

Eurobonds – A window of opportunity for a strategic necessity

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In Summary

Strategic autonomy has become Europe's north star in an increasingly fragmented world, almost ten years after President Macron's first Sorbonne speech. But what will it take to achieve it? In our Future of Europe series over the coming weeks, we will examine the necessary reforms, instruments and investments — from trade policy to energy security and the role of the euro — that will enable Europe to address its critical dependencies and vulnerabilities. Today, we will explore the question of Eurobonds, which have returned to the agenda as Europe's defense efforts call for additional financing options.

- **Capital flows are shifting to Europe and European debt is emerging as a transitory safe asset.** Global capital is increasingly flowing toward euro-denominated debt as the safe-asset status of US Treasuries erodes. Backed by structural strengths, ample balance-sheet capacity and superior liquidity firepower (EUR2trn excess liquidity vs USD300bn). The euro has a renewed opportunity to expand its global role amid rising European investment needs and demand for USD alternatives. This requires scaling up safe collateral by at least EUR1-3trn by 2035. Strategic Eurobonds covering common funding needs in defense, climate change and infrastructure are the best solution. Eventually a more flexible instrument – EU-Jumbos – could reduce institutional and political frictions in an EU that advances at two speeds.
- **Europe's problem is debt supply, not demand: the benefits of a convenience yield.** The entire EUR8trn European safe-asset pool just equals the size of US Treasuries held abroad. Our convenience yield analysis shows that Europe leaves significant untapped potential in Eurobonds issuance. Eurobonds and high-rated sovereign bonds (esp. German Bunds) are complementary and not in competition. At least EUR1,000bn in additional Eurobond issuance would be necessary before substitution effects emerge. These could be limited as markets are already pricing a common fiscal risk factor into euro government bonds.
- **Ultimately, for investors, Eurobonds must become a highly liquid benchmark curve.** We recommend a two-pronged approach: (i) to scale up the Eurobond issuance at the very short end (EU-Bills) to supply more safe collateral to global funding markets to support the internationalization of the euro in digital assets and payment systems, and (ii) to increase longer-dated project-oriented Eurobonds (for defense or climate change) by EUR500bn.

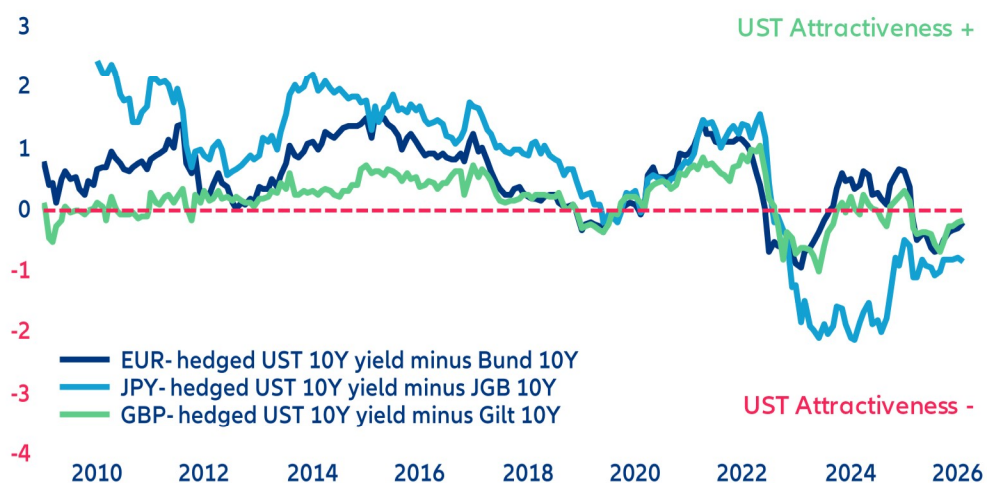
Several European leaders are increasingly in favor of expanding joint debt issuance to strengthen strategic autonomy

Following the example of the Next Generation EU program (EUR800bn) established during the Covid-19 crisis, a policy consensus is emerging across European leaders, from Bundesbank President Nagel to French President Macron to ECB President Lagarde, to expand joint debt issuance for strategic topics such as defense and the climate transition. Indeed, a competitive space for the euro is opening again as Europe's rising investment needs coincide with growing global demand for safe alternatives to USD assets. In fact, the early 2000s saw a similar situation, when the USD share in outstanding

international debt declined from 60% to 40%, with euro-denominated issuances gaining ground. But the reversal after the Great Financial Crisis (GFC) and the Euro crisis showed that these windows close quickly if the financial ecosystem fails to scale up.

For nearly four decades, the US government was able to monetize its deficits through the global need for a safe asset, allowing it to run a “deficit without tears”. But the 2008 subprime crisis exposed fundamental fragilities, triggering the first serious doubts about US institutional credibility and monetary system resilience. To prevent systemic collapse, the Federal Reserve rescued banks and massively expanded its balance sheet. Foreign financing shifted from private bank intermediation to a direct dependence on the Fed’s liquidity provision. Banks faced stricter balance sheet constraints, which limited their capacity to absorb Treasury issuance. As fiscal deficits ballooned, especially after Covid-19 pandemic, non-banks (e.g. hedge funds) emerged as the marginal buyers of US Treasuries, using them as collateral to borrow cash to run leverage. Depending on highly leveraged intermediaries creates a fragile funding equilibrium. And the increased intervention of the Fed into the repo market underlines fragility is rising. The Trump administration’s approach has been to stabilize the system by adjusting disbalances on the dollar through tariff threats, US sanctions and ultimately the Mar-a-Lago Accord which is a tool to pressure foreign investors to continue absorbing US deficits. Together with rising political pressure on Federal Reserve, concerns about the “safe asset” status of US Treasuries are rising. Investors are starting to look for alternatives while the global monetary system is reaching a new equilibrium that does not depend entirely on US institutional credibility. Therefore, foreign investors increasingly find US Treasuries unattractive (Figure 1). Some stopped increasing their exposure; others started seeking returns rather than safety in the US.

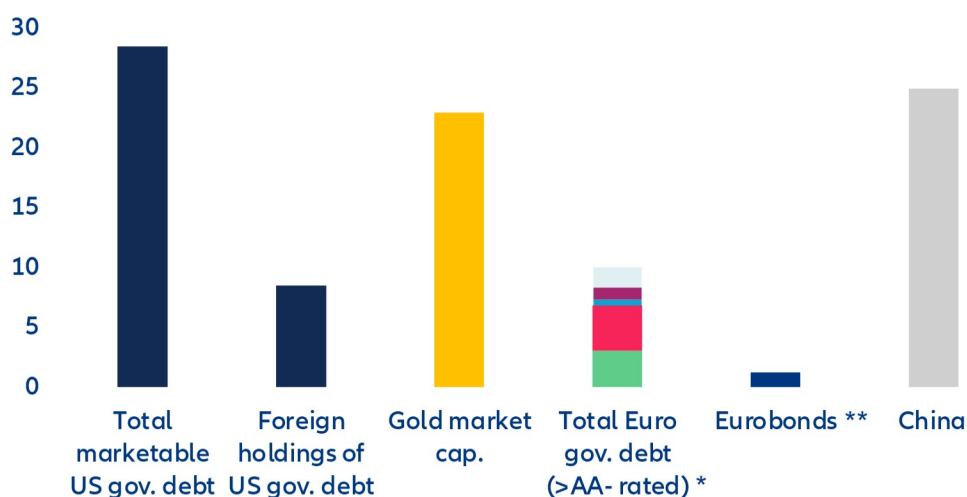
Figure 1: The US Treasury is losing its attractiveness for foreigners



Sources: LSEG Workspace, Allianz Research

Europe is well positioned as a safe alternative to USD assets. But it needs to scale up its pool of safe collateral, which remains scarce and fragmented. The outstanding volume of euro sovereign bonds and supranational bonds (e.g. EU, ESM, EIB) rated A+ or higher amounts to only about EUR8trn – less than the stock of US Treasuries currently held outside the US. Paradoxically, while the US debt stock may now be too large, given its renewed domestic focus, the Eurozone’s aggregate supply of high-quality debt remains too limited and fragmented to meaningfully elevate the euro’s global reserve status (Figure 2).

Figure 2: The Eurozone safe asset market is undersupplied (outstanding volume/market cap in USD trn)



*Euro government debt includes Germany, France, Spain, Netherlands, Belgium, Austria, Finland and Ireland

** Eurobonds: outstanding volume of EU, ESM and EFSF

Sources: LSEG Workspace, World Gold Council, Allianz Research

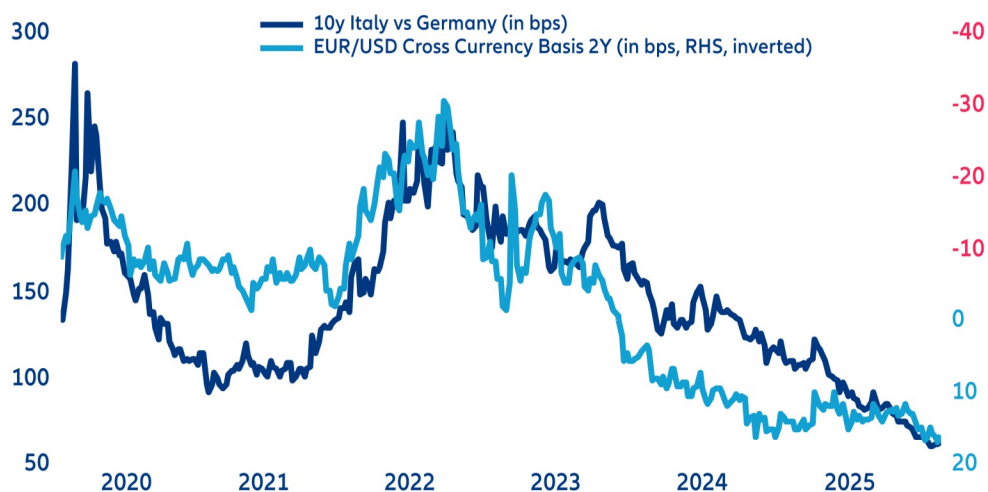
The issuance of Eurobonds as a homogeneous euro safe asset is the best solution to scale the euro safe asset pool. In our view, the advantages of a substantial increase of joint debt together with a stronger international role of the euro in terms of strategic autonomy, lower exchange-rate risks and lower private and public funding costs outweigh the risks of moral hazard, competitiveness and current account deterioration.

From the transitory safest asset to a strategic global asset

As the safe asset status of US Treasuries is under pressure, global capital flows appear to be shifting toward Europe. Several patterns point in this direction. First, global shocks such as the Covid-19 crisis or “Liberation Day” no longer strengthen the USD but rather weaken it – a reversal of the historical “flight to quality” pattern. Second, during episodes of US liquidity tightening, the euro has often appreciated rather than depreciated. This suggests that the liquidity differential between the US and the Eurozone, well captured by the swap spread differential, a proxy for relative debt supply pressure, has turned in Europe’s favor. Finally, in a context of rising geopolitical risk, reflected in the widening cross-currency basis¹ (the cost of hedging FX volatility), Eurozone government bonds have attracted additional demand. This is visible, for example, in the behavior of the 10y BTP–Bund spread that proxies the systemic risk perception in Eurozone, which has remained relatively resilient despite global turmoil. Taken together, these signals indicate that Europe is emerging as an attractive destination for global capital (Figure 3).

¹ Laverriere, P, *The Epistemology of Offshore Dollar Stress: What FIMA and Swap Lines Reveal About the Nature of Systemic Risk*, 2026

Figure 3: The US risk premium is the European liquidity impulse.



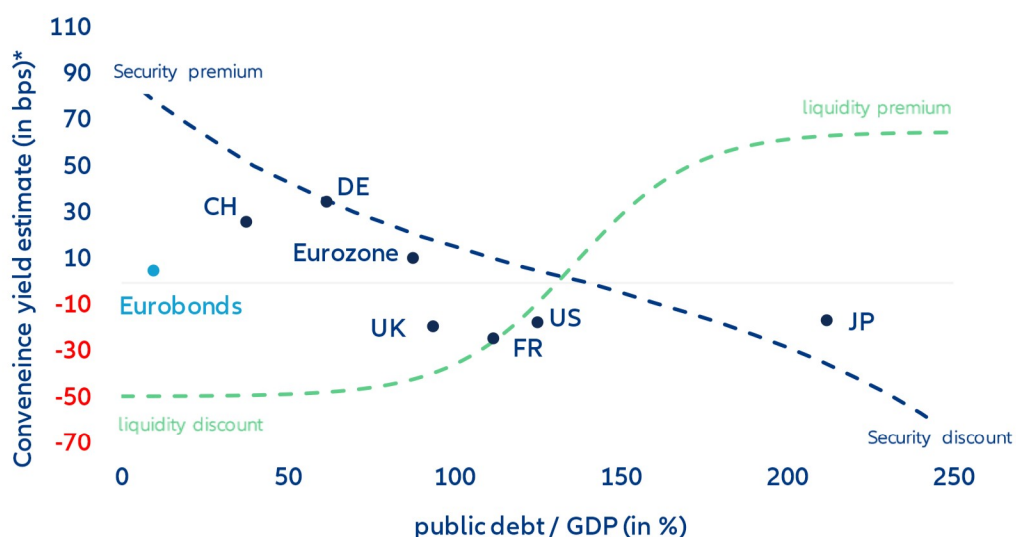
Sources: LSEG Workspace, Allianz Research

This relative attractiveness of Europe is based on strong structural factors (deep and open capital market, rule of law and large common market), with free circulation of capital, in contrast to China’s capital controls and policy uncertainty in the US. Europe can offer a safe, liquid, legally protected and geopolitically more neutral asset. The liquidity and policy backdrop further reinforces Europe’s relative advantage. In the US, the Federal Reserve is compelled to backstop the funding liquidity, because the private sector’s balance-sheet capacity to absorb Treasuries is exhausted. In our view, this points to global investors increasingly using Europe – and particularly core markets like the German Bund – as a global safe asset substitute. Unlike Japan, which is tightening and repatriating capital, reducing its foreign presence in global bond markets, Europe has the capacity to extend its global footprint. The euro money market also offers smoother funding than US, with excess liquidity remaining extremely high in the Eurozone. We estimate excess liquidity at more than EUR2trn (vs only USD300bn in USD), ready to be drained by bills or bond issuance. Europe has the liquidity firepower to capture a significant part of the liquidity flows in search for a safe alternative to US Treasuries. Europe is actually, de facto, the transitory safest asset; it has the potential to become the public good the world is seeking.

The US safe asset status under scrutiny while Euro safe assets have space to expand

Global safe assets trade at higher prices (and therefore lower yields) than debt of comparable risk because of their combination of superior safety (i.e. credible lender-of-last-resort backing) and liquidity (market depth and collateral usefulness). This safety-and-liquidity premium – known as the convenience yield – can be substantial. From the 1960s to the late 1990s, the US government enjoyed a funding-cost discount of around 200bps. After the GFC, the US convenience yield declined to 75-50bps. Today the US has entirely exhausted its convenience yield buffer, which turned negative for the first time in early 2025 and has not recovered since. This illustrates the convenience yield dilemma. Its components – safety and liquidity – point in opposite directions. More debt issuance increases liquidity (more collateral available, larger market with less friction) but it also decreases safety. In other words, the liquidity function is upward, and the security function is downward sloping. While the security function is strictly downward sloping, the liquidity function plateaus at its extremities (Figure 4). This means that at a certain level, additional issuance causes no marginal increase of the liquidity premium but continues to deteriorate the safety premium. There is an optimal spot where the maximum level of issuance meets the minimum level of safety required. The US has gone over that point, as have France, Japan and the UK. But Germany and the Eurozone as whole still benefit from a convenience yield, having a buffer on the issuance side. Looking at Eurobonds alone, their convenience yield is relatively low but strongly distorted. They would benefit from an elevated safety premium but are penalized by a 50bps liquidity discount. So, while the US Treasury has overstretched its liquidity premium, Europe is playing it too safe in terms of Eurobond issuance.

Figure 4: The convenience yield dilemma – downward sloping safety vs upward sloping liquidity



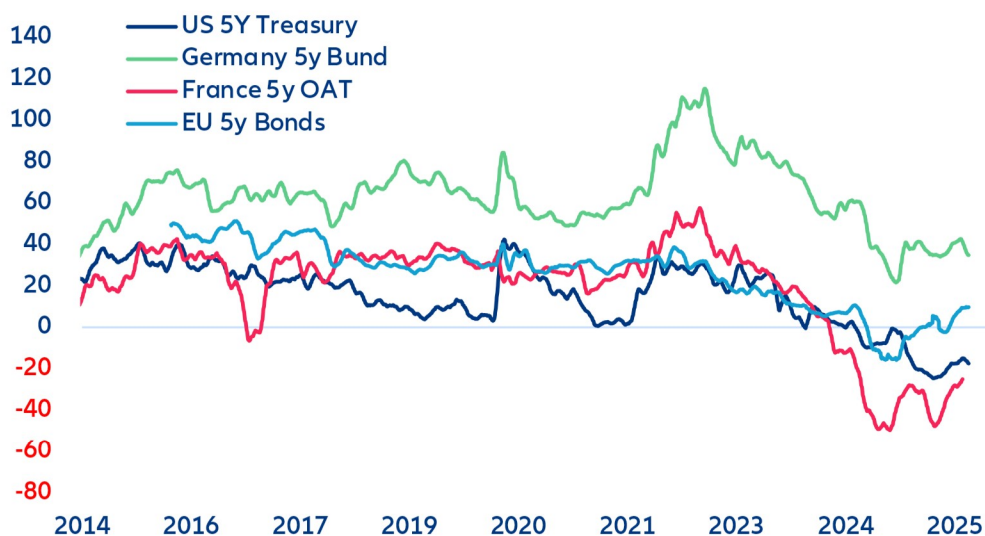
*Convenience yields estimated as the average of synthetic proxies (swap rates, FX hedged AAA foreign bond, CDS adjusted AAA/AA corporate bonds) and inter-sovereign convenience yield based on synthetically creating a fixed-for-fixed currency swap rate using interest rate swap and cross-currency basis swap data. The safety and liquidity functions are stylized from the individual issuer curves. They converge in the middle but can show different slopes at the extremities

Sources: LSEG Workspace, Allianz Research

There is no convenience yield transfer from Germany to Eurobonds – for now

This explains also why Eurobonds and German Bunds currently co-exist as complements, not competitors. Their convenience yields move together rather than in opposition. The reason is structural: Eurobonds are safe but lack liquidity, while Bunds combine safety with superior market liquidity. No substantial transfer of convenience yield from Bunds to Eurobonds is occurring at current issuance volumes. The structural differences of Bunds and Eurobonds are most visible under stress. During both the Covid-19 shock and the 2022 inflation surge, Bund convenience yields increased as flight-to-safety concentrated in the most liquid instrument available. Eurobonds, despite comparable credit quality, barely reacted as liquidity, not safety, is their binding constraint (Figure 5). We estimate that an additional EUR1,000bn in Eurobond issuance is required before meaningful substitution effects on the Bund market emerge. Below this threshold, expanded Eurobond issuance does not eat into the Bund's convenience yield.

Figure 5: The convenience yield development for different issuers*



* Convenience yields estimated as the average of synthetic proxies (swap rates, FX hedged AAA foreign bond, CDS adjusted AAA/AA corporate bonds) and inter-sovereign convenience yield based on synthetically creating a fixed-for-fixed currency swap rate using interest rate swap and cross-currency basis swaps.

Sources: LSEG Workspace, Allianz Research

Markets are already pricing a common fiscal risk factor into Euro government bonds

European government bonds (EGB), notably in Southern Europe, have been on a strong convergence trend since 2022. The 10-year spread of Italian government bonds vs German Bunds contracted from a peak of more than 250bps to around 60bps today. Other periphery issuer spreads like Spain and Portugal have tightened by around 100bps since their 2022-wides. This has been closely linked to the disbursement of the NGEU Funds, notably for Spain, Italy, Greece and Portugal, combined with their political stabilization. We estimate that since 2021, the growth effect of NGEU alone amounts to a cumulative +1.0-1.2pp together with a strengthening of their fiscal positions. This improvement in fundamentals is responsible of 30-50% of the recent spread compression. Without the NGEU, the 10y spread (vs Bund) would currently be +41bps higher for Italy, +20bps higher for Spain and +35bps higher for Portugal. This means that for every GDP percentage point in NGEU transfers, the 10-year spread (vs Bund) was compressed by 2-5bps. NGEU demonstrated the positive effects of joint issuance by distributing the European convenience yields more evenly across member states, which translates into a lower overall EGB spread level and lesser dispersion of European risk premia.² The recent convergence in EGB spreads is thus also a signal that markets are increasingly pricing this joint underlying risk factor. Markets frontrunning European institutional progress is reminiscent of the spread contraction before the introduction of the euro. With the notable difference that this time Europe has all the backstops in place to avoid fragmentation and systemic exit risk. But this also means markets will be punishing EGB spreads if Europe does not deliver on expectations, which could annihilate parts of the NGEU-induced spread compression (Figure 6).

² For a more detailed analysis see our Publication: "What to Watch: NGEU fund - The secret behind sovereign spread convergence", 14 November 2024, https://www.allianz.com/content/dam/onemarketing/azcom/Allianz_com/economic-research/publications/specials/en/2025/november/2025_11_14_What_to_watch.pdf

Figure 6: 10y EGB spreads vs Germany (in bps)* - Convergence during euro introduction (left) vs NGEU (right)



*includes: France, Italy, Spain, Portugal, Ireland, Finland, Austria, Netherlands and Belgium
Sources: LSEG Workspace, Allianz Research

Transforming the opportunity into structural advantage

The issuance profile of Eurobonds (EU, ESM, EFSF) reflects their genesis as a temporary crisis response: opportunistic issuance on most demanded maturities under programs with implicit or explicit expiry dates. This was a signal of lacking commitment that has undermined their use as global market benchmark from the beginning. Accordingly, Eurobonds still struggle to be accepted in traditional sovereign bond indices, which has an additional negative impact on their liquidity and partly explains the bias in their investor base towards hold-to-maturity long-term investors rather than transaction-oriented investors such as asset managers and banks. To create a proper Eurobonds benchmark that also facilitates inclusion in large sovereign bond indices, the Eurobonds issuance policy has to switch to a permanent commitment, creating a liquid benchmark curve. Currently, outstanding Eurobond volumes are compared to the German Bund benchmark curve. As a first step, joint debt issuance should focus on the very short end of the euro yield curve (EU Bills) and opportunistically issue longer-dated instruments to finance defense and climate change programs (e.g. SAFE Bonds for European defense). These instruments are likely to meet the least political resistance as they either do not entail permanent fiscal transfers (EU Bills) or finance widely accepted European public goods. The current Euro Bills market – primarily supplied by Germany, France and Italy – has a volume of only about EUR500bn (vs USD8trn for US T-Bills); to have a meaningful global impact, EU Bills should reach at least two times that size. One should also consider that instead of issuing national bills, the individual DMOs (Debt Management Office) could do so within an “EU bill wrapper”. In this way, the EU-Bills issuance volume could be increased further. In the case of longer-dated Eurobonds, an additional EUR500bn in issuance would represent a substantive step forward. With a focus on defense spending needs, joint issuances could even reach EUR1.8trn in a catch-up phase from 2026 to 2035.³

The creation of a European bills market is part of a broader strategy to internationalize the euro and take over markets share from the USD whose role is still dominant but weakening. The case for internationalizing the euro is compelling in the context of strategic autonomy. Despite higher seigniorage income (annually 0.15% of GDP for the ECB vs 0.5% of GDP for the Fed), a more international euro would reduce Europe's structural dependence on USD funding. Currently, Eurozone banks source roughly 17% of their funding in USD, with around 25% lacking sufficient USD liquidity to cover this exposure.⁴ Shifting more global trade and finance into euros would transfer foreign exchange risk away from European firms, lower hedging costs and stabilize revenues. It would also enhance Europe's geopolitical leverage, increasing its ability to deploy financial sanctions, resist USD coercion (tariff threats) and reduce exposure to US monetary policy spillovers. Developing a deep euro-denominated offshore funding ecosystem is essential to expand the currency's use in global transactions. This is in line with the ECB's recent announcements on expanding the Euro Repo Facility (EUREP). EUREP will give non-euro central banks access to euro liquidity against high-quality collateral (government bonds, Eurobonds).

³ Hildebrand, P., Rey, H. and Schularick, M., “European Defence Governance and Financing, CEPR, November 2025

⁴ European Banking Authority (EBA), EU-wide Stress Test, 2025

Meanwhile, the swap-line system provides foreign institutions with the euros they need to purchase those bonds and manage liquidity. This would support European autonomy by mitigating spillover effects when market stress rises in the US, China or other. To increase this, more collateral is needed. Eurobonds can play an essential role here if they are treated equally to euro government bonds.

Beyond financial stabilization, swap lines reinforce Europe’s diplomatic alliances with partners seeking protection from the growing rivalry between the two major powers. In that sense, swap lines operate as a sort of “financial NATO.” Foreign governments and investors increasingly want to diversify away from the strategic pressure exerted by both the US and China, and toward an economic area that still embraces open markets rather than zero-sum protectionism. This dynamic is also at the core of Europe’s negotiations with Indo-Pacific partners – an echo of Mark Carney’s ambition to “build a new trading bloc of 1.5 billion people.” But for Europe to offer a credible alternative, it must provide the financial infrastructure that makes strategic autonomy possible. The benefits of a more international euro are both financial and geopolitical. Europe would reduce its dependence on US infrastructure for payments, security and technology; strengthen its export competitiveness, secure commodity imports under EU regulatory standards and prevent the ongoing private-sector shift toward US capital markets by offering firms the deep funding pool they need at home. The final component of a successful global-euro strategy is the transition toward a digital euro and a modern mix of public and private money. Blockchain-based technologies – embodied by central bank digital currencies and stablecoins – enable almost instantaneous, low-cost convertibility between currencies without intermediaries. Europe should therefore build a stablecoin infrastructure supported by the newly created European bills market, which would guarantee its value and be held broadly by the retail sector. In parallel, an ECB-issued e-euro would support wholesale payments, ensuring safety and stability across borders and within the Eurozone. This dual system would deliver smooth and reliable funding to all users, strengthen foreign capital inflows, enhance the euro’s role in the global monetary system, reduce dependency on US technological platforms and lower transaction costs for businesses and consumers, in turn enhancing the growth within the union.

The EU increasingly operates through two-speed integration or enhanced cooperation mechanisms like the proposed 28th regime for capital markets. The existing Eurobonds structure relying mainly on the planning of the DG BUDG as de facto DMO for the entire EU might not prove flexible enough to adjust to the funding needs of changing coalitions around strategic targets. A flexible Eurobond architecture might become necessary to accommodate coalitions of the willing without fragmenting the single market. The German Länder-Jumbo model and Nordic Investment Bank framework offer a viable template for scaled Eurobond issuance without requiring full fiscal union or treaty change. Under this EU Jumbo structure, member states would join specific issuances on demand, contributing proportionally to fund specific strategic priorities, such as defense procurement, climate infrastructure or energy transition projects. This variable geometry approach resolves two critical constraints. First, it accommodates shifting political priorities: As defense urgency rises or climate imperatives evolve, the creditor coalition adjusts accordingly without requiring permanent fiscal commitments. Second, it allows non-Eurozone EU members to participate. Defense and climate expenditures are overwhelmingly denominated in euros regardless of national currency and countries like Poland or Sweden face natural EUR demand and would benefit from lower funding costs through pooled issuance. Eurobonds would become EU-Bonds.

The problem is that EU-Jumbos would add a layer of complexity to an already fragmented market. Unlike homogeneous sovereign curves, EU-Jumbos would initially exhibit pricing dispersion across tranches based on participant composition. However, if these instruments receive equivalent collateral treatment to existing Eurobonds and sovereign debt in ECB operations and bank capital frameworks, market acceptance becomes viable. The primary hurdle for Eurobonds is volume, not purity. Eurobond markets face a sequencing challenge: first achieve scale, then refine homogeneity. As issuance grows beyond EUR1–2trn outstanding, liquidity improves, bid-ask spreads compress and pricing converge toward a GDP-weighted benchmark – the trajectory already visible in existing Eurobonds issued since 2021. Participation by all the “Big Four” (Germany, France, Italy, Spain) in early issuances would be essential for market credibility and benchmark establishment.

This represents a cultural shift for national Debt Management Offices accustomed to full issuance autonomy, but it preserves more flexibility than a fully federalized parallel Eurobond structure. DMOs retain discretion over participation levels, maturity preferences and topic selection, while gaining access to deeper liquidity pools and lower funding costs. For smaller member states currently paying material liquidity premia and struggling to maintain primary dealer networks with limited issuance calendars, the EU-Jumbo framework would offer immediate relief. This is the same rationale that drove small German Bundesländer to create Jumbos. Critically, this approach does not immediately resolve Eurozone fragmentation: National sovereign curves would persist alongside EU-Jumbos, and the bifurcation between core and peripheral yields would remain in the near term. But as EU-Jumbo volume scales and market infrastructure deepens, the instrument becomes a structural alternative, gradually redistributing convenience yields and reducing the self-reinforcing concentration in Bunds. The imperfect intermediate solution may be the only politically feasible path to the EUR3–5trn European safe-asset market required for genuine reserve currency status.

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