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Investment Research

What do Germany's fiscal plans mean for investors?

UBS House View Briefcase

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Key message

Germany's Chancellor-in-waiting Friedrich Merz announced plans for a major increase in defense and infrastructure spending. If passed by the German Bundestag, the plans would mark a significant fiscal shift that has the potential to boost growth. Yet, near-term uncertainty remains high, particularly around US tariff risks. In Eurozone equities, we like thematic approaches to position for potential positive catalysts. The recent rise in bond yields offers an opportunity to lock in a source of durable income, in our view.

House view

01 Germany's likely next chancellor wants to boost defense and infrastructure spending.

- Friedrich Merz, who is in talks to form a coalition government after his Christian Democratic Union (CDU) alliance won Germany's election, vowed to do "whatever it takes" to defend Europe.
- He is seeking parliamentary approval to free up EUR 500bn for infrastructure spending and exempt defense spending over 1% of GDP from the "debt brake."
- The euro and Bund yields rose following the announcement. The DAX is up 13% this year as of 13 March.

02 The proposed measures, if approved, would mark Germany's biggest fiscal shift in 80 years.

- If the package passes, government spending could increase by around a cumulative 20% of GDP over the coming decade.
- While the extra spending would take time to feed through, the pro-growth signal from the move could support consumer and business sentiment well before funds start to be deployed.
- We believe the plans have the potential to improve the domestic and regional investment outlook. But near-term uncertainty is high, especially given US tariff risks, warranting a selective approach.

03 We see several ways to position in the Eurozone.

- In equities, we favor selective exposure via our "Six ways to invest in Europe" theme. We also like Eurozone industrials and small and mid-caps.
- We view the rise in yields as an opportunity to lock in attractive yields in medium-tenor quality corporate bonds.
- We like to buy the euro on dips and see the EURUSD trading in a 1.05-1.12 range.

New this week

Merz defended his proposals during a parliamentary debate on 13 March, saying: "Germany must return to the international stage as an effective partner in NATO, in Europe, and in the world." The Green Party has opposed the spending plans. A final vote is due to take place on 18 March.

One liner

Higher German government spending could improve the domestic and wider regional investment outlook—but near-term risks remain, especially around US tariffs.

Did you know?

- Germany's "debt brake" is a rule introduced in 2009 to cap the government's structural budget deficit at 0.35% of GDP.
- The latest proposals would also extend the deficit allowance of 0.35% of GDP to German states (Länder), which currently must run a balanced budget, potentially doubling the government's borrowing cap to 0.7% of GDP per year.
- The 30-basis-point rise in the 10-year Bund yield on 5 March was the largest one-day increase since German reunification in 1990.
- We believe Germany's fiscal profile is strong enough to shoulder the proposed extra spending without losing its Aaa/AAA credit rating.

Investment view

Plans to increase German government spending and reform the debt brake have the potential to improve the domestic and wider regional investment outlook. However, we believe selectivity is warranted given near-term uncertainty around tariffs and growth. In equities, we like thematic approaches to position for potential positive catalysts (see our "Six ways to invest in Europe" theme). We recommend locking in yields on medium tenor quality corporate bonds.

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