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Five things that could derail the ECB

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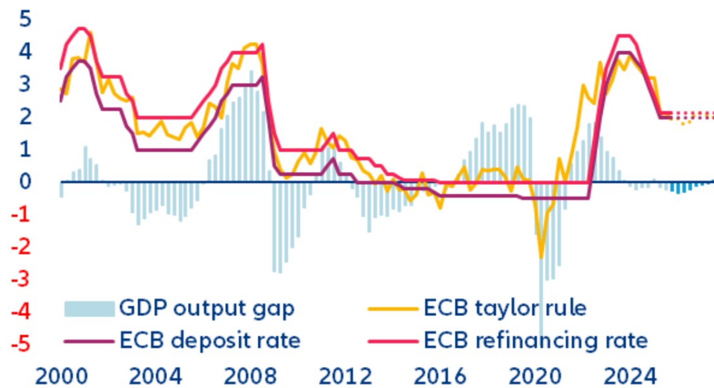
In Summary

- **At its meeting this week, the ECB is set to stay stable in turbulent times.** Despite the stormy news flow, **the** ECB is in a sweet spot in economic terms, confirming our longer-run outlook of policy rates on hold at 2%, a level the ECB views as broadly neutral. Inflation is near target, growth is close to potential and labor markets remain tight, supporting a prolonged pause consistent with ECB communication, Taylor-rule signals and r* estimates. Quantitative tightening remains the key offset: with QT equivalent to about 3.2% of GDP in annual bond supply, long-term yields stay elevated and counteract the transmission of last year's easing to the economy.
- **Credit is recovering only gradually.** Despite 200bps of ECB rate cuts until mid-2024, credit conditions remain sluggish. Private sector lending decelerated to +3.3% y/y in December 2025 from +3.4% in previous month and remains below the long-term average of 4%, Higher long-term interest rates and elevated uncertainty weigh on firms' and households' investment decisions, keeping loan appetite subdued and banks cautious on credit supply.
- **Five factors could derail the ECB's steady stance – with risks tilted to lower policy rates.** The main downside risks are a Fed-independence shock that strengthens the euro, a geopolitics-driven confidence shock lowering European investment and consumption, a Ukraine peace deal that sharply lower energy prices and a rapid AI-led productivity shock that proves disinflationary. The key upside risk to policy rates is a prolonged Middle East escalation that lifts oil prices and inflation forcing a hawkish tilt.
- **Eurozone growth outlook resilient, thanks to the German fiscal spending spree and NGEU final mile boost**. Eurozone GDP rose by a solid +0.3% q/q (1.3% y/y) in Q4 2025 Momentum was broad-based but Spain continues to be the top performer, while Germany is turning the corner only gradually. Early-year momentum should improve, with support from German fiscal easing and accelerating NGEU disbursements throughout 2026.

The Eurozone's economic sweet spot sets the stage for another ECB pause

A 2% ECB rate becomes the anchor in unsettled markets. The ECB is expected to keep its deposit rate unchanged at 2.0% at its next meeting on 5 February. Communications have been consistently neutral, with Bloomberg's ECB-speak index based on Natural Language Processing reinforcing the message. Inflation is hovering around target, economic growth is running at potential, the unemployment rate remains at historical low levels and sovereign spreads continue to tighten. A simple Taylor rule reflects the sweet spot, showing that the ECB is in a good position to hold its policy rate at the 2% neutral level – also reconfirmed by the latest Holsten-Laubach-Wiliams estimate. Our baseline outlook therefore remains at 2% for the medium to longer term, similar to market expectations that have converged to this medium-term view.

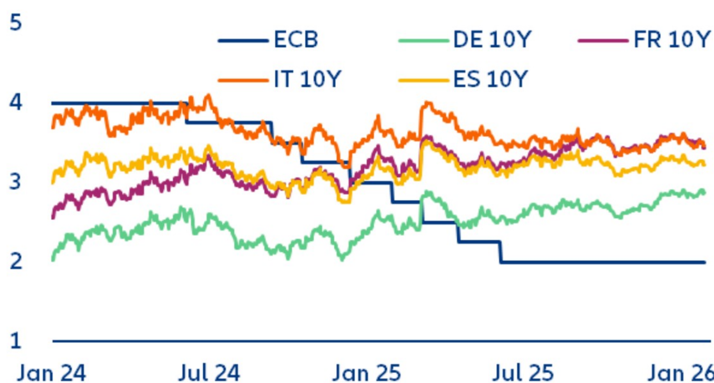
Figure 1: A simple Taylor Rule model for the ECB shows: Stay put at neutral.



Sources: LSEG Datastream, Allianz Research

However, quantitative tightening (QT) continues to exert upward pressure on long-term yields, counter-balancing the transmission from lower policy rates. The ECB and BoJ remain the fastest QT practitioners, unlike the Fed, which has halted QT and even resumed bill purchases. With QT equivalent to 3.2% of GDP in annual bond supply, European investors must absorb significant issuance against a backdrop of high fiscal deficits. Strong demand limits the risk of a UK-style "Truss moment", but QT has blunted the transmission of the rate-cutting cycle that ended last year. Since the ECB's 200bps easing started in June 2024, two-year German yields have fallen only 85bps, while 10-year Bund and OAT yields have risen by 35bps and 45bps, respectively, constraining mortgage markets and residential construction. However, Italy (-35bps) and Spain (-5bps) experienced lower rates in that time period, thanks to lower risk premia amid exceptional economic and fiscal performance.

Figure 2: Lower ECB policy rates did not lower longer-term rates.



Sources: LSEG Datastream, Allianz Research

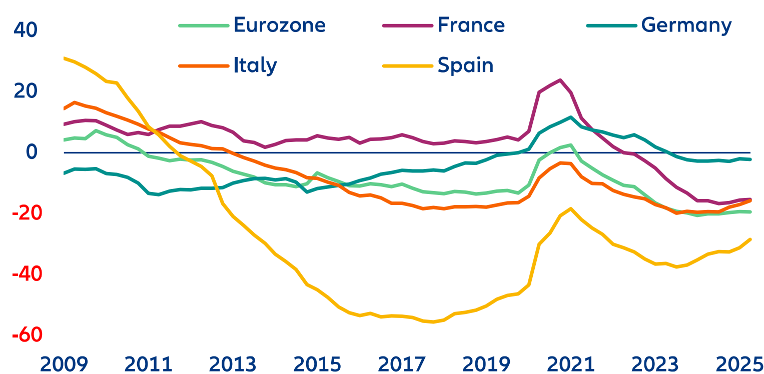
Credit recovery remains sluggish as geopolitics and higher long-term rates weigh

Despite the 200bps of ECB monetary policy easing since June 2024, the passthrough to lending conditions has remained partial and slow, resulting in only a gradual recovery of Eurozone credit. Both mortgage and corporate lending rates have declined from their November 2023 peaks but remain 50-60% above pandemic-era levels. On the demand side, elevated uncertainty has weighed on firms' and households' investment decisions, keeping loan appetite subdued. The ECB Bank Lending Survey for Q4 2025 confirms that loan demand increased only slightly, with banks expecting another modest rise in Q1 2026 – still insufficient to materially support near-term growth.

The ECB Survey on the Access to Finance of Enterprises (SAFE) for Q4 2025 reinforces the picture, showing why monetary easing has not yet translated into stronger credit flows. Firms reported a net increase in loan interest rates, together with higher non-price financing costs (fees, commissions and collateral requirements all rose). Meanwhile, financing needs rose only modestly, while firms reported the availability of bank loans declined slightly, widening the financing gap. Looking ahead, firms expect external financing conditions to remain broadly unchanged, with the general economic outlook still perceived as the main constraint on access to credit.

Monetary aggregates corroborate the sluggishness of credit dynamics: Private-sector lending growth stood at +3.3% y/y in December 2025 (from +3.4% in November), with household lending ticking up to +3.0% and credit to NFCs easing to +3.0% (from +2.9% and +3.1% respectively). The credit-to-GDP gap, which briefly turned positive in 2021, has since slipped back into negative territory and remains so, signaling credit growth weaker than implied by macroeconomic conditions. This persistent shortfall reflects the incomplete unwinding of tight post-2022 financial conditions, structurally higher borrowing costs, shifts toward consumption patterns and investment with weaker collateral value and demographic headwinds, all of which continue to restrain demand even as bank funding pressures and uncertainty weigh on supply.

Figure 3: Credit-to-GDP gaps remained in negative territory



Sources: BIS, Allianz Research. Note: The credit-to-GDP gap is defined as the difference between the credit-to-GDP ratio and its long-run trend.

Across countries, the passthrough to mortgage rates remains highly heterogeneous, shaped by structural differences in funding models, pricing benchmarks and borrower behavior. Italy and Spain should exhibit the fastest adjustment as their mortgage products remain more sensitive to money-market rates and include a larger share of variable or mixed-rate loans. By contrast, Germany and France usually show slower transmission due to the prevalence of long-term fixed-rate mortgages funded through covered bonds or long-term capital market instruments, which are less responsive to short-term policy rate cuts**.**

What could derail the ECB?

The baseline outlook remains uneventful: a 2% policy rate for the foreseeable future. The ECB has repeatedly confirmed this stance, stressing that in the absence of major shocks, it would remain on hold. But we identify five major known unknowns in addition to the inevitable unknown unknowns that could derail the steady stance:

1. **Fed independence shock (cut risk):** If markets began pricing a genuine loss of Fed independence, the euro could strengthen markedly, tightening Eurozone financial conditions and accelerating disinflation, giving the ECB scope (or pressure) to cut below neutral. This tail risk has eased somewhat following the nomination of Kevin Warsh as Fed chair – viewed as a reasonable choice by financial markets – but uncertainty around the FOMC's composition and ongoing pressure from the White House to significantly lower policy rates remain.

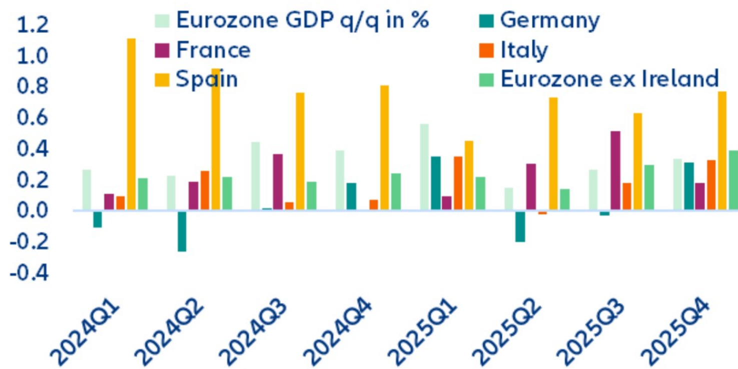
2. **Eurocrisis confidence shock from geopolitics (cut risk):** Two channels could trigger this: (i) a Russia–Ukraine escalation or (ii) a political confrontation with the US over trade, sanctions, Greenland or other flashpoints. The key transmission mechanisms are confidence, risk premia and bank lending rather than trade volumes alone. Lower investment and consumption in an already uncertain environment would weaken domestic demand, drive disinflation and widen Eurozone spreads, quickly reopening fragmentation concerns and potentially prompting insurance cuts.
3. **Ukraine peace deal leading to lower energy costs (cut risk).** A credible peace deal could require reopening Russia–Europe gas pipelines as a concession. This would reduce energy prices and push headline inflation sharply lower. Although confidence effects could boost demand, the risks for rates are tilted to the downside.
4. **AI productivity shock lowering labor demand (cut risk).** A rapid productivity gain could be disinflationary if it stems from cost compression, automation of routine services and weaker labor demand, especially in Europe, which benefits mainly on the supply side, given that AI-related investment is concentrated in China and the US. In the extreme scenario, this would resemble the 2010s environment of low inflation, low wages and a low r*, requiring a more supportive policy stance.
5. **Middle East escalation energy shock (hike risk).** The main upside risk is an oil/gas-driven inflation spike resulting from broader Middle East tensions. The ECB would face an uncomfortable trade-off: higher headline inflation and weaker growth. The reaction would depend on second-round effects – wages and inflation expectations – rather than the initial energy shock, but this is the one scenario that could force the ECB to lean hawkish despite soft economic activity.

Further upside and downside risks exist, but most are either too low-probability or insufficiently material to qualify as shocks. One scenario worth noting is the upside risk to Germany's recovery should fiscal expansion prove stronger than assumed, supported by higher multipliers and firmer domestic demand. However, we do not see this as a scenario that would alter the ECB's reaction function. While it could marginally raise Eurozone growth and inflation, the impact would be too small for the ECB to treat it as a policy-relevant shock.

Eurozone Q4 GDP: Modest momentum builds before expected reacceleration

Eurozone GDP held up well at the end of 2025, providing a modest lift to the 2026 outlook while still revealing notable divergences across economies. Activity expanded by +0.3% q/q in Q4 2025, matching the previous quarter but coming in slightly above our and consensus forecasts (+0.1% and 0.2%). This confirms that the bloc's economy has again demonstrated resilience, managing to maintain momentum despite a challenging and uncertain global environment. Full-year 2025 growth is estimated at +1.5%, a notch above our expectation of +1.4%, offering a favorable carry-over into our projections of +1.1% for 2026. This time, the positive surprise was broadly shared across countries: Germany and Italy delivered slightly stronger outcomes, while the Iberian Peninsula continued to outperform, with both Spain and Portugal exceeding expectations at +0.8% q/q. Latest survey data (PMIs) confirms our outlook that the Eurozone economy should regain some momentum early in the year and benefit more substantially from the German fiscal stimulus toward year-end. In addition, the acceleration in NGEU fund absorption in the final year of the program implies that the Eurozone will receive an amount equivalent to around 1.4% of its 2021 GDP in 2026 – albeit unevenly distributed – with disbursements likely to continue into 2027. Ireland's volatile national accounts continue to blur the economic picture of the Eurozone aggregate not only in quarterly terms (Figure 3) but also annually. While GDP growth for the Eurozone aggregate is expected to decelerate in 2026 compared to 2025 (from 1.5% to 1.1%), the picture turns upside down when excluding Ireland in which case the region's growth accelerates from 0.9% in 2025 to 1.2% in 2026.

Figure 4: The Eurozone's biggest economies posted modest quarterly GDP growth in Q4 2025 (%)



Sources: LSEG Datastream, Allianz Research

German GDP is improving but still in a wait-and-see mode. In the last quarter of 2025, GDP rose by +0.3% compared to the previous quarter. Although a detailed breakdown of Q4 is not yet available, indications suggest a significant contribution from consumer spending, ongoing weakness in investment and a further drag from net exports. For 2025 as a whole, GDP grew by +0.3% year-on-year. This was supported by private consumption (+1.5%) and government spending (+1.7%) but held back by weak private investment (-0.5%), declining exports (-0.3%, with goods down -0.7% and services up +1.1%) and a sharp rise in imports (+3.6%), mainly goods (+5.1%). This aligns with other early signs that the economy may be turning the corner, such as an increase in activity surveys and industrial orders. However, GDP in the last quarter of 2025 still remained below its pre-pandemic level, and we continue to anticipate a slower-than-expected recovery this year due to a gradual implementation and slow pass-through of the fiscal stimulus.

In France, GDP growth slowed down to +0.2% in Q4 on the back of slowing production of both goods and services after a dynamic Q3. On the positive side, household consumption accelerated. The +0.2% increase in GDP was in line with our December 2025 outlook. Manufacturing production declined slightly by -0.1% after a buoyant Q3 (+1.6%). Industrial corporates destocked their large inventories, notably in the aeronautics and ship sectors. The cyclical pick-up in French industrial production and exports remains firm but concentrated in a handful of sectors (military equipment, transport equipment). Exports of transport materials decelerated but remained dynamic at +5.4% over the quarter. Thanks to declining imports and healthy overall export growth (+0.9%), net trade contributed positively (+0.6pp) to Q4 GDP. Household consumption was a bright spot, growing at its fastest clip (+0.3%) since Q3 2024. Households' investment (essentially residential construction and home improvements) was another bright spot, edging up +1.1%. However, non-financial corporates' investments stalled (-0.1%), although this follows a very dynamic Q3. In 2025, French GDP grew +0.9% (after +1.1% in 2024).

Italy's economic activity gained some momentum, with GDP expanding slightly above expectations in Q4 (+0.3% q/q). While a detailed breakdown is not yet available, preliminary data suggest that domestic demand (excluding inventories) made a positive contribution, whereas net external demand weighed on growth. This aligns with our view that NGEU-related investment spending is ramping up and that consumer spending is gradually recovering, thanks to improving purchasing power. The better-than-expected Q4 performance coupled with an upward revision of Q3 implies preliminary annual growth of +0.7% for 2025 (versus +0.6% in our forecast) and remains broadly consistent with our baseline projections of +0.8% and +1.0% in 2026 and 2027, respectively. In the near term, continued NGEU inflows should further support the outlook. Meanwhile, separate trade data point to some resilience in 2025: the extra-EU trade surplus narrowed only slightly to EUR56.1bn from EUR57.1bn the previous year. Despite tariff pressures, the trade surplus with the US declined moderately to EUR34.2bn (from EUR38.2bn), largely reflecting a +36% surge in imports.

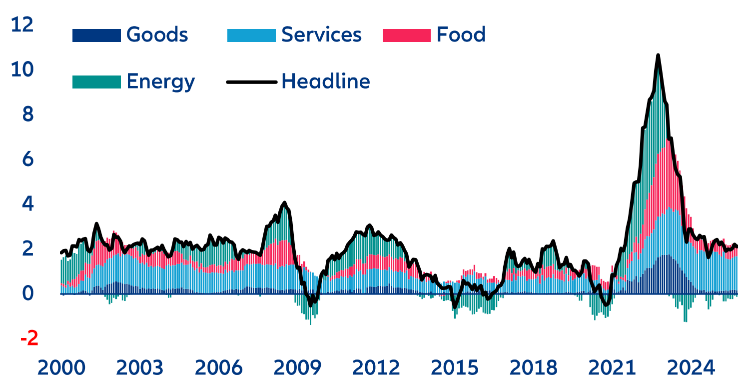
Spain has maintained its position as the Eurozone's economic outperformer, posting solid +0.8% q/q growth at the end of 2025 (above both consensus expectations at +0.6% and our estimate of +0.5%). Strong domestic demand contributed 3.6pps to quarterly GDP growth, while external demand subtracted 1pp. A slight

downward revision to Q1 2025 implies that, for the year as a whole, the Spanish economy expanded by +2.8% (close to our +2.9% forecast), marking a deceleration from +3.5% in 2024. Household and government consumption rose by +3.4% and +1.8% over the year, respectively, while investment posted a solid +6.3% increase. Exports of goods and services grew by +3.4%, compared with a +6.3% rise in imports. We expect Spain's outperformance to continue, with upside risks to our 2026 outlook. For now, we maintain our baseline forecasts of 2.1% and 2.0% growth in 2026 and 2027, as the stronger-than-expected momentum at the start of the year should offset a smaller absorption of NGEU funds. Solid growth and favorable market conditions also supported Spain's decision to renounce over EUR60bn of the loan component of the NGEU package (out of the EUR80bn initially requested).

Base effects drag inflation marginally below the ECB's target in January

Eurozone inflation edged down to +1.7 y/y in January 2026, from a downward revised +1.9% in December. Services (+3.2% y/y) and food (+2.7% y/y) inflation remain the biggest drivers while energy prices continue to fall (-4.1% y/y) As expected the impact on goods prices (0.4% y/y) from the Carbon Border Adjustment Mechanism[1], in effect since 1 January 2026, is low. Core inflation eased slightly to +2.2% y/y from +2.3% in December (-1.1% m/m).

Figure 5: Services inflation pressure remains strong (Eurozone inflation decomposition, % and pp contribution)

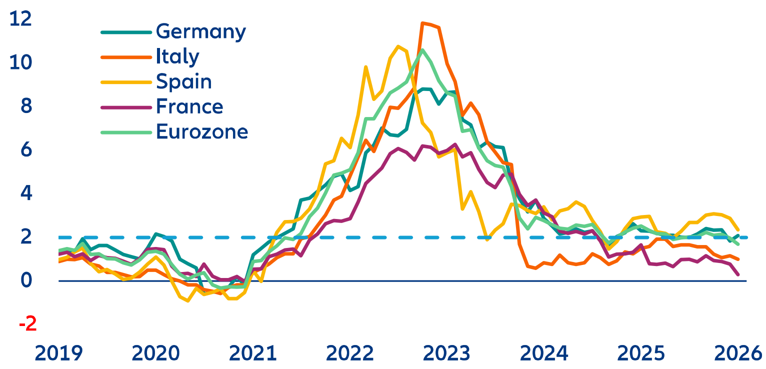


Sources: LSEG Datastream, Allianz Research

Available Eurozone national data ranges from +0.3% in France to +4.2% in Slovakia (HICP). Looking at the major economies, **Germany's** inflation was near target at +2.1% in January, driven by services at +3.2% (-0.3pp m/m), food at +2.1% (+1.1pp) and goods at 1% (+0.6pp), while energy stayed disinflationary at -1.7%. The increase in goods and food prices reflects the cost passed on from the higher national CO_2 price, which rose from EUR55 to EUR65 per ton in January. **France's** inflation cooled substantially to a muted +0.3% (-0.5pp). This is the lowest reading since November 2020. Energy deflation deepened to -7.8% y/y, as well as goods deflation to -1.2%. The latter reflected calendar effects in the textiles sector, where sales lasted longer than last year. Services inflation eased to +1.8%, its coolest since 2021. Similarly, **Italy**'s inflation decreased to +1.0% y/y in January (from +1.2%) with services and goods inflation at +2.5% and -0.2% y/y respectively. In **Spain**, price growth eased to +2.4% y/y from +2.9% in December, with monthly deflation dynamics accelerating to -0.4% m/m from +0.3% the previous month mainly due to energy-price trends. Core pressures remained strong at +2.6% for the third consecutive month.

[1] What to watch I December 11, 2025 | Allianz

Figure 6: National headline CPIs continue to decline, y/y in %



Sources: LSEG Datastream, Allianz Research.

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