



## Four key questions

On Tuesday, the CDU/CSU and SPD agreed on a massive fiscal expansion, breaking the corset of the constitutional debt brake. As we argued in our early [reaction note](#) on Tuesday evening, the proposed fiscal package amounts to the most significant fiscal regime shift since German reunification.

To recap, the proposals are:

1. A EUR 500bn special purpose vehicle for public infrastructure investment, of which EUR 100bn will be allocated to the federal states.
2. A reform of the debt brake rule to exempt any defence spending over and above 1% of GDP, effectively permitting open-ended borrowing for defence.
3. A reform of the debt brake at the Länder level to raise their net borrowing cap from 0% to 0.35% of GDP, as at the federal level.

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But will the two parties manage to pass these constitutional amendments in their current form, and will they unlock as much spending and growth as the headline numbers suggest? In this note we address the key questions we have discussed with clients in recent days.

**(1) What could go wrong?** CDU/CSU and SPD will need the support from either the Greens or the FDP. With the FDP strongly opposed to the reforms, it comes down to the Greens, whose support is not guaranteed either. While party leaders are likely to come to an agreement, we see a risk of obstructive voting from members of parliament losing their seats in late March. To secure the Greens' support, CDU/CSU and SPD might need to make material concessions on spending priorities over the next week. Moreover, the constitutional amendments will also need to pass the Bundesrat, where CDU/CSU and SPD will depend on the cohesion of a number of state-level coalitions with other parties.

**(2) What would be the fiscal impulse?** We expect a positive fiscal impulse in the region of 3-4% of GDP by 2027 at the latest, based on conservative assumptions regarding front-loading. This should be split fairly equally across defence and infrastructure spending. Jointly, this additional deficit-spending should bring the German budget deficit to 5-6% of GDP initially before the expected growth effects kick in and slowly reduce it back about 4% over the medium term. While defence spending will likely be locked in at a higher share of GDP for the foreseeable future,

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the nominal infrastructure budget should fade relative to GDP.

**(3) What would be the growth impact?** Blending a low short-term multiplier for defence spending with a high multiplier for infrastructure spending, we would expect the cumulative growth impact in the next couple of years to exceed 2 ppts of GDP. The cyclical impact would fade after 2027, but we are optimistic that this fiscal expansion could lift the structural growth rate well above 1% again, primarily by jump-starting productivity growth. This effect would be strengthened if the next government paired this fiscal stimulus with supply-side reforms. It will be important to see in coming weeks whether this fiscal package is the prelude to a broader growth-oriented policy agenda.

**(4) What is the cyclical outlook?** Although the growth impact of a fiscal package of such historic proportions would be significant, we are wary of turning too optimistic on Germany's near-term growth outlook just yet. The cyclical outlook for the rest of this year will be dominated by the severe uncertainty shock emanating from US trade and foreign policy. Against this challenging backdrop, our 0.5% growth forecast for 2025 is already sanguine. Our 1.0% growth forecast for 2026 already assumed a modest fiscal expansion next year, and while the package announced this week implies likely further upside, we would prefer to see the whites in the eyes of these constitutional reforms before reviewing our forecast.

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## (1) What could go wrong?

The constitutional amendments have two hurdles to clear: first the Bundestag, and then the Bundesrat. A two-thirds majority is required in both chambers.

Is there enough time? According to press reports, the Bundestag<sup>1</sup> will convene, in its current composition, on March 13 for the first reading of the draft amendment, and then again on March 18 for the second and third readings (see [timetable](#)). According to the Bundestag administration, there is no minimum period for convening a special session of the Bundestag "neither in the rules of procedure nor anywhere else". However, enough time has to be given to individual members of parliament for deliberation and opinion forming<sup>2</sup>. A growing concern over this requirement could potentially lead to some slippage in the schedule and result in a five-to-midnight vote. According to constitutional experts, the Bundestag has until its last session the power of constitutional amendment.<sup>3</sup> This last session could take place the day before the new Bundestag constitutes itself on March 25, a maximum of 30 days after the election.

Is there a two-thirds majority? CDU/CSU and SPD will need the support of either the Greens and/or the FDP to achieve the two-thirds majority needed for constitutional changes. The FDP have clearly [signalled](#) that they would not support the proposed constitutional amendments. It will therefore come down to the Greens. As the Greens will henceforth be in opposition they might insist on putting more emphasis on the green transition in the off-budget fund for infrastructure. Given their strong leverage, we would expect robust negotiations and plenty of political noise over the next few days. The Greens have a political incentive to credibly signal that they

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1 Süddeutsche Zeitung, Wenn der Bundestag zur Sondersitzung ruft, March 5, 2025

2 See [example](#) of the heating law which has been stopped due to insufficient time for deliberation in July 2023

3 See [Tagesschau.de](#), March 5, 2025

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might not support the package.

Eventually, however, we would expect the Greens leadership to agree to the constitutional changes. After all, they have been advocating for a debt-financed infrastructure fund for years, and indeed were the first to propose setting one up with the constitutional majority in the outgoing parliament. As the Greens had not been consulted ahead of Tuesday's announcement and were just "informed" about the agreement shortly before the press conference, its leaders expressed<sup>4</sup> their disappointment.

The vote in the Bundesrat—the second chamber comprising the sixteen state governments—is scheduled to take place on March 21. Here, 46 out of 69 votes are required for constitutional amendments to pass. There is some risk that states in which the Left or BSW are part of government coalitions—Bremen, Mecklenburg-Vorpommern, Thüringen, and Brandenburg, with a total of 14 votes—may not support the amendments. This would still not threaten the required two-thirds majority. Yet, the majority would then depend on the states in which the FDP (Sachsen-Anhalt, Rheinland-Pfalz) and the Free Voters (Bavaria) are part of the coalition. Without the support of states where the FDP is part of the government, the majority would drop to 47 votes, still one vote above the required majority. However, if also Bavaria voted against the constitutional amendment, the result would be five votes short of the required majority. We deem this risk to be very low given that their senior coalition partners strongly support the proposed constitutional change and more fiscal leeway for the Länder and could offer concessions on other issues if needed.

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## (2) What would be the fiscal impulse?

First, it appears unlikely to us that fiscal spending would increase meaningfully as early as this year. Ramping up public investment takes time once decisions are made, and the decision on what to spend the infrastructure fund could continue throughout the coalitions talks in coming weeks. As for defence spending, the new exemption would permit the Ministry of Defence to resume procurement, and first orders would likely go out the door this year. However, as with the current defence fund, the spending would only take place upon delivery.

The spending should thus realistically kick in from 2026 onwards. How would it add up? First, and most simply, the additional leeway for the federal states to borrow up to 0.35% of GDP would unlock a meaningful increase in public consumption and investment at the regional level (about EUR 15 bn based on current GDP). We see no reason to expect any of the states to refrain from this additional deficit-financed spending.

Second, we would assume that the new infrastructure fund would be spent smoothly over ten years, starting in 2026, implying an additional deficit-financed spending of EUR 50 bn per year or (1.2% of current GDP). We would consider this a conservative assumption, as the next government would have economic and political incentives to front-load the investment as much as possible, even if planning periods and capacity constraints would put a speed limit on such efforts.

Third, there should be an even larger fiscal impulse from additional defence

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<sup>4</sup> Table.Briefings., March 5 2025

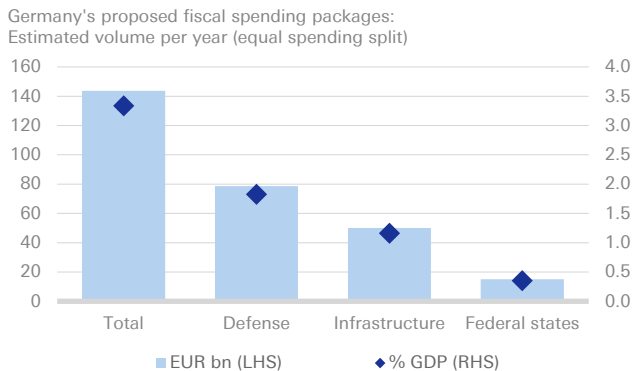


spending. But this is difficult to forecast with any precision. As a conservative base case, we would expect an increase in defense spending towards 3% of GDP as early as 2026. Relative to a projected spending level of 1.8% of GDP in 2025 (on the national measure of defence spending), this would imply a deficit-financed increase in defence spending of 1.2% of GDP. And with about 0.5% of GDP already funded via the existing defence fund, about 0.3% of GDP of current defence spending in excess of the first 1% could be exempted from the debt brake and also be credit-financed. Thus, the fiscal impulse from defence spending alone could amount to around 1.5% of GDP or EUR 65 bn a year.

Putting it all together, we would expect a positive fiscal impulse of about 3% of GDP by 2027 at the latest, with much of it kicking in as early as 2026. Relative to what is likely to be a roughly 2% deficit this year, this implies that Germany's budget deficit could temporarily widen to 5% of GDP. We would reiterate however that these are conservative assumptions. A perfectly smoothed out drawdown of the infrastructure fund is one of them. A defence spending target of 3% may also be low-balled given the urgency in equipping the armed forces. In case of a higher defense spending target of 4% of GDP in the next years, the total fiscal impulse could be as large as 4% of GDP.

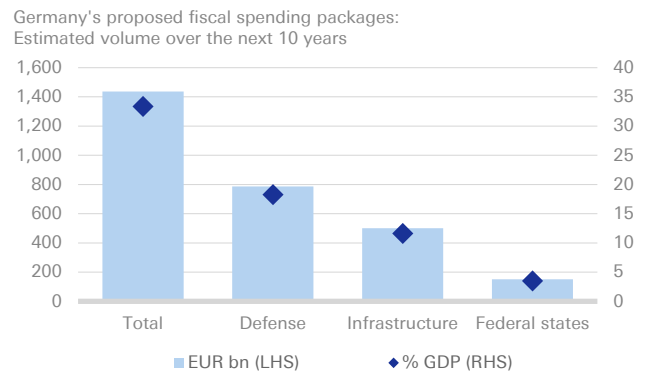
Summing up these permanent annual spending numbers up over the next 10 years should amount to a spending and issuance volume of close to EUR 1.5 tr or c. 33% of 2024 GDP (see figure 2). We would caution, however, against reading this as the prospective increase in the debt ratio, contrary to some commentary in the German press suggesting the Germany's debt ratio could approach or even exceed 100% of GDP in the coming decade. This would assume a non-existent nominal growth multiplier out of this fiscal expansion, which would be an unrealistic assumption, in our view. We now turn to this.

**Figure 1: The additional permanent spending boost could be above 3% of current GDP**



Source : Deutsche Bank Research, Federal Statistical Office

**Figure 2: The spending packages could amount to about EUR 1.5 tr over the next decade**



Source : Deutsche Bank Research, Federal Statistical Office

### (3) What would be the growth impact?

Given the lack of additional fiscal spending in 2025, as argued above, we would expect no meaningful growth impact before the end of this year. To be sure, the prospect of greater public spend could spur private-sector investment in the short term. This is particularly the case in the defence sector, where the major players are investing heavily in their production capacities. These investments are taking place

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relative to a low baseline, however, and are unlikely to boost aggregate investment in the near future. In construction and civil engineering specifically we would expect less of an announcement effect on investment and hiring.

More broadly, our takeaway from client conversations is that this week's announcement has already boosted the corporate sector's confidence in the next government's effectiveness. The two parties have already signaled a clear departure from the policy gridlock of the outgoing government. That said, it is hard to predict the concrete impact this would have on investment decisions in anticipation of any actual spending coming through. Moreover, it remains to be seen whether German households will be more reassured by these political developments or disconcerted by the geopolitical developments that have led to them. The net psychological impact of recent events appears highly ambiguous for now.

Once the spending kicks in from 2026 onwards, we expect the growth impact to differ strongly between defence and infrastructure spending. German defence spending will likely remain focused on capital expenditure. And the crux is that 70-80% of orders go abroad, primarily to the US. In the German context, we are sceptical of estimating the economic impact of greater defence spending by treating it as 'public consumption' in general equilibrium models, let alone of using multiplier effects estimated for the US. Contrary to such approaches, we would expect the ramp-up in defence spending to have a multiplier in the range of 0.4-0.6 in the next couple of years. It would likely only increase in the medium term, as domestic production capacity ramps up and (we would hope) a growing share of expenditure goes toward R&D and other expenditures with high domestic value-added. Hence, we would estimate a cumulative growth impact of 0.6-0.9 ppts in the next two years.

In contrast, we would expect infrastructure spending to have a much higher short-term multiplier in the region of 1. In our view, there is not likely to be any meaningful crowding out of private investment. The only concern is that the recovery in residential construction could be delayed. This means the cumulative growth impact in the next couple of years should be closer to 1.5 ppts. Blending these multipliers into an aggregate growth impact, the fiscal package should raise German GDP by at least 2 ppts over the next two years or so. To reiterate, this is a conservative estimate in terms of the assumed fiscal impulse.

The even more difficult question to answer is the impact on Germany's structural or potential growth rate. At present, the potential growth rate is as low as only about 0.5% a year. Large-scale investment in public infrastructure should raise this meaningfully, if nothing else by rejuvenating the capital stock after years of withering net investment. Depending on how the funds are spent, there may also be positive effects on productivity growth as well as on human capital formation, though it would be academic to speculate about such effects at this stage.

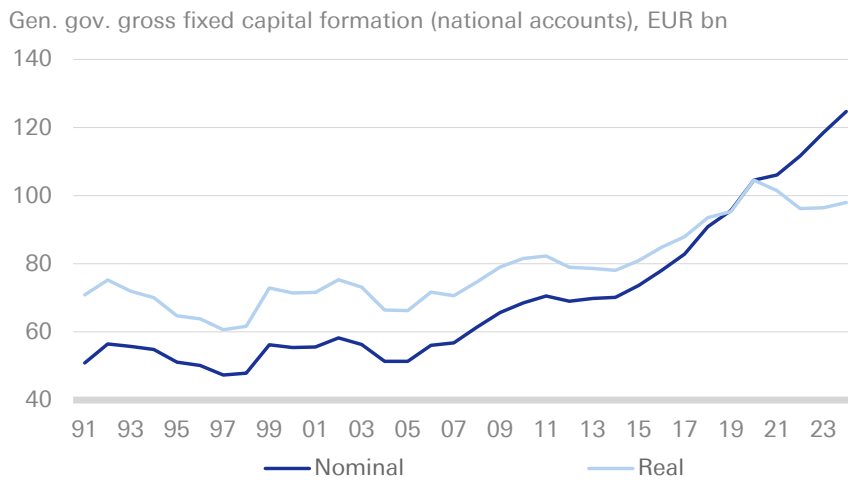
The same goes for defence spending, where a focus on higher military R&D expenditures could boost productivity growth and technological innovation across the economy through spillover effects that are clearly observed in other countries such as the US. By contrast, a focus on expanding troop sizes—whether through the reintroduction of conscription or otherwise—could exacerbate the skilled labour shortage in the private sector. In general, Germany's stagnating labour supply could act as a speed limit to fiscally induced growth recovery, absent supply-side reforms aimed at expanding it.



More broadly, it will be important to see whether these historical fiscal policy reforms are only the prelude to a broader agenda including important supply-side reforms, or if the expansion of the government's fiscal space complicates such reforms. In the absence of ambitious supply-side reforms, the risk is that the real economic impact of large-scale fiscal stimulus could fizzle out once the private sector recovers and the current cyclical slack in the economy is absorbed. The result would be inflationary pressures instead of sustainable real growth.

Recent developments in public investment should be warning enough. Although gross government investment has risen by almost 20% in nominal terms between 2020 and 2024, in real terms it was roughly 6% lower. In other words, the extraordinary price increases for public investment, especially in the construction sector, have more than eaten up these gains. Therefore, additional supply-side reforms appear to be needed to ensure that the economy's capacity limits are expanded accordingly.

Figure 3: Public investments spending has risen noticeably, though is down in real terms compared to 2020



Source : Federal Statistical Office, Deutsche Bank Research

#### (4) What is the cyclical outlook?

Although the growth impact of a fiscal package of such historic proportions would be significant, we are wary of turning too optimistic on Germany's near-term growth outlook just yet. The cyclical outlook for the rest of this year will be dominated by the severe uncertainty shock emanating from US trade and foreign policy. After all, this fiscal regime shift is not taking place in a vacuum, but in response to a deep and fundamental confidence shock. As argued above, the psychological impact of recent developments on the household sector could turn out to be negative. The corporate sector is likely to welcome the fiscal announcement, both for the prospective spending as well as for the signal of the long-standing policy gridlock in Berlin being resolved. Yet in the near term, the risk of a trade war with the US raises the bar for the government to revive animal spirits.

Against this challenging backdrop, our 0.5% growth forecast for 2025 is already sanguine. As for 2026, our 1.0% growth forecast already assumed a modest fiscal

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expansion next year but a more benign global environment than has transpired since the US election. Notwithstanding the downside risks from trade policy, the large fiscal package announced this week implies material further upside if it were to be implemented in its current form. Yet as described above, there remains some execution risk. We would prefer to see the whites in the eyes of these constitutional reforms, and have more clarity on how quickly the infrastructure fund will be drawn on, before reviewing our forecast.

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# Appendix 1

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