S&P Global Ratings

Credit Conditions Europe Q2 2025

Europe Plots A New Course

Mar. 26, 2025

This report does not constitute a rating action.

Key Takeaways

- **Overall:** Emerging U.S. unilateralism on security, trade, and finance has left European policymakers scrambling to coordinate a response. Remarkably, a response is in the offing, after the German government broke with the past to approve a €500 billion (11% of GDP) infrastructure fund and introduced plans to ease its fiscally constraining debt brake rule to accelerate military spending. Despite that, and the EU's commitment to finance European defense via the issuance of common European debt, Europe's aspiration to build a robust security deterrence capability will take years, not months--highlighting the importance of keeping the U.S. onside.
- **Risks:** Persistent uncertainty, notably around the U.S. administration's trade, foreign policy, and financial market strategies, may be a greater economic risk to confidence than the tariffs themselves. Meanwhile, Vladimir Putin's agreement to a "partial" 30-day ceasefire is, in our view, a pause but far from an end to the three-year conflict with Ukraine.
- **Ratings:** Credit quality for financial institutions, insurance, and much of the rated corporate universe has strengthened in recent quarters, providing some buffers to protect against the economic costs involved in navigating the uncertain trading environment. For fiscally constrained European NATO members (apart from Germany), the annual security spending increase in national budgets is unlikely to exceed 0.2 to 0.3 percentage points (ppts) of GDP, market conditions allowing.

Editor's note: S&P Global Ratings' Credit Conditions Committees meet quarterly to review macroeconomic conditions in Asia-Pacific, emerging markets, North America, and Europe. Discussions center on identifying credit risks and their potential ratings impact on various asset classes, as well as borrowing and lending trends for businesses and consumers. This commentary reflects views discussed in the European Credit Conditions Committee on Mar.19, 2025.

In the space of a few short weeks since the new U.S. administration assumed office, the Western global order built on the foundation of global alliances, multinational institutions, and U.S. leadership, which has provided peace and economic security since the end of the Second World War, has been upended. In its own way, this is as unexpected a systemic shock to Europe as COVID-19 or Russia's illegal invasion of Ukraine. The positive news is that European leaders are rising to the challenge expeditiously, drawing strength from the new German government. Less positively, it will take years, in our view, for Europe to become enough of a "steel porcupine" to deter Russia--should the U.S. completely withdraw their security umbrella from NATO. The potential credit implications of prioritizing defense over social spending will, over time, be significant. In combination with the upheaval caused by the U.S.'s embrace of trade protections on friend and foe alike, the near-term credit outlook looks clouded by uncertainty and fraught with risk.

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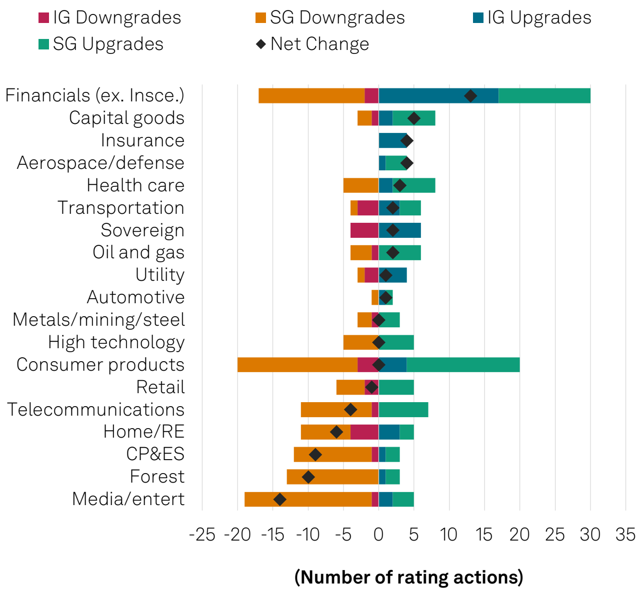
European credit fundamentals are starting from a good base. Fortunately, underlying credit fundamentals have been broadly improving in the last couple of years as businesses and households hunkered down after dealing with the challenges presented by the pandemic as well as the Russia-induced energy/inflation shocks. Even through the end of last year, the impressive resilience of the U.S economy provided a supportive backdrop to European business activity. This has been reflected in the ratings of European issuers, both in terms of rating activity that has been quite balanced, and also in sector outlooks, where, apart from a few sectors including autos, metal, mining and steel, real estate, and a couple of other energy-intensive sectors the net outlook bias is low in a historical context. (see chart 1 and chart 2).

Chart 1

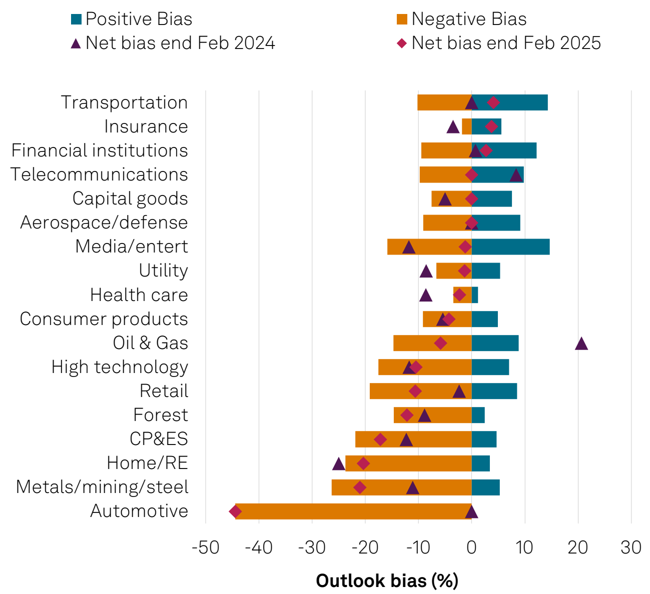
Rating actions were remarkably balanced over the year to end-February, albeit with sector variations



Data as of Mar. 10, 2025. IG--Investment-grade. SG--Speculative-grade. Rating action on higher order entity in hierarchy. Sector wise rating actions are from March 1, 2024 to Feb. 28, 2025.
Source: S&P Global Ratings.

Chart 2

Tariff-targeted and energy-intensive sectors in Europe have the highest net negative outlook bias



Data as of March 10, 2025. CP&ES--Chemicals, packaging, and environmental services. Source: S&P Global Ratings.

Suddenly the trade winds have shifted against the U.S., and Europe is tacking away. The new American isolationist policy is in the process of triggering a transatlantic rift that is fueling diverging economic trends in the two regions as well as in financial markets. There are two main reasons for this. Firstly, the frenetic activity and lack of clear-sighted policy objectives enunciated by the new U.S. administration is starting to unnerve European governments, businesses, and financial markets. This can be seen clearly in the recent sharp sell-off in U.S. risk assets, credit spreads, and the U.S. dollar. And it is reflected in the loss of momentum over the last three months in S&P Global's PMI Composite indicators (driven by services) for the U.S. relative to other major trading partners (see chart 3). A loss of economic momentum on this scale was last seen when inflation peaked in June 2022 and the Federal Reserve was in full tightening mode.

Chart 3

PMI indices highlight significant loss of momentum in U.S. services this year

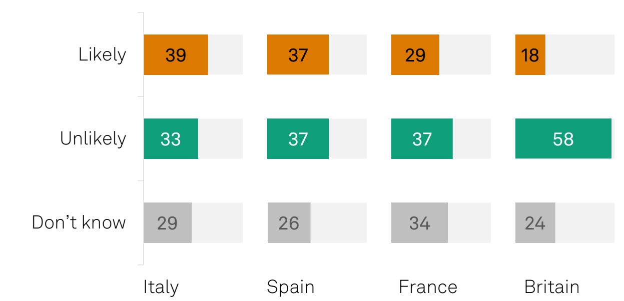
								-----3-month change-----					
Geography	**Industry**	Dec. 23	Mar. 24	Jun. 24	Sep. 24	Dec. 24	Feb. 25	Dec. 23	Mar. 24	Jun. 24	Sep. 24	Dec. 24	Feb. 25
Eurozone	Composite	47.0	49.9	50.8	48.9	49.5	50.2	-0.1	2.9	0.9	-2.0	0.6	2.1
Eurozone	Manuf.	44.2	45.7	45.6	44.8	45.2	47.3	0.7	1.6	-0.1	-0.8	0.3	2.1
Eurozone	Services	48.1	51.1	52.6	50.5	51.4	50.7	-0.3	3.0	1.5	-2.1	0.9	1.5
Germany	Composite	46.7	47.4	50.6	47.2	47.8	51.0	0.5	0.7	3.2	-3.4	0.7	3.7
Germany	Manuf.	43.1	41.6	43.4	40.3	42.5	46.1	3.3	-1.5	1.7	-3.1	2.2	2.9
Germany	Services	48.4	49.8	53.5	50.6	51.0	52.2	-1.3	1.3	3.7	-2.9	0.4	2.8
Japan	Composite	50.4	52.3	50.0	52.5	50.8	51.6	-1.4	1.9	-2.2	2.5	-1.7	1.8
Japan	Manuf.	47.7	48.2	50.1	49.6	49.5	48.9	-0.9	0.4	2.0	-0.5	-0.1	0.0
Japan	Services	52.0	54.9	49.8	53.9	51.4	53.1	-1.3	2.9	-5.0	4.1	-2.5	2.9
U.K.	Composite	51.7	52.9	51.7	52.9	50.5	50.5	4.9	1.3	-1.3	1.3	-2.4	0.6
U.K.	Manuf.	46.4	49.9	51.4	51.5	47.3	46.4	2.2	3.5	1.6	0.1	-4.2	-2.2
U.K.	Services	52.7	53.4	51.2	52.8	51.4	51.1	5.6	0.7	-2.2	1.6	-1.4	1.0
U.S.	Composite	51.0	52.2	54.6	54.4	56.6	50.4	0.8	1.2	2.4	-0.2	2.2	-5.0
U.S.	Manuf.	48.2	52.5	51.7	47.0	48.3	51.6	-0.7	4.3	-0.9	-4.7	1.3	2.9
U.S.	Services	51.3	51.7	55.1	55.4	58.5	49.7	1.1	0.3	3.4	0.3	3.2	-7.2

Source: S&P Global Market Intelligence.

Secondly, in response to the security threat to Europe from U.S. ambivalence towards NATO (see chart 4 and chart 5) and to boost its ailing domestic economy, the incoming German government put a major down payment on future growth by establishing a €500 billion (11% of GDP) infrastructure fund alongside a major relaxation of the debt brake. In addition, the European Commission has launched the ReArm Europe Plan that could release up to €800 billion to increase the EU's military capabilities, including via the issuance of joint EU debt. While this is a strong statement of intent, real challenges remain around absorption, interoperability and command and control, given defense remains a member state competence. Nonetheless, as discussed in the macroeconomic section, these measures have led us to raise our growth outlook for the eurozone, by 0.1% and 0.3% in 2026 and 2027 respectively--with some implications for inflation and the ECB's likely rate path. In contrast, we expect growth momentum in the U.S. to slow sharply to 1.5% by the end of this year.

Chart 4

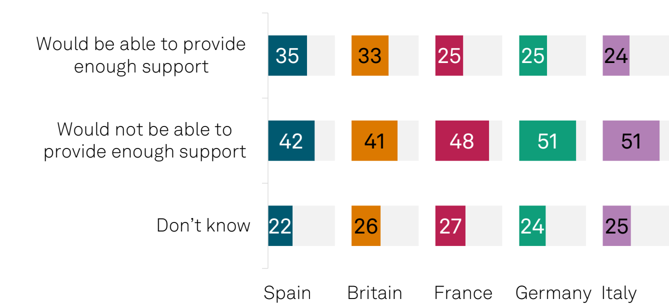
Western Europe doubts the U.S. will fulfill its NATO collective defense obligations if countries come under attack (%)



Question: In the event that Russia launched an attack on the following NATO members, how likely or unlikely do you think it is that the USA would honor its NATO obligations and come to their defense (%)? Source: YouGov (Britain: 20-21 Feb. 2025 / Other countries: Feb. 25 - March 4, 2025)

Chart 5

Europeans don't believe the West can adequately support Ukraine if the U.S. withdraws assistance (%)



Question: In the event that the U.S. withdraws financial and military support for Ukraine, do you think that European and other Western countries would or would not be able to provide enough support to Ukraine to continue to be able to defend itself (%)? Source: YouGov (Feb. 25 - March 4 2025)

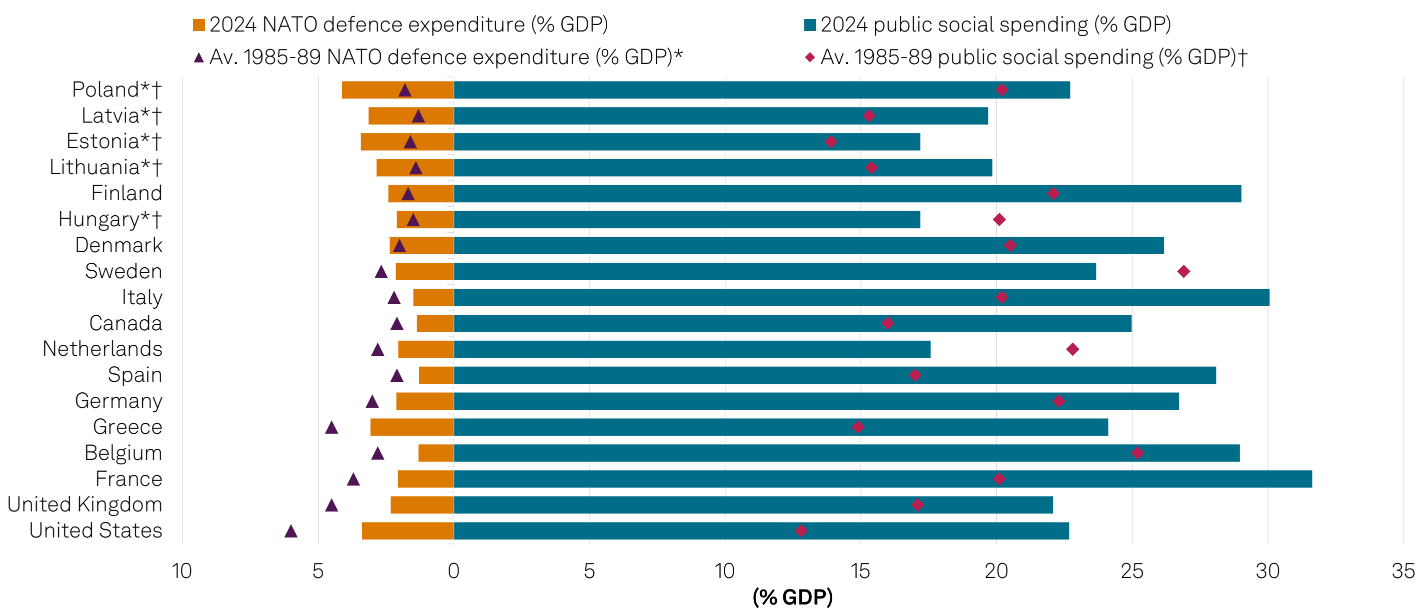
Shifting priorities challenge governments' fiscal plans. From a credit standpoint, while the defense industry in Europe should benefit from long-term contracts awarded to build the requisite capability in cutting-edge technology, the financing burden for governments will present challenges as increasing defense expenditure is not just a one-off commitment. Germany, alone among the major European sovereigns, has substantial fiscal capacity within our

'AAA' rating to facilitate the proposed €500 billion (over 11% of GDP) 12-year infrastructure spending program and any increase in defense expenditure above 1% that is outside of the debt brake. However, ultimately, the credit impact on Germany's net debt stock could range from an additional 5% of GDP to almost 30% of GDP over the next seven years depending on the speed and effectiveness of the programs. This would be over and above our current base case assumptions and would feed into our rating assessment over time.

Most other European NATO members have far less fiscal space to absorb additional defense expenditure without pressuring their creditworthiness. For the likes of France, Italy, and Spain, for example, we expect average annual increases in defense expenditure between 2025-2030 at the national level of no greater than 0.2% of GDP. The end of the peace dividend almost certainly requires difficult trade-offs that will not be popular with the public, such as slimming down benefits relating to social spending. Chart 6 highlights how public social spending (including health) has changed relative to defense expenditure since the fall of the Iron Curtain in the late 1980s. The European Commission's proposals to boost defense spending through common funding recognizes the scale of the defense challenge for Europe but the devil will be in the detail as to how any collective funding program will work, how long it will last, and which countries will be involved (see "European Defense Funding: What Are The Options?," Feb. 13, 2025).

Chart 6

The end of the peace-dividend will require difficult trade-offs



*Defense spending as of 2004. †Public social spending as of 2000. Public social spending includes health expenditure.
Sources: NATO; OECD (2023) OECD Social Expenditure database (www.oecd.org/social/expenditure.htm); S&P Global Ratings.

Trade policy confusion is more damaging than tariffs. In terms of trade, a key message underpinning our updated base case forecasts for Europe is that the uncertainty and apparent conflicting objectives of U.S. trade policy are proving (so far) to be more damaging than the tariffs themselves. So, while our baseline economic assumptions include the U.S. announcing long-lasting reciprocal tariffs on European goods, and 10% on autos and pharmaceuticals in early April, as well as the 25% on steel and aluminum already enacted, the bigger unknowns remain whether, and how, the U.S. might throw other non-trade issues into the mix. Speculation in this regard extends broadly to digital sales taxes, value-added tax (VAT), government subsidy programs, potential changes in accessing the U.S. dollar markets and liquidity, and even tariffs used to obtain leverage over European defense expenditures. In addition, although the U.K. and, to a lesser extent, the EU are minded not to retaliate too quickly it is not difficult to imagine how quickly global trade and complex supply chains could be disrupted. Canada's threat to reconsider its large order of F35 fighter jets from Boeing is an illustration of the scale of risks to trade that the U.S.'s unilateral trade policy entails. Consequently, the risk of an expanding trade war tops our European risk table this quarter.

Ukraine ceasefire in the balance. The other high risk remains spillover from the wars in Ukraine and the Middle East. Russia's agreement on March 18 to a "partial" 30-day ceasefire, in our view, raises the likelihood of unverifiable false flag incidents, intentional obfuscation, and reciprocal mistrust between the combatants--and no end to the military conflict. Without precise and transparent "rules of the game", how and why the U.S. administration determines whether Russia or Ukraine is to blame for ceasefire infractions is not at all clear. Engendering this lack of clarity appears to be part of Russian President Putin's longer-term strategy.

To conclude, a lasting peace is unlikely to be viable without cast-iron security guarantees from NATO/U.S. But these guarantees are unlikely to be forthcoming. Meanwhile, in the Middle East, the status of Iran's nuclear program remains a key outstanding issue from a credit standpoint. We view military action as unlikely, but it carries the potential risk of severe disruption to the global oil market.

We believe there is a high degree of unpredictability around policy implementation by the U.S. administration. Consequently, our baseline forecasts carry a significant amount of uncertainty. As events evolve, we will gauge the macro and credit materiality of potential and actual policy shifts, and reassess our guidance (see our research here: www.spglobal.com/ratings).

Top European Risks

Expanding trade war extending to Europe

Risk level	Moderate	Elevated	**High**	Very high	**Risk trend**	Improving	Unchanged	**Worsening**

The U.S. administration appears set on a path towards a global trade war that Europe is unlikely to be able to avoid. A clear concern is that the objectives and duration of the U.S. trade policy remains uncertain. Beyond reciprocal tariffs on certain export sectors, specific categories--such as steel and aluminium, automotive, pharmaceuticals, chemicals--are already, or could be, targeted with higher tariffs. This burgeoning trade war, and heightened policy uncertainty, raises the risk of reducing/shifting investment, disrupting complex supply chains (where feasible), and raising working capital, all to the detriment of corporate earnings and credit quality. U.S. investigations into European Digital Service Taxes, the proposed EU Carbon Border Adjustment Mechanism, and other areas will only raise trade tensions further.

Transatlantic security rift

Risk level	Moderate	Elevated	**High**	Very high	**Risk trend**	Improving	**Unchanged**	Worsening

While the U.S. administration seems intent on enticing Russia and coercing Ukraine into a short-term ceasefire the risks remain high. Russia could feel emboldened to pursue its maximalist objective of subjugating Ukraine through force. Conversely, a ceasefire in Ukraine without cast-iron security guarantees from NATO or the U.S. would lack credibility given the previous breaches of treaty obligations by Russia. That could weaken Ukraine's political stability and efforts to rehabilitate its shattered economy with the help of Europe. The risks center around a new cold war in Europe, the U.S. no longer being viewed as a reliable security partner for Europe, Europe ramping up its defense capabilities for the longer term, and difficult political choices that could create public discord within, and between, European countries. In the Middle East, while the balance of power has clearly shifted in favor of Israel, the status of Iran's nuclear program remains an outstanding issue. While we view military action to address that as unlikely, it would risk potentially severe disruption in the global oil market.

U.S. hard landing amid policy uncertainty creating a strong headwind for Europe

Risk level	Moderate	**Elevated**	High	Very high	**Risk trend**	Improving	Unchanged	**Worsening**

The threat that a more hostile and uncertain global environment will further erode Europe's economic growth and security has triggered a significant fiscal policy response led by Germany after its recent election. While the fiscal boost to growth from the proposed defense and infrastructure programs announced by Germany and the European Commission (factored into our baseline) is significant, the growth impulse will take time to materialize. In the meantime, the European economy remains quite vulnerable to trade uncertainty and a more volatile financial market environment. Downside risks to European growth could materialize in the event of a U.S. policy mistake that results in a hard landing scenario in the U.S.

Tighter financing conditions in Europe more an exogenous risk

Risk level	Moderate	**Elevated**	High	Very high	**Risk trend**	Improving	**Unchanged**	Worsening

Regional financing conditions remain quite favorable with European banks still well placed to increase lending and as international investors consider shifting towards euros from U.S. dollars, even as U.S. trade uncertainties and heightened market volatility dampen risk appetite in global markets. Risks relate more to any further increase in long-term yields, potential widening of credit spreads, and (potentially most damaging of all) policy actions in the U.S. that disrupt or limit access for banks and investors to U.S. dollar liquidity and markets. Tighter financing conditions would have the greatest negative impact on those borrowers still needing to refinance fixed-rate debt borrowed at low rates as well as more vulnerable issuers that exhibit weak cash flows, excessive leverage, and face near-term refinancing needs.

Real estate risk to the broader economy remains

Risk level	Moderate	**Elevated**	High	Very high	**Risk trend**	Improving	**Unchanged**	Worsening

A material escalation of political and geopolitical risks could disrupt the European commercial real estate (CRE) sector's recovery by hindering CRE companies' ability to dispose of assets quickly, stabilize valuations, and increase rents or maintain occupancy levels if the situation places tenants under long-term financial strain. Moreover, a sustained expansion in government bond yields could derail the recovery in real estate valuations. Adverse developments could spill over to the broader economy and impair consumer confidence, spending, employment, and European banks' asset quality.

Structural risks

Disruptions linked to climate change will increase as weaker policy slows the transition

Risk level	Moderate	**Elevated**	High	Very high	Risk trend	Improving	Unchanged	**Worsening**

Investments in the energy transition are being scaled back amidst evolving political priorities in Europe and abroad, slowing progress towards net-zero emissions. This reduced commitment translates into a higher likelihood that climate targets and regulations could be amended. This could derail business plans and deter investments in the decarbonization of key industries, particularly in hard-to-abate sectors that still need policy support and pressure to change production processes (e.g., building, cement, steel, chemicals).

Cyber and digital transformation risks are gaining momentum

Risk level	Moderate	**Elevated**	High	Very high	Risk trend	Improving	Unchanged	**Worsening**

The pace of digitalization--including the advance of AI--and heightened geopolitical discord expose corporates and countries to mounting cyber risks, with targets ranging from utilities to insurers and government agencies. These risks are being exacerbated by threats to intelligence sharing even among allies (e.g., the Five Eyes alliance). Despite advanced cyber defenses, this cyber arms race can still result in business disruption, monetary loss, and reputational damage, weigh on credit quality, and undermine public confidence in critical infrastructure.

Risk levels may be classified as moderate, elevated, high, or very high. They are evaluated by considering both the likelihood and systemic impact of such an event occurring over the next one to two years. Typically, these risks are not factored into our base-case rating assumptions, unless the risk level is very high.
Risk trend reflects our current view on whether the risk level could increase or decrease over the next 12 months.
Source: S&P Global Ratings.

Macroeconomic Outlook

- Heightened uncertainty is expected to be a bigger drag on European growth than prospective tariffs in the short term. Our new 2025 EU growth forecast is 0.9% (1.2%)
- Our new baseline assumes reciprocal tariffs, 10% tariffs on automobiles and pharmaceuticals from April 2025 (although not in the U.K.), and 25% on steel and aluminum across the whole of Europe.
- The German fiscal stimulus, which could amount to as much as 20% German GDP over 12-years, should significantly boost growth from 2026, close the output gap, and have implications for the potential path of inflation and interest rates.

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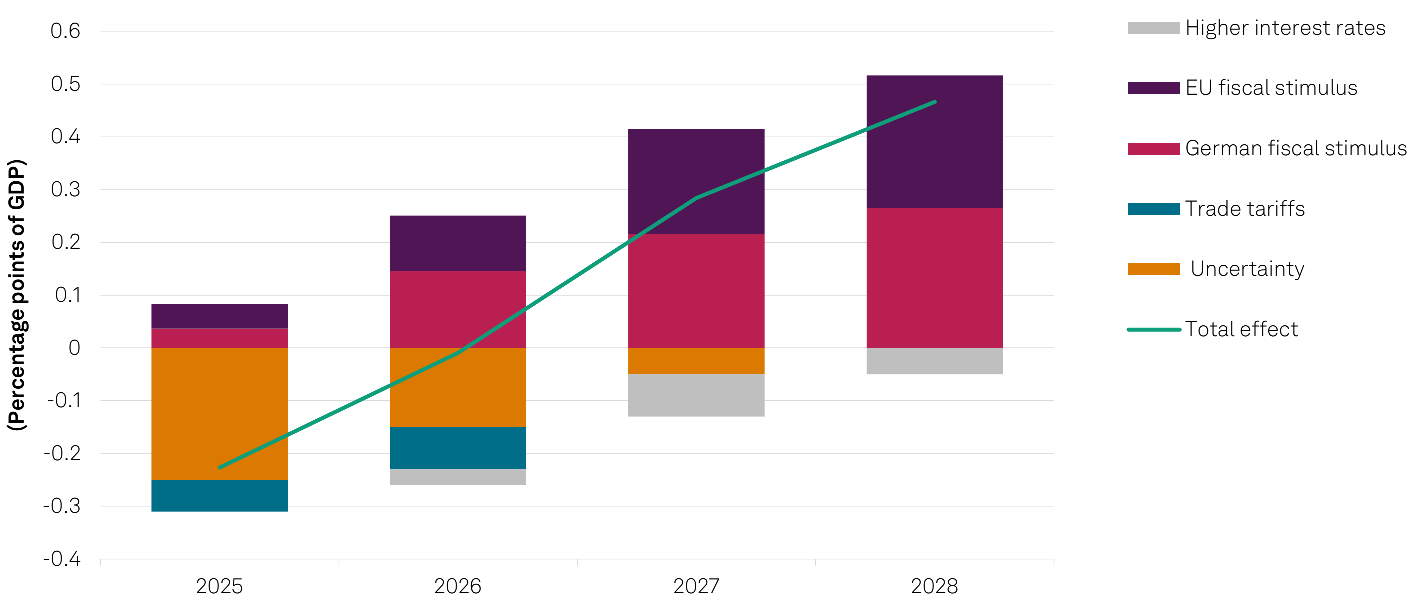
Eurozone

Less growth this year, more growth in coming years, and higher interest rates. The political developments of recent months have led us to rethink our baseline scenario. For this year, GDP growth is revised down to 0.9% as uncertainty should further weigh on demand and higher U.S. tariffs on imports of European goods should curb foreign trade. We believe that uncertainty will cause greater damage to GDP than tariffs (see chart 7). From 2026, GDP should be boosted by fiscal expenditure, with plans in Germany and the EU to increase infrastructure and defense spending. As a result, eurozone GDP growth is revised up by 0.1 to 1.4% in 2026 and by 0.3% to 1.5% in 2027. With the output gap set to turn positive in two years, this fiscal stimulus is likely to push up inflation over the medium term. We forecast inflation at 2% in 2026, compared with our previous baseline of 1.8%. In this new world, the ECB could start raising rates again in the second half of 2026, after a final rate cut to 2.25% in April or June of this year. We also see German 10-year yields higher than before, averaging 2.6% in 2025 and 2026.

Chart 7

Uncertainty will be a bigger near-term drag on growth than U.S. tariffs. German and EU fiscal plans could push growth above potential by 2027

Key drivers of change in the baseline scenario



Note: In terms of tariffs, the baseline scenario assumes the introduction of reciprocal tariffs and 10% tariffs on auto and pharmaceuticals, in addition to 25% on steel and aluminum from April/June 2025. Source: S&P Global Ratings.

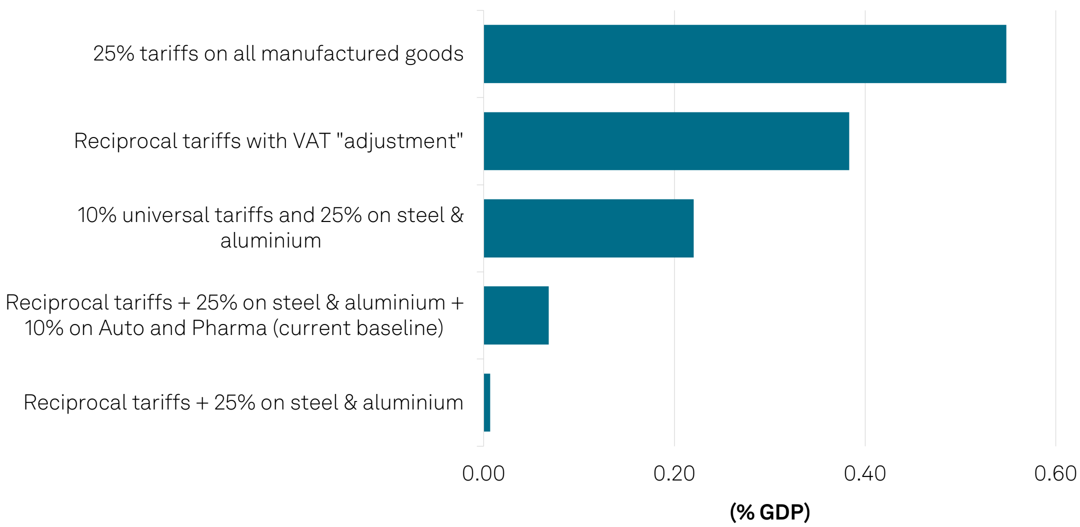
Beyond the policy-driven changes in our scenario, the narrative on EU economic fundamentals remains valid. The rise in real incomes, driven by still-strong labor markets (the unemployment rate was still at a record low of 6.2% in January), disinflation, and the past decline in interest rates, should continue to boost consumer spending in 2025 and 2026, as we have been witnessing since the second half of 2024.

U.S. tariffs could harm the European recovery. At the time of writing, we don't know exactly what tariff increases the U.S. administration might impose on European imports. We therefore consider different combinations of tariffs and estimate their impact on European GDP. The impact, illustrated in chart 8, reflects the direct impact of tariffs on GDP via the trade channel. It is calculated as the product of the domestic value added exported to the U.S. by each manufacturing sector, the price elasticity of trade by sector and the net increase in tariffs for each sector (see Eurozone economic outlook Q2 2025). We expect that an increase in U.S. tariffs to 25% on all goods imported from the EU would reduce GDP by almost 0.6%, while an increase in tariffs to 10% on all goods, in addition to the 25% on steel and aluminum, would reduce GDP by 0.2%. This effect is one-off and concerns a full year of GDP. For the record, our baseline scenario assumes reciprocal tariffs and 10% tariffs on automobiles and pharmaceuticals from April 2025, in addition to 25% tariffs on steel and aluminum from March 2025.

Chart 8

Trade impact on GDP of different tariffs scenarios

Percentage points of EU GDP



Source: S&P Global Ratings.

Lasting uncertainty is an issue. Even if tariffs are unlikely to derail the European economy via the direct trade channel, this environment of uncertainty that results from multiple announcements on tariffs is having a deleterious effect on European demand. We believe that the current uncertainty shock will reduce eurozone GDP by a cumulative 0.4% over 2025 and 2026.

The German fiscal stimulus is a game changer. The incoming German government has proposed spending up to €900 billion, which is almost 20% of German GDP and about 5% of EU GDP. This money would be spent on infrastructure (€500 billion over 12 years), defense (exempted from the debt brake if defense spending exceeds 1% of GDP), and the German states, allowing them to run a structural deficit of 0.35% of GDP per year. Germany's parliament passed the measures on March 18, 2025. We believe its effects on the real economy will materialize gradually and that the multiplier effects will be modest over our forecast horizon. We also assume defense procurement will include a large but declining import content. All in all, the German package is expected to contribute little to GDP growth this year (+0.1%), but progressively more in subsequent years, with an estimated net effect of +0.5% in 2026, +0.7% in 2027 and +0.9% in 2028 for Germany. At the same time, EU member states are expected to agree to increase defense spending by 1% of GDP from 2026 onwards. This plan could lift eurozone GDP by 0.1% in 2026, 0.2% in 2027, and 0.3% in 2028.

U.K.

U.K. economic growth is set to slow this year to 0.8%. We expect external sector weakness will continue to weigh on growth even if it is not directly subject to tariffs, because exporters have lost price competitiveness in recent years. The consumption recovery is set to slow as inflationary pressures reemerge at a time when the labor market is no longer adding jobs. This could increase households' cautiousness about spending.

At the same time, a weaker supply-side will keep the Bank of England cautious about cutting rates too fast. This is to prevent the persistence of second-round effects on inflation. A slower pace of rate cuts this year (we expect only two more) will slow the investment recovery, especially in a context of uncertainty about trade. The picture is set to improve from 2026 as inflation dissipates, the Bank of England can cut rates again to 3.5%, and due to improving external demand from the EU, the U.K.'s main trade partner. We expect GDP will edge back to 1.5% growth.

Key assumptions

- From next month, the U.S. Trade Administration is expected to impose reciprocal tariffs on all goods imported from Europe and 10% on autos and pharmaceuticals (but not on the U.K.), in addition to 25% on steel and aluminum. We don't expect these tariff increases to be reversed any time soon. EU retaliation should remain limited in terms of tariff measures.
- In Germany, the fiscal package proposed by the new government will be passed by the parliament without too many amendments or delays.
- EU member states are expected to increase defense spending by 1% GDP from 2026.

Key risks

- Uncertainty over foreign trade could last longer than expected, and U.S. tariffs could increase by far more than we have factored in (especially for the U.K.). Uncertainty is also likely to be compounded by market volatility, notably in exchange rates and energy prices.
- Tensions over the international role of the US$ could follow trade tensions.
- The implementation of German fiscal plans could be slow or incomplete. The same risks apply to the EU defense plan.
- The U.S. economy could face a hard landing due to higher import prices triggered by tariffs, which could have spillover effects on the European economy.
- Labor markets could further deteriorate.

What to look out for in the next quarter

- Discussions between trading partners on tariffs and retaliation.
- The German government formation and the rollout of fiscal stimulus in Germany and the EU.
- U.K. government policy and underlying inflationary pressures.
- The resilience of the U.S. economy.
- Progress of peace talks in Ukraine.
- Labor market trends.

Financing Conditions

- Periods of market volatility are likely to become more frequent and pronounced as uncertainty around the U.S. administration's stance in key areas, including trade and financial markets, persists.
- Primary market activity may become more subdued, but robust issuance in 2024 has materially reduced near-term refinancing risks, and overall financing conditions remain underpinned by healthy European bank risk appetite.
- Rating performance trends remain resilient, with improving trends in most sectors. In our base case, defaults are projected to decline from the current elevated levels to 3.75% by December 2025, underpinned by improvements in credit quality.

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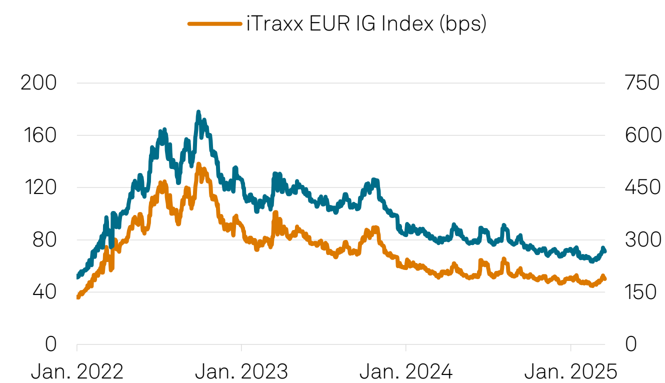
More volatility and market pressure likely, as uncertainty ramps up. Recent market volatility is unlikely to be a one-off event. The uncertainty attached to the economic and market implications of the U.S. administration's stance in key areas is likely to persist, against the backdrop of continuing geopolitical tensions in Europe and the Middle East, and a potentially seismic shift in German spending. The latter triggered a sharp rise benchmark 10-year bund yields, to their highest sustained level since 2011, with a spillover to other European benchmarks. Corporate yields are also trending upward, with 'BBB' yields up around 16 basis points (bps) and 'CCC' yields up 55 bps since the start of 2025.

Credit market no longer immune. Nervousness and uncertainty, primarily associated with the economic implications of tariffs and a potential trade war, has triggered volatility in credit market, with a 40 bps spike in the iTraxx Crossover index in mid-March. Credit spreads have also widened but from very low levels (see chart 9) and much less than in the U.S., potentially reflecting the diverging tracks for both economies. However, European credit markets are far from immune to global trade headwinds, as indicated by a recent decline in primary market issuance and secondary market pricing.

Chart 9

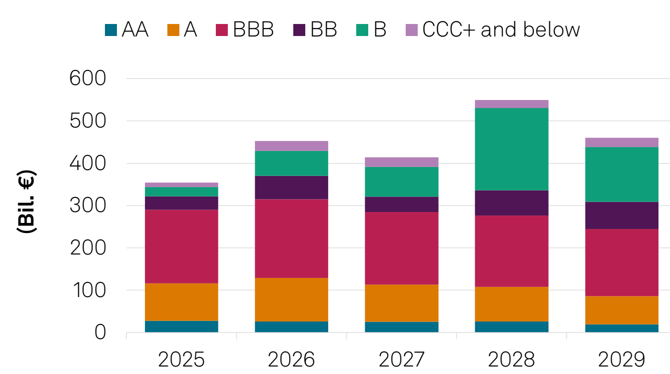
Spreads remain tight despite recent widening



Source: S&P Global Ratings.

Chart 10

Near-term liquidity pressure eases



Source: S&P Global Ratings.

Despite a slowdown in primary market activity, refinancing risk is manageable due to lower near-term maturities and solid bank lending appetite (see chart 10). Bond issuance in Europe is trailing about 15% below 2024 levels (end February). Notably, nearly 90% of the total volume is attributed to investment-grade issuers, with 76% coming from financial institutions. In contrast, speculative-grade bond issuance has been muted, but loan issuance has been far brighter driven partially by a ramp up in collateralized loan obligation (CLO) formation, refinancing and early 2025 expectations for a decrease in funding costs. Rising spreads and yields, along with a pickup in volatility amid continued market uncertainty, may suppress bond and loan issuance levels and increase financing costs.

While primary activity may slow, bank lending appetite remains solid. This is an important factor in determining financing conditions due to the smaller relative size of European capital markets. Furthermore, the robust wave of refinancing activity in 2024 has materially eased near-term liquidity pressures for many issuers, resulting in a 36% decrease in nonfinancial corporate speculative-grade maturities for 2025. At the start of the year speculative-grade issuers made up only about 18% of refinancing needs in 2025. Remaining refinancing needs will continue to be at higher costs. Our early January estimate indicated that European borrowers with 'BBB' or 'BB' rated bonds could face a funding cost rise of about 170 to 195 bps for maturities in 2025 and 2026 if refinanced at current new-issue yields. That is only likely to have increased given recent increases in spreads and yields. Higher borrowing costs associated with new debt issuance may exert increasing pressure on lower-rated borrowers.

Ratings performance remains resilient, and European default rate should fall despite specific sector pressures. Rating performance remains quite resilient. Although downgrades have picked since the start of the year, the negative corporate outlook bias has declined and remains well below five-year averages (at about 27% for 'B-' and lower rated issuers, versus the five-year average of close to 33%). We have also seen a marginal decline in the number of weakest link ratio issuers (rated 'B-' and lower with a negative outlook, or credit watch negative) to 7%. Just over 80% of downgrades since the start 2025 have originated from speculative-grade issuers, primarily in consumer-facing sectors such as media and entertainment, consumer products, and retail. These downgrades are mostly linked to weak operating metrics and unsustainable capital structures.

Corporate defaults in Europe (as of end February) lag 2024 (at six versus eight). Currently, the European speculative-grade default rate remains historically elevated at 4.1% (as of end January) due to the prevalence of distressed exchanges and debt restructurings. In our base case, we forecast that this default rate will decrease to 3.75% by December 2025, though we include optimistic and pessimistic forecasts of 2.5% and 6.25%, respectively, which reflect limited visibility and increased uncertainty.

Credit Cycle Indicator (CCI)

CCI points to improving household and corporate credit quality

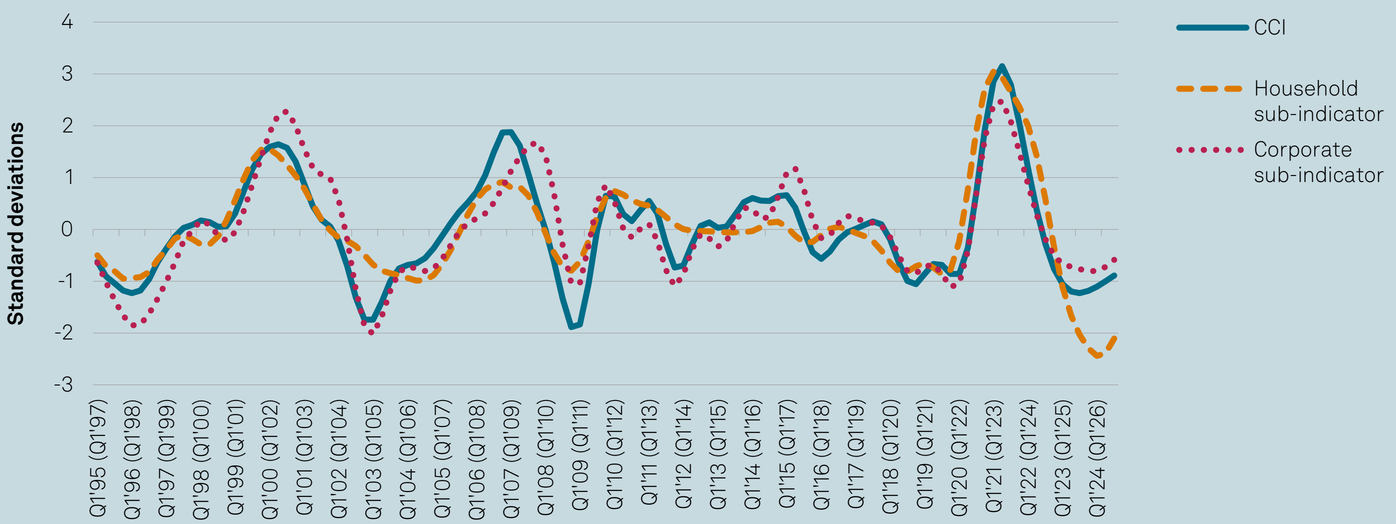
The Eurozone CCI has continued its improvement journey from its trough in late 2023 (see chart 11). Driving the momentum are positive equity price developments and somewhat recovering house prices for most countries. Borrowing capacity for households and corporations is still increasing due to continuous falling debt to GDP, high levels of employment, and rising real wages. However, current heightened geopolitical and political uncertainty poses risk to the credit recovery signaled by the CCI.

Corporates: Corporate sector debt to GDP continues to decline across most European countries over the last reported quarter barring Sweden (2.1% - quarterly increase), Germany (0.3%), and Austria (0.2%). This means borrowing capacity broadly improved with average debt levels remaining about 12% lower than four years ago (Q3'2020). Lower indebtedness is normally a good starting point for the next credit upswing, but when paired with low GDP growth figures (2024 euro area GDP at about 0.9%), this could also be consistent with continuing low appetite for investments (despite broadly improving financing conditions during this period). Indeed, Eurostat reported a 3% fall in industrial production for 2024.

Households: European households have remained cautious even while equity markets and house prices continue to improve for most countries on the back of the easing of monetary policy. Strengthened household balance sheets translate to debt to GDP, which are on average 16% lower than four years ago (Q3'2020), albeit with some minor exceptions where debt has increased. This includes Hungary (0.6% - quarterly change), Czech (0.3%), and Norway (0.3%). With mixed signals from recent EU surveys—economic sentiment improving and employment expectations deteriorating—and given heightened geopolitical and political uncertainty, it seems unlikely that households will materially change their financial risk appetite in at least the near term.

Chart 11

Eurozone credit cycle indicator



Data as of Q3 2024. Peaks in the CCI tend to lead credit stresses by six to 10 quarters. When the CCI's upward trend is prolonged or the CCI nears upper thresholds, the associated credit stress tends to be greater. Sovereign risk is not included as a formal part of the CCI. CCI--Credit cycle indicator. Q--Quarter. Sources: Bank for International Settlements, Bloomberg, S&P Global Ratings.

Financial Institutions

- Our outlook for European banks is largely stable (79% of rating outlooks), but there is still a relatively high share of positive outlooks (15%), largely concentrated in Southern Europe and among lower-rated issuers.
- European banks should continue to benefit from solid profitability, sound capitalization and liquidity, and benign asset quality in 2025.
- Mergers and acquisitions (M&A) will remain a key theme as some banks are leveling up their ambitions to build scale and diversify product lines.
- Adverse geopolitical events and trade protectionist measures that challenge our base case macroeconomic scenario or heighten market turbulence are key risks.

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Key developments

Sound profitability in 2025. 2024 was the second consecutive year in which European banks achieved double-digit returns on equity (10.5% for Euro/EEA banks). The last time that happened was pre-2008, when banks held far less capital and had riskier balance sheets. The outlook for 2025 is reasonably positive. While banks will continue to feel the impact of declining interest rates, we expect only a slight and gradual erosion of their net interest income as banks have taken steps to deal with declining interest rates, through hedging and active management of their deposit pricing. A focus on fees and cost control and contained credit risk will also contribute.

Generous distributions to shareholders will continue. Solid returns allowed banks to confirm their distribution targets. For most banks, the dividend payout is around 50%, and several have announced additional share buybacks that should continue to support their good market momentum. Equity valuations improved significantly in the past few months, with many banks now finally trading again above book value.

Loan growth is timidly returning. The increased lending volumes that we saw in the second half of 2024 should continue to gather pace in 2025, especially in European countries where economic conditions are more favorable and where a long deleveraging phase is ending (e.g., Spain). Fragile confidence-- conditioned by geopolitical developments--represents a risk, though.

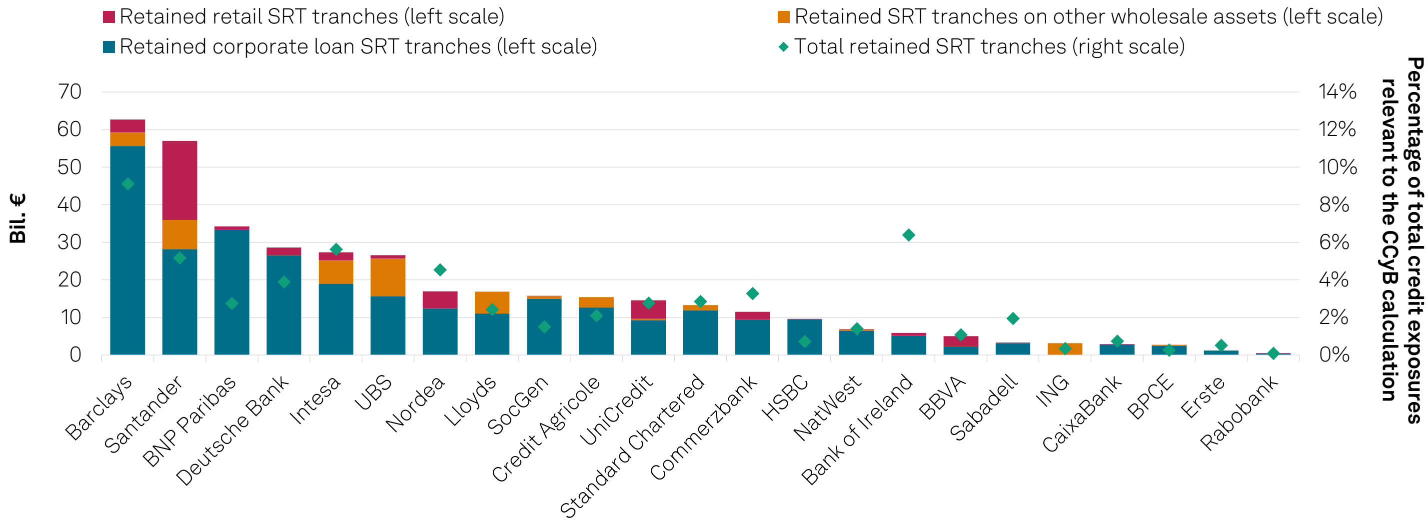
Bank capitalization remains solid. Of the top 100 European banks, 69 have capital levels that we consider strong, and thus supportive of our ratings. The revised CRR regulation, which came into force on Jan. 1, 2025, was easily accommodated, thanks to several legislative deviations and the gradual phase-in of the output floor. Furthermore, the EU Commission’s decision to delay the implementation of the Fundamental Review of the Trading Book will offer additional relief to banks with significant market operations. The introduction of capital conservation buffer requirements in some Southern European countries should also be managed smoothly.

Significant risk transfer (SRTs) will become more widely used by banks as a capital tool. A few players dominated issuance volumes in 2024 (see chart 12), but we think its use will become more broad-based over time, as SRTs (which are largely synthetic and bilateral) have proved to work effectively to manage credit risk (reducing credit costs for banks) and, more recently, to raise capital at attractive prices given investors' strong demand. European regulators also appear supportive of SRTs.

Chart 12

Barclays and Santander lead European banks' SRT activity

Banks' non-trading book exposures to originated SRTs



SRT--Significant risk transfer. CCyB--Countercyclical buffer. The data for BPCE and UBS include all originated securitizations, some of which may not be SRTs. Total credit exposures relevant to the CCyB calculation exclude certain counterparties such as governments and central banks. The figure for total credit exposures relevant to the CCyB calculation is not available for UBS. Source: Tables SEC1 and CCyB1 from June 2024 Pillar 3 reports.

Asset quality deterioration remains contained, though targeted trade tariffs could create new pockets of risk. Asset quality proved stable or slightly improved in most countries over 2024, with the exception of Germany, Austria, and France, where banks' nonperforming loan ratios and credit costs slightly increased. We expect asset quality to remain benign in 2025, supported by lower financing costs and economic growth (even if modest). But uncertainty remains high, and the possibility of the U.S. imposing tariffs on targeted sectors could lead to an uneven impact on banks' credit quality. On top of the CRE sector and the auto industry, which have been on our radar over the past couple of years, other potentially vulnerable economic sectors are metals, chemicals, and pharmaceuticals. The exposure of top European banks to those sectors looks manageable (see chart 13). Thus, a scenario where credit losses spike, and banks have problems absorbing that through earnings looks remote.

Some U.K. lenders built up provisions to cover potential remediation costs arising from the motor finance commissions case, but the Supreme Court hearing in early April could lead to further hits. Lloyds topped up its existing GBP 450 million provisions by a further GBP 700 million in the fourth quarter of 2024, Santander U.K. set aside GBP 295 million in the third quarter, while Barclays added a more modest GBP 90 million in the fourth quarter. The three banks saw their net income reduce as a result. Whether these provisions are enough, or if affected banks have to take a further hit this year will very much depend on the outcome of the Supreme Court decision, specifically on whether it upholds the Court of Appeal ruling, which considered historic motor finance commission payments unlawful because customers did not provide informed consent.

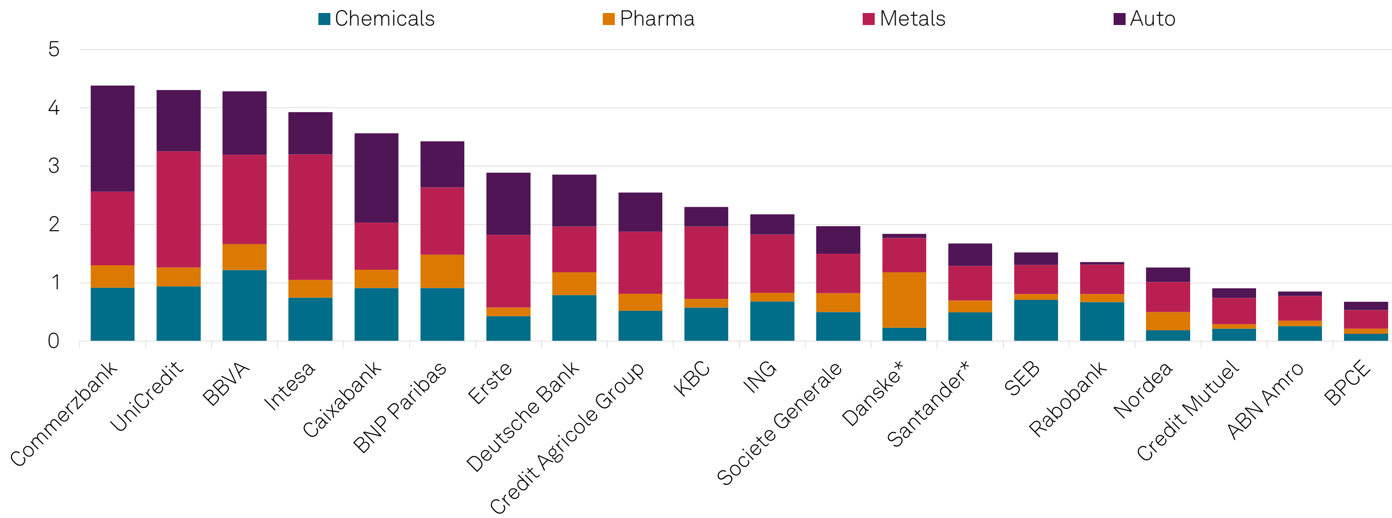
Intense M&A activity. The flow of M&A announcements continues. Italy is at the epicenter of domestic consolidation, with four potential deals announced in just three months: Banco BPM and ANIMA; UniCredit and Banco BPM; Monte dei Paschi and Mediobanca; and BPER Banca and Banca Popolare di Sondrio. It is unclear whether all of them will finalize, but the activity suggests that consolidation is inevitable as banks look for economies of scale and better revenue diversification to enhance their earnings capacity. Some cross border deals have also been announced, with acquirers aiming to strengthen their presence in countries where they already operate, e.g., UniCredit's interest in Commerzbank, and Greek Alpha Bank's offer for Cypriot

Astrobank. And finally, we have seen a third group of banks looking to deepen their presence in complementary, capital-light business lines, mainly asset management. BNP's acquisition of Axa Investment Managers, BPCE's decision to create an asset management JV with Generali, and ING's announced acquisition of a minority stake in Von Lanschot Kempen fit in this group.

Chart 13

European banks' exposure to sectors potentially subject to targeted tariffs is contained

% of total loans



*Banks data as of YE2024, the rest as of H1 2024. Banks' disclosures. Source: S&P Global Ratings.

A slow start for issuance in 2025 after a record 2024. As of February, issuance volume was 21% lower than a year ago. Pre-financing completed in 2024 amid supportive market conditions, still-growing deposit bases, and increased uncertainty probably explain the difference. Banks' liquidity remains quite comfortable, and the possibility of regularly resorting to central bank funding adds further confidence. Still, banks' need to refinance their maturing Minimum Requirement for Own Funds And Eligible Liabilities (MREL) instruments, which means they will have to tap the markets recurrently.

A move towards some regulatory simplification is starting. Banks are pushing for it, to help alleviate the significant compliance burden they face--especially smaller banks and those operating in multiple jurisdictions. Authorities seem receptive. U.K. authorities, for example, are initiating a simplified prudential regime for smaller banks with balance sheets below GBP 20 billion. The ECB is also working to fast-track the recognition of SRTs for plain-vanilla transactions. We don't consider it likely that risk will arise from laxer regulations, not least because banks' current health stems, in large part, from the higher bar of prudential regulation and supervision.

Key risks

- **Negative geopolitical developments and trade protectionism affecting Europe's economic growth,** undermining the health of the corporate and household sectors, and leading to weaker asset quality and business prospects.
- **Market turbulence and disorderly repricing,** which could destabilize financial institutions, pressure liquidity, cause market tail risks to materialize, and increase defaults.
- **Weak fiscal and public debt dynamics,** which could constrain governments' ability to support the economy, thus make the operating environment for banks riskier.
- **Insufficient resilience against cyber and IT risks** risking the viability of some institutions.

Nonfinancial Corporates

- Worsening relationships between Europe and U.S. are creating uncertainty, lower visibility, and higher volatility. This scenario makes strategic planning more difficult for corporates, including due to increasing risks of globally lower growth and higher inflation.
- Tariffs on European goods have not yet been announced. Sectors that are very much rooted in Europe, like luxury goods and alcoholic beverages, are on top of the list. We expect potential tariffs to add pressure on credit quality in sectors that were already experiencing difficult conditions like automotive and auto suppliers, and metal downstream, among others. The defense sector is the most notable exception, as recent news supports further expansion.
- Potential negative effects from tariffs could be mitigated by several factors, like the existence of local productions, flexible supply chains, or the possibility to divert goods to other countries. Many corporates are considering alternatives to their current set-up.
- In Europe, the increased volatility resulted in a change to the net direction of rating actions. Since December 2024, downgrades have outpaced upgrades, while the net outlook bias continues to be negative.

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Key developments

The shift in U.S. policy has created volatility that can affect corporates in several ways. For many sectors, U.S. sales represent an important percentage of total revenues--chemicals, pharmaceuticals, machinery, and transportation are among those with the largest exposure. According to the scarcity of goods and companies' ability to use substitutes, tariffs can be more or less impactful. We can assume that some manufacturers will be able to pass some of the cost through to their customers but, in many cases, tariffs are likely to result in volume or profit contraction. However, looking at our rated portfolio, we observe that many potential impacts could be mitigated by different factors, with localization of production to meet U.S. sales being the most preferred.

Ongoing uncertainty is reducing visibility on the business outlook. The negative effect of this is difficult to overstate as there are no mitigants and it is making strategic planning, including decisions on large investments, complicated for corporates. Our reference scenario is increasingly uncertain, as national and EU economic priorities have rapidly changed, notably with new defense commitments now likely to absorb a larger proportion of budgets. Part of that will be covered by new debt, but it seems likely that other national priorities will be reviewed, including investments in energy transition and welfare, especially for countries with low headroom to increase debt.

Potentially weaker global economic conditions are negative for corporates and utilities. In several sectors, European corporates annual results for 2024 are showing resilience despite the still relatively weak economic environment. Average revenue and operating profit have grown across most sectors, excluding autos, oil and gas, and metals, where results have skewed more negatively. However, CEOs and CFOs remarks, during full year results presentations, have in many cases pointed to softness in consumption of goods and we assume that this situation will deteriorate further if uncertainty increases and consumer confidence weakens.

The U.S. could detail the tariffs to be applied to the EU within weeks. Based on what we know at this stage, we believe that the luxury sector could be affected as the mitigants are very limited, given that most companies we rate have no production in the U.S. Alcoholic beverages are also likely to be affected, in particular the spirit segment. A few companies that we rate in this sector have large portfolios including U.S. spirits, meaning tariffs are likely to affect only some specific products.

Tariffs already imposed globally, or in other regions, are also relevant for European companies. The automotive sector is exposed to potential tariffs on the EU, and affected by tariffs already applied and then suspended on Mexico. European original equipment manufacturers (OEMs) with sales in the U.S. set up factories in Mexico to reduce labor costs (a similar strategy to that adopted by U.S. OEMs). If tariffs on Mexico take effect, they will add further pressure to financial performance at a time when many European OEMs are already dealing with soft demand, in particular for electric vehicles, and tough competition from Chinese OEMs. The metal downstream sector is already subject to 25% tariffs on steel and aluminum exported to the U.S. That tariff alone is unlikely to put pressure on downstream metal sector ratings, but it adds to the issues of low demand, low prices, and high energy costs that are already affecting the sector in Europe.

Many companies benefit from mitigants that can significantly reduce the potential pressures from existing and future tariffs. Looking at our rated portfolio, we note that companies that might be expected to be most affected by tariffs, based purely on the percentage of revenues coming from the U.S., are likely to avoid much of the pain due to local production facilities. A good example is the building material sector, where a few large players have exposure to the U.S., but typically make their heaviest products in local factories, and appear confident that they can pass tariffs on lighter imported products on to customers. The major risk for this sector is a serious economic setback that reduces demand. Similarly, some players in the chemical sector have applied the local-for-local strategy. We also note that, the U.S. is a net exporter of chemicals, so harsh tariffs would make the sector vulnerable to retaliation, while some imported chemicals can be very difficult to source elsewhere.

We believe that the service sector is, currently, relatively shielded from U.S. tariffs. A significant part of our rated portfolio is represented by service companies. These tend to rely on local labor forces. Furthermore, we do not expect tariffs to be imposed on these sectors by the U.S. administration, for now, as they seem to be concentrated on rebuilding an industrial backbone in specific sectors.

Key risks

- **The escalation of U.S. tariffs and potential consequential retaliation from Europe.** Any tightening of U.S. tariffs is likely to result in measured retaliation from the EU, leading to a deterioration in trading conditions. This could pressure consumer and business confidence with a likely negative impact on corporates sales and profits.
- **A sharp change in the reference scenario due to increasing geopolitical tensions.** Corporates need visibility and predictability to plan long-term investments, like those related to the energy transition and digitalization. The increasing uncertainty risks creating significant delays in the implementation of important investments addressing these megatrends.
- **Rising protectionism.** Rising protectionism can entail a reduction of trading dependencies from countries that can be difficult to mitigate, notably if they require existing supply chains to be reconfigured. In some cases, this process can have long-term benefits, but this does not apply in all sectors. In most cases, it has costs that can be very significant if the readjustment must be completed urgently.

Structured Finance

- European securitization issuance started the year strongly, especially in the collateralized loan obligation (CLO) sector, where volumes have more than doubled.
- The European Commission is considering responses to its wide-ranging consultation on the functioning of the securitization market, with proposed regulatory changes in the pipeline.
- The credit performance of loans backing residential mortgage-backed securities (RMBS) is diverging between sectors, with U.K. nonconforming, U.K. legacy buy-to-let, and Irish non-prime sectors seeing rising arrears.

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Key developments

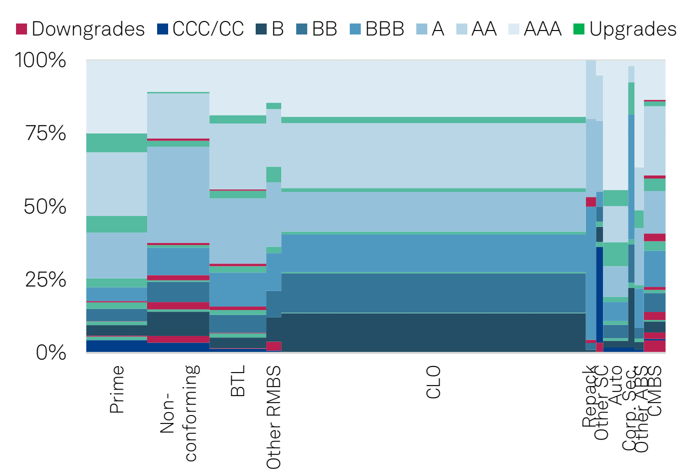
European securitization issuance continues apace. Investor-placed volumes in the first two months of 2025 exceeded €26 billion--up more than 50% on the equivalent period in 2024 and a new high for the post-financial crisis era. The strongest growth has been in the leveraged loan CLO sector, where year-to-date issuance has more than doubled from already-high levels in 2024. However, there are also signs of increasing diversity: the commercial mortgage-backed securities (CMBS) sector, for example, has already seen more issuance than in the whole of 2024. And last year's firsts--including debut public transactions backed by solar, data center, and Israeli mortgage assets--also point to broadening use of securitization technology in the region.

The prospect of regulatory rehabilitation could be supportive. In late 2024, the European Commission closed a wide-ranging consultation on the effectiveness of the EU securitization regulatory framework. This followed renewed calls to revive the sector as part of wider initiatives to enhance EU competitiveness and further develop capital markets. The consultation covers many areas that could be constraining issuance, including requirements on disclosures and investor due diligence, as well as the treatment of securitization exposures in banks' and insurers' regulatory liquidity and capital rules. The Commission has indicated that there could be a legislative proposal, based on the consultation feedback, by mid-2025.

Chart 14

Upgrades still the norm, but downgrades in some areas

European structured finance ratings heatmap

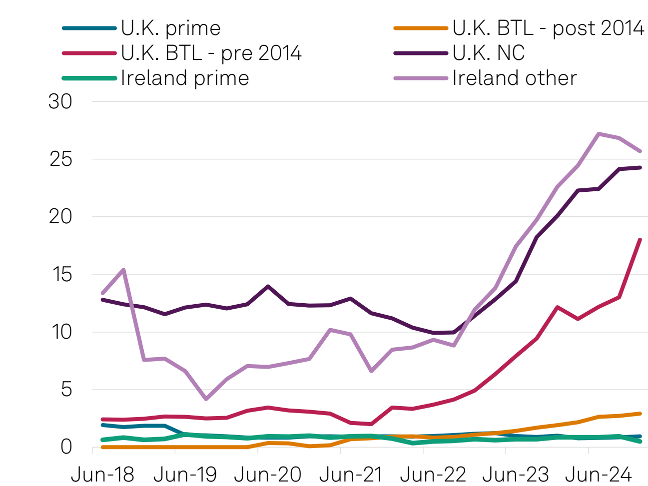


Based on rating transitions over the 12 months to Feb. 28, 2025. ABS--Asset-backed security. BTL--Buy-to-let. CMBS--Commercial mortgage-backed security. CLO--Collateralized loan obligation. SC--Structured credit. Source: S&P Global Ratings.

Chart 15

Mortgage arrears diverging further between sectors

U.K. and Irish RMBS average arrears rate, by subsector (%)



RMBS--Residential mortgage-backed securities. BTL--Buy-to-let. NC--Nonconforming. Source: S&P Global Ratings.

In terms of performance, European structured finance ratings continued to move higher over the past 12 months. We lowered 2% of our securitization ratings in the 12 months to end-February 2025, while we raised 8% (see chart 14). Most downgrades were in the CMBS and nonconforming residential mortgage-backed securities (RMBS) sectors.

Key risks

- **The number of borrowers in arrears on their mortgage payments continues to rise for some collateral pools backing European RMBS**. However, the arrears trend is strongly polarized between different subsectors of the residential mortgage space. For example, arrears have typically increased substantially since 2022 in U.K. nonconforming, legacy U.K. buy-to-let (BTL), and Irish non-prime RMBS, but have remained broadly flat for the U.K. and Irish prime subsectors (see chart 15). The U.K. subsectors exhibiting rising arrears include a significant number of loans originated before the global financial crisis. The borrowers, who typically pay a floating rate at present, could be unable to qualify for more favorable rates on new loan products. Additionally, almost all securitized BTL mortgage loans make payments on an interest-only basis, meaning any rate rise affecting the loans has had a directly proportional effect on borrowers' monthly installments. In Ireland, the non-prime RMBS subsector includes nonconforming and reperforming loans, where similar dynamics are at play. For well-seasoned collateral, one mitigant is that current interest rates generally do not exceed those that the borrowers were paying when their loans were originated, and both rents and income have generally increased substantially since then. Another mitigant is that regulated loans will have been underwritten to stressed interest rates that are again higher than current levels. However, borrowers' circumstances may also have changed significantly over the years since origination.

International Public Finance

- An expected increase in sovereign defense spending will likely trickle-down financial pressure to European local and regional governments (LRGs) and their related enterprises.
- We also anticipate a revision of framework regulating LRGs' fiscal policy in many European counties, specifically Germany, Spain, and the U.K.
- European social housing providers continues to prioritize spending on existing units, while interest rates remain relatively elevated.
- U.K. universities may need to adjust their strategies as the expected decline in the number of international students will weaken their financial performance.

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Key developments

The incoming German government is proposing substantial amendments to the country's stringent fiscal rules that may ultimately allow states to increase budget deficits. So far, we anticipate that the debt burden of German LRGs will gradually decline (see chart 16). That could change though, depending on the degree to which each state loosens its budget policy and the effect of positive economic growth.

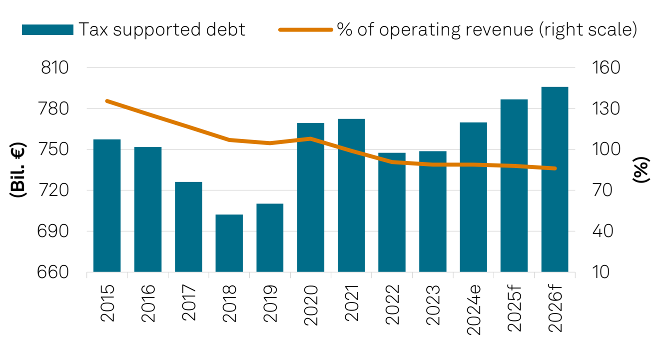
The Spanish government is progressing with partial, regional debt absorption. For some regions, debt account for a very high 350% of annual operating revenues. The process could conclude by the end of 2025, absent any political difficulties. The debt absorption, based on the state's current proposal, would cover about 26% of the total debt of Spain's normal status regions. The measure could reduce their debt burden, although it will prove temporary absent structural reforms. It may also generate moral hazard by diminishing regions' incentive to stick to tight fiscal policy.

French public sector entities aren't immune to the financial pressures that led to a recent revision of the outlook on the sovereign rating to negative. We don't think that the institutional arrangements of French LRGs and government-related enterprises allow any of them to be rated above the sovereign.

The credit quality of U.K. social housing providers is stabilizing after years of decline. The negative outlook bias is the lowest in a decade and continues to shrink (see chart 17). They are currently focusing on improving quality of existing units and accumulation of debt raising capacity ahead of projected lowering of interest rates.

Chart 16

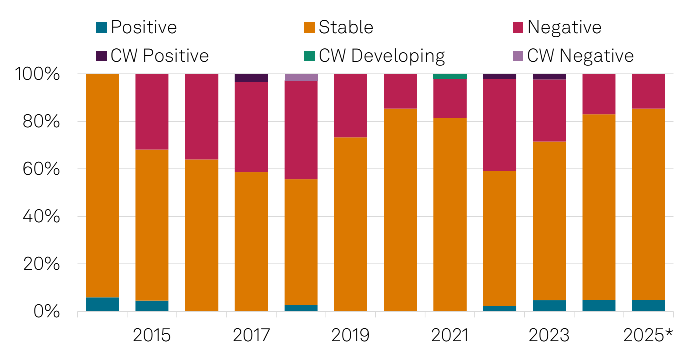
German LRGs' debt burden is set to reduce, for now



f—forecast. Source: S&P Global Ratings.

Chart 17

Negative outlook bias for U.K. social housing continues to shrink



*Year-to-date. Source: S&P Global Ratings.

Insurance

- We observe ongoing motor insurance claims inflation due to increasing prices for car parts and repairs. Some non-life insurers raised premium rates in line with claims inflation to improve underwriting margins, yet we believe further premium rate adjustments are necessary to recover margins.
- Reinsurers' earnings prospects remain sound due to still favorable pricing and robust terms and conditions, and despite moderate price declines in recent renewals. Significant losses from the L.A. wildfires in January reduced the sector's natural catastrophe loss budget for the remainder of 2025.Our neutral sector view on re-insurers is unchanged.
- Recent capital market trends have been stable, enabling life insurers to benefit from stable re-investment rates. However, geopolitics and economic performance might lead to significant capital markets volatility, potentially impacting life insurers' balance sheets.
- We maintain our insurance sector view, with on average strong ratings and predominantly stable outlooks, on the back of solid capitalization and generally prudent investment risk appetite.

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Key developments

California's wildfires drained Europe-based global re-insurers' natural catastrophe budgets for 2025. Despite those early losses, we believe reinsurers are entering 2025 from a position of capital strength and will post strong results this year. The fire-related losses will be absorbed within industry players' annual earnings, albeit leaving less catastrophe budget for the remainder of 2025.

We expect pricing in short-tail lines will remain firm through the remaining renewals this year. Meanwhile, reinsurers will continue to grapple with the new normal of elevated natural catastrophes and the effects of inflation on casualty loss reserves, which remain at the forefront of industry concerns.

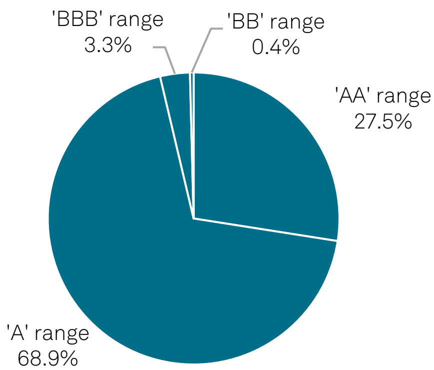
European non-life insurers adapted to higher re-insurance costs while facing frequent natural catastrophe events. Flooding, drought, and wildfires in southern Europe have become the new normal in recent years. Retail non-life insurers take their fair share in frequency claims but remain dependent on excess-of-loss re-insurance cover. Despite the need to adjust motor insurance rates to meet rising costs, competitive pressures are increasing in some countries and weighing on insurers' ability to sufficiently increase premiums.

Despite geopolitical turbulence and muted economic growth, life insurers have benefitted from favorable capital markets, so far. We consider that life insurers are mainly exposed to investment risk and capital market volatility. Most European life insurers' investments are in sovereign bonds and investment-grade bank bonds. However, we note there are sizable investments in listed and unlisted equities, real estate, and (to a lesser extent) private debt and structured investments.

European insurers' Solvency II ratios remain strong at an average of over 200%. Most European insurers operate well within their operating solvency ratio target levels. European Union 27 member states are working towards incorporating into national law the latest reforms of Solvency II regulations, which will take into effect in January 2027. We expect the reforms will slightly benefit many EU insurers Solvency II positions.

Chart 18

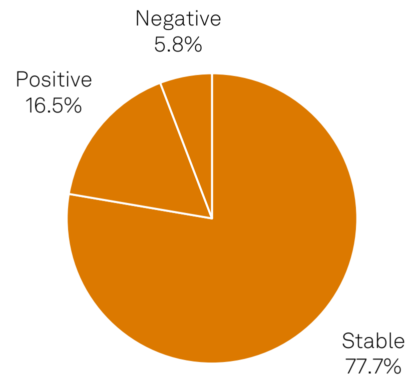
Financial Strengths Ratings on European insurers are mainly in the 'A' category



Data as of March 10, 2025. Source: S&P Global Ratings.

Chart 19

Our ratings outlooks on most European insurers are stable



Data as of March 10, 2025. Source: S&P Global Ratings.

Key Risks

- **Geopolitical turbulence and other external events could materially impact capital markets.** Despite profit and loss sharing with policyholders in many cases, a prolonged capital market downturn might impair life insurers' investments and balance sheets.
- **Natural catastrophes might increase in number and size.** Flooding and other natural catastrophe events in Europe have been more frequent and severe in recent years. Whilst primary insurers and re-insurers have, so far, managed to cover insured losses and offer insurance cover after an event, disproportionate losses for regional focused (re)-insurers following regionally concentrated perils are increasingly likely.

Related Research

- Economic Outlook Eurozone Q2 2025: A World In Limbo, March 25, 2025
- U.K. Economic Outlook Q2 2025: Recovery In Consumption Slows As Inflationary Pressure Returns, March 25, 2025
- EMEA Structured Finance Chart Book: March 2025, March 21, 2025
- Tariffs cloud corporate earnings, March 20, 2025
- Corporate Results Roundup Q4 2024, March 19, 2025
- European Banks Power Through Uncertainties, March 12, 2025
- CreditWeek: What Does The U.S.-Ukraine Fallout Mean For Europe? March 6, 2025
- Sovereign Debt 2025: Developed European Governments To Borrow About $1.8 Trillion, March. 4, 2025
- The European Speculative-Grade Default Rate Could Level Out At 3.75% By December 2025, Feb. 21, 2025
- European Defense Funding: What Are The Options?, Feb. 13, 2025
- Have Positive Rating Performance Trends Peaked Or Plateaued?, Feb. 3, 2025

Appendix: Q2 2025 Economic Data And Forecast Summaries

Table 1

Real GDP (%)

	Eurozone	Germany	France	Italy	Spain	Netherlands	Belgium	Switzerland	U.K.
2023	0.5	-0.1	1.1	0.8	2.7	0.1	1.3	0.7	0.4
2024	0.8	-0.2	1.1	0.5	3.2	0.9	1.0	1.3	0.9
2025-f	0.9	0.3	0.7	0.6	2.6	1.5	1.1	1.2	0.8
2026-f	1.4	1.4	1.1	1.0	2.0	1.2	1.3	1.5	1.6
2027-f	1.5	1.7	1.2	1.0	1.9	1.5	1.3	1.7	1.6
2028-f	1.5	1.6	1.1	0.9	1.8	1.5	1.2	1.8	1.4

f--Forecast, annual average. Source: S&P Global Ratings Research.

Table 2

CPI inflation (%)

	Eurozone	Germany	France	Italy	Spain	Netherlands	Belgium	Switzerland	U.K.
2023	5.4	6.0	5.7	5.9	3.4	4.1	2.3	2.1	7.3
2024	2.4	2.5	2.3	1.1	2.9	3.2	4.3	1.1	2.5
2025-f	2.1	2.4	1.5	1.7	2.5	2.8	2.9	0.5	3.3
2026-f	2.0	2.2	1.8	1.7	2.0	2.2	2.5	0.8	2.5
2027-f	2.0	2.1	1.9	1.8	2.0	2.0	2.4	0.9	2.1
2028-f	1.9	2.0	1.9	1.7	1.9	2.0	2.1	0.9	2.0

CPI--Consumer price index. f--Forecast, annual average. Source: S&P Global Ratings Research.

Table 3

Unemployment rate (%)

	Eurozone	Germany	France	Italy	Spain	Netherlands	Belgium	Switzerland	U.K.
2023	6.6	3.0	7.3	7.7	12.2	3.6	5.5	4.0	4.0
2024	6.4	3.4	7.5	6.5	11.3	3.7	5.7	4.4	4.3
2025-f	6.3	3.6	7.7	6.5	10.6	3.8	5.7	4.6	4.6
2026-f	6.2	3.4	7.7	6.6	10.2	3.9	5.7	4.6	4.7
2027-f	5.9	3.2	7.5	6.5	10.0	3.9	5.6	4.4	4.5
2028-f	5.7	3.1	7.4	6.5	9.8	3.8	5.5	4.2	4.5

f--Forecast, annual average. Source: S&P Global Ratings Research.

Table 4

10-year government bond yields (%, annual average)

	Eurozone	Germany	France	Italy	Spain	Netherlands	Belgium	Switzerland	U.K.
2023	3.3	2.5	2.9	4.3	3.5	2.8	3.1	1.1	3.9
2024	3.0	2.4	2.9	3.7	3.1	2.6	2.9	0.6	4.0
2025-f	3.2	2.6	3.2	3.8	3.2	2.8	3.2	0.6	4.4
2026-f	3.2	2.6	3.2	3.9	3.3	2.9	3.2	0.8	4.1
2027-f	3.2	2.6	3.2	3.9	3.3	2.9	3.2	1.0	3.8
2028-f	3.2	2.6	3.2	3.9	3.3	2.9	3.2	1.1	3.9

f--Forecast. Source: S&P Global Ratings Research.

Table 5

Exchange rates (annual average)

	----Eurozone----		----U.K.----		----Switzerland----	
	USD/EUR	EUR/USD	USD/GBP	EUR/GBP	CHF/USD	CHF/EUR
2023	1.08	0.92	1.24	1.15	0.90	0.97
2024	1.08	0.92	1.28	1.18	0.88	0.95
2025-f	1.02	0.98	1.25	1.22	0.88	0.90
2026-f	1.05	0.95	1.27	1.21	0.93	0.98
2027-f	1.13	0.88	1.30	1.15	0.97	1.10
2028-f	1.15	0.87	1.30	1.13	0.98	1.13

CHF--Swiss franc. f--Forecast. Source: S&P Global Ratings Research.

Table 6

Policy interest rates (%, year-end)

	----Eurozone (ECB)----		U.K. (BoE)	Switzerland (SNB)
Policy rates	Refinancing rate	Deposit rate	Bank rate	Policy rate
2023	4.50	4.00	5.25	1.75
2024	3.15	3.00	4.75	0.50
2025-f	2.40	2.25	4.00	0.25
2026-f	2.90	2.75	3.50	0.50
2027-f	2.65	2.50	3.50	0.50
2028-f	2.65	2.50	3.50	0.50

BoE--Bank of England. f--Forecast. SNB--Swiss National Bank. Source: S&P Global Ratings Research.