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EcoFlash

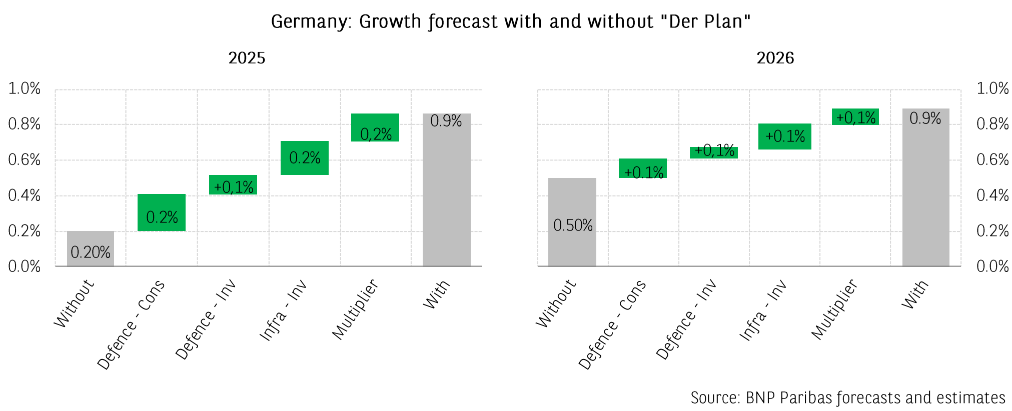
Germany: “whatever it takes”?

We are almost a week away from a vote that could change the face of Germany. On 18 March, the Bundestag will decide on the adoption of two structural defence and infrastructure projects. A massive budget plan that could exceed EUR 1,000 billion[1] over the next ten years and revive German growth, which has been absent for almost 3 years.

1. What is this plan? *Der Plan*. Germany is on course to become the European country with the largest budgetary impetus in the years ahead. Announced on 4 March, the agreement between the CDU/CSU and the SPD provides for defence spending in excess of 1 point of GDP to be exempt from the debt brake. A fund dedicated to infrastructure, outside the budget, of EUR 500 billion over 10 years (EUR 50 billion per year, including EUR 10 billion for the Länder) should also be set up. With this in mind, the authorised structural deficit of the Länder should be increased from 0 to 0.35 points of GDP. This fiscal shift was authorised by the result of the parliamentary elections on 23 February and accelerated by the spectre of a US withdrawal from European defence.

2. Towards rapid implementation? The outgoing parliament will debate these plans on 13 and 18 March (the day of the formal vote), before the new parliament takes office on 25 March. Adoption will require a two-thirds majority in both the Bundestag and the Bundesrat, implying the support of the Greens or the FDP - the latter only being in favour of the defence part. The text sets no limit on the defence budget, giving the next government considerable room for manoeuvre. Implementation should be rapid, with a government expected by Easter. The agreement reached on 8 March between the CDU/CSU and the SPD on the broad outlines of their coalition programme is in line with this approaching deadline.

3. Growth: an end to lethargy? According to our calculations, *Der Plan* could generate almost EUR 120 billion in additional annual expenditure, including EUR 50 billion for infrastructure and EUR 70 billion for defence, potentially as early as 2026, if its budget was increased from 2 to 3.5% of GDP (including EUR 30 and 40 billion respectively as early as 2025, according to our assumptions). This spending would directly stimulate public consumption and investment and indirectly stimulate the economy as a whole. Assuming a multiplier effect of 1.3[2], German growth could therefore reach +0.9% in 2025 and 2026 (our current forecasts are +0.2% for 2025 and +0.5% for 2026), after -0.2% in 2024. In the medium term, potential GDP is expected to be 2% higher in 2029 than in the absence of *Der Plan*, and 1.6% higher in 2027 (thereby offsetting the negative impact of potential additional US tariffs, estimated by the Bundesbank at 1.5 points of GDP in 2027[3]).



4. Does more public debt mean higher interest rates? *Der Plan* looks like a “whatever it takes” plan. Public debt could reach 71.5% of GDP in 2029, also taking into account a higher GDP (compared with 60% in the absence of this plan, according to our scenario), an increase close to that of 2020 (+9pp). Unlike Covid debt, which had fallen as early as 2021 and was accompanied by massive purchases of securities by the ECB, this time the debt would increase in a more permanent way. Long-term interest rates,

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1 Infrastructure spending would represent EUR 500 billion and additional defence spending an extra EUR 70 billion per year, if increased from 2 to 3.5% of GDP. If this spending were increased as early as 2026, the total over the next ten years would be EUR 1,200 billion.

2 We base our analysis on an ECB study ("Fiscal multipliers and beyond", Occasional Paper No. 162, 2015), which calculates fiscal multipliers under various assumptions, including the one Germany faces (low growth, with a negative output gap, and moderate debt). In this context, the multiplier would be 1.3 in both 2025 and 2026 (growth of 0.9% in 2025 being insufficient to reduce the gap between GDP and its potential).

3 Joachim Nagel, "The German economy in choppy international waters", speech at Speaker’s Luncheon, Union International Club, Frankfurt, on 17 February 2025.

which have already risen sharply following the announcement (+40 bps between 4 and 12 March for ten-year rates), could also remain structurally higher.

5. Germany once again driving European growth? 1/ The German effort could have a significant positive effect on growth in other European countries, particularly France, the world's second largest arms exporter, in contrast to 2024, when the fall in exports to Germany reduced its growth by nearly 0.1 points. 2/ The German plan could also harden the ECB's job. Our current short-term scenario, which anticipates two residual rate cuts, in April and June 2025, is not called into question. On the one hand, however, a rise in long-term interest rates would reduce the transmission of ECB rate cuts to the rest of the economy. On the other hand, in the medium term, the sudden increase in the defence effort could have inflationary consequences in the event of supply constraints.

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