

Euro Area Stability Watch 2026.

Global shocks,
domestic shields:
Resilience under strain

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European Stability Mechanism

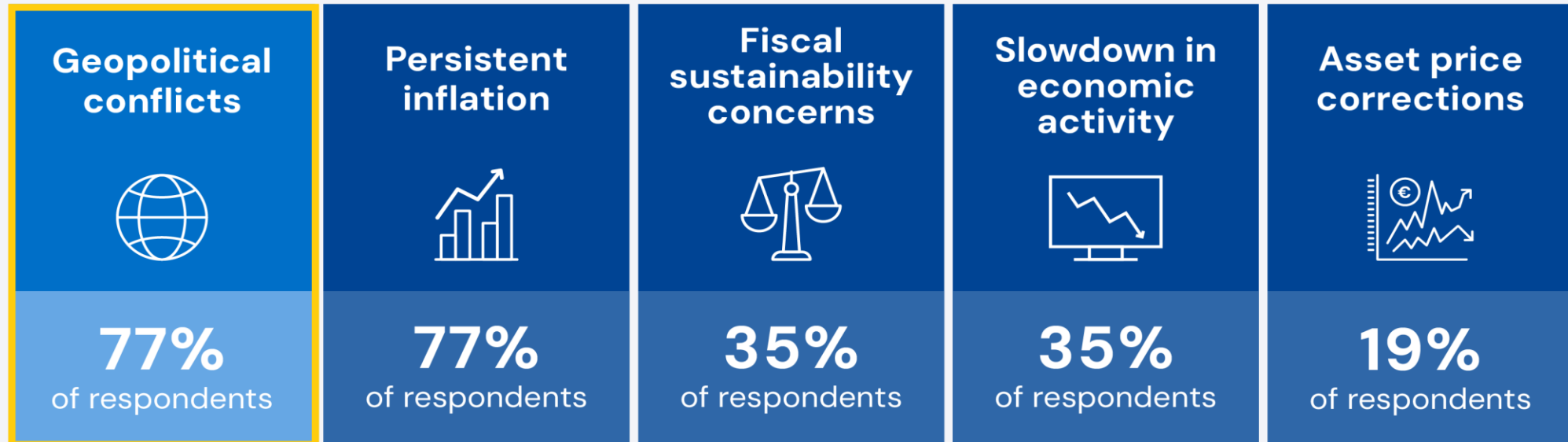


The euro area in a volatile world

Geopolitical risks are on the top of investors' minds

Top five risks for euro area sovereign bond markets

(share of respondents, in %)



Note: Respondents were asked about most material adverse risks for euro area sovereign bond markets over the next 12 months.

Source: ESM Sovereign Sentiment Survey

Adverse scenario: Middle East tensions and US asset repricing

Combined shocks can push the euro area towards recession, with inflation soaring

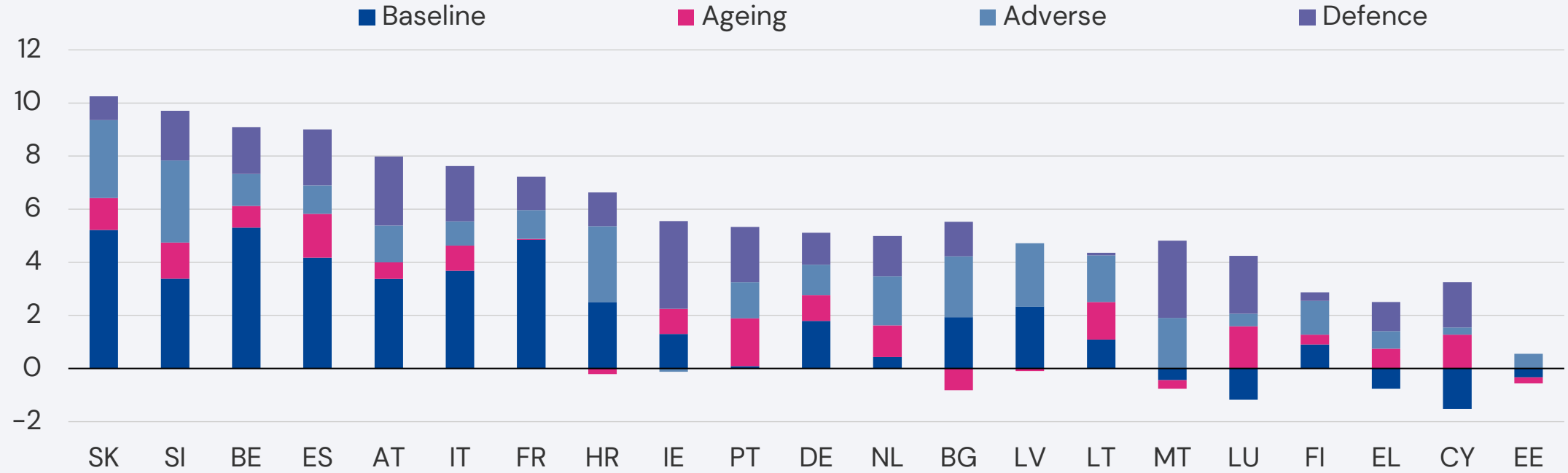


Source: ESM calculations based on European Commission Spring Forecasts April 2026 and Eurostat data

Fiscal constraints require difficult policy choices

Credibility is essential for fiscal resilience

Cumulative adjustment needs 2026-2035
(in percentage points of GDP)



Notes: Adjustment needs are split into (i) baseline needs stemming from initial budgetary conditions (ii) additional needs to offset adverse economic conditions; and (iii) long-term spending pressures from defence to reach NATO’s 3.5% of GDP target by 2035 and costs of ageing (2024 Ageing Report). Austria, Cyprus, Ireland, and Malta are not NATO members, but an increase in defence spending up to 3.5% of GDP target is also included in the exercise.

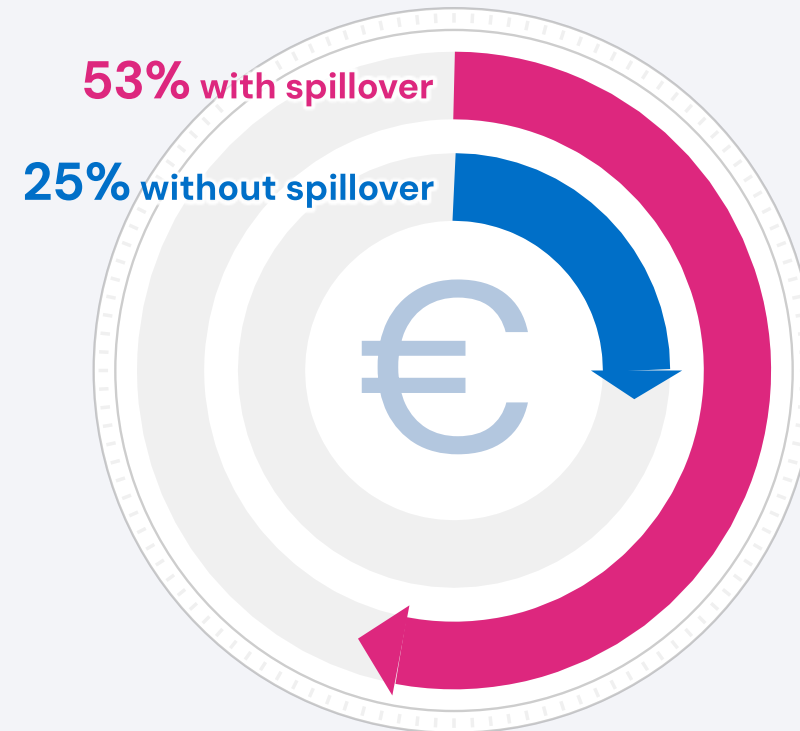
Source: ESM calculations based on European Commission’s AMECO data, spring 2026 package data and the 2024 Ageing Report

Well-designed defence spending can partly pay for itself

Productivity spillovers to the civilian economy yield stronger growth and higher revenues

Self-financing ratio of defence spending

(% recovered in the long-term)



Source: ESM calculations

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