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The price of political fragility in Europe

Ludovic Subran
Chief Investment Officer & Chief Economist
ludovic.subran@allianz.com

Patrick Krizan
Senior Investment Strategist
patrick.krizan@allianz.com

Pierpaolo Fiore
Research Assistant
pierpaolo.fiore@allianz.com

In Summary

- **With elections ahead in France, Spain, Greece, and Italy in 2027, political risk will be at the center of European government bond markets. Our high-frequency Political Fragility Index (PFI) shows that Europe is at a peak level of political fragility.** Our PFI, is built on polling data across four drivers — fragmentation, disaffection, polarization and governability. The Netherlands and Belgium sit high on fragmentation (votes splintered across a rising number of smaller parties), while France tops the list on polarization (rising voting share for far-left, far-right, Eurosceptic and populist parties). Germany and the UK show the sharpest increases in fragility since 2020 both suffering from weakening governability.
- **Sovereign risk premia (defined as asset swap spreads or ASW) have never been more sensitive to political fragility, and institutions matter more than the level of fragility.** The effect of political fragility on risk premia is a one-way ratchet: once triggered, it stays in the equation even after the trigger fades. This link, latent under QE, is now structural, with sensitivity at a record high (+1 std. dev. in the PFI adds +53bps to Italy's ASW). The risk premium is purely fiscal. Note that despite rising Eurosceptic votes, markets have priced out redenomination or euro breakup risk.Institutionally, majoritarian systems (UK and France) carry more political tail risk than their fundamentals imply for a given rating. This argues for a wider hedge around their electoral and budget calendar, while risk premia from consensus system issuers (e.g. Netherlands) tend to stay anchored through political noise.
- **To date, and since the end of QE in 2022, political fragility has resulted in an additional interest expense of around EUR 98bn (partly paid and partly still to be paid), when we sum up Italy, France, Spain, Belgium and the UK. On average, this represents an extra 3% of their annual debt servicing costs past and future.** This burden is concentrated in the UK (EUR 41bn which represents roughly 2.8% of additional debt service costs per annum over the maturity of the debt) and Italy (EUR 41bn; 4.9%), followed by Spain (EUR 14bn; 4.5%) and France (EUR 11bn; 2.3%). In France's case, most of this additional cost stems from the dissolution of parliament in 2024. Safe haven countries like Germany, the Netherlands and Austria show no structural fragility premium yet. Their shift from a negative to a positive ASW was mainly driven by a repricing of their fiscal fundamentals. However, given their underlying fragility this could change quickly, a structural fragility premium could add 1-2% to annual interest expenditure. Portugal and Greece were excluded given their bailout-distorted financing conditions.
- **France's presidential elections (April 18 and May 2, 2027), followed by Italy's general election due by 2027, are the next big *rendezvous* between political fragility and the bond market.** Our PFI shows France's sovereign premia are structurally sensitive to political fragility (+1 std. dev. adds +38bps to the ASW). This channel may keep pushing the OAT-Bund spread toward 90bps by year-end, with normalization contingent on a parliamentary majority in June 2027. In Italy, fragility is the single most sensitive channel in our sample (see supra) but it is currently dormant. Our baseline holds the BTP-Bund spread near 80bps, though a Eurosceptic turn on either flank, amplified by the proposed majoritarian electoral reform, is a fatter tail that could reawaken the redenomination premium France's spread no longer carries.

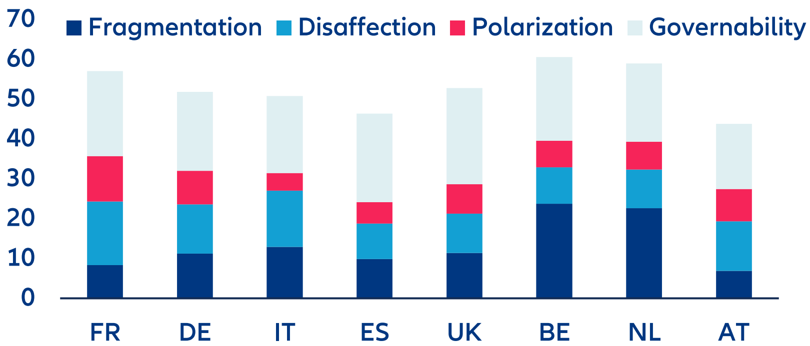
Political fragility is a major yet hidden factor for pricing European government bonds

With upcoming elections in France (spring 2027) and Italy (latest in December 2027), political risk will be at the center of European government bond markets. But it is notoriously difficult to measure. Political risk has played an important role in European government bond prices since the euro crisis of 2012, influencing them in two ways: Political risk can amplify or dampen the risk premia implied by economic and fiscal fundamentals depending on whether the political environment is perceived as fragile or stable, and it can also reflect the probability of an intentional Euro exit. This so-called "redenomination risk" is closely related to the fragmentation of Europe's political systems under the ascent of populist, euro-sceptic movements. But political risk is notoriously difficult to measure, especially on a market-relevant frequency, and often remains under qualitative assessment prone to personal biases. To bring this hidden factor into the light of objective measurement, we develop a high-frequency index to quantify the impact of political fragility on European government bond prices, and ultimately set a fiscal price tag on political fragility in Europe.

Our Political Fragility Index (PFI) turns a country's politics into a single weekly number. Our base assumption is that we can observe the risk inherent in political systems by observing the dynamics within the party system. This is a crystallization of the underlying social cleavages and can therefore serve as a proxy for the political system as a whole, using weekly aggregations of election polls, which are available for almost all EU countries plus the UK. In this analysis, we will focus on eight countries: France, Germany, Italy, Spain, the UK, Belgium, the Netherlands and Austria. We leave out Portugal and Greece, whose bailout and debt-restructuring programs distorted their financing dynamic and, with them, our results. Based on the polls data, we can further separate four dimensions of political fragility:

1) *Fragmentation (30%):* arises when votes splinter across a rising number of smaller parties (rescaled Laakso effective number of parties).[1]
2) *Disaffection (20%):* occurs when voters abandon the traditional governing parties, which usually indicates a weakening of traditional institutions (100 – traditional-party share).
3) *Polarization (20%):* as the result of a rising voting share for far-left, far-right, Eurosceptic and populist parties (the average of far-left-plus-far-right, Eurosceptic and populist vote shares).[2]
4) *Governability (30%):* is affected when the government itself leans on political forces on the extreme right and left of the political spectrum (100 – the share of not extreme governing parties).

Figure 1: The Political Fragility Index (July 2026)



Notes: The Political Fragility Index is a weekly, poll-based index on a 0–100 scale (higher = more fragile), built from smoothed (Kalman filtered) poll-of-polls vote shares. Sources: Wikipedia, Allianz Research

1 Laakso, M. & Taagepera, R. (1979)

2 Party-family classifications (populist, far-left, far-right, Eurosceptic) follow The PopList (EiQCC Database) and, like government composition, are time-aware. Source: Rooduijn M. et al. (2024)

This separation determines the dominant sources of the political fragility in each country. The latest data shows that all countries exhibit an elevated score in terms of governability. Belgium and the Netherlands structurally score higher in fragmentation while polarization is stronger in France, Germany and Austria where populist vote concentrates on one or two parties. France, Germany and Austria along with Italy also score high when it comes to the decline of traditional parties measured by disaffection (Figure 1).

Political fragility has ratcheted higher in Europe since 2010, levels still differ from country but they are converging as safe haven erode. We can distinguish three phases in the evolution of political fragility in Europe since 2010. The post-GFC hangover (2010-2012) drove an economic and fiscal fragmentation that opened a gap between a politically fragilizing periphery (Italy, Spain) and a politically stable core (Germany). That built into the 2012 euro sovereign crisis where fiscal austerity and reform fatigue seeded a durable rise of Eurosceptic and populist parties that has since raised fragmentation and polarization. The third phase opens in 2020 with the Covid-19 shock. After a first compression fragility rebounds to fresh peaks due to eroded institutional trust and economic uncertainty, with the noticeable difference that the periphery-core spread is narrowing as fragility migrates into the core. Indeed, Germany and the UK show the strongest increases in fragility since the Covid-19 pandemic (Figure 2). The combination of rising median fragility and decreasing dispersion indicates that safe haven are eroding as Europe become equally fragile (Figure 3).

Figure 2: The Political Fragility Index, 2010–2026

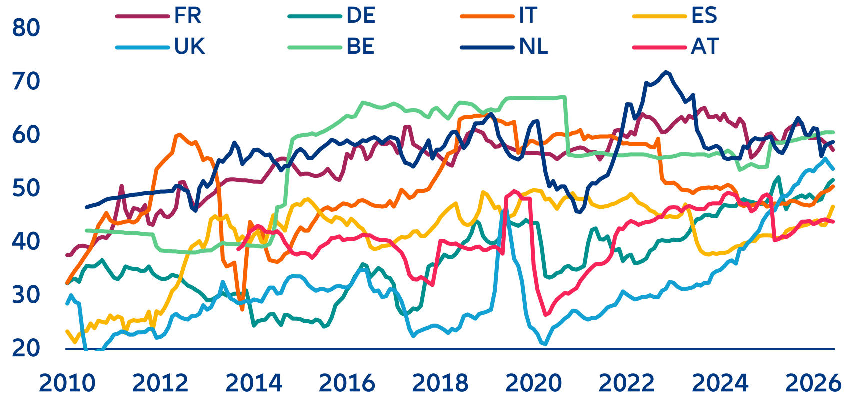


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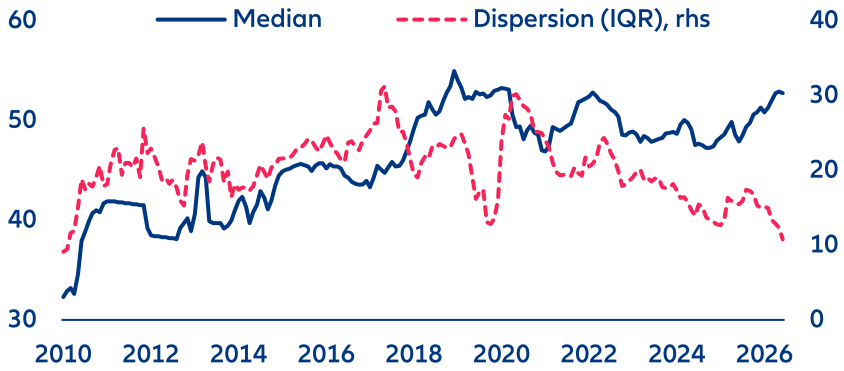
Figure 3: The Political Fragility Index, 2010–2026

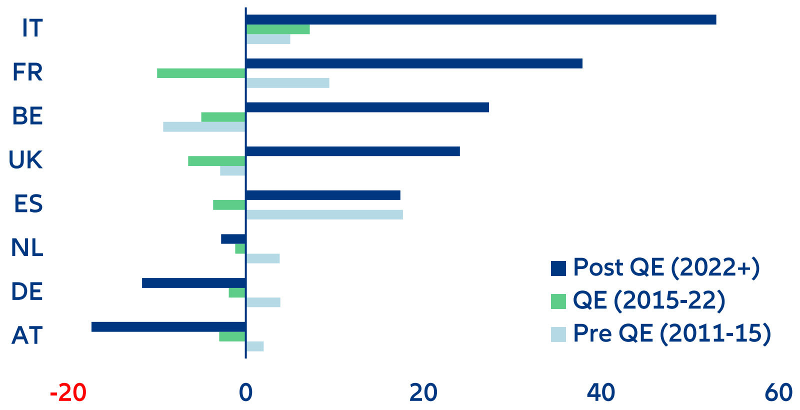


Notes: The Political Fragility Index is a weekly, poll-based index on a 0–100 scale (higher = more fragile), built from smoothed (Kalman filtered) poll-of-polls vote shares. Sources: Wikipedia, Allianz Research

Sovereign risk premia have never been more sensitive to political fragility

The translation of this political fragility to European Government Bond risk premia is anything but mechanical. Fragility can remain latent for years without leaving a clear imprint on sovereign debt prices. On the other hand, risk premia can reprice strongly on news flow even though the underlying political fragility remained unchanged. To measure political fragility as marginal driver of sovereign risk premia, we determine the part of each 10y asset-swap spread (ASW) that is not explained by country fundamentals (growth, fiscal balance, debt stock-flow, current account and competitiveness) and see how these residuals react to the PFI Index in different monetary regimes (Pre-Quantitative Easing (QE), QE and Post-QE). Before QE (2011–2015) changes in political fragility is not a driver for sovereign risk premia as the euro crisis effect prevails. Under QE (2015–2022), when central banks became the marginal buyer of government bonds, the sensitivity of sovereign risk premia to political fragility was suppressed and mostly negative (only Italy as exception as ASW surged under Salvini government despite QE) (Figure 4).

Figure 4: Sensitivity to political fragility (10y ASW, bps per 1sd of PFI Index)



Notes: The pricing analysis uses the surprise in fragility: the PFI's deviation from its own two-year moving average, lagged one week. Sources: Wikipedia, LSEG Datastream, Allianz Research

When QE purchases stopped in 2022 after the Covid-19 pandemic, Europe found itself in a weak fiscal position and was also politically strongly fragilized. The sensitivity of sovereign risk premia to political fragility has increased materially. A one-standard-deviation increase in PFI Index now adds 53bps to the Italian and 17bps to the Spanish ASW. The effect also extends to the UK (+24bps), Belgium (+27bps) and France (+38bps). Germany, the Netherlands and Austria continue to show no positive response (Table 1).

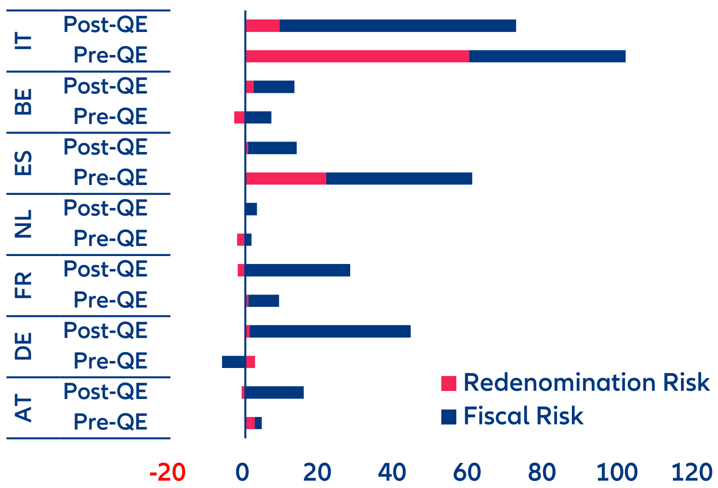
Table 1: PFI levels, range, volatility and sensitivity to spreads

Country	Current PFI	Max PFI	Min PFI	1 std	Sensitivity to ASW per 1 std (Post-QE)
Belgium	55	67.2	38.0	9.8	+27bps
Netherlands	57	72.0	43.9	5.7	-3bps
France	54	65.7	37.3	7.2	+38bps
United Kingdom	31	56.3	18.5	7.8	+24bps
Germany	36	52.3	24.0	7.4	-12bps
Italy	49	63.9	26.7	9.5	+53bps
Spain	39	50.2	18.6	9.1	+17bps
Austria	41	49.8	26.2	5.3	-17bps

Sources: Wikipedia, LSEG Datastream, Allianz Research

European government bonds are pricing out euro break-up risk almost entirely, despite a rise in Eurosceptic votes. The risk premium on Eurozone government bonds embeds two distinct risks: a fiscal risk tied to economic fundamentals and a "redenomination risk" reflecting the probability of a country exiting the euro, whether by political intent or market accident. By decomposing the risk premium into these two components and examining to which extent they respond to changes in the PFI Index, we can establish whether markets price political fragility primarily as a fiscal risk or as a euro break-up risk. The result is clear. Before the ECB launched QE in 2015, redenomination risk was present and accounted for almost half of the spread sensitivity for Italy and Spain. Today, sensitivity is driven almost entirely by fiscal risk. Redenomination risk has totally disappeared since QE, suggesting the emergency mechanisms put in place by the ECB and the EU are viewed as credible; an exit by market accident is no longer seen as plausible. An intentional exit, whether through a Eurosceptic populist government or a referendum, remains a tail risk. But it is one the market no longer appears to price. The Eurosceptic risk seems to have shifted entirely from a mix of fiscal and implied currency risk to a risk of populist fiscal profligacy (non respect of domestic and European budget rules) (Figure 5).

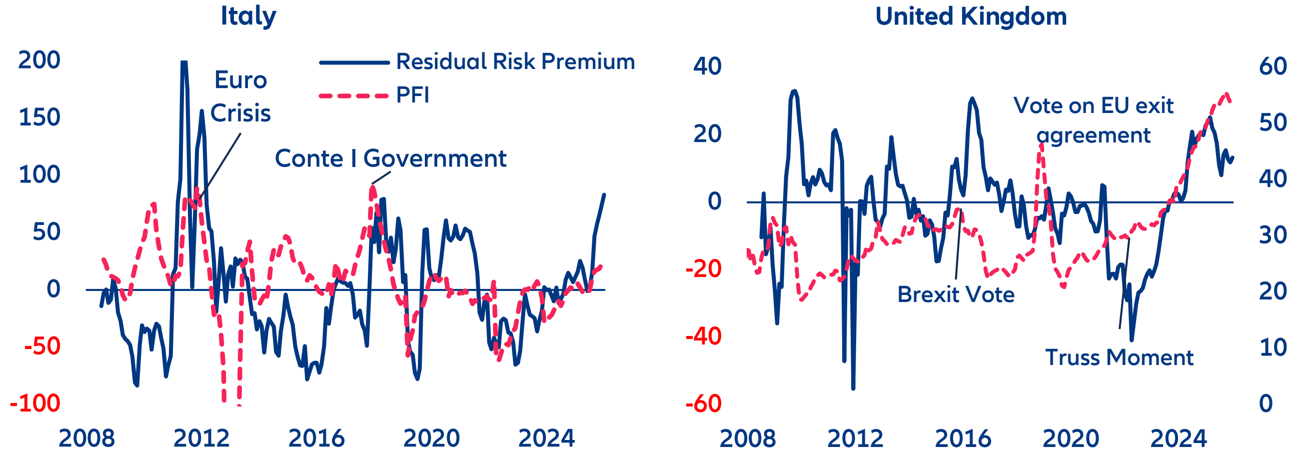
Figure 5: Sensitivity to political fragility (10y ASW, bps per 1sd of PFI Index)



Notes:. We use a variance decomposition model to separate the risk premia, methodology can be found here.
Sources: Wikipedia, LSEG Datastream, Allianz Research

The relation between political fragility and sovereign risk premia has become structural. Two conclusions follow. First, political fragility is not priced into sovereign premia automatically. A threshold effect appears to be at work. But once priced, the effect persists. Second, current sensitivity levels are the highest observed to date. Italy and the UK offer instructive case studies. The Italian risk premium has long shown elevated sensitivity to political fragility. Historically, however, this relationship was episodic, driven by news flow and distinctive political events. Therefore, we observe sensitivity peaks during the 2012 euro crisis and again with the formation of the Salvini-led populist government in mid-2018 (notably, despite ongoing QE). Since 2022, the relationship has become structural, marked by a sustained elevated correlation between risk premium and political fragility. A similar structural change is observable in the UK. The 2022 Truss moment established a durable link between political fragility and UK sovereign risk premium, marking the onset of a synchronous rise. Prior to this, UK risk premium were largely insensitive to political fragility, even the Brexit referendum and the protracted EU exit negotiations left little discernible mark (Figure 6).

Figure 6: Sensitivity to political fragility (10y ASW, bps per 1sd of PFI Index)

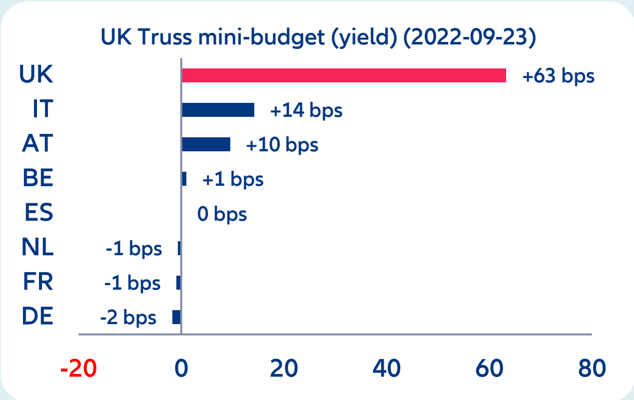


Sources: Wikipedia, LSEG Datastream, Allianz Research

Four case studies – How Political Fragility reacts to distinctive events

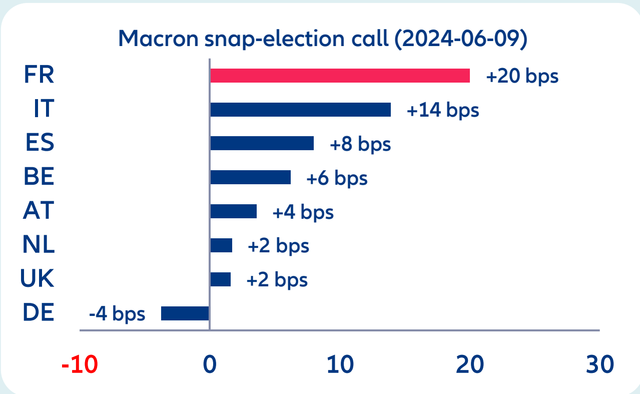
The UK is the cleanest switch-on in the sample. Fragility went unpriced for a decade, then repriced violently at the September 2022 mini-budget. Around GBP45bn of unfunded tax cuts met a fragile mandate, the 30y Gilt yield jumped roughly 120bps in three days and a forced-selling loop in liability-driven pension funds left some "hours from collapse" until the BoE stepped in with emergency long-gilt purchases. The gilt premium has tracked political stress ever since. The moment fragility started to matter is dated almost to the day.

10y ASW change, post 4w – pre 8w mean, bps



France has crossed from core to periphery, and the market charges it for polarization. The premium opened at the June 2024 dissolution: When Macron called a snap election, the 10-year OAT-Bund spread widened from about 45bps to as much as 80bps, its widest since the 2011–2012 crisis. France's headline fragility actually fell as the far right consolidated, so the composite score understates the risk while polarization is what the market prices. The correlations confirm the shift: Before the dissolution the French spread tracked Germany and the Netherlands (+0.61) more closely than Italy and Spain (+0.51); since the snap election

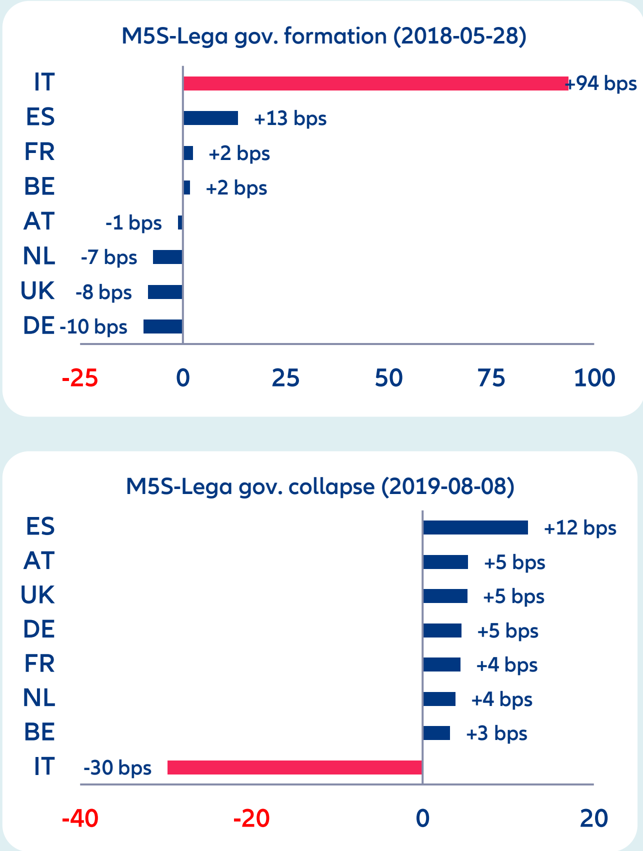
10y ASW change, post 4w – pre 8w mean, bps



that ranking flipped, with France co-moving with the periphery (+0.69) than the core (+0.57).

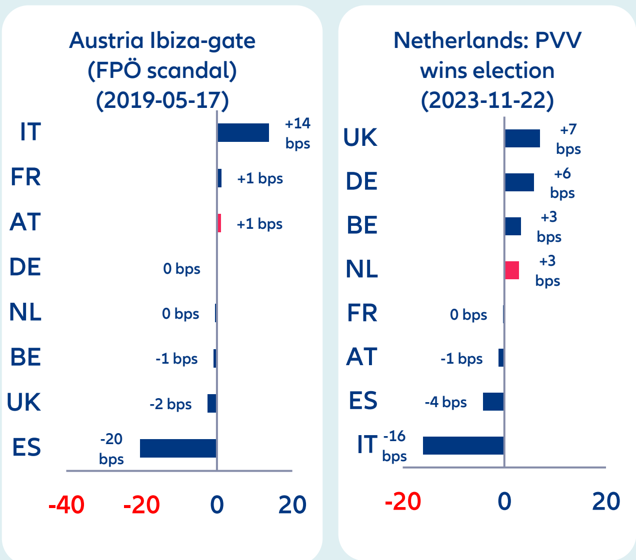
Italy is the mirror image of France, and the clearest proof that the price is state-dependent. Italy is Europe's archetypal political-risk pricer: The 2018 League-Five Star coalition added some 60bps of redenomination premium, and the 2019 collapse handed it back. Yet under Meloni the BTP-Bund spread (Italian over German government bonds) has fallen from about 250bps in late 2022 to a 15-year low below 90bps in 2025, alongside fiscal consolidation (the deficit cut from 4.3% towards 2.8%) and a string of rating upgrades. Two caveats keep us honest: Part of the narrowing reflects higher Bund yields (Germany's debt and defense package) and French instability rather than Italian strength alone, and our index shows the political channel is dormant, not gone. When fragility recedes, so does its price.

10y ASW change, post 4w – pre 8w mean, bps



Germany, the Netherlands and Austria are the negative controls. None show a robust positive response to fragility once QE ends. Germany needs a caveat: Its recent spread regime is partly supply-driven, owing to the fiscal package and heavier issuance, so the political reading there is an upper bound, not a signal.

10y ASW change, post 4w – pre 8w mean, bps



Note: UK shown on yield because in the 2022 Truss moment the SONIA swap dislocated more than the gilt, compressing the gilt-swap ASW. Sources: Wikipedia, LSEG Datastream, Allianz Research

Institutional design matters: Why the same fragility costs more in some countries

The country the market punishes most for fragility is not the most fragile one. The Netherlands looks more fragile than the UK, yet the market charges it almost no premium while the UK pays political premium. We see one explanation: Investors take into account the stability and reliability of the country's institutions. Political science separates two virtues: decisiveness (the power to change policy) and resoluteness (the power to commit and not reverse it), which trade off against a system's number of veto players.[3] A centralized majoritarian system like the UK or France concentrates power and is decisive but not resolute, so one election can especially rewrite the budget. A federal consensus system like the Netherlands or Germany spreads power, so no single result moves fiscal policy far and its commitments are more credible. Investors may take into account that a shock change in Dutch fiscal policy is likely to dissipate in coalition and corporatist bargaining whereas a British one will hit immediately.

In majoritarian systems, investors hedge around the electoral calendar as they carry more political tail risk. Within our political fragility framework we score our eight countries according to the democracy type, the active cleavage behind its political party system and the type of welfare state acting as a cushion against political fragility (Table 2).

Table 2: Institutions, not the level of fragility, decide the bill

Country	Democracy type [4]	Active cleavage [5]	Welfare regime [6]	Political fragility	Cost when fragility rises	Profile
Netherlands	Consensus	Functional	Corporatist / social-dem.	**57**	**-3bps**	High volatility
Belgium	Consensus (federal)	Territorial	Conservative-corporatist	**55**	**+27bps**	High active fragility
France	Majoritarian	Functional	Conservative / social-dem.	**54**	**+38bps**	Acute crisis risks, recoverable
Italy	Consensus → majoritarian	Territorial + functional	Mediterranean	**49**	**+53bps**	Low now, high latent
Austria	Consensus (corporatist)	Functional	Conservative-corporatist	**41**	**-17bps**	Rising corporatist erosion
Spain	Consensus-hybrid	Territorial + functional	Mediterranean	**39**	**+17bps**	Territorial-cleavage strain
Germany	Consensus (federal)	Functional + territorial	Conservative	**36**	**-12bps**	Resilient but fragmenting
United Kingdom	Majoritarian	Functional	Liberal	**31**	**+24bps**	Majoritarian with high latent risk

Notes: Democracy type: majoritarian = power concentrated, one bloc can govern alone; consensus = power shared across coalitions, chambers and courts. Active cleavage: the social divide driving politics, territorial (region, language, identity) or functional (class, economy). Welfare regime: liberal = thin and market-based; conservative = contributory and status-preserving; Mediterranean = family-based and dualistic, generous to insiders but thin for outsiders. Sources: Wikipedia, LSEG Datastream, Allianz Research

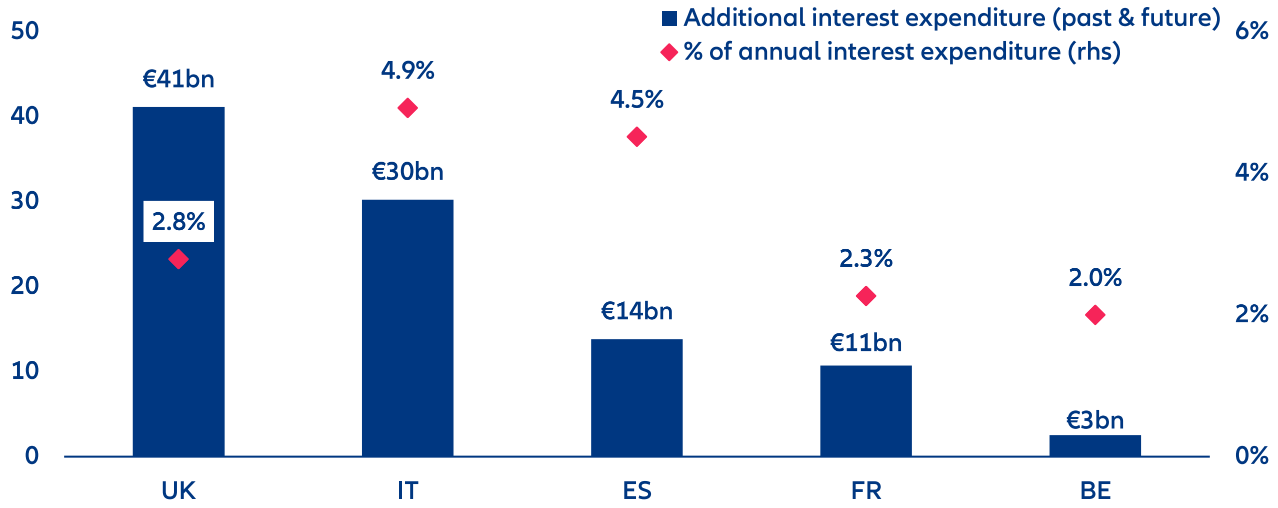
[3] Cox and McCubbins(2001); Tsebelis (2002); [4] Lijphart, A. (2012); [5] Rokkan, S. (1970) ; [6] Esping-Andersen, G. (1990) and Ferrera, M. (1996)

For a given rating, majoritarian issuers carry more political tail risk, while consensus-system spreads tend to stay anchored through political noise. In our estimates, a rise in fragility adds around +31bps to the premium in the majoritarian systems, UK and France. Among the consensus democracies, the safe havens (the Netherlands, Germany and Austria) barely move. The bond market seems not to charge for how fragile the political system is – as measured by the changes in electoral polls via the PFI, but rather how likely this fragility will translate to financial turmoil and/or affect fiscal sustainability. The threshold for majoritarian systems seems to be lower especially when associated with deep active cleavages. The welfare state does not have a clear cushioning effect.

Political fragility accounts for 2% to 5% of annual debt service, but only for some countries

Political fragility can increase annual debt service by 3.3% on average, but the effect remains still unevenly distributed among European countries. We show that increases in political fragility can increase sovereign risk premia (asset-swap spread or ASW) which translates into higher government funding costs. Since the end of central bank QE in 2022, we estimate that political fragility has added a premium on newly issued European sovereign debt, raising past and future interest expenditure for Italy, France, Spain, Belgium, and the UK by a combined EUR 98bn. In relative terms, this premium represents on average about 3.3% of these countries' annual debt service, ranging from 2% to 5% (Figure 7). The burden is concentrated in the UK and Italy, with a cumulated effect of EUR 41bn and EUR 30bn (2.8% and 4.9% of annual debt service, respectively). Spain and France follow, with a cumulated effect of EUR 14bn and EUR 11bn. For France, the increase in debt service can be almost entirely attributed to the June 2024 parliamentary dissolution. For safe haven countries like Germany, the Netherlands or Austria political fragility has not yet become a structural driver of their sovereign risk premia. Their shift from a negative to a positive ASW was driven mainly by a changed perception of fiscal supply, such as the German Sondervermögen, not by shifting perceptions of political stability. However, given their underlying elevated fragility, it cannot be ruled out that this changes ahead of uncertain elections or during a government crisis. Should the premium become structurally priced in, it could quickly amount to 1-2% of annual interest expenditure.

Figure 7: The cost of political fragility since 2022 (EUR bn, % interest expenditure)



Notes: We estimate, for each country and monetary regime, the sensitivity of the political premium to fragility (γ, bps per one-standard-deviation move in the excess Political Fragility Index). The committed cost is based on the post-QE regime (from 2022), when fragility became a priced risk factor: the attributable premium is taken as max(γ × z, 0), retained only where γ is positive and capped at the total non-fundamental (ASW) premium. Because most sovereign debt is fixed-rate, this premium is locked into coupons at issuance and paid until maturity. The committed cost then applies this index-attributable premium to the debt as it rolls over across its maturity structure (average residual maturity of 7 to 14 years): following standard debt-sustainability practice, the premium feeds into the interest bill gradually as maturing debt is refinanced, rather than repricing the entire stock at once. UK converted to EUR. Sources: Wikipedia, LSEG Datastream, Allianz Research.

The 2027 elections: upside risk to political fragility in France and Italy

We see a risk that the OAT-Bund spread widens further into the French presidential election (April 28 and May 2, 2027), particularly if polling continues to confirm the strength of the far-left and far-right blocs. The market is already positioning for this: The 10y OAT-Bund spread has trended clearly wider over the past two months and we expect it to reach 90bps by year-end (from 80bps today). Whether this widening proves structural or reverts quickly to fair value (that we see around 60bps), as has typically been the case in prior episodes, will depend not only on whether a moderate candidate wins the presidency, but critically on whether that candidate can also secure a parliamentary majority (elections in June 2027). Without a majority, France's majoritarian system heavily passes political fragility through to the sovereign risk premium. This makes this French election differs from prior ones. In the past, market risk repricing around French elections was effectively resolved after the two rounds of the presidential vote. This time, full resolution may not come until after four rounds, following the legislative elections as well. However, the nature of the French sovereign risk premium remains entirely related to fiscal sustainability, the probability of a "Frexit" is not priced - at least not for now.

We see upside risk to the Italian spread around the next general election, due by 2027, even though our baseline keeps the 10y BTP-Bund spread broadly stable at around 80bps over the next two years, on the back of the fiscal credibility the current government has built. The risk sits on both flanks: on the left, a win for the opposition coalition would return to the government the historically Eurosceptic, higher-spending Five Star Movement; on the right, the rise of Futuro Nazionale, a far-right party founded by the MEP and former army general Roberto Vannacci, could pull the governing coalition into chasing him on Eurosceptic ground. What makes this more than the usual noise is the institutional backdrop. The new

"Stabilicum" electoral law hands a large majority bonus (58% of the seats) to any coalition that clears 42% of the vote; and because the President of the Republic is elected by parliament, that same reinforced majority would come close to choosing the next president in 2029, dissolving the counterweight the president has exercised before, as in 2018, when he vetoed a Eurosceptic economy minister in the first Conte government. A more Eurosceptic politics on either flank, transmitted through a majoritarian system stripped of its circuit-breaker, is what could reawaken the redenomination component that France's premium lacks and that Italy prices most acutely at the short end. It is not our base case, but it is a fatter tail than today's tight spread implies.

These assessments are, as always, subject to the disclaimer provided below.