

FOCAL POINT

EA Fiscal Outlook 2026: Rising Deficits and Record Bond Issuance

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Our Focal Point series explores topical issues on macro, markets and investment

- In 2026, the euro area budget deficit is projected by the European Commission (EC) to rise to -3.4% of GDP, from -3.2% of GDP in 2025.
- There are huge differences among countries; most remarkable is the deterioration of Germany's budget balance by 0.9 pp due to the forthcoming implementation of the "fiscal bazooka". We see the risks tilted towards fiscal slippage, with the French budget being in focus.
- The ECB will continue with non-investing redemptions from purchases made under the APP and PEPP, meaning that € 420bn of government bonds will not be reinvested in 2026.
- Euro area government bond net-net issuance will rise slightly to almost € 900bn in 2026. Increasing redemptions imply that gross issuance is set to reach a new record level of over € 1400bn.
- Germany is likely to be the frontrunner in 2026, with a net issuance of over € 140bn. Spain and Italy, in particular, are expected to further reduce their new borrowing.
- We anticipate the volume of green bond issuances to rise moderately in 2026, reaching up to € 60bn.

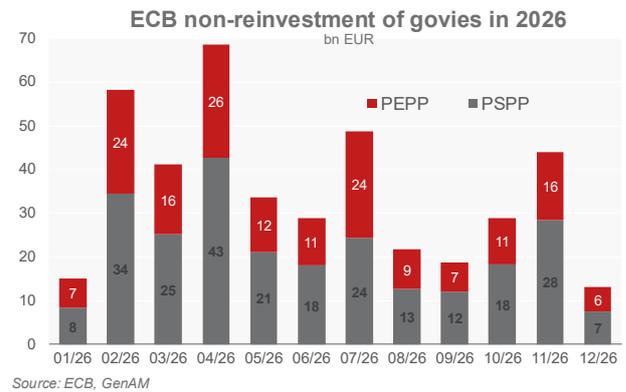
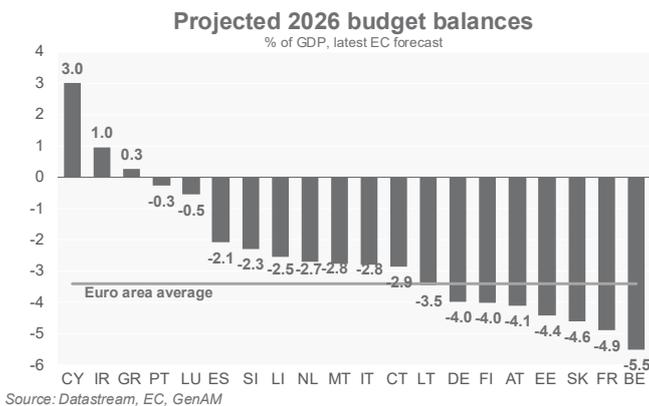
A challenging year for government bond markets. In 2026, the European government bond market will be impacted not only by the ECB's ongoing passive Quantitative Tightening (QT) but also by a sharp increase of Germany's budget deficit towards -4% due to forthcoming "fiscal bazooka" spending. This will push net-net issuance close to € 900bn. Apart from Germany leaving the camp of fiscally frugal countries, the economies with the highest expected budget deficits – Belgium and France – will stay in the market spotlight. In what follows, we will take a closer look at the 2026 issuance activity that will set the stage for sovereign bond markets.

Moderately rising euro area deficit in 2026 but risk of fiscal slippage

Deficits on the rise. Notwithstanding the reinstatement of the (revised) Stability and Growth Pact (SGP), the euro area budget deficit is set to remain above the 3% threshold and rise slightly, from -3.2% of GDP in 2025 to -3.4% of GDP in 2026, according to the European Commission (EC) forecast. We consider this realistic, assuming growth of 1.2% in 2026, close to our forecast of 1.3%. The forthcoming German fiscal bazooka plays a major role, as Germany's deficit alone is set to rise by about 1 pp to -4.0%. That said, even the euro area deficit ex Germany (of -3.1%) would remain above the threshold.

The risk of fiscal slippage dominates in our view. Back in 2024, the EC's growth forecast for 2025 was at 1.3%, which seems to be materializing. At that time, the fiscal plans were consistent with a deficit of -2.9%, while it is now likely to be at -3.2%. We believe the risk remains on balance tilted towards fiscal slippage in 2026 as well.

In its 2026 Autumn Package (from Nov 25) the EC identified risks of fiscal slippage in several countries. In Croatia, projected net expenditure growth of 5.6% exceeds the recommended 4.9%. Likewise, Slovenia's expected net expenditure growth of 5.7% in 2026 breaches the 4.4% cap. For Malta, the Commission raised concerns over cumulative spending and deemed the 2026 plan "at risk of material non-compliance", despite a legally compliant annual deficit. The Netherlands' draft plan notably exceeds net expenditure ceilings, prompting a formal request for clarification on overspending. Lithuania received an explicit draft budgetary warning for potential non-compliance.



Germany benefits from escape clause. Germany's projected 2026 net expenditure growth of 5.2% clearly exceeds the threshold of 4.5%, but this is permitted under the national escape clause, given Germany's increased defence spending (rising from 1.1% of GDP in 2021 to 1.9% in 2026).

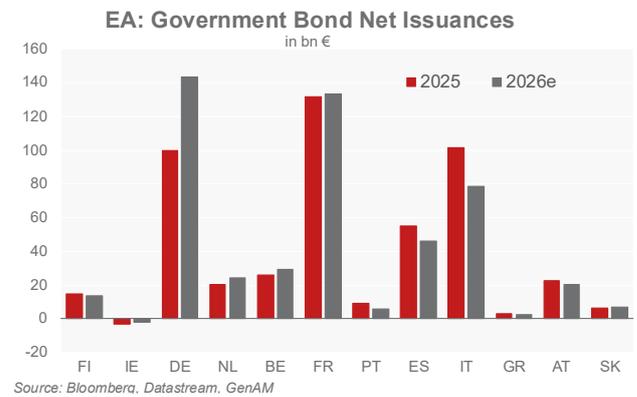
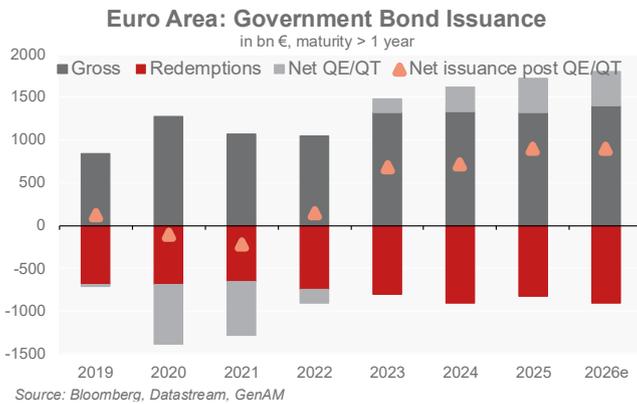
Risks related to France remain. The EC deems France's draft budget compliant with fiscal rules and sees no major risk, though uncertainties persist amid parliamentary debates. On November 22, the National Assembly rejected the revenue component of the 2026 bill, creating uncertainty over deficit measures. The Senate is now reviewing and stripping amendments before a joint committee reconciles differences for final ratification. The budget must pass by December 31 or be enacted via a special law ("loi spéciale") or temporarily extend the 2025 budget into 2026. As the government has vowed not to use Article 49.3, full parliamentary agreement is required, increasing the risk that consolidation measures will be further diluted.

ECB's passive Quantitative Tightening will continue

The ECB's reduction of government bond holdings will continue. Since the launch of Quantitative Easing (QE) in 2015, the ECB had consistently acted as a buyer in the sovereign bond market – either by purchasing new bonds or by reinvesting redemptions from previous purchases. 2025 was the first year without such purchases. The ECB's projected non-reinvestments of government bonds under the PSPP and the PEPP sum up to € 420bn, a number similar to the one in 2025.

Gross government bond supply to reach a record

Government bond supply in 2026 remains subject to revisions. We forecast government bond supply for the coming year based on the published 2026 budget plans and our own forecasts. As is typical at this stage, uncertainties remain (e.g., because the budget is not yet passed), so revisions are possible. Primary market activity cannot be directly inferred from budget deficits. Besides conventional bonds, all countries also use non-standard instruments (e.g., repos, retail bonds), external financing sources (NGEU, SAFE) and t-bills.



Historical peak of gross issuance expected in 2026. We assume that net issuance will remain at the high levels seen in recent years. Specifically, we expect a moderate increase of € 15bn, bringing net issuance to € 502bn by 2026. As redemptions are also set to rise significantly (due to heavy issuance during the pandemic) to over € 900 bn (up from around € 830bn), we even forecast gross issuances of over € 1400bn, setting a new record.

Net-net issuance volume remains close to the record level in 2026. We expect the ECB to maintain QT, allowing bonds to mature and reducing its balance sheet. Excluding supranationals, QT volume in 2025 will exceed € 400bn, cutting holdings by about 20% from the 2022 peak. Another € 400bn will roll off by end-2026, leaving roughly 70% of peak holdings, underscoring the ECB' cautious QT approach compared to other central banks. Despite higher redemptions, ECB QT will decline slightly in 2026 because PSPP reinvestments stopped in June 2023, meaning short-dated bonds maturing in 2026 are not in PSPP. Moreover, PEPP included T-bills, boosting QT in 2025 – a factor absent in 2026. Overall, QT volume will edge lower versus 2025 (from € 407bn to € 395bn), and net-net issuance (including ECB's QT) will reach almost € 900bn.

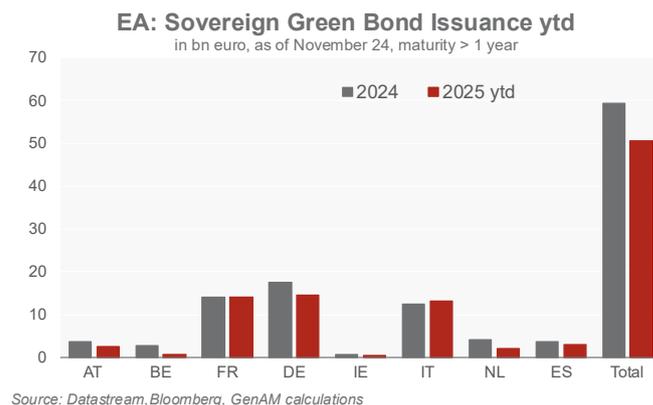
Significant changes at country level. Although aggregate net issuance will rise only slightly, notable shifts occur at country level. Germany stands out with a record net

issuance of over € 140bn and gross issuance above € 350bn, making it the dominant player in EA primary markets by 2026. The Netherlands will also increase issuance, while France, for the time being, sees only a slight rise given ongoing budget uncertainty. Declining net issuance of heavy weights Italy and Spain offsets Germany's expansionary policy, keeping the increase in the EA aggregate net issuance volume moderate. As smaller non-core countries (Ireland, Greece and Portugal) are also reducing or maintaining low net issuance, this should support tight non-core government spreads going forward.

Overall smooth absorption of bond supply expected. By 2025, the share of long-term bonds (10+ years) will drop from 43% to 36%. With a slight steepening of the yield curve expected in 2026 and the waning structural demand for Dutch pension funds, EA treasurers will likely cut this share further. As usual, Q1 should be particularly active, absorbing about one-third of supply. Attractive yield levels will also encourage retail issuances to take down part of the supply. Assuming a stable macroeconomic and financial market environment, even the record-large gross bond supply can be placed smoothly, though idiosyncratic risks remain (e.g., French politics).

Muted growth keeps green government bonds niche

Green bonds show weaker growth than in 2025. The issuance of green government bonds declined slightly in 2025 compared to the previous year. Year-to-date, the gross issuance volume is marginally above € 50bn (compared to € 59bn in 2024), primarily due to Germany and a few smaller issuers. Only Germany (2035, outstanding amount € 5.75bn) and Italy (2046, outstanding amount € 5bn) have issued new green bonds. Otherwise, existing bonds have been tapped. The share of green government bonds in total issuance fell from 4.4% in 2024 to 3.8% in 2025, indicating EA green sovereign bonds remain a niche product. The overall outstanding volume increased by € 42bn to reach € 325bn in 2025 (in October, a green Bund worth € 8.5bn was redeemed), with France holding the largest outstanding volume, totalling over € 87bn.



Germany is set to drive higher green bond issuance in 2026. Given the expected increase in gross issuances in 2026, we also forecast higher green bond volumes. As in 2025, Germany, France and Italy will contribute most. Overall, gross issuance volume is projected to reach up to € 60bn. With no green bonds maturing in 2026, this equals the expected net issuance volume. Germany will drive much of the increase, with at least one new green bond issuance and up to € 20bn in volume.

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