Debt Sustainability and Resilience

Taking stock and looking ahead

GDV Volkswirtschaft Trilogie "Staatsschulden"

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European Stability Mechanism

Grappling with high deficits and debt

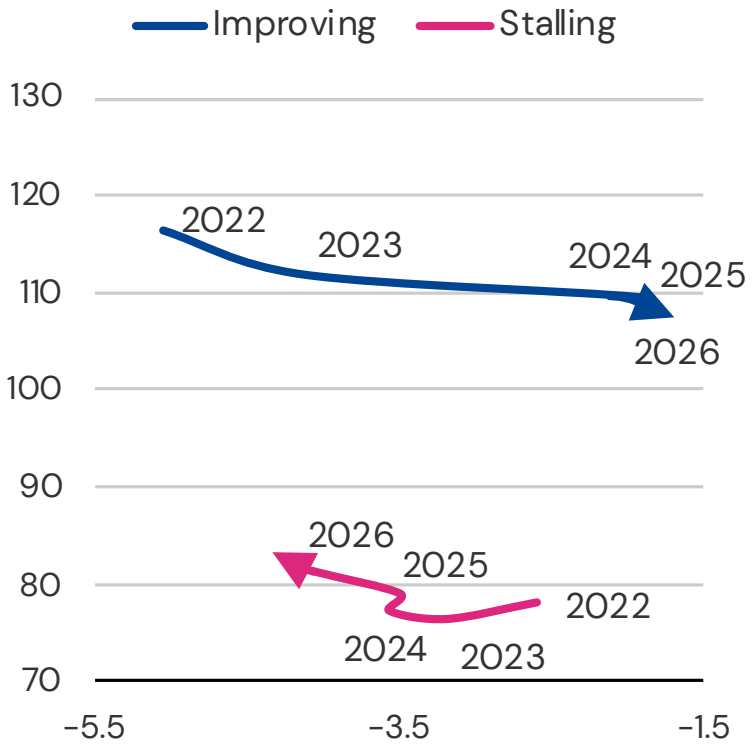
European Stability Mechanism

Contrasting debt and fiscal dynamics across countries

Aggregate numbers mask diverging fiscal performances across countries from 2022-2026

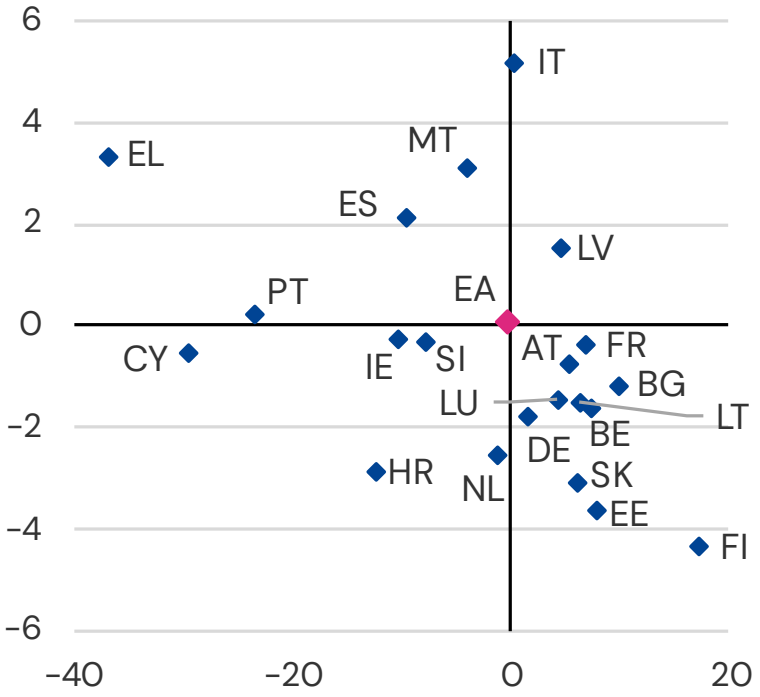
Fiscal trajectories by country group

(x-axis: headline budget balance; y-axis: public debt, in % of GDP)



Cross-country fiscal developments

(x-axis: change in public debt; y-axis: change in headline budget balance, in percentage points of GDP)



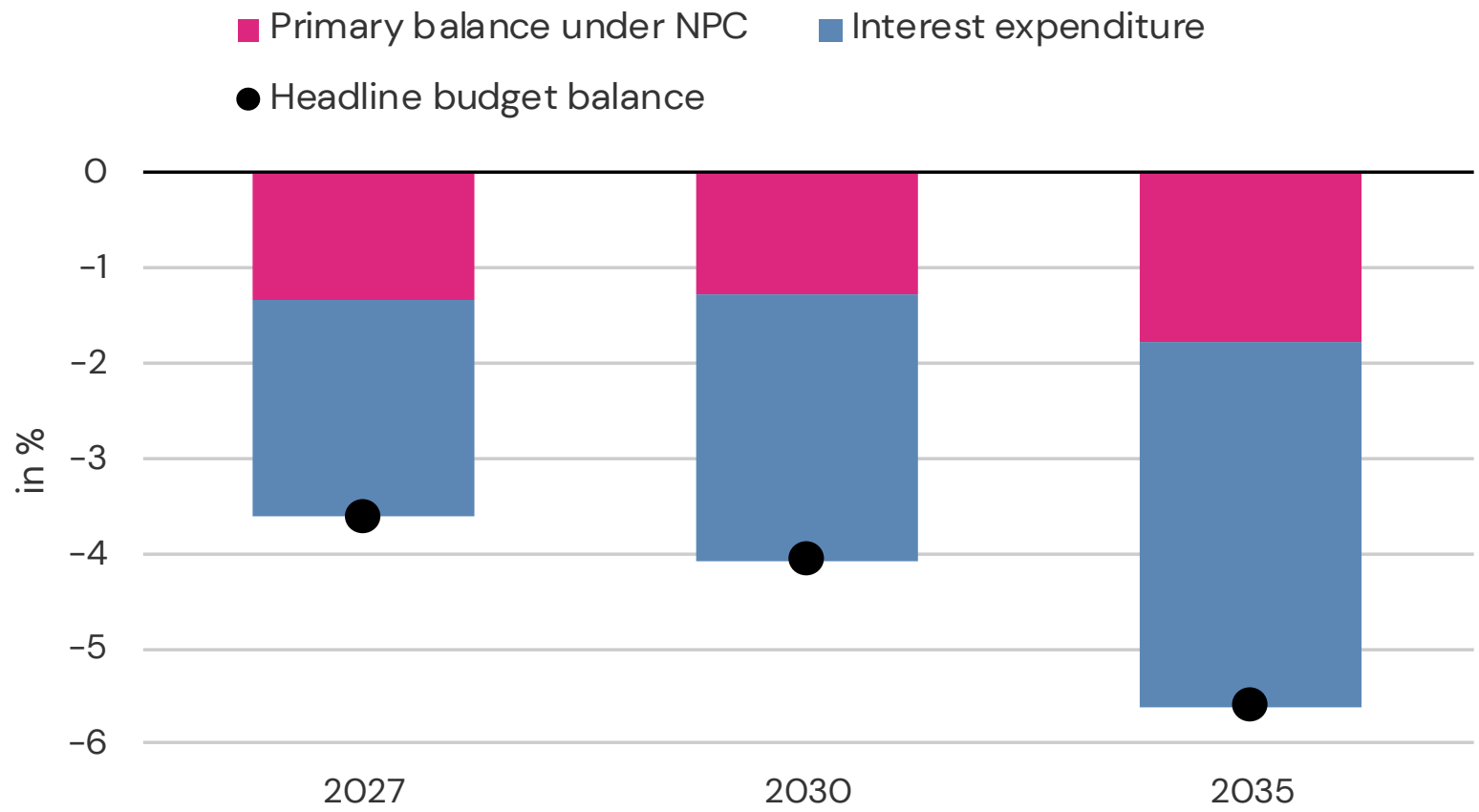
Source: ESM calculations based on European Commission Spring Forecasts April 2026 and Eurostat data

Fiscal pressures look set to persist

Spending pressures will gain momentum, particularly in healthcare, pensions, and debt service

Euro area headline budget balance decomposition

(in % of GDP)



Notes: The aggregate euro area headline balance is decomposed for 2027, 2030 and 2035 under the baseline scenario, into the primary balance under the no-policy-change (NPC) scenario (including ageing-related costs) and interest expenditure.

Source: ESM calculations based on European Commission's spring 2026 economic forecast data and the 2024 Ageing Report

Resilience under strain

European Stability Mechanism

Main risks: geopolitics and US asset price correction

Re-escalation of Middle East conflict

- **Prolonged conflict/escalation will further raise inflation and weigh on growth**
  - → Higher energy prices, supply disruptions and second round effects
  - → Higher uncertainty and weaker confidence
  - → Tightening of global financial conditions
- **Longer-term GDP losses due to lower competitiveness and investment**

US asset price correction

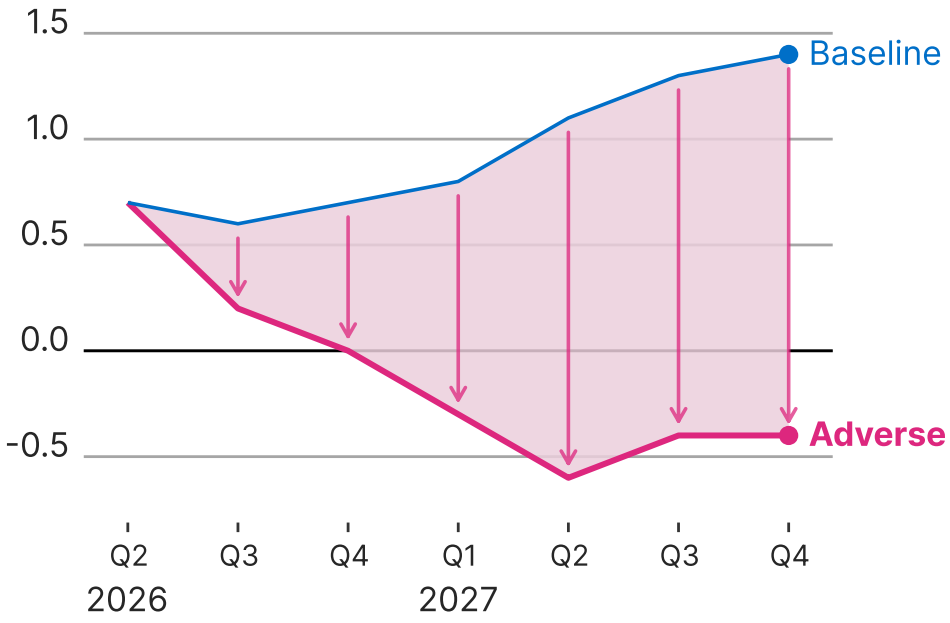
- **Higher US policy uncertainty:**
  - lower demand for US assets → higher US yields
  - correction in US equity markets → global risk aversion
- **Spillovers to Europe**:
  - → EU holdings of US assets
  - → Global risk aversion
  - → Exchange rate and capital flows.

Adverse scenario: prolonged Middle East conflict & US asset repricing

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

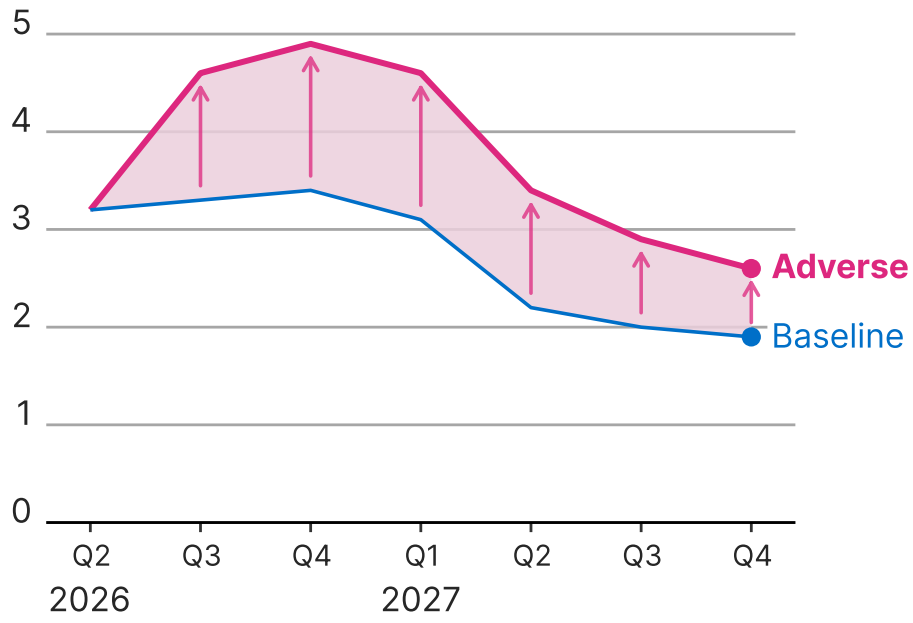
GDP growth

(%, year-on-year)



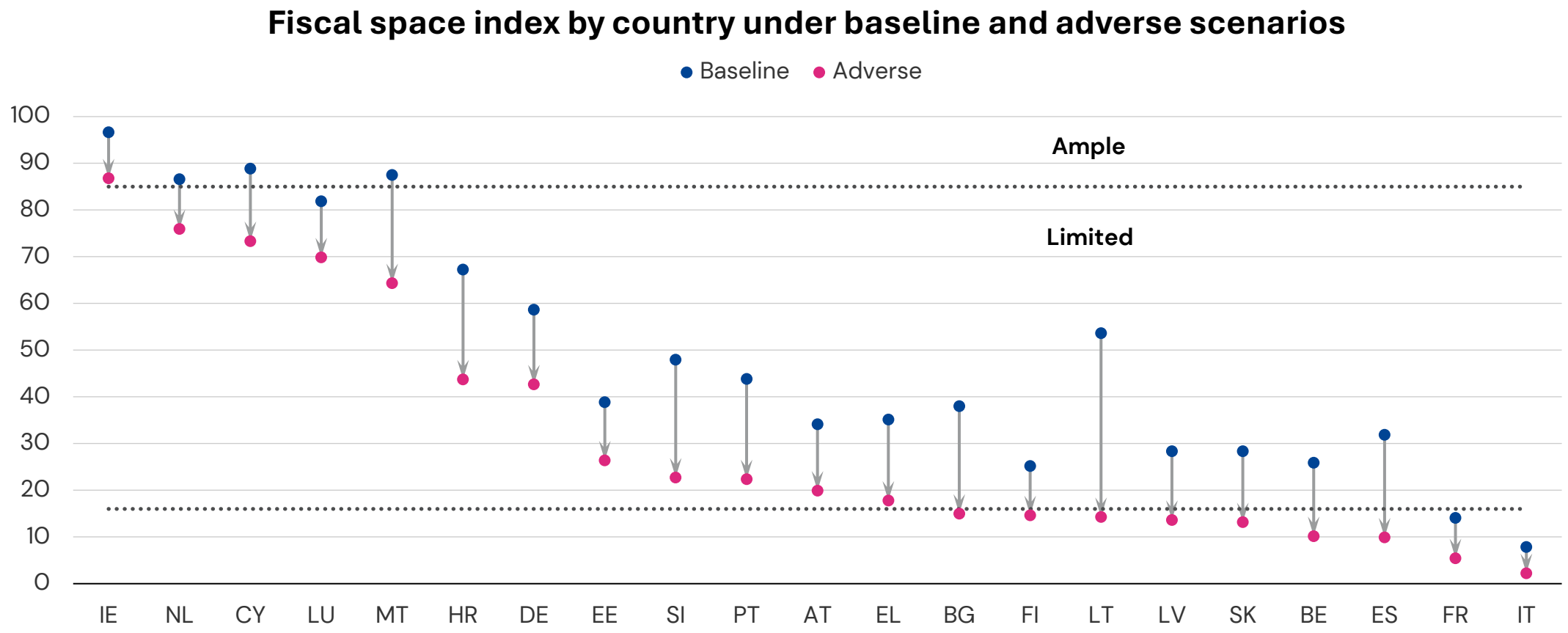
Inflation

(%, year-on-year)



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

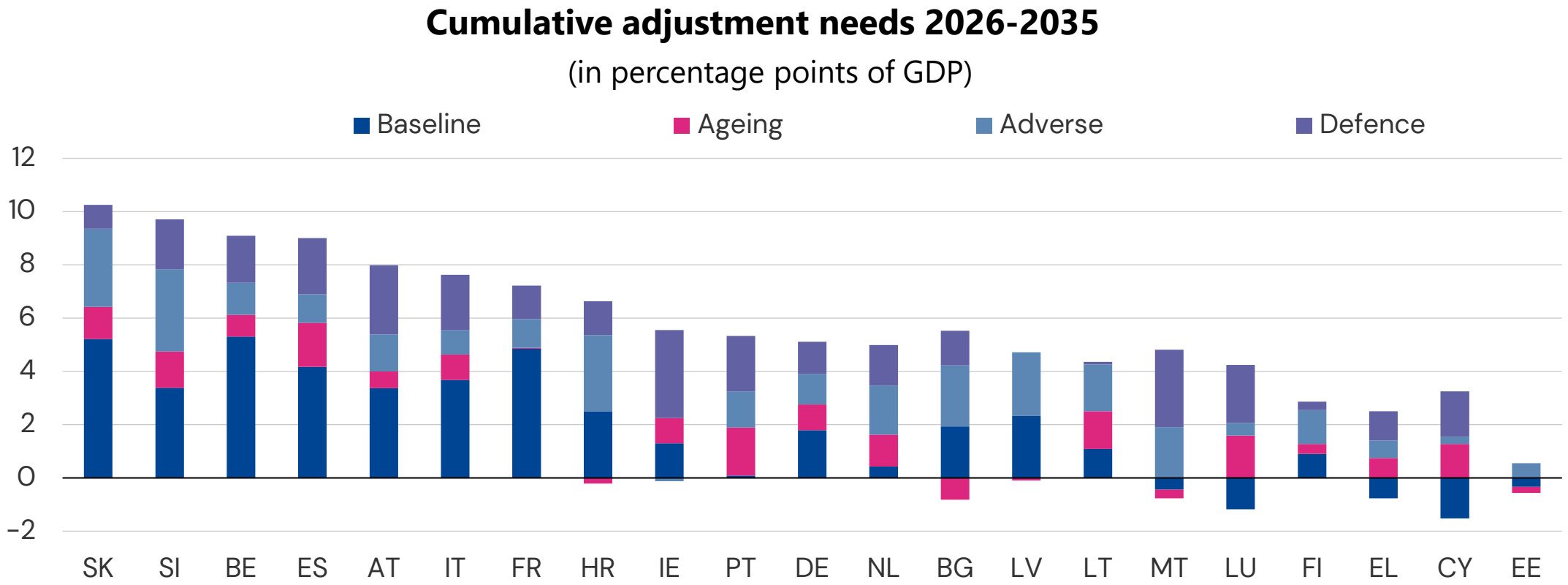
Few countries retain ample fiscal space under the adverse



Notes: The horizontal dotted lines indicate the thresholds used to distinguish three fiscal space categories: ample (100–85), some (84–16), and limited (15–0). The index measures the relative fiscal space of euro area countries through a composite indicator combining four fiscal metrics under the baseline scenario in 2028: (i) revenue-to-debt ratio; (ii) budget balance; (iii) interest-growth differential; and (iv) share of usable revenue (revenue net of rigid spending). Fiscal space under the adverse scenario is assessed relative to the baseline distribution of the same indicators. See Annex A8 for more details. Source: ESM calculations based on European Commission's spring 2026 economic forecast data, Eurostat data, European Commission's spring 2026 package data and the 2024 Ageing Report

Fiscal constraints require difficult policy choices

Consolidation requirements go well beyond what many countries have achieved in the past



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

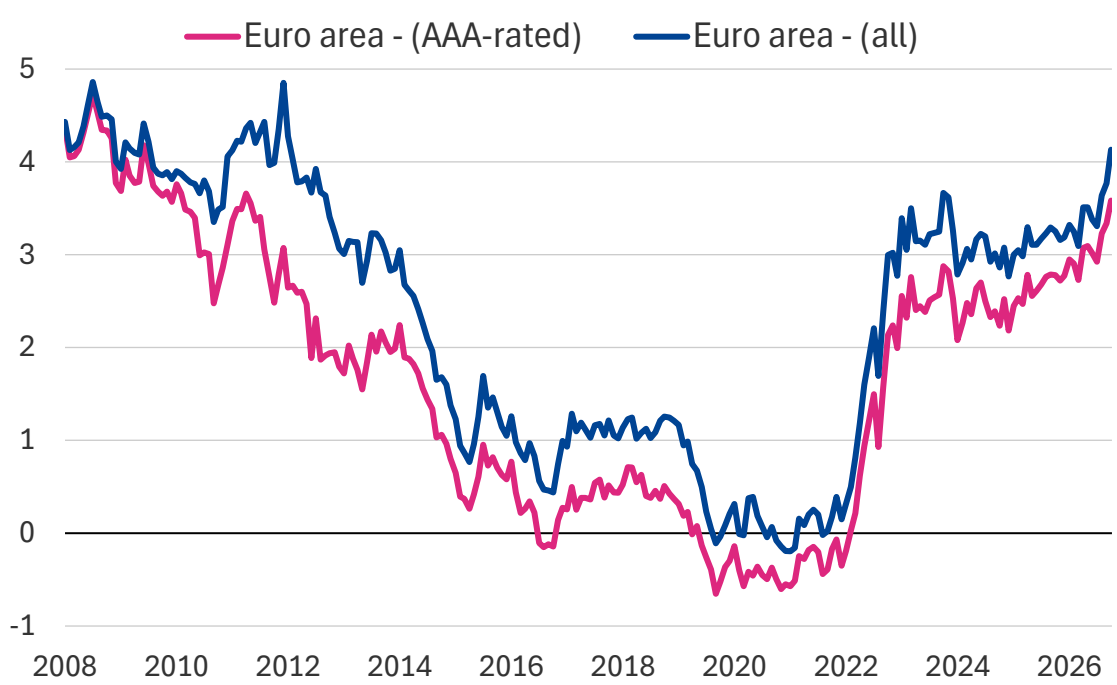
A call for fiscal credibility

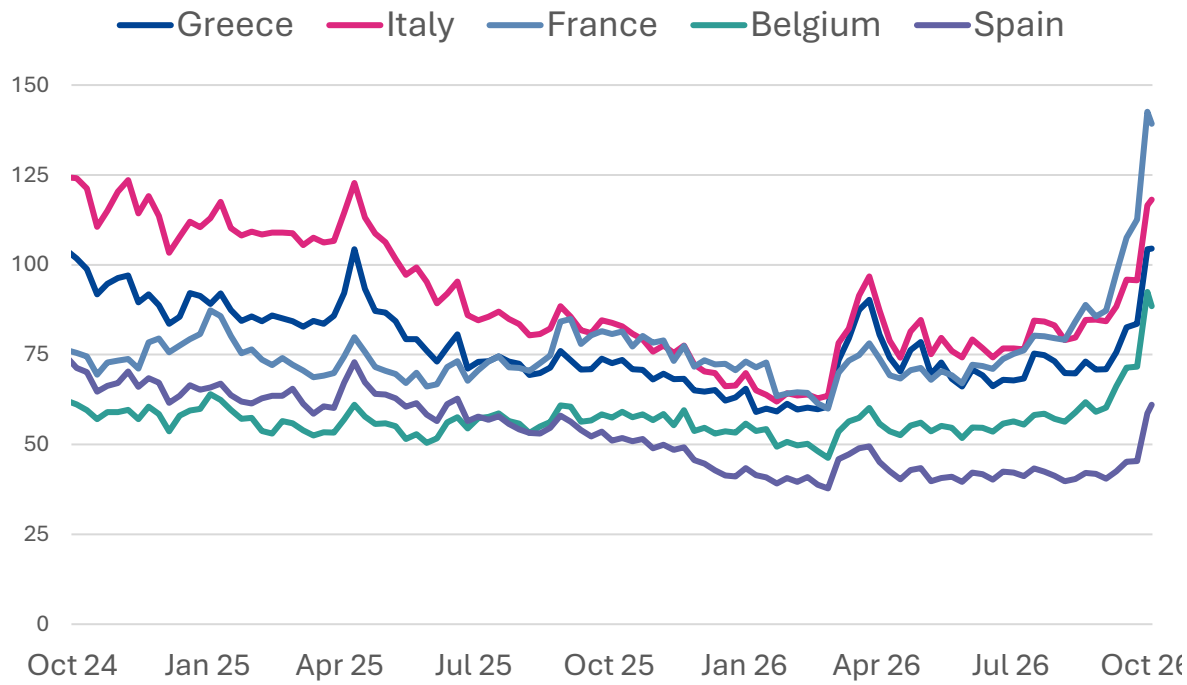
European Stability Mechanism

Rise in global yields trigger reassessment of sovereign risks

Higher global monetary policy expectations and country-specific factors weigh on yields dynamics

Euro area 10-year government bond yields

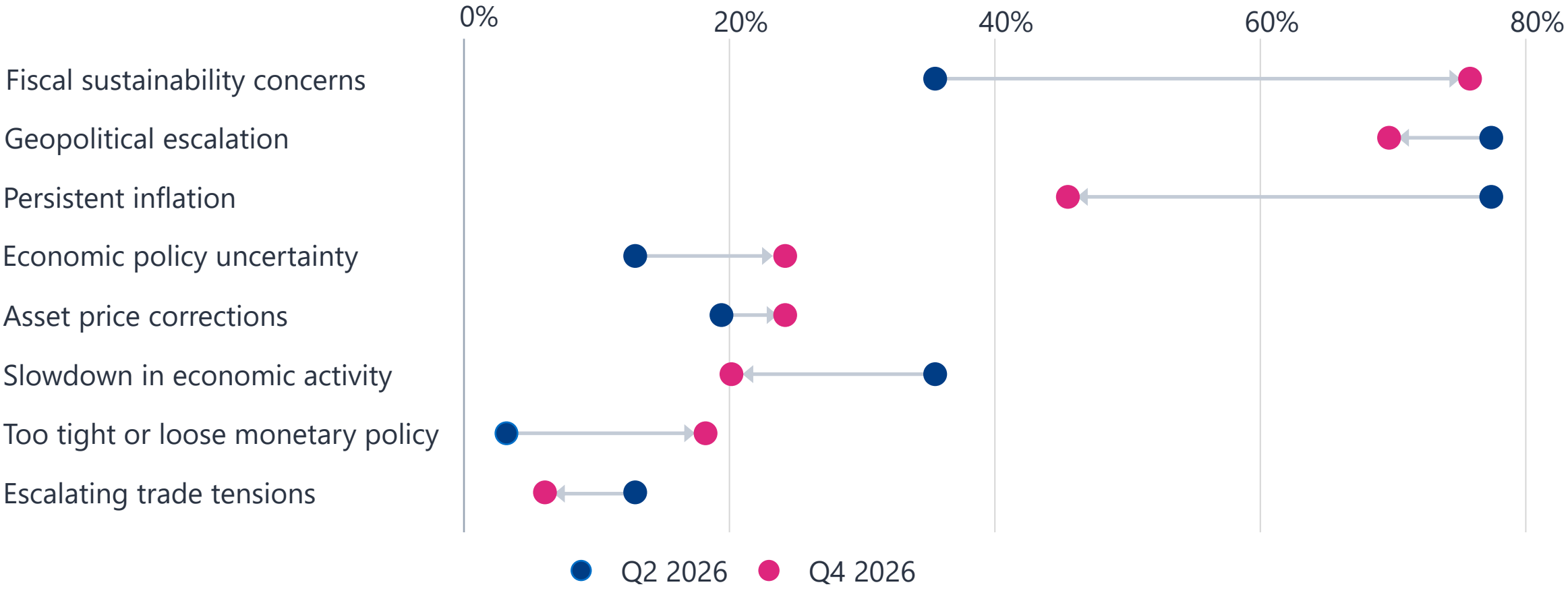




Notes: The euro area yields are 10-year spot yields based on ECB methodology for AAA-rated and all euro area countries (available at **https://data.ecb.europa.eu/methodology/yield-curves**). The latest observation is 5 October 2026.
Source: ESM calculations based on Bloomberg and ECB data

Fiscal risks has joined geopolitics and inflation at the top of investors concerns

Most material adverse risks over 12 months (share of respondents)

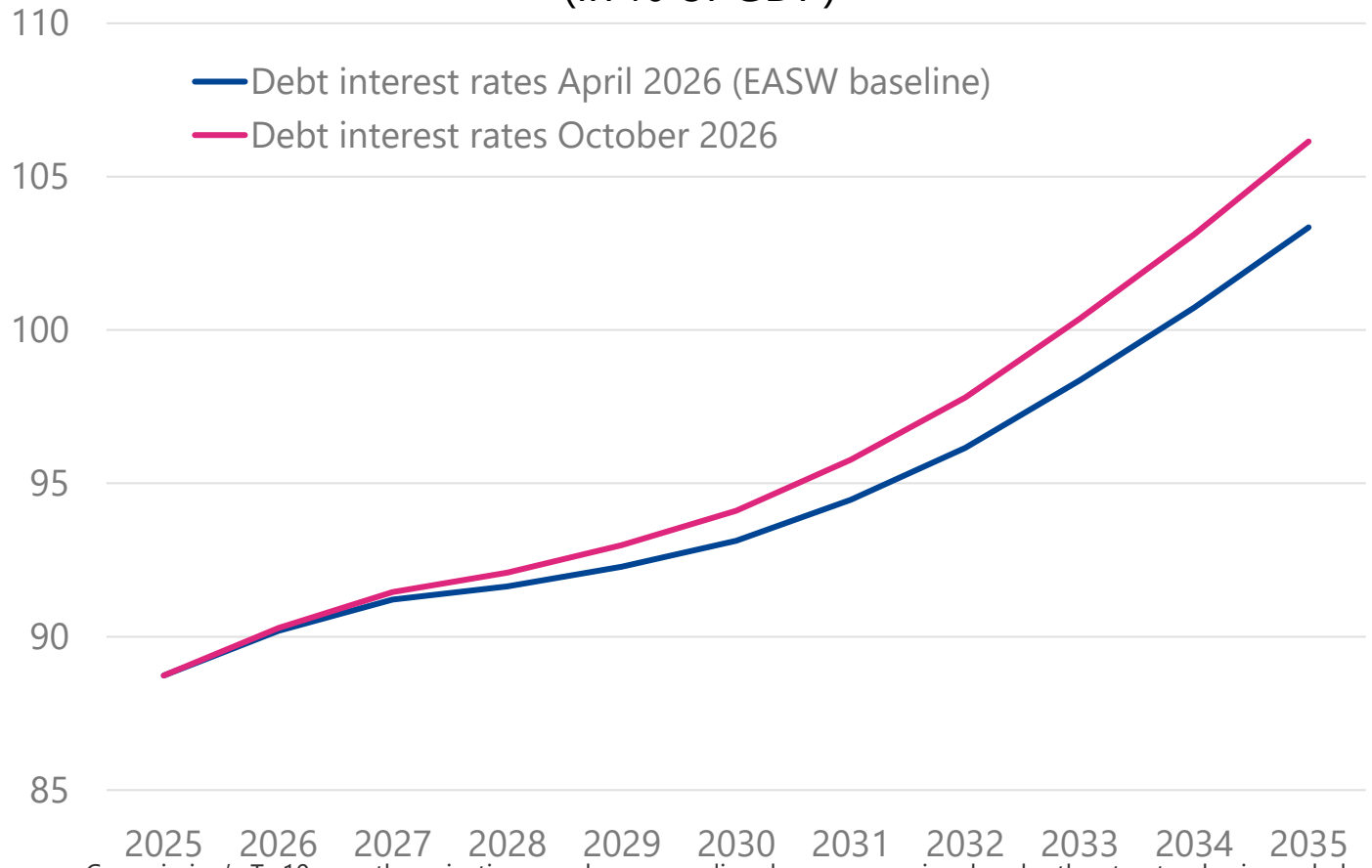


Source: ESM Sovereign Sentiment Survey Q4 2026. Multiple selection possible.

Overall fiscal risks have intensified

Uneven impact of higher interest rates on public debt dynamics

Public debt under different interest rates scenarios
(in % of GDP)



Note: Debt paths use the European Commission's T+10 growth projections, under a no-policy change scenario whereby the structural primary balance is held constant at its 2027 level. Data computed as monthly average for October 2024, and average 1-16 October 2026.
Source: ESM calculations based on European Commission 2026 Spring forecast data

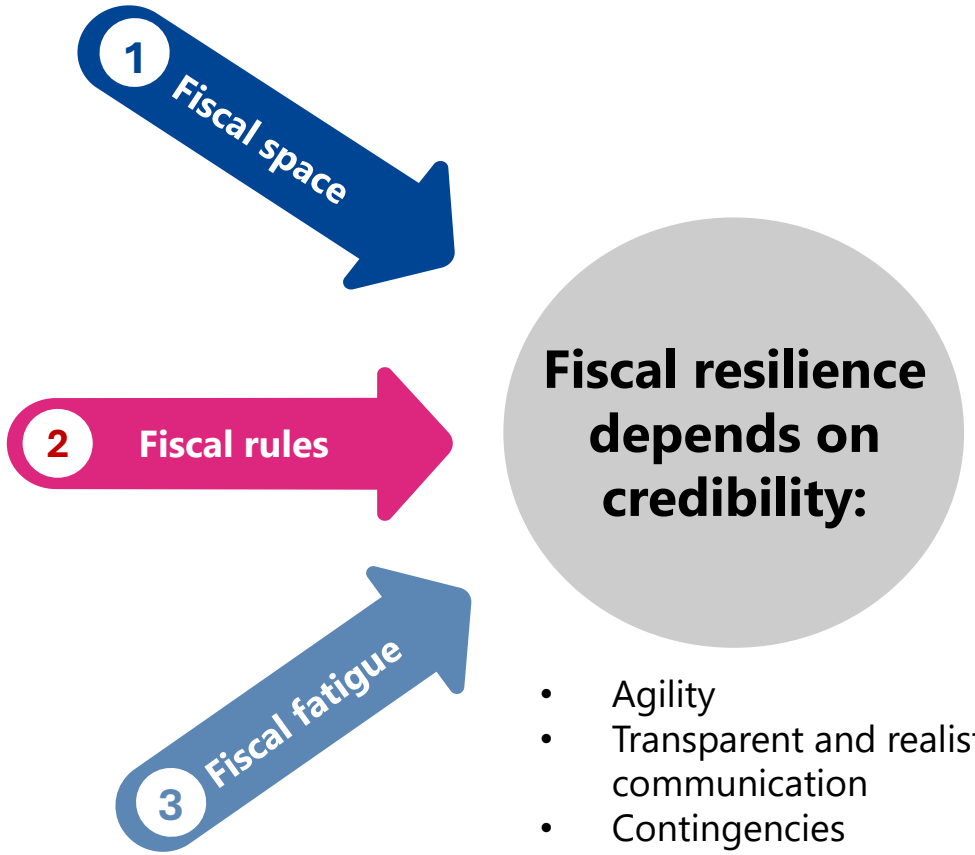
Fiscal resilience: credible adjustments can preserve market trust

Where political fragmentation is larger, fiscal support has proven more difficult to unwind.

Shrinking fiscal space
Fiscal space is limited, spending pressures are mounting and adverse shocks further deteriorate debt sustainability

Reformed EU fiscal framework as anchor
Complying with Stability and Growth Pact can anchor expectations and ensure sustainability. With market trust, large adjustment needs can be spread over time.

Premium on prudence
Room for policy missteps is narrow. Fiscal fatigue & political fragmentation will constraint capacity to adjust



- Agility
- Transparent and realistic communication
- Contingencies
- Expenditure reprioritization instead of new debt

Conclusion: Fiscal credibility is the best protection



Fiscal pressures are set to intensify
Governments' capacity to respond to shocks will be further constrained.



Global shocks can erode resilience
Geopolitical and US repricing shocks can weaken growth and raise inflation.



Fiscal credibility matters
Uneven fiscal space limits shock absorption, making policy credibility essential.

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