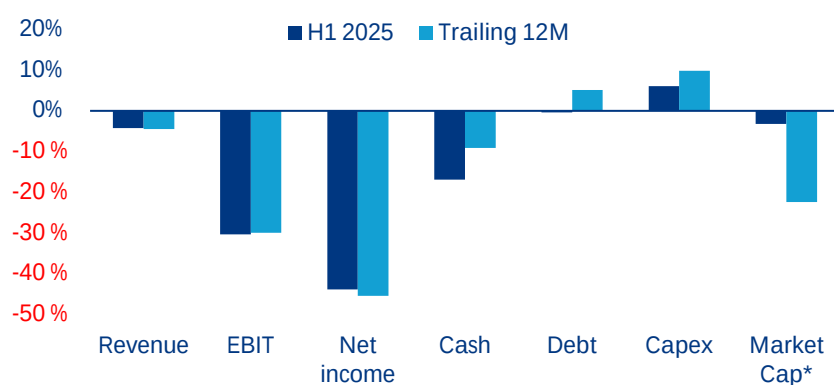
The risks of circular deals in AI. A surge of interlocking deals (USD65bn in equity and over USD800bn in purchase agreements) is reshaping the AI sector. Chip companies are taking stakes in AI firms in exchange for massive hardware orders, while cloud giants lock in exclusive computing contracts by injecting capital. This circular structure has helped inflate valuations and deepen sectoral entanglement, even as AI firms spend far more than they earn. Investors expect annual revenue and profit margin growth of +20% and although demand and revenue growth are real, equity valuations of US chipmakers and cloud providers could drop by 25-35% if profit targets are not met. Unlike the Japanese keiretsu model, which was designed to secure supply chains, the AI loop is built to secure revenues – often without underlying end-user sales. These partnerships rather resemble large-scale vendor financing – locking in revenues upfront, but relying on future demand to justify soaring capital flows. While the top US tech players expect over USD200bn in post-capex free cash flow this year, the sector's exposure to a single factor only raises the bar for AI to deliver. Going forward, investors should focus on monetization and deployment rates before mistaking closed-loop financing for organic growth.

Eurozone takes a step forward, but Germany hits snooze again. Eurozone growth surprised to the upside in Q3, reaching +0.2% q/q (+1.3% y/y), supported by domestic demand and despite weak net exports. Support came from France's economic rebound (+0.5% q/q) defying political uncertainty, and continued Iberian strength (Spain 0.6% q/q). Germany (0.0%) remained the main drag on Europe's economic potential, with its output gap (-1.7% vs +0.6% on average for the other Big-3 economies) back at early-2000s levels when it was labeled the "sick man of Europe". Like then, the divergence is stark as most peers are currently operating around or above potential. But a fiscal-induced gradual recovery is expected, with its deficit peaking at 3.9% by 2027, while structural headwinds still limit momentum. Overall, this quarter adds some upside risk to our current Eurozone growth forecasts of +1.2%, +0.9% and +1.4% for 2025–2027. With headline inflation printing close to target in October (2.1% y/y), the ECB held rates steady at 2.0% as expected and reiterated its comfort with policy rates at neutral levels.

Europe won't be fully electric before 2040

Europe's plan to ban sales of internal combustion engine (ICE) vehicles by 2035 is caught in the clash between national industrial interests and regional green ambitions. Germany and Italy are pressing for a postponement of the 2035 deadline and a more flexible framework for carbon-emission targets, arguing that the automotive industry needs relief as profit margins are squeezed by higher production costs and falling demand. However, France and Spain firmly oppose any revision, fearing it would send a discouraging signal to investors and undermine the credibility of Europe's carbon-neutrality roadmap. The rift reflects the differing weight of the automotive sector in national economies: it represents over 5% of GDP and 800,000 jobs in Germany, and around 6% in Italy, compared with less than 3% in France and Spain. Strategically, the debate also reflects contrasting positions among Original Equipment Manufacturers (OEMs): German and Italian manufacturers, heavily reliant on exports, face tougher electric vehicle (EV) prospects abroad. The US halted EV purchase incentives in September, while in both China and Europe, European brands are struggling to compete against Chinese EV models that offer both quality design and advanced technology at a very competitive price. Confronted with shrinking profitability and cash reserves, German OEMs remain reluctant to commit fully to an all-electric future as the return does not look attractive enough to offset the recent rise of costs due to new US tariffs and industrial overcapacity in Europe.

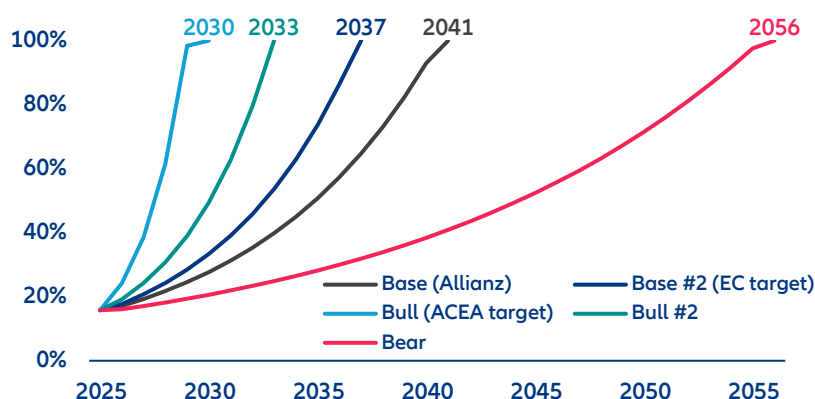
Figure 1: Variation of financial fundamentals of German OEMs over the past 12 months



*YTD and last 12-month variation as of end-October 2025. Sources: LSEG Datastream, Allianz Research

Short-term concerns risk overlooking the big picture: The EU is likely to miss its target to turn fully electric by 2035, which in turn threatens the goal to become carbon-neutral by 2050. The pace of EV registrations and installations of public charging stations (including fast and ultra-fast chargers) over the past decade suggests that the EU will only achieve the shift by 2041. In a more optimistic scenario, it could be reached in 2037 if the EU manages to set up the targeted 3.5mn public charging stations by 2030. Achieving the 2035 target would require a far stronger fiscal impulse for EV infrastructure development, an improved supply pipeline and a moderate recovery of retail demand for new cars (2-3%), which looks unlikely as major economies tighten their belts and European automakers battle financial difficulties.

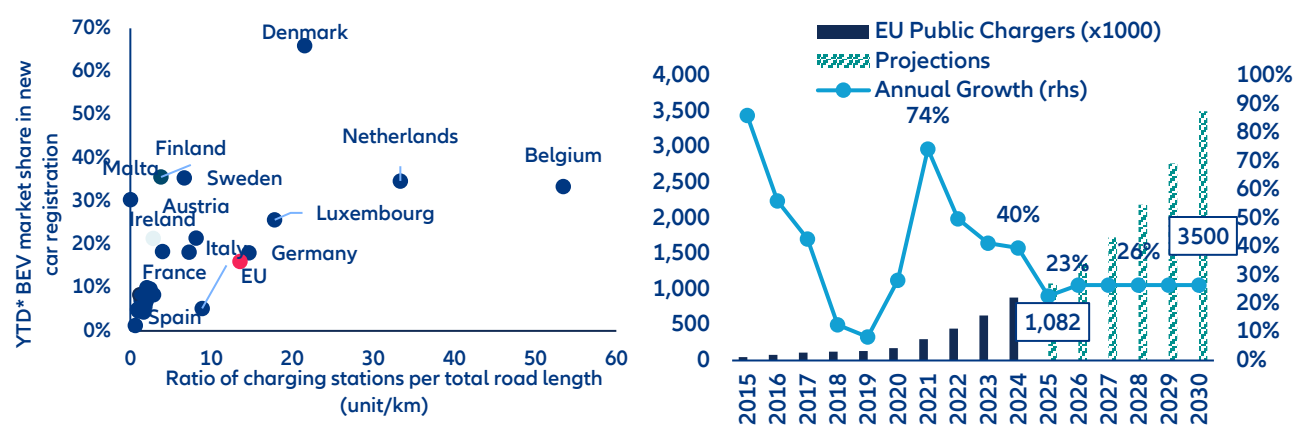
Figure 2: Scenarios for the EU's full shift to electric vehicles (new passenger car registrations = 100% BEV)



Projections of charging stations required by 2030 to align with carbon reduction targets: 3.5mn for European Commission and 8.8mn for the European Automobile Manufacturer Association (ACEA). Source: Allianz Research

Consistency in infrastructure development is key for scaling up electrification. EV and PHEV (+24% and +32%) are the best-performing powertrain categories this year despite a tepid European car market (+1% YTD as of September) that seems to have reached a new plateau below 11mn, or around 30% below its pre-Covid level. But despite the noticeable progression of EV penetration year after year, which has made the BEV category the third choice for buyers ahead of diesel powertrain (+3pts YTD at 16%), the pace is too slow to achieve the 2035 target. BEV penetration is also suffering from competition with hybrid vehicles, which are absorbing around half of the market loss of full-combustion powertrain models (~10 pts YTD). Since last year, hybrids are the most popular category at the European level. Without investments in well-scaled and efficient EV-dedicated infrastructure – particularly charging stations, parking facilities and affiliated maintenance and network services – to sustain the growth and adoption of EVs in the region, their share of sales is likely to be capped. There is a strong correlation between the level of dedicated public infrastructure to EVs and BEV market share in new registrations, as seen in the Nordics region, where EV penetration is the most advanced. By the end of this year, the EU is expected to have around 1.1mn charging stations, less than one-third of the European Commission's 2030 target of 3.5mn. And the current installation pace has slowed sharply, reaching just 23% in 2025, the weakest rate since 2019. This slowdown, combined with the uneven distribution of infrastructure – 56% of charging points are concentrated in France, Germany and the Netherlands, while over 80% of EU countries fall below the regional average of 13.3 stations per kilometer of road – hampers broader EV penetration. To meet 2030 objectives, installation must accelerate to an average annual growth of 26% over the next five years. Although this target remains below the 47% average of the past five years, achieving it will demand coordinated action across member states to address national disparities and create a balanced, efficient and accessible European charging network capable of supporting the continent's transition to sustainable mobility.

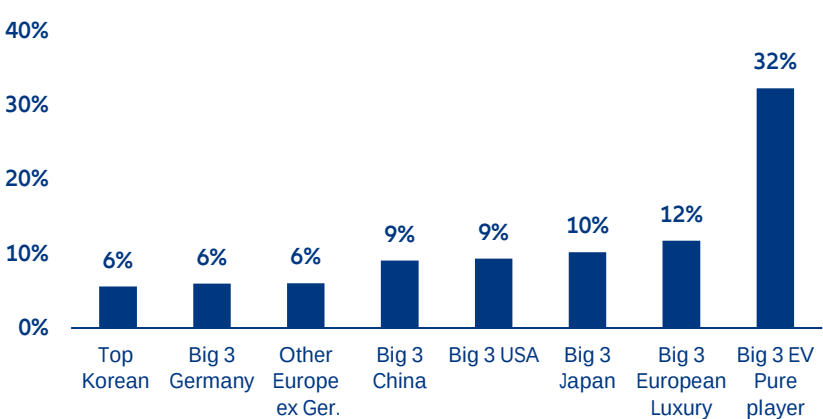
Figure 3: EV infra density vs. market share / Evolution & projections of public charging stations by 2030



Sources: European Commission (European Alternative Fuels Observatory), Allianz Research

Europe’s technology lag could widen if it shifts away its green ambitions. The price differential between ICE and EV models continues to influence purchase decisions but it is not a “no-go” criteria anymore as the gap has declined substantially to below 20% in Europe and the US, compared to over 50% in 2018, helped by the sharp decline of battery costs, driven by weaker commodity prices and productivity gains, but also public incentives and aggressive pricing policy from Chinese brands. Yet, this has not boosted EV demand. Automakers are struggling to find the right formula to reduce revenue exposure to the very profitable ICE segment. Years of underinvestment compared with international peers – and notably American and Japanese ones – have created a growing technology gap, leaving Europe heavily dependent on China for battery supplies and key EV components. This dependency limits the region’s ability to scale production and innovate competitively. At the same time, manufacturers face difficulties aligning with customer expectations: Vehicles that combine long driving range, affordable prices and proven reliability remain rare as most models rarely succeed in all three. In this context, a potential easing of Europe’s carbon framework risks sending the wrong signal and could be counterproductive for the whole industry over the long run by discouraging investors, deepening doubts about the industry’s trajectory and widening the gap with global rivals that benefit from clearer strategies and stronger financial backing.

Figure 4: Capex ratio of main OEMs over the past decade, per geography and car category breakdown

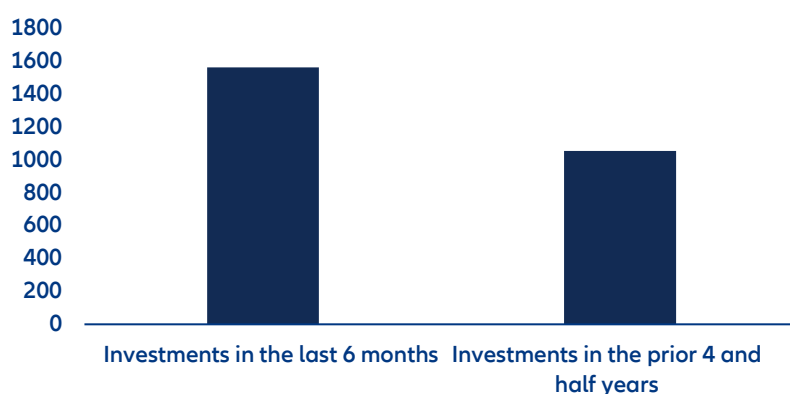


Based on annual data as of FY2024. Sources: LSEG Datastream, Allianz Research

The risks of circular deals in AI

The AI sector is being propelled by a web of circular deals, with at least USD65bn in equity deals and another USD800bn in sales agreements, linking chipmakers, AI startups and cloud providers. A simplified version of the supply chain for AI starts with chipmakers, which design and manufacture high-end chips and sell them to cloud service providers. These providers operate large data centers that allow AI companies to train and run their models. AI firms pay rental fees to cloud providers to use compute power, and cloud providers pay chipmakers for the hardware they need to offer the compute power. But in recent months, chip companies have been taking equity stakes in AI firms, prompting cloud giants to also take or increase equity stakes in AI firms in exchange for exclusive partnerships. This mutual entanglement of investments and sales has created a tightly interwoven ecosystem that recirculates capital among the same players. Moreover, corporate investments in AI start-ups have massively increased over the last six months (see Figure 5). Overall, we estimate that the AI value chain has invested over USD65bn within itself in equity deals and stake sales agreements to the magnitude of USD800bn. As a result, a semi-closed economic loop is emerging: revenues flow from large tech firms through high-value contracts with AI start-ups, which, in turn, reinvest in the same ecosystem's computing infrastructure. This circular dynamic reinforces short-term growth narratives while masking the long-term risks of an overheated, hype-driven AI economy.

Figure 5: Corporate and corporate venture investments in AI start-ups (number of investments)

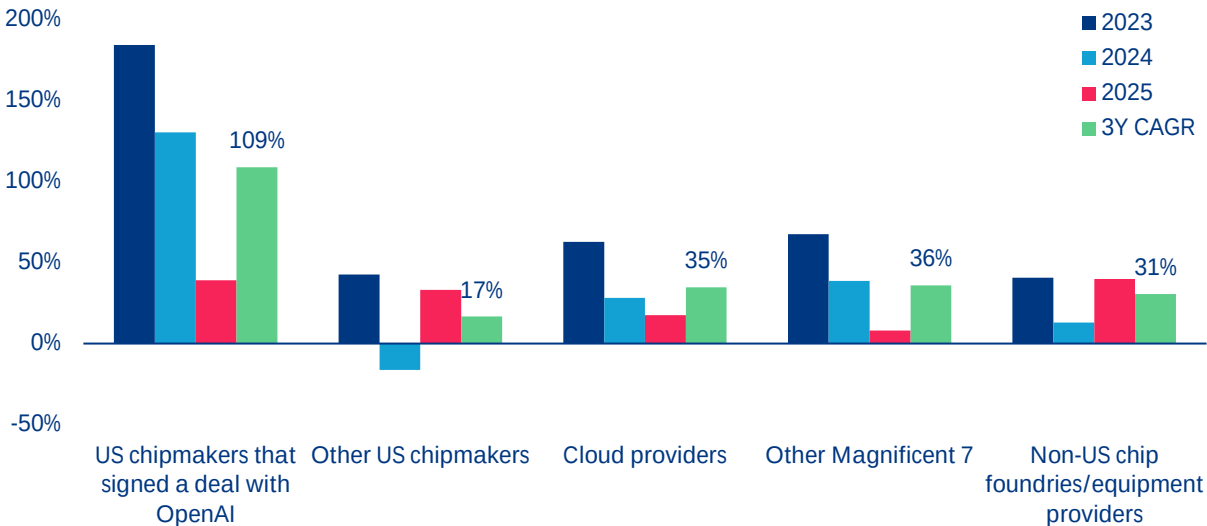


Sources: PitchBook, Allianz Research

Markets expect a roughly +20% revenue and margin boost from the AI ecosystem as a result of these deals. In recent quarters, a major US chipmaker and a leading cloud provider have reported substantial revenue and profit gains, driven by the accelerating adoption of AI technologies. Their integrated AI ecosystems – spanning advanced semiconductors, cloud infrastructure and large language model (LLM) services – have attracted significant investor enthusiasm, inflating market capitalizations across the sector. At this stage, US semiconductor firms, which recently hit the headlines by signing hefty contracts with LLM developers, have benefitted the most from this hype. Their market capitalization has more than doubled each year since 2023 against 30-35% on average annually for cloud providers and major non-US chipmakers and equipment manufacturers. The inflating valuations reflect high market expectations for an “AI boost” that could increase both revenues and margins. Indeed, tech companies’ outlooks for 2025-2027 suggest a sizable 20% difference in both average annual growth of revenue and profit margins between firms that recently signed multi-billion deals with LLM providers and those that have not. Tech giants appear to be leveraging this momentum strategically, capitalizing on investor complacency and the widespread belief in future transformative gains to sustain aggressive investment in non-profitable ventures. However, the equilibrium of this booming ecosystem is fragile as high expectations mean that all tech firms exposed to AI need to deliver strong revenue and generate high cash-flow to justify massive capital investments. If not, market prices might correct quickly, as already seen during the ongoing Q3 earnings season, with some stocks suffering a correction of over 30%.

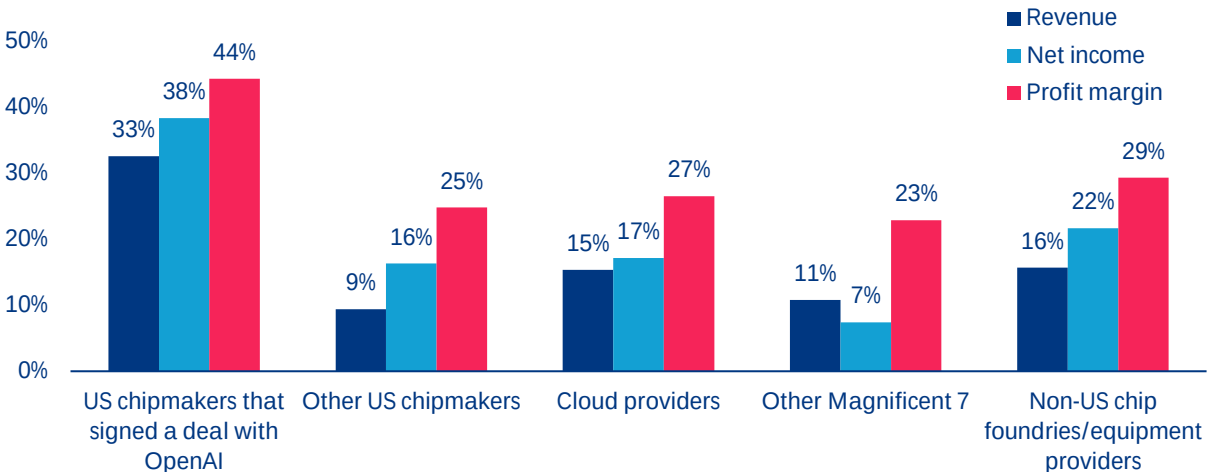
Currently, profit growth expectations stand at about 60% for chipmakers and 35% for cloud providers and we estimate equity valuations could drop by 25 to 40% should these profit growth targets be 20% lower¹. Cloud providers appear to be the most at risk to of a backlash effect as current revenue expectations are based on prospective computing use from the LLM and corporate side, while inversely revenue from chipmakers is derived from physical backlog based on a very active datacenter capacity pipeline. The current market consensus for major cloud providers estimates an over USD150bn annual free-cash-flow for the period 2025-2027, with the highest CAGR (+50%) among all other segments of our analysis.

Figure 6: Evolution of market capitalization of tech firms with high exposure to AI development over the last three years (USD)



Sources: LSEG Datastream, Allianz Research

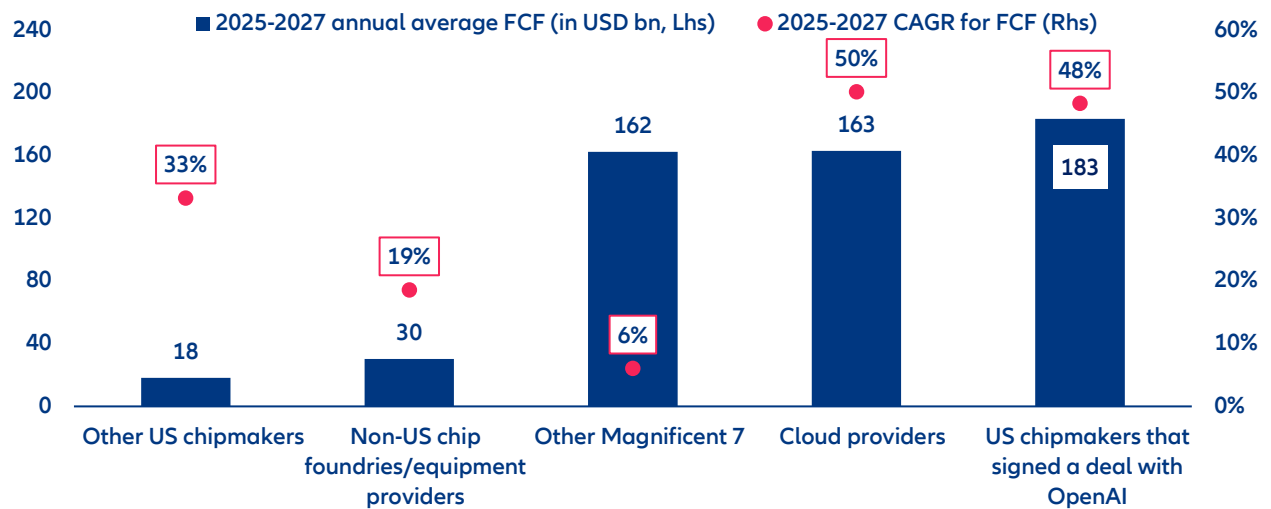
Figure 7: 2025-2027 outlook for tech firms with high exposure to AI development (based on average metric labelled in USD per segment)



Sources: LSEG Datastream, Allianz Research

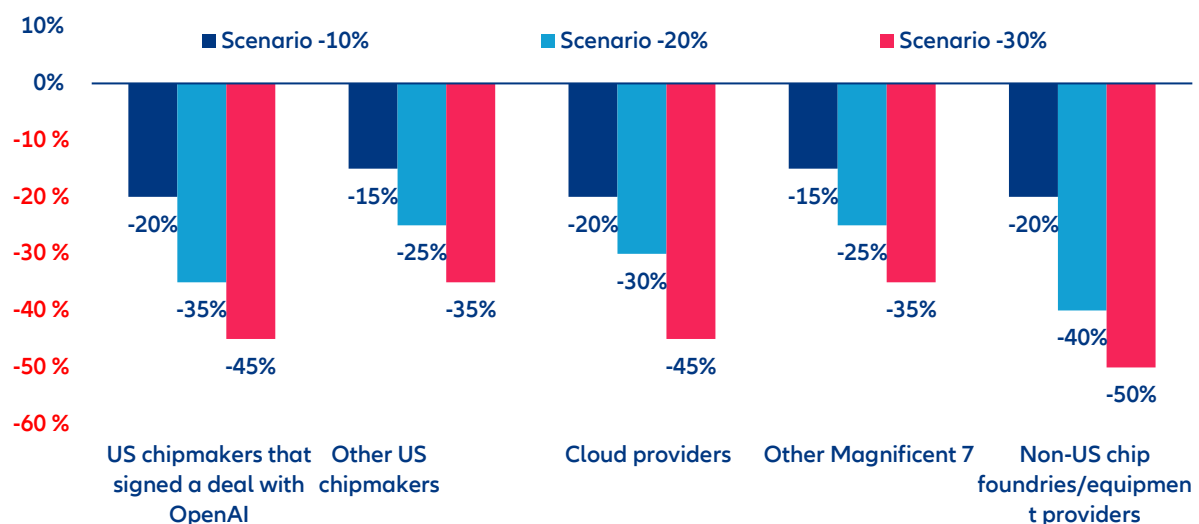
¹ We estimate growth rates and potential price corrections based on a Gordon growth model, taking into account free cash flows of tech companies and their relevant cost of capital

Figure 8: 2025-2027 average annual free cash flow for tech firms with high exposure to AI development (in USD bn)



Sources: LSEG Datastream, Allianz Research

Figure 9: Price correction projections based on profit deterioration scenario¹

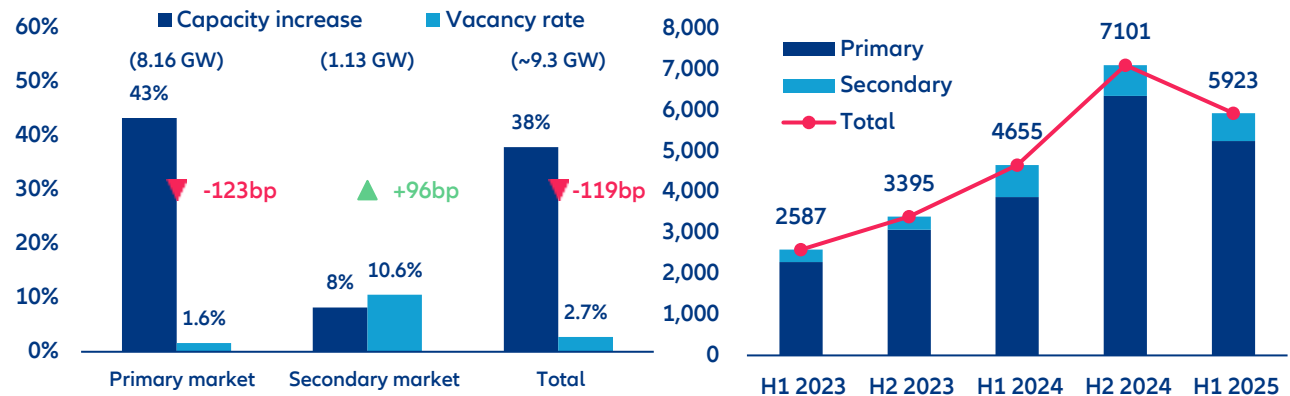


Sources: LSEG Datastream, Allianz Research

The demand is real and backs the ongoing inflation of infrastructure capex. We also notice positive indicators from the data center segment, which represents the largest share of revenue for chipmakers. Despite concerns of a potential over-supply situation in which AI investment would yield low to no returns due to weaker-than-expected demand, we see supportive data. Indeed, over the past 12-24 months, the US data center market has entered one of its most dynamic expansion phases to date, driven by the accelerating integration of artificial intelligence across all layers of the economy. As a result, operational capacity grew by more than 40% in H1 2025, marking a record pace of delivery alongside a sizable pipeline, with roughly 6 GW of capacity under construction. This pipeline should increase capacity to 15 GW (+65%) over the next two to three years.

While the rush for increasing computing capacity could look excessive, the record-low vacancy rate (less than 2% in primary markets that account for nearly 90% of total current capacity in the US) suggests pent-up demand for computing capacity and cloud services as enterprise adoption accelerates and AI-enhanced services are beginning to penetrate the consumer market. However, all of these products and services are not paid for by AI firms' final customers. Most AI firms spend vastly more on chips and computing than they make in sales revenues, which raises questions about the sustainability of these positive trends.

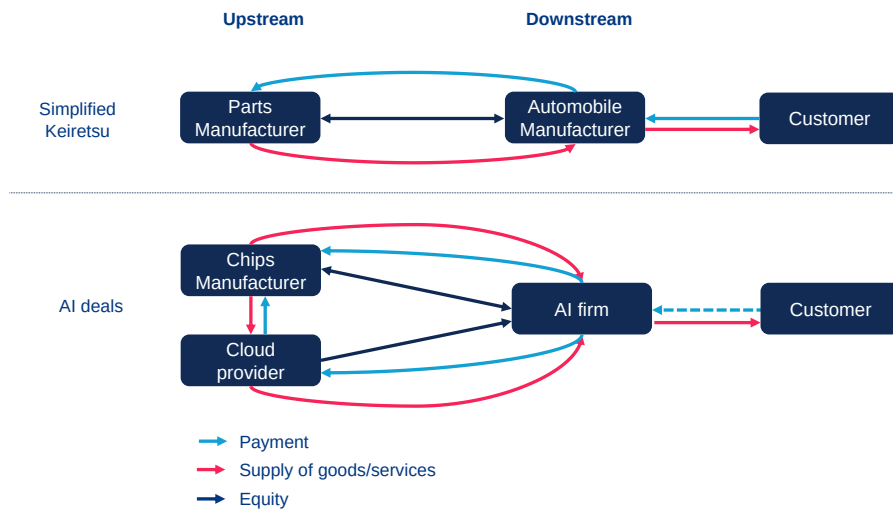
Figure 10: US data center inventory, under-construction capacity & vacancy rate in H1 2025



Sources: CBRE (H1 2025 North America update), Allianz Research

AI circular deals are no Keiretsu 2.0; they are (risky) vendor finance. The flurry of deals within the AI space has sparked comparisons to Japanese Keiretsu networks, where manufacturers and suppliers cemented relationships through mutual shareholdings to guarantee stable supplies. For example, a carmaker and a parts supplier would own stakes in each other while one would buy the auto parts manufactured by the other. This "family" model prioritized reliable production pipelines over short-term profits and is ultimately funded by a customer actually purchasing the car. However, these were built to secure supply chains in a capital-scarce era. By contrast, today's AI giants are awash in cash. Interestingly, most carmakers around the world, from Japan to the US, also developed a tool to prop-up their sales: integrating vendor financing. Through vendor finance they would lend money to their customer so that they could buy a car. Today's AI alliances look more like vendor finance but they flip the script: upstream firms invest in downstream partners primarily to lock in sales, while downstream firms lock in steady supply. However, the purchases from AI firms are mostly financed by equity and debt, not their own sales, as revenues are yet to boom. The long-term success of these operations relies entirely on AI firms' ability to deliver actual revenues from clients and sales in the future.

Figure 11: Illustration of financial and product/services flows



Source: Allianz Research

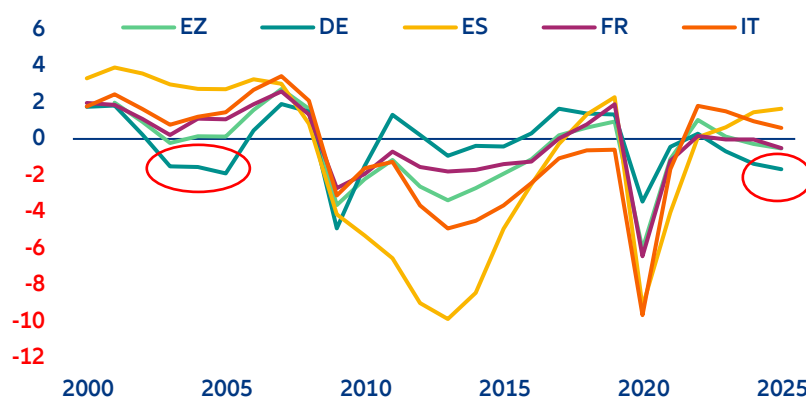
For now, systemic vulnerability remains limited but caution is warranted. The growth of circular deals is raising concerns about systemic risk as major AI companies now not only rely on each other operationally, but are also financially invested in one another's fortunes. With many chipmakers already deriving most of their revenue from AI data centers, they are effectively already highly vested in the AI bet, and by now financing their own customers, it could look like they are doubling down. These entanglements means correlations are extremely high – success or failure in one corner of the ecosystem rapidly transmits to others. While investments are spread across multiple partners, arguably diversifying company-specific risk, they are binding the tech sector more tightly to the fate of AI as a whole. If AI adoption or revenues disappoint, the feedback loop that once fueled growth could quickly turn into a vicious cycle of cutbacks, write-downs, and collapsing confidence. For investors, the key is to focus on fundamentals and early warning signals, while keeping in mind that investing in a cloud service provider also brings in exposure to AI firms. Fortunately, leading tech players are financially robust: the top four US tech firms together expect over USD200bn in post-capex free cash flow in 2025, and current AI leaders trade at more moderate earnings multiples than the froth of the late '90s tech bubble. But time will tell if capacity buildouts yield real monetization, which will be visible in enterprise adoption rates, AI service revenues and utilization of new hardware.

Eurozone takes a step forward, but Germany hits snooze again

Eurozone growth nudged higher in Q3 but the output gap remains negative, dragged down by Germany. Eurozone GDP rose by +0.2% q/q (+1.3% y/y), slightly up from +0.1% in Q2 and 0.2pp above our own forecast. The economy defied global headwinds and likely negative net export contributions but seemed to get more support from domestic demand than initially expected (Figure 12). Geographically, the upside surprise came from a strong rebound in France (+0.5%) and continued resilience on the Iberian Peninsula (Spain +0.6%, Portugal +0.8%). In contrast, Germany and Italy stagnated (both 0.0%). Germany in particular remains the key drag on the Eurozone's economic potential, with its output gap now back in early-2000s territory (Figure 10) despite already having the lowest estimated potential growth among major Eurozone economies (Table 1). The broader picture is also sobering: Germany's economy has flatlined for five years since the Covid-19 shock. However, looking ahead, that picture should flip: We expect Eurozone growth to further accelerate sequentially, supported by a rebound in Germany as the long-awaited fiscal stimulus finally kicks in (Figure 11). This quarter's positive surprise also puts

some upside risks to our annual growth forecasts of 1.2%, 0.9% and 1.4% for the years 2025-2027 (0.8%, 1.2%, 1.3% excluding Ireland).²

Figure 12: Output gap, % of GDP



Sources: LSEG Datastream, AMECO, Allianz Research

Notes: Red circles highlight Germany's "sick-man-of-Europe" period in the early 2000s and current levels.

Table 1 : Historical average growth, potential growth and output gaps

	GDP hist. avg. growth		Current Output Gap	Current Potential Growth	Latest y/y growth
	CAGR (2000-Today)	CAGR (2019-Today)			
EZ	1.2%	1.0%	-0.5%	1.1%	1.3%
DE	1.0%	0.0%	-1.7%	0.3%	0.3%
FR	1.2%	0.9%	-0.5%	1.1%	0.9%
IT	0.4%	1.1%	0.6%	1.0%	0.4%
ES	1.7%	1.6%	1.7%	2.4%	2.8%
US	2.1%	2.2%	1.7%	2.3%	2.1%

Sources: LSEG Datastream, AMECO (Eurozone), CBO (US), Allianz Research

Germany's GDP stagnated in the third quarter of 2025 (0.0% q/q) but on the positive side it accelerated compared to negative growth in the previous quarter (-0.2% q/q). Investment in equipment increased due to the introduction of a 30% depreciation rate over three years in June, as well as tax incentives on R&D. However, as expected, exports declined compared to the previous quarter amid weaker demand from China and reduced shipments to the US, which are at a four-year low, as well as stagnating demand from the Eurozone. Current business sentiment remains negative, with falling industrial output and weak orders reflecting persistent structural issues. Global fragmentation and trade tensions are also putting pressure on the economy. Following mixed data in September, October surveys suggest a modest rebound, driven entirely by stronger expectations, and a potential return to growth in Q4. Momentum is expected to strengthen in 2026 as fiscal measures take effect. These developments pose a mild upside risk to our growth forecast. We now expect growth to increase to +0.2% in 2025 (+0.1pp to our Q3 forecast), followed by +1.0% in 2026 and +1.4% in 2027. A EUR500bn infrastructure fund, tax incentives for private investment and R&D are intended to stimulate growth. Nevertheless, demographic decline, labor inefficiencies and pension pressures are weighing on mid- to long-term prospects. The government's "Autumn of Reforms" is facing delays due to slow progress in cutting red tape and initiating structural reforms (see [What to watch I October 16, 2025 | Allianz](#)). To ensure sustainable growth, Berlin must streamline bureaucracy, advance structural reforms and invest in digital transitions to boost productivity and resilience. But fiscal pressure will increase due to geopolitical tensions, an ageing population and increasing investment requirements. Despite the

² Ireland's highly volatile growth numbers due to tax optimization in particular in Q4 2024 and Q1 2025, distorted the entire economic growth picture of the Eurozone. Hence, looking at the Eurozone excluding Ireland gives a clearer picture. See [What to watch I May 02, 2025 | Allianz](#)

announcement of the significant fiscal stimulus, we believe that spending will pick up only gradually due to capacity constraints and approval procedures. This will lead to wider projected fiscal deficits of -3.1% of GDP in 2025, -3.5% in 2026 and -3.9% in 2027 (Figure 12). Particularly in 2026, our projections diverge from the official German government projections set out in the October Draft Budgetary Plan, which came as an upside surprise at 4.75%, compared to the July Fiscal Structural Plan (FSP) at +3.8% and the Bundesbank forecast at +3.6%. The Draft Budgetary Plan likely assumes an outdated GDP forecast from spring, which saw nominal growth of just +3% in 2026 instead of the current +3.9%, which would result in higher projected revenues in 2026. Correcting for this would reduce the currently outlined government net deficit by -1pp. Our fiscal estimates are generally a bit lower as we remain skeptical of Germany's ability to spend as much and as quickly as the government plans.

Figure 13: GDP contributions, (EZ, DE, IT contributions for Q3 are Allianz Research estimates), %

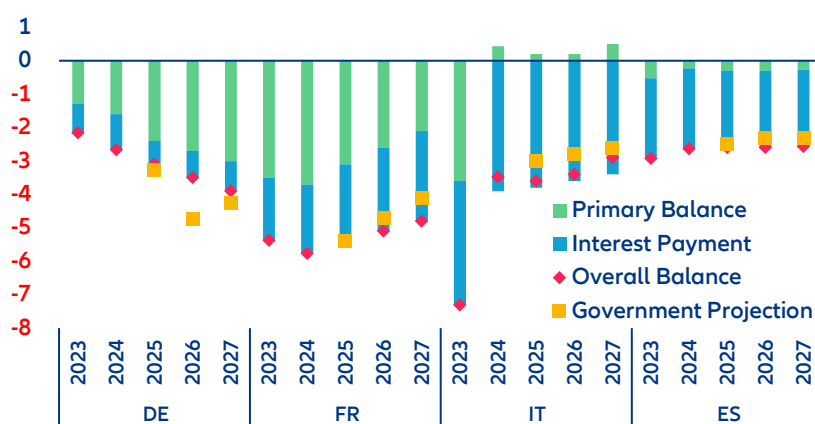


Sources: LSEG Datastream, Allianz Research

French GDP surprised strongly on the upside in Q3, increasing by a dynamic +0.5%, after an already good showing in Q2 (+0.3%). However, growth momentum is likely to fade in Q4. Non-financial corporate investment was the bright spot, with very dynamic growth (+0.9%). Investment in manufactured goods rebounded after several

consecutive quarters of decline, driven by spending in capital goods and in transport equipment. This could be linked to the boost in defense spending in Europe and elsewhere. Investment in services was also dynamic. The easing of political volatility in Q2 and Q3 could have also supported business investment. The contribution of net trade was positive over the quarter, thanks to a sharp acceleration in exports (+2.2% after +0.3%), echoing the broad-based positive dynamic in the industrial sector in terms of both investment spending and production. The easing of supply-chain disruptions in the aeronautic sector also supported industrial production and exports. The weak spots were consumer spending (+0.1%), which has barely grown over the past four quarters, and residential investment, whose fickle recovery was cut short. Both highlight that downbeat households are the main drag on the French economy. Looking ahead, we think growth momentum will fade in Q4 (at +0.1/0.2%). Industrial and export new orders have softened a bit in business surveys. Meanwhile, the construction cycle shows no signs of picking up, with the September PMIs falling across most categories and mortgage demand from households weakening according to the ECB Bank Lending Survey.

Figure 14: Fiscal balance, % of GDP



Sources: national governments, Banco de Espana, LSEG Datastream, Allianz Research
Note: 2025-2027 are Allianz Research forecasts except yellow squares.

Italy's GDP stagnated in Q3, against both our and consensus expectations of a slight 0.1% quarterly increase. The detailed breakdown is not yet available, but preliminary data indicate a positive contribution from net external demand, while domestic demand (including inventories) made a negative contribution. The figure consolidates our GDP forecast of +0.5% this year, before a moderate acceleration to +0.7% and +0.9% in 2026 and 2027, respectively. Separate trade data showed that in September both exports and imports to non-EU countries returned to growth. In the first nine months of 2025, extra EU exports showed a positive trend (+2.6% y/y, +3.0% excluding energy), while imports grew much more strongly (+9.0%). As a result, the trade surplus with non-EU countries amounted to EUR35.1bn, a EUR 10bn decrease compared with the same period in 2024. Italy's recent fiscal performance has been notable, with higher revenues helping to narrow the fiscal deficit toward the 3% target. NGEU resources are supporting the outlook, as they both support the economy and reduce the need for deficit-financed spending. Given that Italy remains one of the main beneficiaries of the program, it has shown a good absorption rate compared with the EU average (above 70% versus 55%). Nonetheless, the actual spending rate stands at only around 45%, implying that resources equivalent to roughly 5.6% of GDP still need to be deployed. This mismatch suggests that, in the best-case scenario where Italy receives its full EUR194bn allocation by end-2026, the positive impact on growth is likely to extend beyond 2026. Still, as we pointed out recently³, on the fiscal side challenges persist in 2027, especially as grants are now accounting for capital revenues (alleviating pressures on the deficit) and upcoming election pledges could potentially derail recent fiscal discipline.

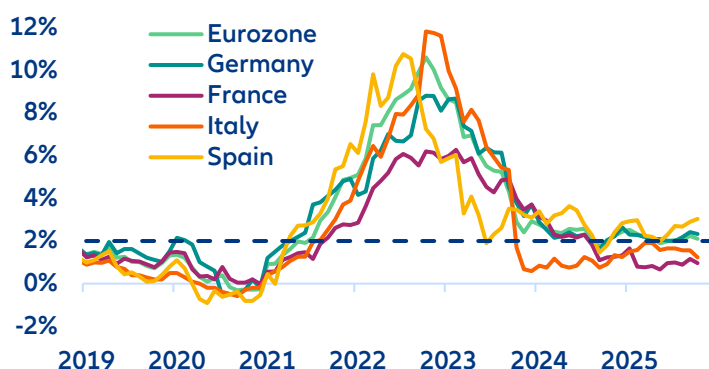
Spain's economy continued to expand at a solid pace, although momentum has slowed. The preliminary estimate for Q3 GDP shows growth of +0.6% q/q, in line with consensus expectations and a touch above our forecast. Domestic demand remained the key growth driver, contributing 1.2pp to quarterly GDP growth. Household and

³ [What to watch | October 09, 2025 | Allianz](#)

government consumption rose by +1.2% and +1.1% q/q respectively, and investment increased by +1.7%. In contrast, external demand subtracted 0.6pps, as exports of goods and services fell -0.6% q/q (1.9pps lower than in Q2), while imports increased by +1.1%. Combined with the recent upward revisions to Spain's 2024 GDP growth (from +3.2% to +3.5%), these figures introduce upside risks to our 2025 GDP forecast of +2.6%. Strong domestic demand is compensating for some of Spain's missed opportunities. Notably, the country has failed to pass a new fiscal budget for three consecutive years due to the government's political minority, effectively rolling over the 2023 budget. This limits fiscal flexibility and prevents the implementation of new, targeted fiscal measures. Moreover, the impact of the NGEU funds could be more significant if absorption accelerates. So far, Spain has received only around 55% of the funds, with just over a year remaining in the program's timeline. Slow absorption risks reducing the stimulus effect; in the best-case scenario, resources equivalent to 4.6% of GDP could still flow into the economy over the coming years, providing additional support to growth.

Meanwhile, latest Eurozone aggregate inflation came out as expected and stands close to the ECB target with 2.1% y/y in October. Services (3.4%) and food inflation (2.5%) remain the biggest drivers while energy prices deflated (-1.0%) and goods inflation is still soft (0.6%). Core inflation remained at 2.4% y/y. Germany's inflation eased only slightly to 2.3% y/y in October compared to 2.4% in September, with core inflation standing at 2.8%. Services inflation increased to 3.5%, while goods inflation slowed to 1.2%. Meanwhile, the energy component remained disinflationary at -0.9%, while food inflation moderated further to 1.3%. French inflation declined back down to +1.0% y/y (-0.2pp from September), pushed down by deepening energy deflation and a significant easing of food inflation. Also, Italy's inflation dropped below expectations to 1.2% y/y from 1.6% in September, due to a marked deceleration of regulated energy and food prices, while core pressures remained stable at target. On the other hand, Spain's inflation surprised on the upside at 3.1% y/y from 2.9% in September, maintaining the highest inflation rate among the four largest Eurozone economies, consistent with its ongoing economic outperformance.

Figure 15: Headline inflation, CPI y/y in %



Sources: LSEG Datastream, Allianz Research

The ECB left its deposit rate unchanged at 2.0% this week as widely expected (see [What to watch | October 23, 2025 | Allianz](#)). In the historically short statement, the ECB reiterated its data-dependent, meeting-by-meeting approach amid an uncertain outlook. We expect the ECB to keep rates at 2.0% for now, but the risks are clearly tilted to the downside. A still-negative output gap, strong euro, weak energy prices, high precautionary savings and imported disinflation from China all point to subdued price pressures ahead.

But despite the ECB having lowered policy rates by 200bps until June this year, Eurozone credit demand has shown limited signs of revival. Lending to the private sector grew by +2.8% y/y in September, unchanged from August. Corporate loan growth eased slightly to +2.9% from +3.0%, while the ECB's Bank Lending Survey signalled that loan demand from firms picked up slightly, though it remained weak overall, with uncertainty and postponed investment decisions tempering activity. At the same time, credit standards for firms tightened marginally as elevated geopolitical and trade-related risks prompted closer scrutiny of borrowers. In the housing market, credit standards stayed broadly unchanged despite earlier expectations of easing, while demand for housing loans

continued to rise – supported by lower rates and improving market prospects – though this was only partially reflected in actual lending volumes, with household lending inching up to +2.6% from +2.5% y/y. Looking ahead, Eurozone banks expect largely stable corporate credit standards and a slight tightening in housing loan conditions in Q4 2025.

These assessments are, as always, subject to the disclaimer provided below.

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The statements contained herein may include prospects, statements of future expectations and other forward-looking statements that are based on management's current views and assumptions and involve known and unknown risks and uncertainties. Actual results, performance or events may differ materially from those expressed or implied in such forward-looking statements.

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