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What to watch: The cost of rising waters for European families, fiscal reality check for France and Italy and the ECB's next cut

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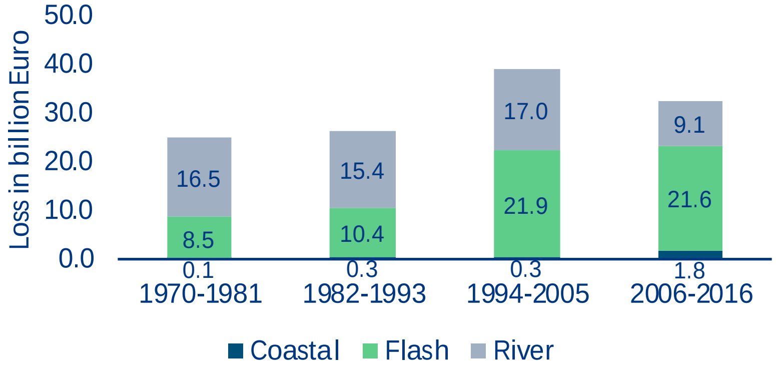
In summary

- The cost of rising waters for European families. Storm Kirk is the latest to highlight Europe's vulnerability to severe flooding, just a month after Storm Boris triggered severe flooding across Central Europe, impacting nearly 2mn people and causing insured losses estimated at EUR2-3bn. With climate change increasing the frequency and intensity of flooding events, households are paying the price. We find that a 1-meter rise in river flood reduces household disposable income growth by -0.08% on average. Between 2000 and 2010, families in France, Italy and Germany experienced total cumulative disposable income losses of EUR16,400, EUR10,500, and EUR7,800. An already hefty price which could rise further by as much as +40%, +60% and +24% over the next decade, even under climate mitigation.
- Fiscal policy reality check for France and Italy. October's multiple fiscal deadlines will be the first test for the EU's reformed fiscal rules; all eyes are on France and Italy's recently announced medium-term fiscal plans. Italy seems to have committed to some fiscal discipline, on top of positive developments on the revenue side. Its fiscal deficit is now expected at 3.8% of GDP in 2024 (from 4.3% previously estimated) and the primary balance is already returning to a 0.1% surplus this year. However, given the limited details from the government, some assumptions such as the 1% target growth for this year and the catch up in NGEU spending, seem overly optimistic. Meanwhile, the French fiscal deficit has been confirmed at -6.1% of GDP in 2024, the largest fiscal slippage the country has registered since 2000 (excluding 2009 and 2020). The -5% of GDP fiscal deficit target for 2025 looks unrealistic and we expect a fiscal slippage of -0.5pp. In this context, a potential downgrade from its current AA- rating is a possibility since France is currently borrowing at similar conditions as Spain (rated A-).
- Good things come in threes? ECB to cut again amid cloudy outlook. At its next meeting on 17 October, we expect the ECB to cut the deposit rate for a third time this year to 3.25%. With leading economic indicators surprising on the downside and inflation at 1.8% y/y, speeding up the rate-cutting cycle seems appropriate. Going forward, we still expect a terminal rate of 2.25% to be reached in the second half of 2025, though uncertainty remains high. Factors such as fluctuating oil prices and the outcome of the US elections could significantly impact growth and inflation, potentially altering the ECB's course. With quantitative tightening accelerating on autopilot, government bond yields will face additional pressure as some EUR400bn per year (currently worth 2.8% of GDP) is offloaded from the ECB's balance sheet going forward. Combined with the fiscal outlook, there is little room for Eurozone spreads to narrow, despite lower policy rates.

The cost of rising waters for European families

A month after Storm Boris, Storm Kirk is the latest example of the mounting extreme floods risk in Europe. In mid-September 2024, Storm Boris unleashed torrential rains and powerful winds across Central Europe, leading to severe flooding in several countries. Over the course of four days, the storm shattered rainfall records in Poland, Czechia, Austria, Romania, Hungary, Germany and Slovakia, directly impacting nearly 2mn people. Although flood defenses mitigated some of the worst effects, the storm still caused substantial damage, with insured losses estimated at EUR2-3bn and total costs expected to be 2.5 times higher[1]. Climate change is contributing to rising flood risks by intensifying rainfall patterns and increasing the frequency of extreme weather events, including flash floods[2]. Over the past four decades, these have caused the greatest losses in Europe (Figure 1), peaking at EUR21.9bn and remaining significant at EUR21.6bn in recent years. Coastal floods, while contributing less overall, have also seen a noticeable rise, with losses increasing from EUR0.3bn to EUR1.8bn. Meanwhile, river floods, which caused substantial damage in the earlier periods (peaking at EUR16.5bn), have seen a decline, with losses reduced to EUR9.1bn in the most recent decade mainly due to advancements in protection standards across Europe.

Figure 1: Evolution of flood-related loss in the EU-27 countries (bn EUR, 1970 – 2016)

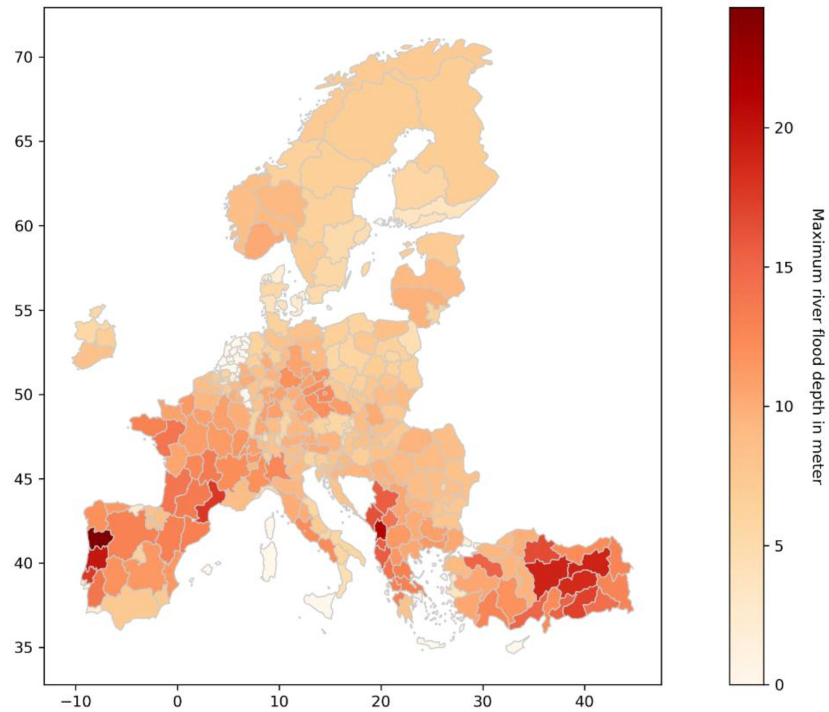


Sources: HANZE, Allianz Research

Southern Europe is particularly at risk. Figure 2 illustrates the regional distribution (using NUTS-2 classification: Nomenclature of territorial units for statistics) of maximum flood depth (in meters) across Europe for the period from 2000 to 2010, highlighting significant disparities in flood risk among various regions. Notably, areas in southern Europe, particularly parts of Greece, Spain, Italy and France, exhibit the highest flood depths, indicating a pressing need for targeted flood-management strategies in these vulnerable regions. These data account for FLOPROS protection standards[3], which serve as a benchmark for assessing flood risks and implementing appropriate protective measures. Conversely, northern Europe generally shows lower flood depths, though localized hotspots of risk still exist, suggesting that no region is entirely immune to flooding.

[1] https://www.fitchsolutions.com/bmi/esg-country/recovery-floods-could-boost-growth-central-europe-23-09-2024
[2] https://www.nature.com/articles/s41467-018-04253-1
[3] https://nhess.copernicus.org/articles/16/1049/2016/

Figure 2: Regional distribution of the maximum flood-depth (meters) in Europe for the period 2000 – 2010

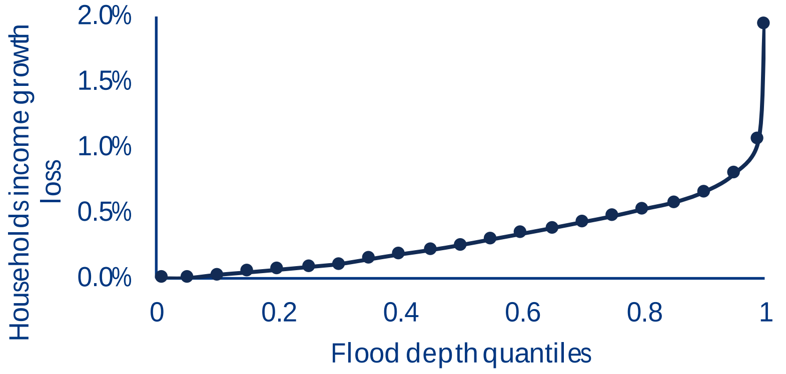


Sources: ISIMIP2a, Allianz Research

We find that the most severe floods can cut household income growth by as much as 2%, which can deepen income inequality and increasing poverty risks. Climate change is pushing up costs for households, notably in health care, food, energy and insurance, which can strain budgets, especially among the most vulnerable groups[4]. To calculate just how much, we use two key datasets. The first covers river flood depth for the period 1970 to 2010 at a 150-arcsecond resolution, incorporating FLOPROS protection standards. The second dataset includes historical household disposable income (purchasing power standards, PPS) data spanning from 2000 to 2020, aggregated at the NUTS-2 regional level. Our analysis reveals statistically significant results, demonstrating that an increase in floodwater depth of 1 meter is associated with an average reduction in household income growth of approximately 0.08%. This decline is substantial when we consider the magnitude of river flooding observed in Europe during 2000-2010. For instance, the most severe flood event during this period led to a reduction of household income growth by as much as 2% (as depicted in Figure 3). Figure 3 further illustrates the non-linear relationship between flood severity and household income growth. The impact of river flooding on income growth becomes progressively more pronounced beyond a certain resilience threshold. This suggests that while households can absorb moderate flood events with limited economic consequences, extreme floods (those in the upper tail of the severity distribution, beyond the 80th percentile) result in disproportionately large income losses.

[4] https://www.eesc.europa.eu/sites/default/files/files/qe-04-23-897-en-n.pdf

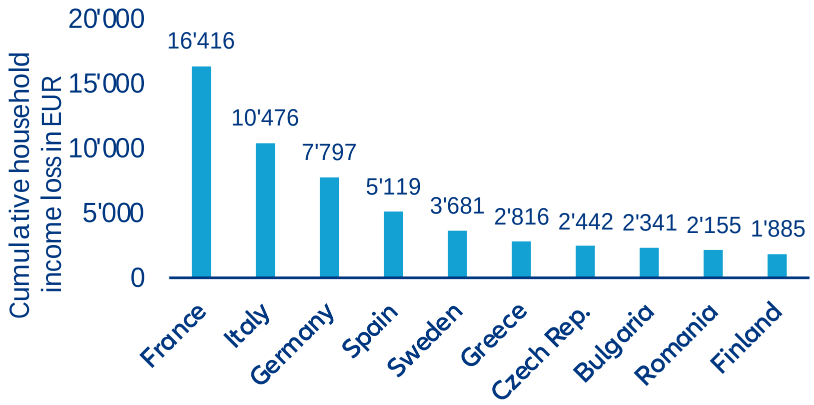
Figure 3: Household income loss with respect to river flood severity



Sources: ISIMIP2a, Allianz Research

Households in France have faced the highest cumulative disposable income losses (PPS) from river flooding (EUR16,416 per household over 2000-2010), followed by Italy (EUR10,476) and Germany (EUR7,797). Building upon the previous analysis, Figure 4 provides further insights into the cumulative household income losses in various European countries between 2000 and 2010 as a result of river flooding. The losses highlight the significant financial toll on households, with substantial disparities between countries. France experienced the highest cumulative income loss, an estimated EUR16,416 per household during the decade 2000-2010. It is followed by Italy at EUR10,476 and Germany at EUR7,797, reflecting the high exposure of these nations to severe flooding events over the decade. Spain (EUR5,119), Sweden (EUR3,681) and Greece (EUR2,816) also experienced notable losses, albeit at a smaller scale compared to the top three countries. The distribution of income losses emphasizes how flood damage is not evenly spread across Europe, with some countries bearing a much heavier burden. This could be attributed to several factors, including geographical location, the intensity of flood events and the resilience and preparedness of households and infrastructure in these regions. Moreover, Figure 4 confirms the earlier observation that income loss due to flooding exhibits a non-linear pattern. For countries that face frequent and severe flooding events, such as those at the top of the distribution, the economic impact becomes exponentially larger. Beyond a certain point, the compounded effects of successive floods overwhelm household resilience, leading to increasingly severe economic consequences.

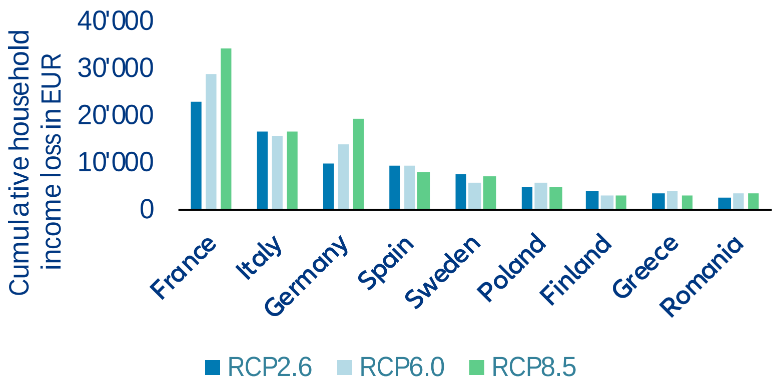
Figure 4: Top 10 cumulative households income loss in Europe for the decade 2000 – 2010



Sources: ISIMIP2a, Allianz Research

These losses could only rise further as river flooding is projected to increase in both intensity and frequency across all climate change scenarios. This will be the case even in a scenario with strong mitigation efforts like RCP2.6, which anticipates shifts in precipitation patterns and a greater probability of flood events. Figure 5 illustrates the projected economic impact on household income from river flooding between 2025 and 2035. The top five most affected countries in Europe – France, Italy, Germany, Spain and Sweden – remain unchanged from the previous decade, 2000–2010. However, under RCP2.6, the cumulative household disposable income losses (PPS) will rise significantly in these countries, with increases ranging from +24.2% in Germany to a staggering +110.1% in Sweden. For example, French households will see cumulative income losses of EUR23,099 (+40.7%), while Italian households will face losses of EUR16,736 (+59.7%), and Spanish households EUR9,172 (+79.1%). In a hothouse scenario, RCP8.5, French and German households emerge as the most heavily impacted compared to a scenario with strong mitigation efforts (RCP2.6). Cumulative French household income loss would rise by +47.8% compared to the RCP2.6 scenario, while German households would face a +100.7% increase. In contrast, households in the Netherlands (not displayed in Figures 4 and 5) are projected to experience minimal economic impact from future river floods as the country remains the least affected under all scenarios. This is largely due to its advanced flood protection standards. During the 2000–2010 period, the Netherlands registered no household income losses from river flooding. Projections for the 2025–2035 period show only minor cumulative households disposable income (PPS) losses: EUR55 under RCP2.6, EUR218 under RCP6.0 and EUR459 under RCP8.5. These relatively low figures indicate that the Netherlands' robust flood-defense infrastructure, with already 1-in-4000-year to 1-in-10000-year return period protection infrastructure[5], continues to effectively mitigate potential economic damage.

Figure 5: Top 10 cumulative household income loss in Europe for the decade 2025 – 2035 across different emissions scenarios



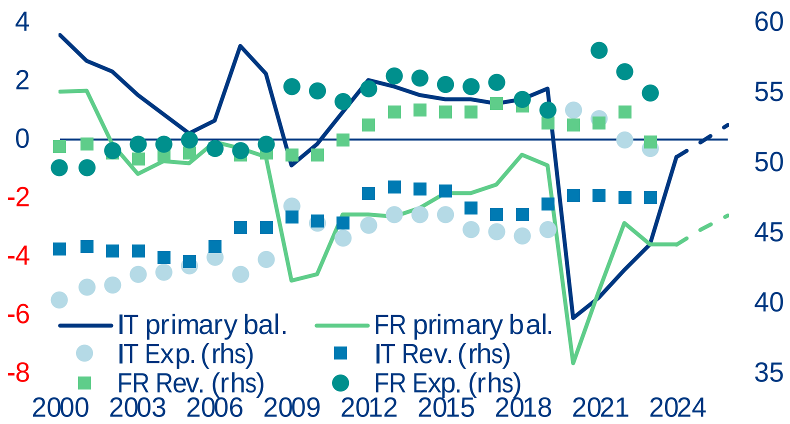
Sources: ISIMIP2b, Allianz Research

[5] https://nhess.copernicus.org/articles/22/2567/2022/

Fiscal policy reality check for France and Italy

Ahead of the 2025 Draft Budget deadline, France is warning of large fiscal slippages, while Italy commits to some fiscal discipline. The EU fiscal framework is facing its first test as countries submit their medium-term fiscal-structural plans (MTPs), a key component of the renewed EU fiscal framework approved last April. All eyes are now on France and Italy's budgetary proposals for the next five years, given that the two EU heavyweights were placed under the Excessive Deficit Procedure (EDP) in July for breaching the 3% deficit rule. While the new rules will allow for a more gradual and country-specific consolidation path than the previous framework, they do not seem as simple to apply as initially hoped.

Figure 6: Government primary balance, expenditures net of interests and revenues (% of GDP)



Source: LSEG Datastream, Allianz Research

The French fiscal deficit has been confirmed at -6.1% of GDP in 2024, out of which the structural deficit stands at -5.7%. At -1.7pp of GDP deviation from the target, this would be the highest fiscal slippage France has registered since 2000, excluding 2009 and 2020. The second worst instance of fiscal slippage over the same period was in 2003, with a deviation of -1.5pp to the target (to a total deficit of -4.1% of GDP). At that time, tax revenues were lower than expected due to the economic slowdown, which contributed to the widening deficit. In addition, government spending increased due to higher social welfare costs, public sector wages and other expenditures. The current fiscal slippage is mainly due to the worsening of the structural deficit, adjusted for the effects of the economic cycle and one-off (temporary) measures, on the back of (i) higher local government expenditures both in operations (-0.2pp of GDP) and in investment (-0.2pp of GDP), (ii) the evolution of pension benefits, particularly supported by the revaluation in 2024 based on 2023 inflation (-0.5pp of GDP), (iii) lower tax receipts (-0.5pp of GDP), (iv) an increase in debt-servicing costs (-0.2pp of GDP) and (v) an increase in expenditures for future investments (-0.1pp of GDP). However, these effects would be mitigated by the gradual phasing out of exceptional measures taken to protect households and businesses from rising energy prices (+0.7pp of GDP). Hence the remaining 1pp of GDP of additional fiscal consolidation measures needed.

The -5% of GDP fiscal deficit target in France for 2025 looks unrealistic; we expect a fiscal slippage of -0.5pp. While the government's macroeconomic assumptions look more plausible with GDP growth forecasted at +1.1% in 2025 vs +1.7% previously, consistent with the announced size of the fiscal adjustment (i.e. EUR60bn or 2% of GDP), we are doubtful that they will manage to consolidate by a sizeable 1% of GDP in40% only one year. First of all, there is little incentive in the National Assembly (both for the left and the far-right) to push for sharp fiscal austerity so the minority government will likely have to water down its plans if it wants to avoid a no-confidence vote. The key dates to watch will be 21 October – the start of the Parliament debate on tax receipts; 24 October – the debate on local government spending and other debates on different spending/receipts measures ongoing between 05 November and 18 November. Secondly, the planned spending cuts look difficult to achieve as half of them come from a combination of local government and social security budgets (see Figure 7). Indeed, the issue is that the central government has no leverage to force local governments to reduce spending, even as it partially banks on the increased efficiency of spending and a crackdown on tax evasion, which have proved inefficient over the past years. Since 2009, the French government has managed to collect EUR12bn on average every year by tackling tax evasion, equivalent to less than 0.5% of GDP. Finally, while the government intends to rely on tax hikes for about a third of the fiscal adjustment, tax collections are likely to undershoot expectations because of the shrinking tax base in a country where the tax burden is already very high. The main focus is on doubling the internal consumption tax on electricity (TICFE), reducing the state subsidy, and therefore almost doubling the MWh from EUR22.50 to EUR42 in February 2025. There will also be an additional tax on households earning EUR500K per year (65,000 of them in France) and an 'exceptional tax,' for 'one year or maybe two', on the profits of 300 companies that have a turnover of EUR1bn or more. Lastly, there will be an increase in taxes on polluting transport and sports betting, and a change in the tax system for Airbnb rentals. In the end, the government decided not to cut back some of the unfair, costly and inefficient tax rebates (EUR80bn in total) or reinstate a wealth tax, to decrease the deficit and potentially fund lower social contributions, which could improve French companies' competitiveness. The minimum pace set by the EU fiscal rules is a deficit reduction of 0.5pp of GDP per year from 2025, which should bring French government debt on a downward path by 2029 from a peak of around 117% of GDP in 2027. The minimum adjustment set by the new EU fiscal rules would bring France's deficit down to 3.6% of GDP by 2029 with a primary deficit of -1.2% of GDP, the level needed to bring French public debt ratio down.

Figure 7: Main policies announced by the French government as part of the 2025 Budget

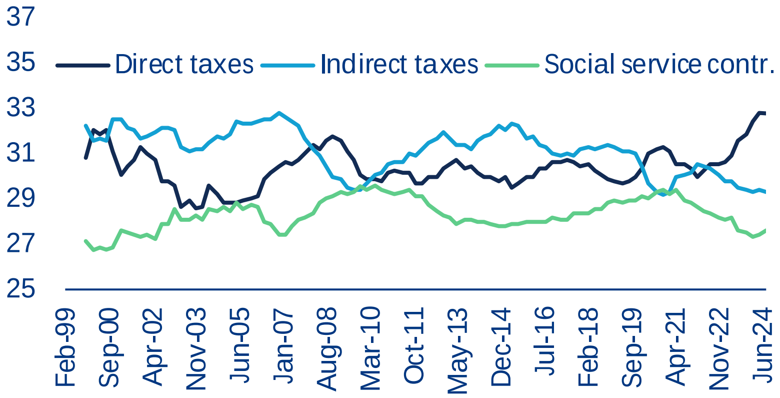
Higher tax receipts	EUR 19.3bn	Spending cuts	EUR 41.3bn
Surtax on large corporates	8.5	Lower subsidies to corporates	4.7
Other tax measures on corporates	5.1	Budget freezes (excl. defence, incl. apprenticeship schemes)	21.5
Taxes on households (incl. Lower tax optimization schemes for wealthy households)	5.7	Social Security cuts (incl. pensions indexation 6-month delay)	10.1
		Local governments spending cuts	5

Sources: various sources, Allianz Research

Downside risks to our French GDP growth forecast remain high. France's economy is growing broadly at potential. While the business cycle will not provide much support to fiscal consolidation, the latter can in turn reduce GDP growth through negative confidence effects, mainly from tax hikes. Overall, these measures could cut French GDP growth by -0.5pp in 2025 (if fully implemented) while financial and monetary conditions could slightly alleviate the negative impact as the ECB will implement 100bps of rate cuts by mid-2025. A -0.5pp cut in GDP growth (to 0.7% in 2025) would push the fiscal deficit to -5.8% of GDP (against the -5.5% we forecast and the -5% the target of the government). For debt dynamics, the key for stabilizing the ratio in the medium run is to protect growth and reassure investors to keep the effective interest rate low (currently at 1.8%).

In Italy, a mix of an improved outlook and non-recurrent inflows sets the stage for a more compliant fiscal approach, but it is only the beginning. Indeed, the fiscal deficit for this year is lower than previously estimated by the government, down from 4.3% to 3.8% of GDP (our estimate was 4.6%); next year is estimated 0.4pps down at 3.3% and for 2026 already below 3% (in a no-policy-change scenario). Approximately EUR10bn of these savings could provide some breathing room for next year's budget. On top of GDP revisions, the better starting point is mainly coming from the expenditure side: direct taxes have significantly increased (Figure 8), in turn, due to the record performance of the Italian labor market. Job creation has been strong in the aftermath of the pandemic crisis, and employment has hit its highest level at 4.5% above both April 2008 and December 2019 levels.

Figure 8: Italy - government revenues breakdown (% of total revenues)

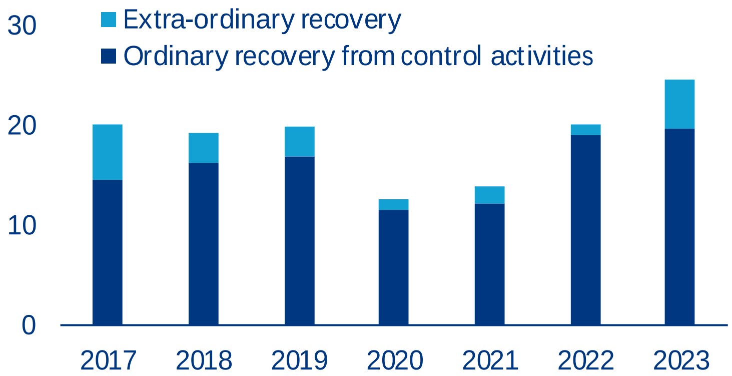


Sources: ISTAT, Allianz Research

Italy also opted for an extended seven-year adjustment period instead of the "canonical" four years, given the commitments to pursue investments and reforms outlined in the National Resilience Plan in areas such as justice, public administration, the tax system and the business environment. The net expenditure path, the new framework's anchor, is expected to average 1.5% in the plan horizon, as required by the EC, to reach a structural primary balance of 3.3% of GDP by 2031. However, few details have been given so far on how the targets will be reached. While the MTP appears feasible, envisaging a 0.5% primary structural fiscal adjustment for the coming years, some assumptions may seem overly optimistic. Indeed, the upward revision of the 2021-2023 national accounts implies a carryover of 0.4% instead of 0.6% at the end of Q2 2024, making the government's +1% GDP growth forecast for this year clearly ambitious (our forecast was +0.8% before the statistical institute's revisions). The full absorption of the NGEU funds by 2026 also appears to be a challenging assumption as of today. Although it is true that Italy has received more than 50% of the allocated resources (well above the average for other countries), the payments have not fully translated into actual spending; only around EUR51bn out of the EUR194bn have been employed.

Playing little tricks; non-recurrent revenues to alleviate public finances in Italy in the near term. As part of a larger privatization plan (EUR20bn by 2026), the Italian government is preparing to sell 14% of Poste Italiane soon, which could generate over EUR2.3bn based on current market values. So far, EUR3bn has already been secured through the sale of shares in Eni and Monte dei Paschi di Siena. Additional resources are also being raised through ongoing efforts to combat tax evasion, which have led to some reasonable inflows (Figure x4). However, a significant portion of the funds comes from tax amnesties, which are at high risk of becoming structural.

Figure 9: Italy - government revenues (in bn) from fight against tax evasion and collection activities.

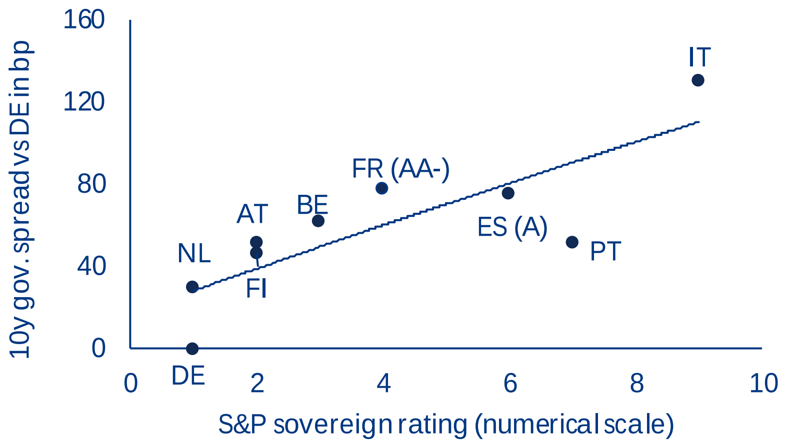


Source: Agenzia delle Entrate, Allianz Research

Clouds have cleared in Italy, but not completely. The debt stock remains relevant and is still expected to follow an upward path in 2025-2026 due to the massive repercussions of the Superbonus while the new framework requires an annual debt reduction of 1pp over the adjustment period. The cost of servicing this debt will remain significant. Despite the ECB loosening its monetary stance, the debt burden is projected to stay around 3.9% of GDP on average over the next three years. Medium- to long-term sovereign bonds maturing amount to approximately EUR235bn for 2025 and EUR283bn for 2026. Fiscal credibility in the financial markets remains crucial for refinancing Italian debt. The appetite for BTPs continues to be solid among retail domestic investors, which now hold 14.5% of total government debt, up from 9.5% at the end of December 2019. These investors are gradually – though not entirely – absorbing the chunk of bonds the ECB is releasing.

The upcoming rating decisions will be a moment of truth, especially for France. A potential downgrade from its current AA- rating (with Fitch's decision due tonight, 10th October, currently maintaining a stable outlook) remains a possibility. From a historical perspective, a negative watch would be more likely than an outright downgrade. In the latter case, further market volatility in French spreads cannot be excluded. Even though the market is already pricing in one or two notches downward (Figure 10), such a quick move would be seen as a potential blueprint for the other rating agencies' decisions to follow until the end of the year. Moody's (currently AA2 stable) will review on 25 October and S&P (currently AA- stable) on 29 November. Recent political events, compounded by the new government's fiscal announcements, have caused the convergence of French OAT spreads with Spanish Bonos spreads, despite Spain being rated A-. Additionally, the spread between French and Italian 10-year bonds has narrowed to its lowest levels since January 2010 – not only thanks to a better position on the fiscal side, but also thanks to strong domestic retail demand for Italian government bonds. Italy seems to be safe from any downgrades for the time being, but markets will still pay attention to the forthcoming reviews by Fitch and S&P next week (18 October) and Moodys thereafter (22 November), and to any fiscal slide.

Figure 10: Country ratings and government bond spreads over Bund



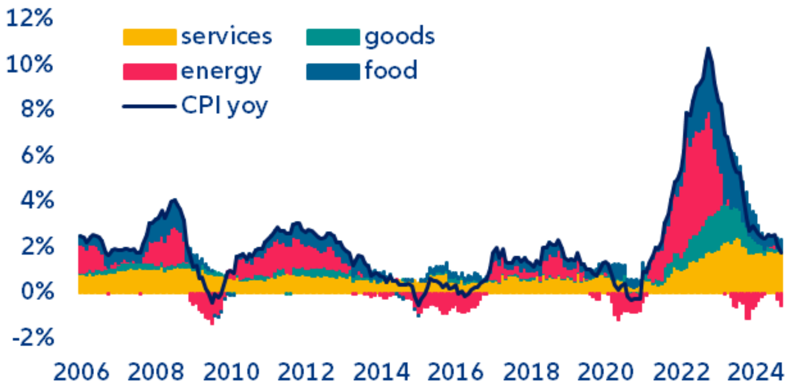
Sources: various rating agencies, Allianz Research

Good things come in threes? ECB to cut again amid cloudy outlook

The ECB will likely accelerate its rate-cutting cycle by delivering a third cut this year after recent economic data surprised on the downside. At its next meeting on 17 October, the ECB is likely to lower the deposit rate again by 25bps to 3.25%, thereby shifting from a quarterly to a meeting-by-meeting pace. Lower-than-expected inflation as well as weak economic surveys would indeed allow for a faster rate-cutting path. ECB president Lagarde almost committed to an October cut by saying that the latest inflation numbers strengthened her confidence and will be taken into account at the "next monetary policy meeting". However, that was before the blockbuster US labor report came out last Friday, pointing to a slower Fed cutting cycle ahead, something ECB policy makers are unlikely to ignore. Additionally, there have been opposing views recently, with ECB vice president de Guindos saying that it is too early to claim victory on inflation. While markets are pricing in a 95% chance of a cut, it seems this is not yet a done deal.

The inflation rate in the Eurozone fell from 2.2% to 1.8% y/y in September, undershooting the target for the first time since 2021. Notably, the sharp drop was again largely driven by the energy component as core inflation only inched down from 2.8% to 2.7% y/y (Figure 11). The biggest driver remains services inflation, which similarly only fell a tenth of a percentage point to 4.0% y/y, thereby staying at historically elevated levels. Sequentially, however, services prices fell by an annualized -2.0% m/m[6], which is the largest decline since 2021.

Figure 11: Eurozone inflation and contributions by component, %

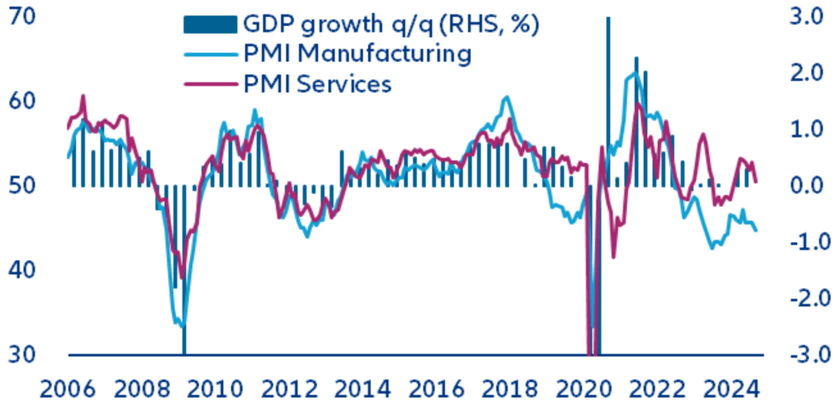


Sources: LSEG Datastream, Allianz Research

Meanwhile, leading economic indicators fail to confirm an economic rebound while the labor market shows some signs of weakness. In a somewhat disappointing development, purchasing manager indices (PMI) – widely regarded as the best leading indicator of economic activity – fell to a 10-month (8-month) low in the manufacturing (services) sector in September (Figure 12). Similarly, subcomponents such as employment and input prices fell substantially, implying ongoing disinflation but also a slowdown in the labor market. Looking at hard indicators, the unemployment rate is still at a record low but the vacancy rate has fallen at a rapid pace lately (Figure 13). These developments raise concerns about the expected economic recovery, especially following five quarters of stagnation that ended last year and the still-muted growth seen this year, driven mostly by net exports rather than domestic demand. Against this backdrop, ECB policymakers could set aside the gradual approach and cut rates faster than previously expected.

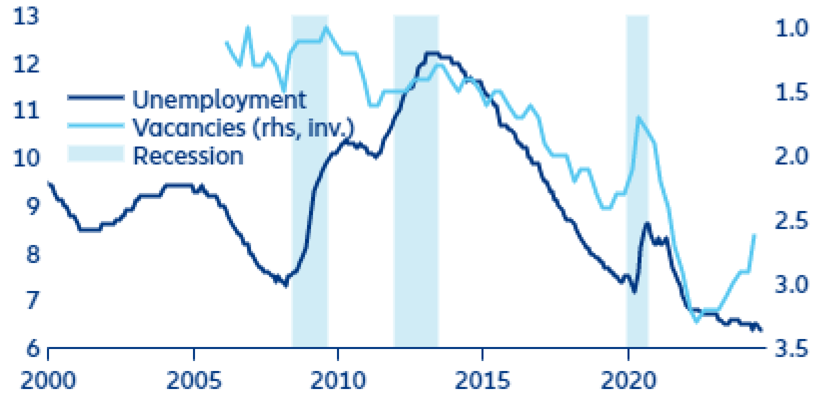
[6] *Using our own standard seasonal adjustment as official data are not seasonally adjusted on a subcomponent level.*

Figure 12: Eurozone growth and purchasing manager indices, % (RHS), index (LHS)



Sources: LSEG Datastream, Allianz Research
Notes: Values during the Covid-19 pandemic and the GFC (2009 and 2020) are truncated

Figure 13: Eurozone unemployment rate and vacancy rate, %

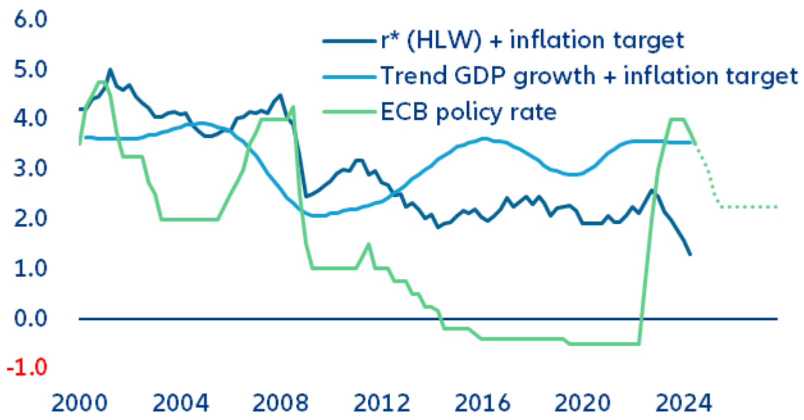


Sources: LSEG Datastream, Allianz Research

Going forward, we expect one more cut in 2024 and a terminal rate of 2.25% to be reached by mid-2025. Unfavorable base effects will push headline inflation up again towards the end of the year but Lagarde has already announced that the ECB will look through these statistical peculiarities. Hence, we expect one more rate cut at the meeting in December as the focus shifts from fighting inflation to supporting a lackluster economy. In 2025, we still expect a somewhat slower, quarter-by-quarter adjustment of the policy rate as policymakers will want to see how the first 100bps of cuts support economic activity. According to the ECB's own models this should translate to 0.5-1.5pp of additional growth over two years and 0.1-0.5pp more inflation.[7] Since our latest quarterly economic outlook we have lowered our expectations for the terminal rate from 2.5% to 2.25%, still to be reached by September 2025. This level would still be significantly above the current estimate of the neutral rate using the Holsten-Laubach-Williams approach but considerably lower than structural nominal GDP growth, which serves as another anchor for a long-term neutral rate (Figure 14).

[7] *See [The transmission of monetary policy (europa.eu)]*

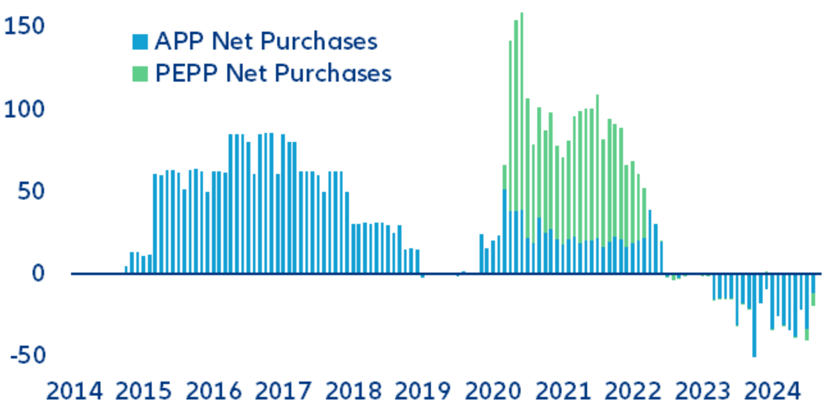
Figure 14: Eurozone nominal neutral rate measures and policy rate, %



Sources: LSEG Datastream, Fed New York, Allianz Research
Notes: ECB policy rate is the deposit rate since June 2014 and the main refinancing rate before. Dots represent Allianz Research forecast. Trend GDP growth is the HP-filtered trend component of the annualized quarterly real GDP growth rate. HLW stands for the Holsten, Laubach, Williams approach to determine the real natural interest rate r which is published by the New York Fed for the US and the Eurozone.*

Meanwhile quantitative tightening continues at an accelerated speed after the partial roll-off of the PEPP portfolio started in July. As already announced in December last year, the ECB has allowed for a EUR7.5bn capped roll-off from its PEPP QE program since July.[8] In addition to the full roll-off from the APP program, the average monthly bond reduction now amounts to EUR35bn and is set for another acceleration to around EUR40bn from January next year onwards (see Figure 15). As the lion's share of these bonds are government bonds, this will keep the pressure high on the long-term yields in the Eurozone. Figure 16 shows, that at this speed, an additional EUR400bn of government debt annually, currently equivalent to 2.8% of GDP, will have to be taken up by private investors until the end of 2026, with Italy at the upper range (3.2%) and France (2.7%) and Germany (2.3%) somewhat below. ECB policymakers have repeatedly emphasized that they intend to keep quantitative tightening on autopilot, and for good reason – Figure 16 also shows, that the ECB will still own around 19% of Eurozone debt (in % of GDP) at the end of 2026. And since owning government debt has led to large central bank losses in 2023[9], central bankers in Frankfurt are obviously inclined to reduce the holdings as much as possible – if market conditions allow for that.

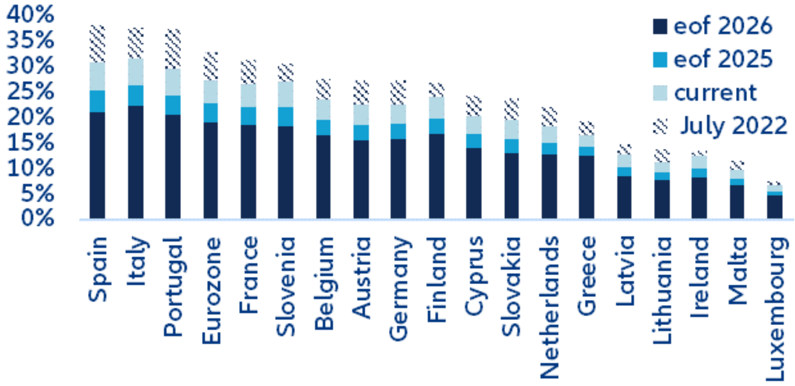
Figure 15: ECB quantitative easing and tightening by program, EUR bn



Sources: LSEG Datastream, Allianz Research

[8] *See Monetary policy decisions (europa.eu)*
[9] *See our story in 2024_02_29_what_to_watch.pdf (allianz.com) (and Figure 3 in particular).*

Figure 16: ECB holdings of government debt by country at different points in time, % of GDP



Sources: LSEG Datastream, Allianz Research

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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