18 March 2025, 03:30PM UTC
Chief Investment Office GWM
Investment Research

German Bundestag approves fiscal package

Blog

Samuel Adams, Economist, UBS AG, UBS AG London Branch
Dean Turner, Economist, UBS AG, UBS AG London Branch
Maximilian Kunkel, Strategist, UBS Switzerland AG

After two weeks of intense negotiations, and with only days to spare before the current parliament lapses, Germany's Bundestag has paved the way for a large increase in government spending on defense and infrastructure. In the end, the fiscal package only saw some mostly technical changes following discussions between the likely next government coalition and the Greens, whose support was needed to pass the legislation. (See "Europe's fiscal moment," 5 March 2025, for context.)

The constitutional amendments underpinning the spending program foresee three changes to Germany's fiscal framework: First, any spending on defense exceeding 1% of GDP will no longer count against the debt brake (which so far has limited cyclically adjusting borrowing to 0.35% of GDP per year). On the request of the Greens, the definition of "defense" has been extended to include civil protection, the national intelligence agencies, and Ukraine aid, among other things. Second, a EUR 500bn off-budget vehicle will be established for the duration of 12 years to invest in infrastructure, of which EUR 100bn will be allocated to the *Länder* (i.e., states) and another EUR 100bn to energy transition. And third, the borrowing cap for the states has been raised to match the federal government's limit of 0.35% of GDP on a cyclically adjusted basis, compared to no net new borrowing under the previous rules.

Together, these measures imply a significant increase in fiscal space against the domestic borrowing rules (Figure 1). For example, if Germany were to take defense spending beyond 3% of GDP, as might become necessary given the geopolitical context, government expenditure could increase by around 3% of GDP per year from current levels (~EUR 130bn). On a cumulative basis, extra spending could therefore comfortably exceed EUR 1 trillion over the next decade.

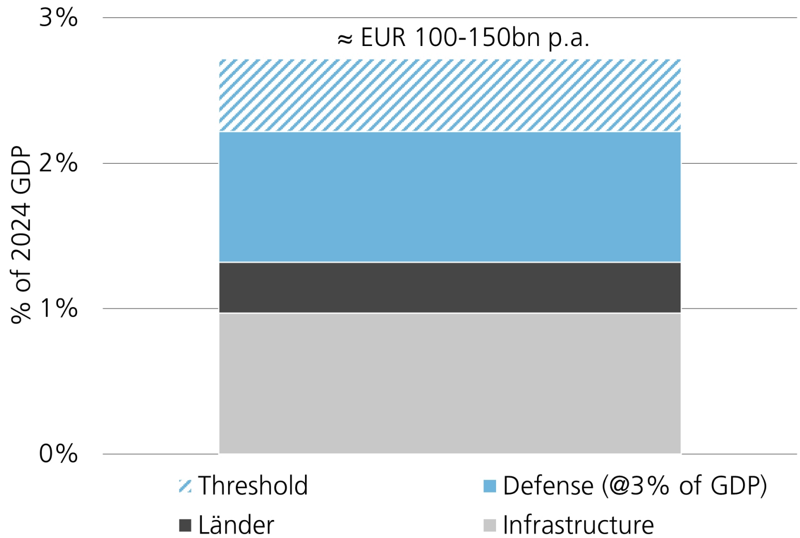
Of course, to what extent any rise in government spending will come close to matching this potential is yet to be determined. Experience shows that large-scale government investment programs often take longer than expected to come through owing to limits on administrative capacity. Similarly, bottlenecks in the defense industry could make it difficult to quickly accelerate the pace of defense spending, and some *Länder* might need to amend their own state constitutions before they can tap their newly found fiscal space. So while we would expect to see a sharp increase in government spending over the coming years, it might not amount to quite as much as some headline figures suggest. This rings especially true when considering

This report has been prepared by UBS AG London Branch, UBS Switzerland AG. **Please see important disclaimers and disclosures at the end of the document.**

the as yet uncertain role that the EU fiscal rules will play in constraining future spending plans, especially if the most acute geopolitical concerns were to fade again at some point.

Figure 1 - Fiscal impulse could be large

Potential increase in government spending under approved fiscal package.



Source: UBS calculations, as of 18 March 2025.

Note: "Threshold" refers to the increase in fiscal space from setting the threshold at which defense spending is exempt from the debt brake below what is currently planned in the regular budget, as well as the non-defense element of the amendment.

In any case, Germany's economy should benefit from what could be a sizable boost to demand from the public sector. Estimates of government spending multipliers are uncertain and vary according to the economic context and the type of expenditure (with, for example, spending on military equipment having a higher risk of leaking abroad than domestic civil engineering projects, although this could change as the European defense industry adds capacity). However, it is reasonable to expect Germany's economy to experience significant tailwinds from next year onward as more public investment comes through and private sector sentiment recovers amid a more growth-friendly policy mix under a new government. This should allow the economy to finally move past its years of stagnation, even if it continues to face downside risks from tariffs in the near term (see "Reciprocal tariffs for Europe — no quick fix," 12 March 2025, for context).

The legislation still needs to be approved by the *Länder* in the Bundesrat before being enacted, but we don't expect this hurdle to present any issues after Bavaria has confirmed its support for the package, which all but assures the required two-thirds majority. Looking beyond the immediate policy at hand, however, the adoption of the fiscal package will likely reduce the appetite of the incoming government to implement other deficit-raising policies, or incur significant liabilities from joint EU borrowing schemes. While preliminary coalition talks between the CDU/CSU and the SPD have signaled a range of other fiscal support measures for the economy, such as through lower energy prices and unspecified corporate incentives, the pressure to find offsetting savings or slow down implementation until the growth benefits from the fiscal package are felt could therefore be high.

Investment implications

Euro bond yields have risen significantly in response to Germany's spending plans, likely reflecting a combination of more hawkish market pricing for ECB policy and the anticipation of higher bond supply. We have nudged our Bund yield forecast higher in response (see "German fiscal policy and yield implications," 13 March 2025 for details), but still see them declining from current levels. Notably, we don't expect the fiscal package to be a drag on Germany's credit rating, especially in a scenario of gradual implementation and with some growth benefits coming through. Hence, we still see scope for investors to lock in yields at attractive levels, although select quality corporates could present better risk-return opportunities amid elevated volatility in Bunds, in our view.

Appendix

Risk information

UBS Chief Investment Office's ("CIO") investment views are prepared and published by the Global Wealth Management business of UBS Switzerland AG (regulated by FINMA in Switzerland) or its affiliates ("UBS"), part of UBS Group AG ("UBS Group"). UBS Group includes former Credit Suisse AG, its subsidiaries, branches and affiliates. Additional disclaimer relevant to Credit Suisse Wealth Management follows at the end of this section.

The investment views have been prepared in accordance with legal requirements designed to promote the **independence of investment research**.

Generic investment research – Risk information:

This publication is **for your information only** and is not intended as an offer, or a solicitation of an offer, to buy or sell any investment or other specific product. The analysis contained herein does not constitute a personal recommendation or take into account the particular investment objectives, investment strategies, financial situation and needs of any specific recipient. It is based on numerous assumptions. Different assumptions could result in materially different results. Certain services and products are subject to legal restrictions and cannot be offered worldwide on an unrestricted basis and/or may not be eligible for sale to all investors. All information and opinions expressed in this document were obtained from sources believed to be reliable and in good faith, but no representation or warranty, express or implied, is made as to its accuracy or completeness (other than disclosures relating to UBS). All information and opinions as well as any forecasts, estimates and market prices indicated are current as of the date of this report, and are subject to change without notice. Opinions expressed herein may differ or be contrary to those expressed by other business areas or divisions of UBS as a result of using different assumptions and/or criteria.

In no circumstances may this document or any of the information (including any forecast, value, index or other calculated amount ("Values")) be used for any of the following purposes (i) valuation or accounting purposes; (ii) to determine the amounts due or payable, the price or the value of any financial instrument or financial contract; or (iii) to measure the performance of any financial instrument including, without limitation, for the purpose of tracking the return or performance of any Value or of defining the asset allocation of portfolio or of computing performance fees. By receiving this document and the information you will be deemed to represent and warrant to UBS that you will not use this document or otherwise rely on any of the information for any of the above purposes. UBS and any of its directors or employees may be entitled at any time to hold long or short positions in investment instruments referred to herein, carry out transactions involving relevant investment instruments in the capacity of principal or agent, or provide any other services or have officers, who serve as directors, either to/for the issuer, the investment instrument itself or to/for any company commercially or financially affiliated to such issuers. At any time, investment decisions (including whether to buy, sell or hold securities) made by UBS and its employees may differ from or be contrary to the opinions expressed in UBS research publications. Some investments may not be readily realizable since the market in the securities is illiquid and therefore valuing the investment and identifying the risk to which you are exposed may be difficult to quantify. UBS relies on information barriers to control the flow of information contained in one or more areas within UBS, into other areas, units, divisions or affiliates of UBS. Futures and options trading is not suitable for every investor as there is a substantial risk of loss, and losses in excess of an initial investment may occur. Past performance of an investment is no guarantee for its future performance. Additional information will be made available upon request. Some investments may be subject to sudden and large falls in value and on realization you may receive back less than you invested or may be required to pay more. Changes in foreign exchange rates may have an adverse effect on the price, value or income of an investment. The analyst(s) responsible for the preparation of this report may interact with trading desk personnel, sales personnel and other constituencies for the purpose of gathering, synthesizing and interpreting market information.

Different areas, groups, and personnel within UBS Group may produce and distribute separate research products **independently of each other**. For example, research publications from **CIO** are produced by UBS Global Wealth Management. **UBS Global Research** is produced by UBS Investment Bank. **Research methodologies and rating systems of each separate research organization may differ**, for example, in terms of investment recommendations, investment horizon, model assumptions, and valuation methods. As a consequence, except for certain economic forecasts (for which UBS CIO and UBS Global Research may collaborate), investment recommendations, ratings, price targets, and valuations provided by each of the separate research organizations may be different, or inconsistent. You should refer to each relevant research product for the details as to their methodologies and rating system. Not all clients may have access to all products from every organization. Each research product is subject to the policies and procedures of the organization that produces it.

The compensation of the analyst(s) who prepared this report is determined exclusively by research management and senior management (not including investment banking). Analyst compensation is not based on investment banking, sales and trading or principal trading revenues, however, compensation may relate to the revenues of UBS Group as a whole, of which investment banking, sales and trading and principal trading are a part.

Tax treatment depends on the individual circumstances and may be subject to change in the future. UBS does not provide legal or tax advice and makes no representations as to the tax treatment of assets or the investment returns thereon both in general or with reference to specific client's circumstances and needs. We are of necessity unable to take into account the particular investment objectives, financial situation and needs of our individual clients and we would recommend that you take financial and/or tax advice as to the implications (including tax) of investing in any of the products mentioned herein. This material may not be reproduced or copies circulated without prior authority of UBS. Unless otherwise agreed in writing UBS expressly prohibits the distribution and transfer of this material to third parties for any reason. UBS accepts no liability whatsoever for any claims or lawsuits from any third parties arising from the use or distribution of this material. This report is for distribution only under such circumstances as may be permitted by applicable law. For information on the ways in which CIO manages conflicts and maintains independence of its investment views and publication offering, and research and rating methodologies, please visit www.ubs.com/research-methodology. Additional information on the relevant authors of this publication and other CIO publication(s) referenced in this report; and copies of any past reports on this topic; are available upon request from your client advisor.

Important Information About Sustainable Investing Strategies: Sustainable investing strategies aim to consider and incorporate environmental, social and governance (ESG) factors into investment process and portfolio construction. Strategies across geographies approach ESG analysis and incorporate the findings in a variety of ways. Incorporating ESG factors or Sustainable Investing considerations may inhibit UBS's ability to participate in or to advise on certain investment opportunities that otherwise would be consistent with the Client's investment objectives. The returns on a portfolio incorporating ESG factors or Sustainable Investing considerations may be lower or higher than portfolios where ESG factors, exclusions, or other sustainability issues are not considered by UBS, and the investment opportunities available to such portfolios may differ.

External Asset Managers / External Financial Consultants: In case this research or publication is provided to an External Asset Manager or an External Financial Consultant, UBS expressly prohibits that it is redistributed by the External Asset Manager or the External Financial Consultant and is made available to their clients and/or third parties.

USA: Distributed to US persons only by UBS Financial Services Inc. or UBS Securities LLC, subsidiaries of UBS AG. UBS Switzerland AG, UBS Europe SE, UBS Bank, S.A., UBS Brasil Administradora de Valores Mobiliarios Ltda, UBS Asesores Mexico, S.A. de C.V., UBS SuMi TRUST Wealth Management Co., Ltd., UBS Wealth Management Israel Ltd and UBS Menkul Degerler AS are affiliates of UBS AG. **UBS Financial Services Inc. accepts responsibility for the content of a report prepared by a non-US affiliate when it distributes reports to US persons. All transactions by a US person in the securities mentioned in this report should be effected through a US-registered broker dealer affiliated with UBS, and not through a non-US affiliate. The contents of this report have not been and will not be approved by any securities or investment authority in the United States or elsewhere. UBS Financial Services Inc. is not acting as a municipal advisor to any municipal entity or obligated person within the meaning of Section 15B of the Securities Exchange Act (the "Municipal Advisor Rule") and the opinions or views contained herein are not intended to be, and do not constitute, advice within the meaning of the Municipal Advisor Rule.**

For country information, please visit ubs.com/cio-country-disclaimer-gr or ask your client advisor for the full disclaimer.

Additional Disclaimer relevant to Credit Suisse Wealth Management

You receive this document in your capacity as a client of Credit Suisse Wealth Management. Your personal data will be processed in accordance with the Credit Suisse privacy statement accessible at your domicile through the official Credit Suisse website https://www.credit-suisse.com. In order to provide you with marketing materials concerning our products and services, UBS Group AG and its subsidiaries may process your basic personal data (i.e. contact details such as name, e-mail address) until you notify us that you no longer wish to receive them. You can optout from receiving these materials at any time by informing your Relationship Manager.

Except as otherwise specified herein and/or depending on the local Credit Suisse entity from which you are receiving this report, this report is distributed by UBS Switzerland AG, authorised and regulated by the Swiss Financial Market Supervisory Authority (FINMA).

Version D/2024. CIO82652744

© UBS 2025. The key symbol and UBS are among the registered and unregistered trademarks of UBS. All rights reserved.