

# **Euro area resilience under strain as global risks intensify**

## Euro Area Stability Watch 2026.

- **The new ESM publication assesses how intensifying external risks could affect euro area resilience and public finances.**
- **The topical chapter shows that, over the long run, military spending can to a significant extent pay for itself if it supports innovation and growth.**

(Luxembourg) - The European Stability Mechanism (ESM) today launched a new publication: the *Euro Area Stability Watch*. As part of the ESM's crisis prevention mandate, the report provides an annual assessment of risks to the euro area economy and examines whether resilience can be sustained as external risks intensify and fiscal buffers erode. It focuses on sovereign vulnerabilities, supporting a forward-looking and integrated assessment.

The first edition finds that the euro area has proven resilient in the face of repeated crises, but that this resilience is coming under strain.

"The euro area's resilience is not self-sustaining. In a more uncertain world, it will depend on credibility, discipline and the policy choices that are made today," said Rolf Strauch, Chief Economist of the ESM.

Two external risks dominate the outlook: prolonged geopolitical tensions, including the possibility of renewed escalation in the Middle East, and an abrupt loss of value of US assets. These two risks could reinforce each other through higher energy prices and uncertainty, weaker confidence, and tighter financial conditions.

Protracted and severe geopolitical tensions tend to cause disproportionately larger economic damage. Persistently sluggish investment leaves lasting scars on economies.

Weak spots in parts of the financial system, particularly among non-bank financial institutions and in sovereign bond markets, act as amplifiers, making shocks spread faster and hit harder.

The report presents an adverse scenario using the European Commission's 2026 Spring Economic Forecast as the baseline. It shows that risks do not simply add up. The combination of prolonged geopolitical tensions and a sharp repricing of US assets could push the euro area into recession, raise annual inflation close to 5%, and put most countries on upward-trending public debt paths, assuming no monetary or fiscal policy response. Over the long run, and under persistent slow growth, debt dynamics would worsen markedly. Public debt would increase by about 20 percentage points of GDP compared to the baseline in 2035, with almost all euro area countries moving onto upward debt trajectories.

The adverse scenario implies significant fiscal adjustment challenges. Governments would face large and sustained consolidation needs, beyond what many countries have achieved in the past, at a time of tighter financing conditions and rising spending pressures, including defence. Fiscal frameworks provide time and flexibility only if markets trust governments' commitment to sound public finances. As debt rises and fiscal buffers erode, policy choices will become increasingly important. Credibility, discipline, and targeted support will therefore be essential.

The report also includes a topical chapter on the fiscal implications of higher defence outlays. It shows that the long-term fiscal cost is not fixed. When spending is well designed, up to 53 cents of every additional euro spent can be recouped over time through stronger growth and higher revenues. This requires a European approach to defence, a focus on innovation-intensive procurement, efficient European supply chains, and credible fiscal frameworks.

Economic returns are strongest when defence spending drives investment, innovation and productivity across Europe. By contrast, spending concentrated on personnel, maintenance or imported equipment delivers significantly weaker growth effects.

The *Euro Area Stability Watch* is [available on the ESM website](#).



## Euro Area Stability Watch 2026

### Global shocks, domestic shields: Resilience under strain

The Euro Area Stability Watch provides an integrated assessment of macroeconomic and financial risks in the euro area, highlighting their implications for public finances and sovereign debt markets.

[Go to the report →](#)

## Contacts



### [Cédric Crelo](#)

Head of Communications and Chief Spokesperson

+352 260 962 205

[c.crelo@esm.europa.eu](mailto:c.crelo@esm.europa.eu)



### [Anabela Reis](#)

Deputy Head of Communications and Deputy Chief Spokesperson

+352 260 962 551

[a.reis@esm.europa.eu](mailto:a.reis@esm.europa.eu)



### [Juliana Dahl](#)

Principal Speechwriter and Principal Spokesperson

+352 260 962 654

[j.dahl@esm.europa.eu](mailto:j.dahl@esm.europa.eu)