

What to watch: Germany's pension time bomb, the UK's difficult budget balancing act and Europe's data-center dilemma

In summary

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Germany's pension time bomb: high costs, high political risks. While the 2025 pension package fulfils key coalition commitments, the proposal to extend the 48% pension level (a worker with average earnings over 45 years receives a pension equal to 48% of their net wage) beyond 2031 has sparked political tensions as it would increase costs and delay structural reforms. However, a full coalition collapse ending in a minority government remains unlikely. Maintaining the pension level would increase social security contributions by +5.2pps by 2031 and a further +6.6pps until 2040. To finance this project, personal income tax would also need to rise from 16.7% today to 17.1% by 2032 and 19.4% by 2040. The combined employee burden would propel Germany to the top of OECD social contribution rates by 2028, close to 51.5% by 2040, cutting real disposable incomes by -5.2% by 2031 and almost -19% by 2040, thereby limiting private or occupational pension savings. Meanwhile, businesses would face rising non-wage labor costs of +11.5pps by 2040 amid stagnant productivity. In fiscal terms, pension spending could reach 14.2% of GDP by 2035, requiring significant state subsidies and thus annual increases in federal tax revenue of +2.1%. This could crowd out investment and weigh on long-term potential growth. Ultimately, the package is likely to be reopened and adjusted to secure support and allow reforms within the 2026 pension commission.

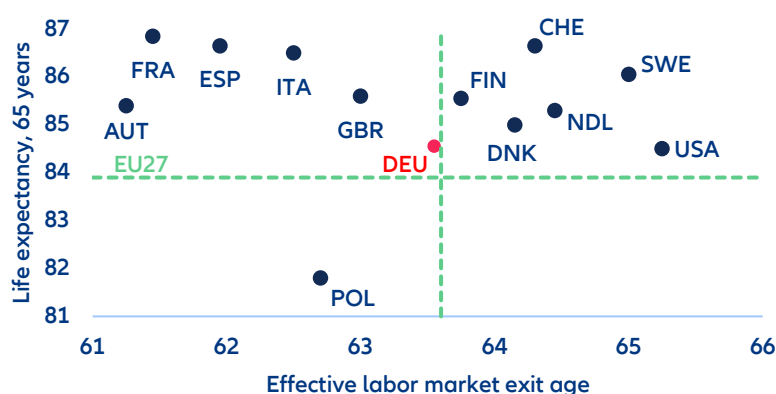
UK: The difficult budget balancing act. Chancellor Reeves is set to unveil her Autumn budget on 26 November amid increasing political fragility, large fiscal imbalances and close market scrutiny. We expect around GBP30bn of net fiscal tightening – mostly via tax hikes and mostly front-loaded in 2026. The Chancellor is likely to try to please both Labour MPs and financial markets by unveiling a mix of hikes in both “big” taxes (GBP16.7bn) on large corporates and high-income individuals and “small” ones (GBP8.4bn), namely property and capital income tax hikes. The market reaction should be mildly negative, with volatility potentially spiking in the short term. But if the government bows to political pressure to further increase the tax burden on business, capital or wealth, the market reaction could be much more adverse. Despite further fiscal tightening measures coming in 2026, we do not expect the deficit to narrow much (-5.1% of GDP, from -5.4% of GDP in 2025) because of weakening GDP growth (+0.9% expected after +1.4% this year) and strong public capital spending negating some of the tax-hike-induced savings. Ultimately, strengthened policy credibility – both monetary and fiscal – are essential to significantly improve the UK's economic and market performance.

Europe's data-center dilemma: A EUR100bn investment gap. As part of its digital omnibus to streamline rules and bolster competitiveness, the European Commission proposed to grant major AI developers greater leeway to use certain categories of personal data for model training, while postponing the implementation of the landmark AI Act. In parallel, the EU has also just launched a new probe into US cloud giants amid rising concerns over the protection of European consumer data – even as it depends on US hyperscalers to bridge its technological gap. However, Europe's own cloud capacity remains insufficient to meet exploding demand for computing and AI infrastructure. Trailing well behind US, which accounts for around two-thirds of current and expected data-center capacity, Europe is battling rising competition from Asian players in the AI race, notably China, whose current operating capacity (4.5GW) is now equivalent to the total capacity of primary European markets, which struggle with high construction costs and regulatory and energy constraints. Beyond the EUR200bn roadmap announced last year, an additional EUR100bn is needed to build up new capacity and match the official target to triple Europe's data-center capacity over the next 5-7 years.

The German pension time bomb: high costs, high political stakes

The coalition's 2025 pension package props up benefits for longer than originally planned, putting essential structural reforms on the back burner and creating long-term fiscal risks and political disputes. The 2025 pension package sees the German federal government moving forward with key initiatives from the coalition agreement, such as stabilizing pension levels at 48% (a worker with average earnings over 45 years receives a pension equal to 48% of their net wage) until 2031 and expanding mothers' pensions by 2027, which will put additional strain on the budget. The government is also encouraging the continued employment of pensioners and making constructive improvements to occupational pensions. However, extending pension levels at 48% beyond 2031 was not part of the coalition agreement, sparking significant political debate. This move could delay or prevent meaningful structural reforms even after 2029, particularly with regard to the long-term sustainability of the pension system. With the number of retirees expected to rise by 2.1mn by 2035, while the working-age population shrinks by 2mn, pushing the retiree-to-contributor ratio to over 61% by 2036, the strain on Germany's pension system will only increase. Yet crucial reforms, such as adjusting the retirement age in line with life expectancy or indexing pensions to inflation, are currently off the table. Compared Nordic countries, Germany ranks low in terms of the effective labor market exit age (Figure 1). The stakes are high and the outcome of this debate could have far-reaching implications not only for Germany's pension system but also its long-term fiscal health, economic growth potential and, ultimately, its political orientation. The Junge Union, which holds 18 seats in the Bundestag, has not without reason threatened to block the pension package due to the extension of the pension levels beyond 2031, set for approval in December. As seen recently in France, this move could have political consequences in Germany.

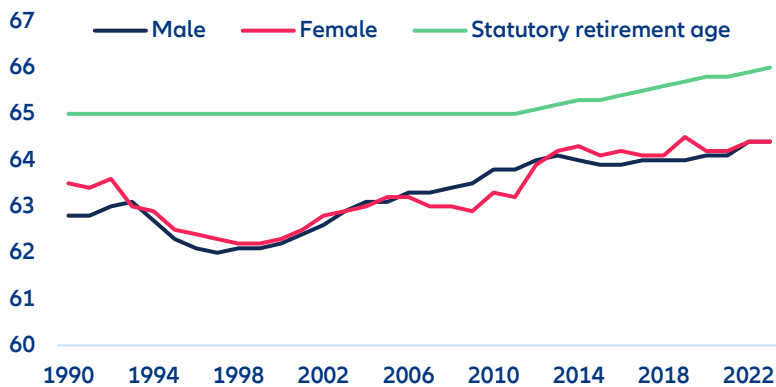
Figure 1: Effective labor market exit age and life expectancy, 65 years in selected countries



Sources: OECD, Allianz Research. Notes: EU27 is a simple average driven by CEE economies with mostly lower than average life expectancy (not shown).

The rising costs associated with an ageing population must be financed through increased contributions and taxes from the working-age population. In order to maintain the pension level at 48%, the government will have to suspend the sustainability factor, which is designed to ensure that pensions increase less sharply when the ratio of pensioners to contributors worsens. Although the statutory retirement age has steadily increased from 65 to 66 since 2012, the effective retirement age has remained stagnant over the past decade (Figure 2). This means that retiring early is still financially attractive for many people. This exacerbates the pension burden further by raising the retiree-to-contributor ratio. Without action, the pension level will start to decline after 2029, dropping to 47% by 2031 and 46.3% by 2040. This means that the shortfall would need to be made up through private or occupational pensions, savings or working for longer. To avoid this, the government would need to raise the sustainability factor from 0.2 to at least 0.3 times the average monthly pension insurance expenditure. As the pension system's reserves are expected to reach their lower limit by 2028, this would trigger higher contribution rates. In order to maintain the current system, pension contributions are set to rise by +1.2pp from 18.6% to 19.8% by 2028, followed by a further increase to 20% by 2029. These rates could continue to increase, potentially reaching 21.2% by 2037, where they would then stabilize until 2040. Currently, the government only needs to intervene with corrective measures if the contribution rate exceeds 22%. The highest contribution rate in Germany to date was 20.3% at the end of the 1990s, meaning that the pension system is now approaching levels not seen in decades.

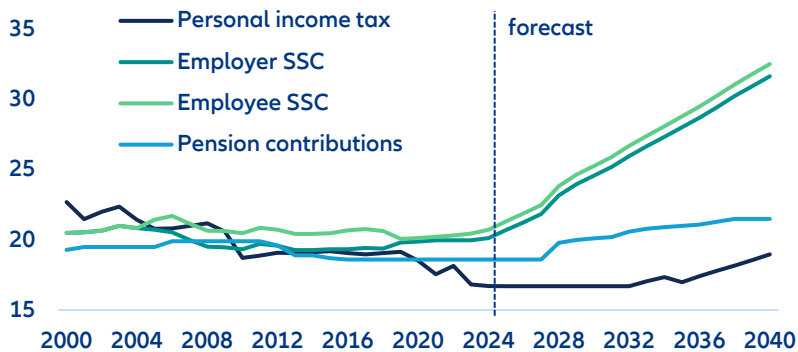
Figure 2: Effective retirement age and statutory retirement age, 1990-2023



Sources: Deutsche Rentenversicherung Bund, Allianz Research

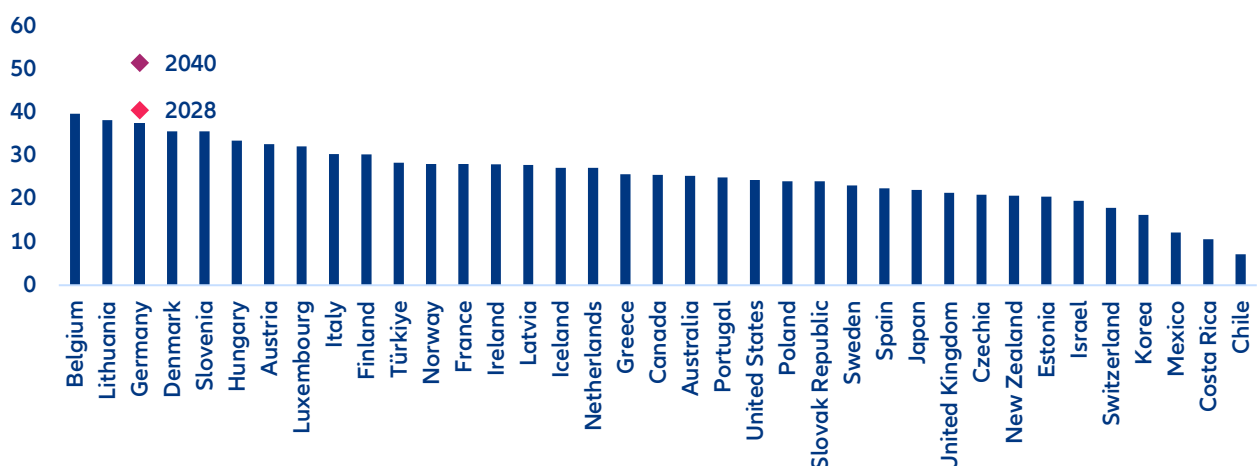
Extending the holding line would put pressure on both employees and employers, and falling real income levels would reduce the opportunity of making private arrangements. In order to maintain the holding line beyond 2031, social contribution rates are projected to rise. For employees with no children on an average wage, social contributions are set to rise by +5.2pps, increasing from 20.7% of gross earnings in 2024 to 25.9% in 2031 and then rising by a further +6.6pps up to reach 32.5% in 2040 (Figure 3). The growing cost of pensions will also be compounded by higher personal income taxes, which will be used to finance the fiscal burden on the government budget (an additional EUR111bn of demographic-related federal subsidies will be required between 2032 and 2040). The tax burden will thus rise from 16.7% in 2024 to 17.1% in 2032 and 19.4% in 2040. By 2028, Germany will have the highest personal social contribution rates in the OECD, surpassing Belgium and Lithuania in terms of personal income tax and employee social security contributions (Figure 4). The combined burden could reach 51.5% by 2040. Real disposable incomes could fall by -5.2% by 2031 and -18.7% by 2040, leaving less room for private or occupational pension savings. Currently around two-thirds of workers invest 4-5% of their annual income in private pension plans and 60% of employees participate in occupational pension plans, contributing 1-4% of their gross salary. However, these percentages are likely to decrease with the higher burden. But there is another side factor: Lower disposable income will also lead to weaker private consumption, which will weigh on growth (long-term potential around +0.3%) and raise the risk of recession. Businesses will face mounting pressure as non-wage labor costs are set to rise by +11.5pps between 2024 and 2040, while productivity stagnates. Germany currently ranks 14th with employer social security contributions at 20.1%, but it could overtake Portugal (11th) by 2028 and have the fourth-highest by 2040 (32.5%), which would put it behind France (1st, 36.3%), Czechia and Estonia.

Figure 3: Simulation of an increase in pension contributions, employer and employee social security contributions and personal income tax due to pension level of 48%



Sources: OECD, Destatis, Deutsche Rentenversicherung Bund, Allianz Research. Note: Pension contributions are a part of the employee social security contributions (SSC). We assume that the personal income tax increases with our wage forecast until 2027 and with average wage increases thereafter. In addition, we also assume that the burden of a stabilization of the pension level at 48% will have to be borne by taxpayers and thus spread the EUR111nm equally across the years, assuming a tax increase based in income and VAT tax revenues projected for 2025.

Figure 4: Personal income tax and employee social security contributions, as % of gross wage earnings



Sources: OECD, Destatis, Allianz Research. Note: We assume that the personal income tax increases with our wage forecast until 2027 and with average wage increases thereafter. In addition, we also assume that the burden of a stabilization of the pension level at 48% will have to be borne by taxpayers and thus spread the EUR111nm equally across the years, assuming a tax increase based in income and VAT tax revenues projected for 2025. All other countries remain equal to the 2024 level, ceteris paribus.

The project will result in persistently higher pension expenditures of up to 14.2% of GDP by 2035, which will be incompatible with the current state of the federal budget. Pensions account for 9.1% of GDP in 2025, and could rise to 10.4% by 2029 and 14.2% by 2035 if the pension level of 48% is extended beyond 2031. Financing this will require further state subsidies, which could increase by around a third between 2030 and 2040 and would ultimately be financed through taxes. As early as 2026, one-third of all tax revenues will be allocated to the pension insurance system. To maintain the pension level of 48% beyond 2031, an estimated additional EUR111bn will be needed between 2032 and 2040, which would require an increase in federal tax revenues of +2.1% every year. Without proper labor market reforms, discretionary spending in the federal budget may decrease from 22% in 2026 to below 5% by 2035 due to demographic ageing and mounting interest costs. As more federal funds are directed into the pension system, there will be less available for investments in future projects, putting further strain on the federal budget and lowering potential GDP growth.

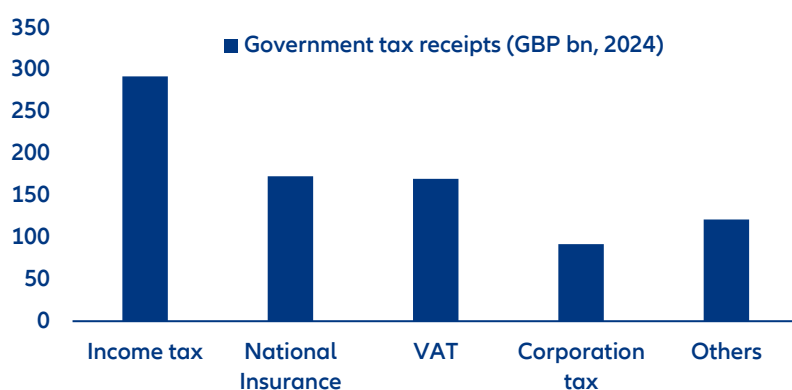
Although the pension package has the potential to cause significant political tension, a collapse of the coalition is unlikely. In its aftermath, a minority government would be highly improbable, not least because shifting majorities in the Bundestag would make stable legislation almost impossible. None of the parties could be interested in new elections, given that current polls show a further shift to the right (CDU/CSU 26% vs. 28.5% in February; SPD 14% vs 16.4%; Grüne 12% vs. 11.6%; and AfD 26% vs 20.8%). Although the coalition agreement did not include provisions for maintaining pension levels beyond 2031, this issue raises concerns about generational fairness and long-term fiscal costs. Nevertheless, both governing parties are under electoral pressure to deliver some form of reform. The package will therefore probably be reopened or modified to secure votes, given that the coalition only holds a majority of 12 seats, including the 18 members of the Junge Union, in order to pass the bill in December. This also leaves room for more substantial structural reforms, which are expected from the pension commission in mid-2026. The commission is mandated to propose a new benchmark for old-age security across all three pillars: statutory, occupational and private. However, for Germany's pension system to become truly sustainable, reforms must go beyond distributional fixes. They must address the looming labor shortage caused by an ageing population by recalibrating the balance between pension levels, contribution rates and retirement ages; removing age barriers in employment contracts, incentivizing longer working lives and expanding retraining options for workers in physically demanding jobs. Only then can Germany secure a viable long-term pension framework and achieve economic and fiscal stability.

UK: The difficult budget balancing act

Chancellor Reeves's Autumn 2025 Budget – to be unveiled on 26 November – is likely to represent around GBP30bn of net fiscal tightening (mostly via tax hikes), on top of the GBP41.5bn tax package delivered last year. The UK faces sizable fiscal challenges, with a hefty general government budget deficit of -5.4% GDP expected in 2025 and public debt at 100.5% of GDP. To reduce fiscal imbalances, the UK government is bound to comply with its fiscal rules¹ and, additionally, "headroom" against these rules to preserve fiscal buffers in case of worsening economic or market conditions. In all, we estimate that the Chancellor will announce around GBP30bn² of fiscal tightening, overwhelmingly skewed towards tax hikes (GBP30bn) and limited spending cuts (GBP3-5bn). Around 80% of these tax hikes will likely be frontloaded in 2026, while the spending cuts will be pushed to 2029/2030. This follows the GBP41.5bn of tax hikes unveiled in last year's Autumn Budget, which fell mostly on businesses, capital income and wealth. Businesses bore the brunt, with a rise in employer national insurance contributions (besides the rise in the national living wage) last April and increases in carried interest and capital gains tax rates. The government also extended the energy profits levy targeting North Sea Oil (marginal rate of 79%). In addition, the 2024 Autumn budget ended the tax exemption on foreign incomes of non-domiciled persons and increased the inheritance tax.

The Chancellor faces tough fiscal decisions as she cannot please everyone at the same time. Reports that she is ruling out "big" tax changes (recently income tax) increase the risk of negative market reactions because of weakened credibility. Disconnect is growing within the Labour party over fiscal tightening, and the government is increasingly under pressure to shy away from spending cuts. Last spring, the backlash from Labour MPs against planned cuts in social benefits forced the Chancellor to backtrack. MPs want more spending, no income tax rises for the middle class and no increases in VAT – essentially close to what was promised in the Labour manifesto during the election in 2024. However, sticking to the manifesto pledges makes it increasingly challenging to raise enough revenues to plug fiscal holes. The "big" taxes (VAT, income tax, NICs (including employers) and corporate tax) make up 85% of total tax receipts (Figure 5). For markets, increasing big taxes is a much more credible way to reduce fiscal imbalances. Indeed, ruling out big tax changes means the government will have to resort to steep hikes on "small" taxes which have a narrower tax base. These steep tax hikes can have severe distortionary effects (eg. reducing the incentive to save and invest) and, ultimately, lead to receipts undershooting the government's targets through a shrinkage of the tax base. In this respect, reports that Chancellor Reeves has made a U-turn and ruled out raising income tax in the coming Autumn budget is concerning, all the more so as it comes on top of VAT hikes likely being out of the equation too. With the Chancellor unlikely to deliver major spending, it will be tougher to fill the fiscal holes in a credible manner, potentially leading to adverse market reactions.

Figure 5: UK government tax receipts, GBP bn (2024)



Sources: LSEG Datastream, Allianz Research

¹ The two main fiscal rules are i) to balance the central government "current budget" (i.e. excluding investment spending) and ii) public sector net financial liabilities (in % of GDP) must be reducing. Both rules are binding by 2029/30.

² We estimate GBP20bn will be to meet the fiscal rules, and gbp10bn to increase fiscal headroom, as has already been suggested.

In all, we expect a mix of small taxes (such as property taxes) and two big taxes (top income rates and surtax on large corporations), which will likely lead to a modestly negative market reaction. We do expect the Chancellor to rely more on hiking big taxes (GBP16.7bn) rather than small ones (GBP8.4bn). However, part of the big tax hike will hinge on the extension of the freeze on income tax thresholds (GBP7.5bn), which should happen from 2029/2030 only. Markets are likely to question the credibility of this. Nevertheless, we do expect the Chancellor to resort to income tax rates hikes in 2026, targeted at higher income individuals (top two thresholds). This would have the advantage of raising receipts in the short term, being perceived as credible by financial markets and assuaging Labour MPs by protecting the middle class. We would also expect the Chancellor to increase corporation taxes one way or another, potentially by targeting larger companies – a move that would mimic France’s 2024 surtax on large corporates. However, we expect most (GBP20bn, ie 80%) of the upcoming tax burden to fall on households, with the emphasis on higher earners, wealthy individuals, landlords, pensioners and owners of expensive properties (Figure 6). This is likely to result in a modestly negative market reaction (Figure 8): high volatility in the short term can be expected, but gilts yields will end up mostly higher than they were before the budget announcement and the sterling would be slightly weaker. However, if the government further increases the tax burden on businesses/capital/wealth, the market reaction could be much more adverse.

Figure 6: Expected measures to be announced in the Autumn budget

Tightening measures 2029/30 (lack credibility)	Tightening measures 2026, based on "small" taxes (weaken credibility)	Easing measures in 2029	Tightening measures 2026, based on "big" taxes (strengthen credibility)
Freezing income tax thresholds for two more years (GBP7.5 bn) Day-to-day spending cuts (GBP5bn)	Property tax hikes/levies on landlords (NI on rental income) (GBP2-6bn) Salary sacrifice pension relief cut (GBP2bn) CGT (GBP4bn) IHT (GBP1bn) Gambling profits tax (GBP2.4bn)	Extend freeze on fuel duty (-GBP5bn)	Income tax hike for top thresholds (GBP4.2bn) Surtax on large companies' profits & other business taxes (GBP5bn)

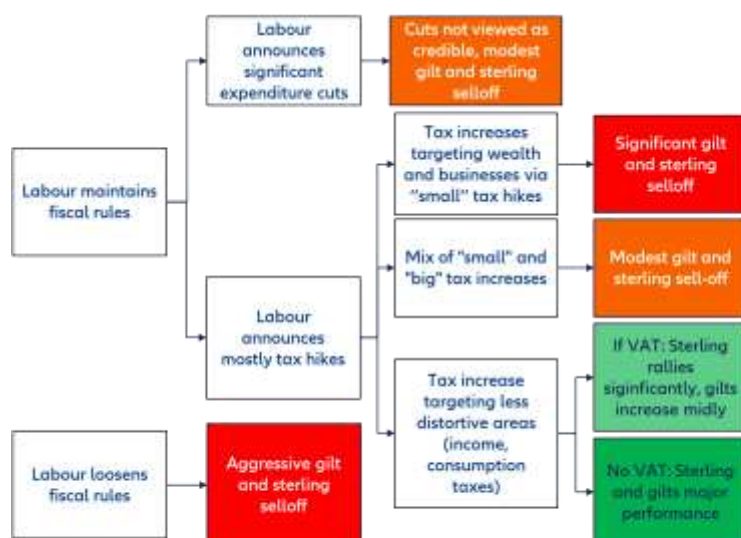
Sources: HM Treasury, Capital Economics, Allianz Research

Figure 7: Possible measures in the budget

Tax Options	Extra Revenue 2029/30 (£bn)	Political Considerations
Politically palatable:		
Council tax: Double rates on band G and H properties	4.2	Burden on those with the "broadest shoulders"
CGT: settle up charge leave UK/end forgiveness at death	4.0	Hits wealthy individuals
Tax on landlords: NI of 8% on rental income	2.2	Hits landlords
Reduce small business tax gap	2.0	Affects businesses
VAT: phased reduction in threshold (£90,000 to £30,000)	2.0	Hits small businesses
Broaden UK emissions trading scheme	2.0	Increase the price of long-haul flights. Consistent green objectives
Mansion tax: CGT 18-24% on primary residence > £1.5m	2.0	Hits wealthy not "working people"
Employer NI on partnerships	1.9	Hits wealthy not "working people"
Tax on banks: bank surcharge 3% to 8%	1.5	Hits banks not "working people"
Inheritance tax: remove relief on AIM shares	1.0	Hits wealthy not "working people"
Capital gains: Abolish business assets disposal relief	0.9	Disproportionate impact on smaller businesses
Sub-Total	24	
Some political Concession		
Stealth tax: Freeze personal tax thresholds from 2020/29	7.5	Break tax pledges in spirit, but avoids immediate economic damage
Raise income tax by 2p, cut employee NI by 2p	6.0	Break tax pledges, but burden on pensioners and landlords
Raise gambling duty	2.4	Does not only fall on those with the "broadest shoulders"
Scrapping tax exemptions on cars for disabled people	1.0	Hits disabled people
Income tax: Increase additional rate from 45% to 47%*	0.5	Break tax pledge, but hits highest earners only
Sub-Total	17	
Politically unpalatable:		
Income tax: Increase basic rate from 20% to 21%*	8.2	Break tax pledge, burden on "working people"
Income tax: Increase higher rate from 40% to 42%*	4.2	Break tax pledge, burden on "working people"
VAT: Charge 1% on all zero-rated products	4.2	Break tax pledge, exacerbates near-term inflation
Fuel duty: 10% increase in rates	1.9	Hits "working people" and exacerbates near-term inflation
Sub-Total	19	

Sources: HM Treasury, Capital Economics, Allianz Research

Figure 8: Financial market outcomes

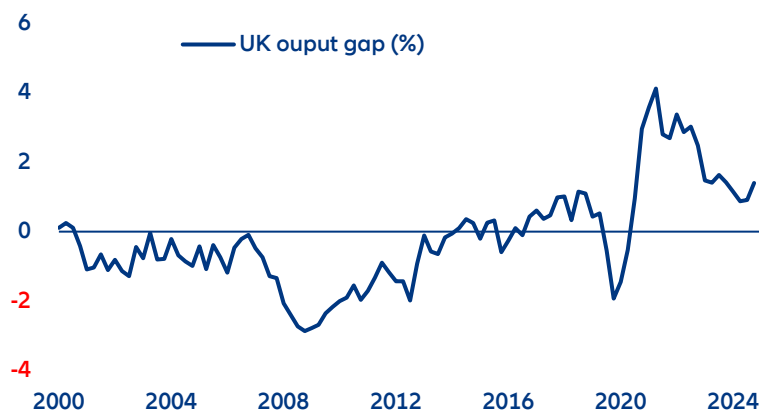


Sources: Allianz Research

We expect the general government deficit to narrow only mildly in 2026 as growth should soften. Growth in 2025 has been relatively strong, at around +1.4%. However, the pickup in growth partly reflected, temporary, not sustainable one-off boosts that are unlikely to be repeated in 2026, such rapid decline in real short-term rates boosting credit creation, and strong dwellings investment ahead of the budget's expected taxes on the property sector. Additionally, we estimate the UK's output gap is largely positive (Figure 9), because of tight capacity constraints such as difficulties for firms to find adequate, skilled labor. In all, we expect GDP growth to dip to +0.9% in 2026 - below consensus forecasts. Weakening growth should weigh on the fiscal deficit. Additionally, that the tax hikes announced in the upcoming budget for 2026 – close to GBP 23bn – will be partially offset by strong public capital growth, reducing the net fiscal effort. In all, we project the deficit to narrow to -5.1% GDP in 2026, after -5.4%

in 2025 (primary balance: -2.2% GDP, after -2.5% GDP), while the gross debt to GDP ratio will rise from 100.5% to 102%.

Figure 9: UK's output gap (in % of potential GDP)



Sources: LSGE Datastream, Allianz Research

Strengthening policy credibility – both monetary and fiscal – would significantly improve the UK's economic and market performance. Successive governments' unclear and often inconsistent communication around fiscal decisions has created unnecessary uncertainty for businesses and households, weighing on investment and growth. The private sector needs stability and clear guidance on fiscal policy to commit to long-term, productivity-enhancing investment. With greater clarity, the government could rely less on large-scale public capital spending as much of this burden could be carried by private investors. As noted above, restoring fiscal balance will require substantial tax increases, as well as a reduction in rebates and allowances that tend to be inequitable and add unhelpful complexity to the tax system. Among potential tax rises, VAT remains the least damaging for economic activity and should therefore be prioritized. Public spending should focus primarily on housing construction, which would help moderate house prices, ease rental pressures and improve affordability for households. Also, current fiscal rules are complex and not simple enough for the public to understand them, which undermines their credibility. A shift towards a simple expenditure rule (capping general government real primary spending growth to a certain threshold) would improve the credibility of UK public finances, which could lead to lower borrowing costs eventually. On the monetary side, the Bank of England has taken a notably dovish stance, cutting interest rates even as inflation has risen and remains way above the 2% target. Its central priority must be to return inflation to target, even if it means hurting growth in the near term. Doing so would not only enhance the business environment (more stable, predictable inflation), and also make VAT increases more effective by reducing the risk of second-round inflation effects.

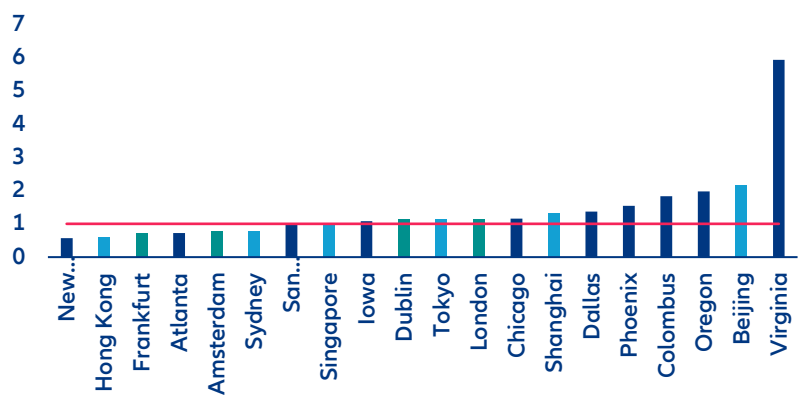
Europe's data-center dilemma: A EUR100bn investment gap

Europe is torn between accelerating tech and protecting consumers. The EU finds itself in an increasingly ambivalent position as it unveils its digital omnibus, a comprehensive package aimed at streamlining rules and bolstering the competitiveness of domestic SMEs in the face of accelerating digitalization and the growing integration of AI into routine operations. The Commission's proposal specifically grants major AI developers greater leeway to use certain categories of personal data for model training, a shift meant to help European firms keep pace with global rivals, while postponing by 16 months the implementation of several requirements introduced by the AI Act. In parallel, the EU also continues to scrutinize the dominance of US cloud giants. Amid frequent digital outages, the latest investigation launched this week against large US providers highlights rising concerns over their ability to protect European consumer data. Under this probe, officials may tighten mandatory obligations for foreign cloud providers that previously enjoyed a light application of the Digital Market Act (DMA), increasing interoperability with local software companies and data portability with consumers.

Even as Brussels seeks to regulate their influence more tightly, Europe depends on US hyperscalers to bridge its technological gap. Europe's cloud market has been multiplied by eight since 2017, but the surging demand is mostly

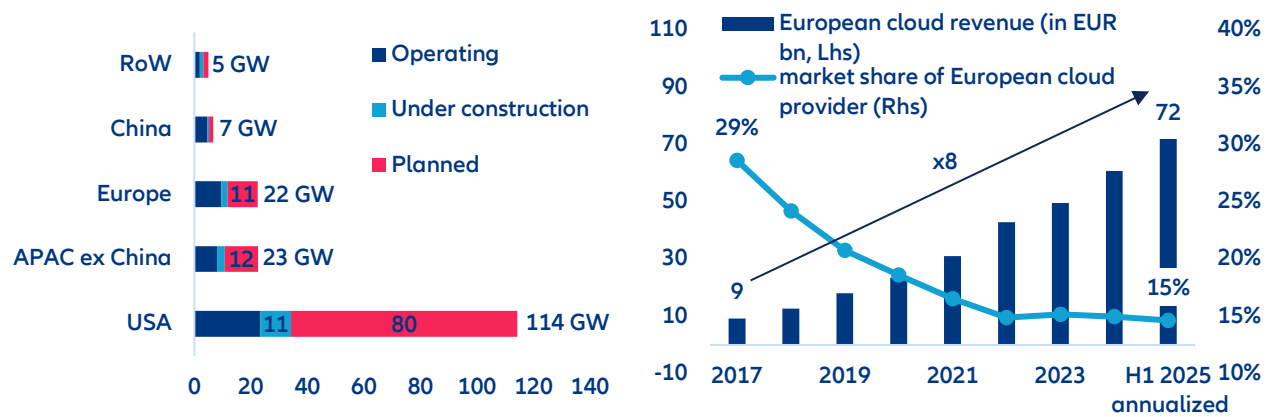
absorbed by US hyperscalers: The top three providers account for 70% of market share. Meanwhile, the market share of local providers has been cut in half as they struggle to match the technological deployment and investment power of their US peers. This dynamic deepens Europe’s reliance on foreign firms and raises concerns not only over digital sovereignty but also security, especially as control over European data becomes a strategic asset for corporates. Despite initiatives like GAIA-X or national sovereign-cloud programs, Europe’s own cloud capacity remains insufficient to meet exploding demand for computing and AI infrastructure. Europe has thousands of data centers but few with the large power capacity required to meet the exponential needs of energy-intensive AI-powered technology. Europe counts only two areas with data-center capacity above 1GW against four in Asia (of which two are in China) and seven in the US. Meanwhile, Europe’s position in the global AI race is also increasingly constrained by its structural weakness in operational computing capacity, where it trails far behind the US (roughly three times less) while also facing rising competition from the Asia-Pacific region, driven largely by China’s rapid expansion. Capacity within Europe itself is unevenly distributed, with just five countries accounting for about half of the region’s total, limiting the benefits of scale and integration. Although the current pipeline suggests around 13 GW of additional capacity in the medium term, this remains nearly 30% below the EU’s ambition to triple data-center capacity within the next five to seven years. Despite the EU’s EUR200bn roadmap to build up new capacities and close the gap with competitors in AI development, member states continue to court foreign investment, as illustrated by the EUR15bn in contracts signed with big US cloud providers this month.

Figure 10: Top 20 biggest areas in term of reported data-center capacity (in GW, as of H1 2025)



Sources: Cushman & Wakefield (H1 2025 update), Datacentermap.com, Allianz Research

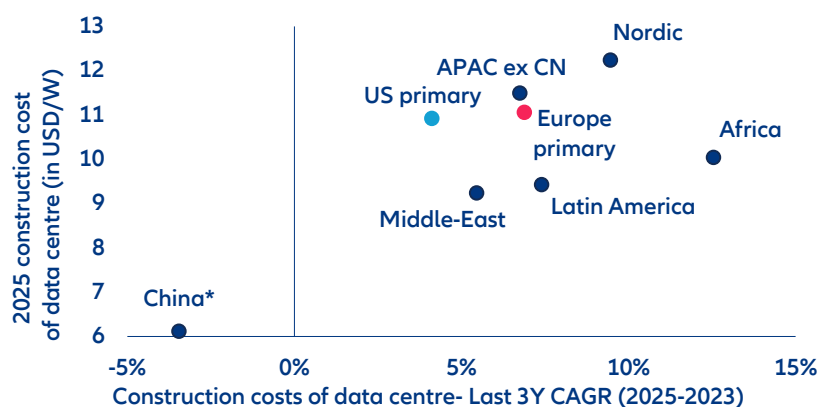
Figure 11: Regional breakdown of data-center power capacity (current & planned) / European cloud market revenue & market share of local providers



Sources: Cushman & Wakefield (H1 2025 update), Datacentermap.com, Allianz Research

High construction expenses and regulatory and energy constraints are slowing project delivery and inflating costs are slowing data-center expansion in Europe. Construction expenses rank among the highest globally and have risen far faster than in competing regions – over twice the pace seen in major US markets over the last three years – driven by higher land, energy and labor costs. Second, administrative bottlenecks and extensive permitting procedures stretch development timelines: In many cases, the average time required to obtain permits is around 18 months but in some complex cases this extends to up to 48 months, which is approximatively the average period for the construction process. Third, Europe lacks harmonized electricity-pricing frameworks, exposing operators to high volatility and complicating long-term planning. Fourth, the heavy concentration of data-center clusters has created grid congestion, slowing new developments in hubs such as Amsterdam and Dublin, but also inflating the operating bill. Congestion-related costs exceeded EUR4bn in 2024. Similar pressures are emerging in Spain and Finland, where data-center demand can reach or exceed 10% of grid capacity during peak periods. Finally, Europe’s ambition to operate a carbon-free data-center ecosystem – already powered by renewables for 94% of its supply – introduces additional grid-stability challenges. This is by far the primary issue pointed out by data-center developers in Europe as difficulties in plugging new data centers into the existing grid network or ensuring a consistent source of power during activity peaks weigh on general efficiency while also hindering the investment pipeline. Together, these constraints weigh heavily on the continent’s ability to scale digital infrastructure at the pace required by accelerating demand.

Figure 12: Data-center construction cost per regional breakdown /
Top five challenges for data-center operation in Europe over the next three years

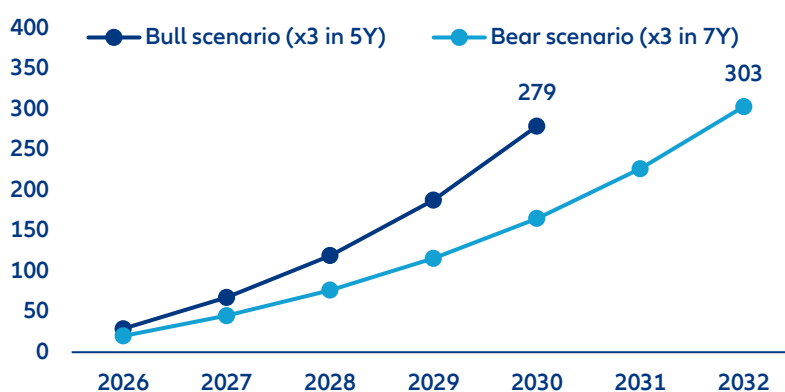


*One data for China. Sources: Turner & Townsend, State of European data centers 2025 (EUDCA report), Allianz Research

Against this backdrop, Europe needs to redefine its priorities to meet its ambitious target. Europe faces a difficult strategic choice as it seeks to reconcile its ambitious goals for AI and cloud development with the realities of its current investment landscape. The EU’s EUR200bn roadmap appears insufficient to meet the objective of tripling data-center capacity by 2030; our estimates suggest that EUR280–300bn would be required just to close the gap in infrastructure capacity. Further investment would be needed to modernize the grid network and harmonize

electricity prices in Europe to gain in both efficiency and operability. Given this shortfall, external support will be unavoidable – whether through direct foreign investment or through service contracts with non-European providers able to balance emerging supply-demand pressures. However, Europe’s limited pool of local options and a comparatively less dynamic venture-capital market constrain its ability to scale while keeping a full control on new digital infrastructure. The recent EUR15bn investment announcement from US hyperscalers to develop data centers in Germany and Portugal confirms this picture. Stricter regulation on large US technology firms would certainly help reducing systemic risks but it could also imply some unwilling side effects like deterring the foreign investment that would be crucial to strengthen Europe’s computing base. As a result, policymakers face a tricky balance: expanding capacity rapidly while preserving strategic control. Achieving both goals simultaneously will be challenging, and some sovereignty concessions will have to be made in the absence of domestic alternatives, though this should not come at the cost of consumer protection.

Figure 13: Total construction cost required to triple data-center capacity in Europe by the next five (bull scenario) to seven years (bear scenario)



Source: Allianz Research

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

FORWARD-LOOKING STATEMENTS

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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