



Impact of the fiscal package on debt and sectors

The fiscal package passed in March 2025 is likely to cause German government debt to rise significantly in the coming years. This contrasts with hopes for a revival of the currently weak economy. The public investments triggered by the fiscal package will have a positive effect on the economy, with some sectors benefiting particularly.



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Germany faces major **transformative challenges**. Changes are imminent in many social and economic areas, which **require significant investment**. In addition to private commitment, addressing these challenges also requires public sector involvement.

The list of areas of responsibility is long: defense, climate change, and infrastructure, to name just the most common ones. Estimates of the **amount of investment required** vary widely, but often range in the tens to hundreds of billions of euros. Too much to finance from current budgets.



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Against this backdrop, the new governing coalition of the CDU/CSU and SPD had to find a way after the 2025 federal election to provide **large sums of financial resources** that could not or should not be directly "snatched" from the federal budget. The main focus was on strengthening defense capabilities, modernizing infrastructure, and revitalizing the sluggish economy.

It became clear early on that a **change to the debt brake** enshrined in the Constitution "Grundgesetz" was necessary. The required majority in the "new" Bundestag seemed elusive, so the "old" Bundestag passed the fiscal package in one of its final sessions on March 18. A further reform of the debt brake is also announced in the coalition agreement, although the details have not yet been announced.

The adopted package provides **three components**:

1. An exemption from the debt brake for defense spending exceeding 1% of GDP per year.
2. A borrowing option for the federal states "Länder" of 0.35% of GDP per year.
3. The establishment of a special infrastructure fund with 500 billion euros for 12 years.

Development of defense spending crucial for debt

In light of the persistent threat from Russia and increased pressure from the US for stronger military commitments from other NATO members, the new coalition made it clear that it would not only maintain the **rise in defense spending** (the „Zeitenwende“) but significantly expand it. The 100 billion euros allocated through the Bundeswehr Special Fundis expected to be exhausted by 2027. Therefore, the debt brake will be suspended for defense expenditure exceeding 1% of gross domestic product (GDP), allowing this additional spending to be financed through borrowing. The objective is to rapidly strengthen defense capabilities while avoiding fiscal constraints.

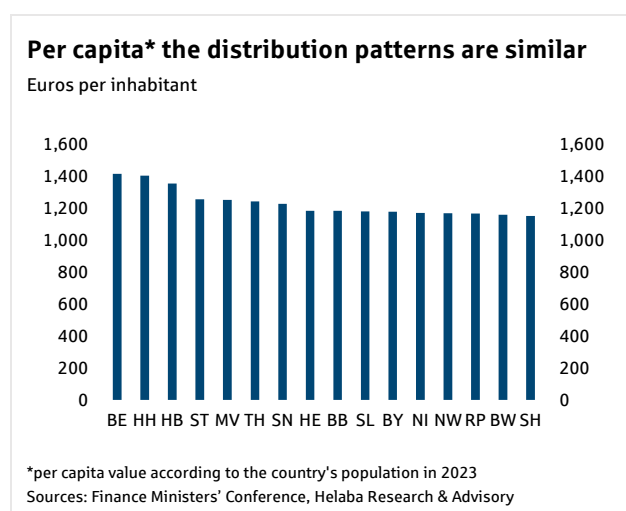
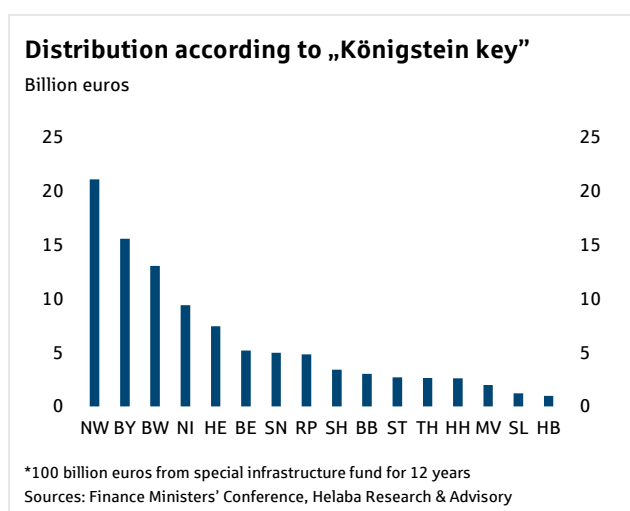
In 2024, 1% of Germany's GDP equated to approximately 43 billion euros. Germany invested around 62 billion euros in its defense that year, meaning that more than 19 billion euros could have been financed through debt under the new rules. This is based on an expanded definition of the term "defense," which includes not only spending on the Bundeswehr itself, but also, for example, purposes of civil defense and civil protection. In anticipation of a

targeted **expansion of defense spending** to significantly exceed the current share of 2% of GDP, borrowing for these purposes is likely to be even higher in the coming years.

In addition, the 16 federal states as a whole – like the federal government “Bund” – will be granted an **annual borrowing leeway** of 0.35% of GDP. This currently corresponds to a potential borrowing of approximately 15 billion euros, although the allocation of this amount among the states has not yet been determined. Previously, states were only permitted to take on debt in emergencies or for debt restructuring. Whether the states will fully utilize their new borrowing leeway is uncertain and depends on their respective budgetary situation and budgetary rules.

Special infrastructure fund aims to strengthen public investment

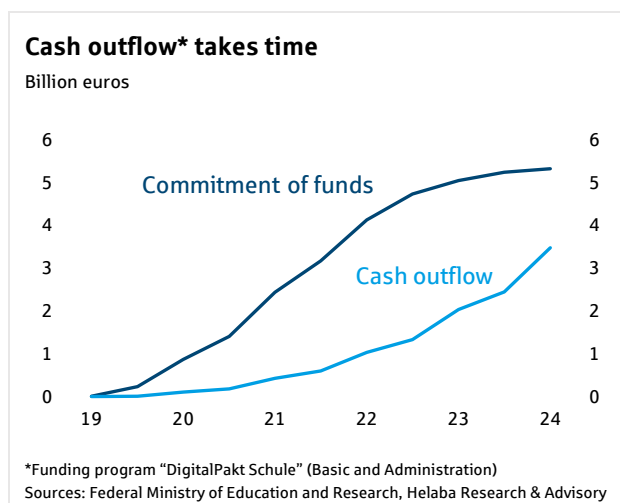
The rundown infrastructure was increasingly becoming a disadvantage for the location. To accelerate **modernization** and provide **economic stimulus**, the federal government is creating the Infrastructure and Climate Neutrality Special Fund with a debt financing volume of 500 billion euros. The fund will support additional investments over the next twelve years. The long period of time providing long-term financial planning security.



100 billion euros is earmarked for the **Climate and Transformation Fund (KTF)**, and also 100 billion euros each for the **federal states and municipalities**. The allocation among the federal states is to be based on the Königstein key, with the allocation to the KTF being made in ten equal annual tranches. Further priorities for the remaining 300 billion euros have not yet been determined. The eligible infrastructure sectors are broadly defined. The draft law identifies some investment purposes: civil and population protection, transport, hospital, energy, education, care and science infrastructure, research and development, and digitalization.

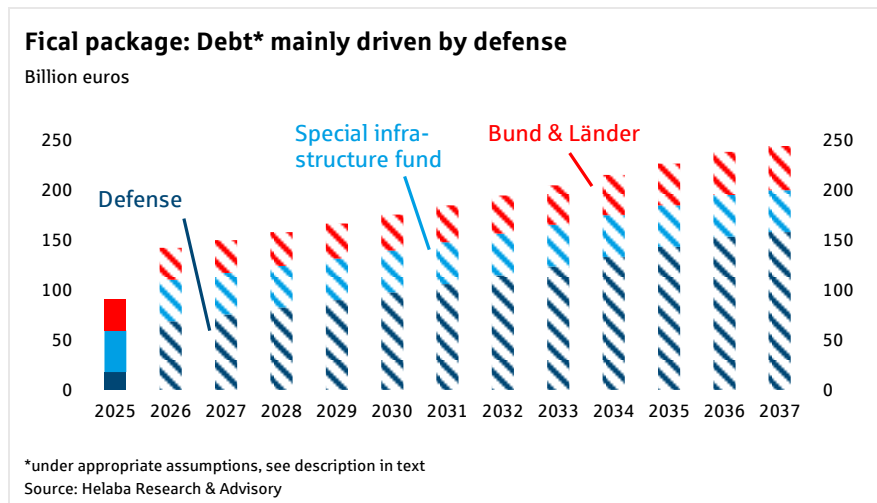
Implementation of infrastructure investments raises a number of open questions

These funds are intended to be used for **additional investments**. According to the Federal Ministry of Finance, additionality is to be ensured through a minimum share of 10% of investment expenditures in the federal budget. This flat rate is controversial, as the investment share of the federal budget is already higher at approximately 12%. Furthermore, it is unclear to what extent additionality also applies to funds from the states and municipalities or the Climate and Transformation Fund. To ensure the correct use of funds, recurring performance reviews are planned.



The actual federal borrowing will depend on the pace of planning and the **outflow of funds**. Experience from other funding measures such as the Digital Pact for Schools suggests an increasing outflow of funds over time. In contrast, the funds are planned quickly but then require time for implementation. The decisive factors will therefore be the design of the specific intended uses as well as the determination of the project sponsors and the financing flows within the federal state.

In addition, **capacity constraints** in the construction industry and public authorities (administrative bottlenecks) will influence the pace of implementation, as will regulations governing construction, awarding, and the monitoring of public investment projects. The coalition has announced further reform measures in this regard.



Questions regarding **follow-up costs** are also currently unresolved. While the interest payments for the special fund's borrowing will be covered by the federal budget, the repayment or dissolution of the special fund after its term has not yet been defined.

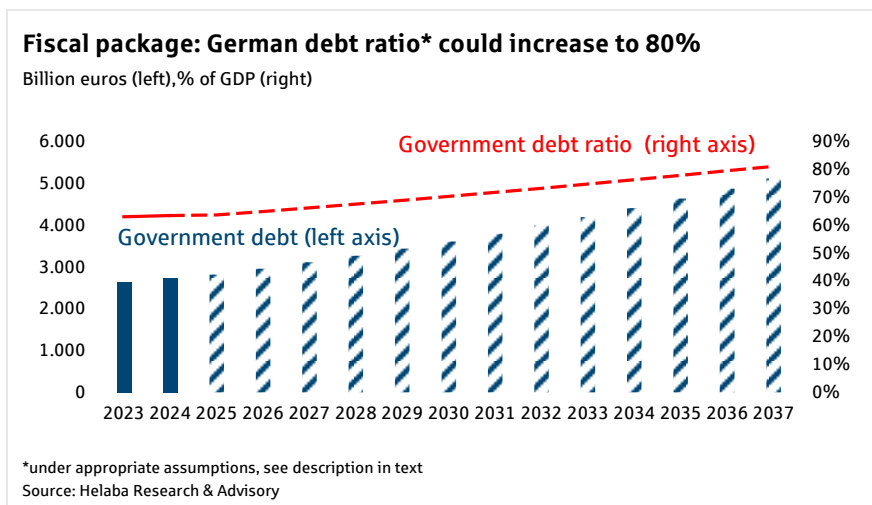
Public budgets will also be challenged by **infrastructure maintenance and replacement investments** (expressed in accounting terms as depreciation),

so further adjustments to federal fiscal relations may be necessary.

Fiscal package causes German debt to rise

The federal government will take on new debt to finance the fiscal package. This is likely to take the form of **federal bonds (Bunds)**, which are expected to be the main financing tool for the federal government to finance itself. As the additional investment funds are clearly defined in terms of amount, the unknown component for future German government debt is primarily the level of defense spending. In addition, the reference value GDP is variable, resulting in a wide range of estimates for the development of the debt ratio depending on the assumptions.

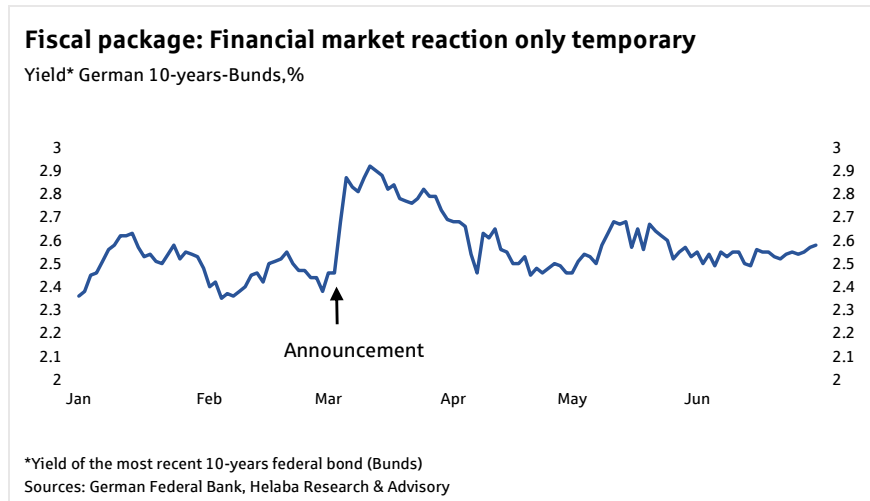
A number of assumptions can be made for a simple scenario for the **development of government debt**: Assuming constant annual borrowing over the course of twelve years, nominal GDP growth of 3% per year and a continuous increase in defense spending to 3.5% of GDP by 2037, new debt would be around 90 billion euros in the first year and would rise to over 240 billion euros in 2037 if the possible scope for borrowing were exhausted.



The total over twelve years would amount to almost 2.4 trillion euros. If the borrowing of local authorities and social security funds as well as an interim repayment of existing debt are excluded, the **German debt ratio** of currently 62% would be around 80% of GDP in 2037.

European fiscal rules and market reactions set only weak limits

With the increased public debt ratio, Germany would still be below the current European average of 84% of GDP for the EU and 90% of GDP for the eurozone. Nevertheless, this would significantly exceed the threshold of 60% of GDP, which is decisive for the **European fiscal rules**. Under the Stability and Growth Pact adopted in 2024, Germany would have to agree on a consolidation path with the EU. However, in view of the current geopolitical situation, it remains to be seen how this could look in detail and how the new rules will be implemented. Exceptions have already been made for defense spending, so it seems unlikely that the EU will insist on overly tough consolidation.



Limits on government debt are therefore more likely to be set by the **financial markets**. Following the announcement of the fiscal package, for example, interest rates on the 10-year German government bond jumped by 30 basis points to 2.9% but fell shortly afterwards and have since been quoted in a range of 2.4% to 2.7%.

Other market indicators also do not point to a loss of confidence in **Germany's creditworthiness**.

Rather, positive sentiment prevails, predicting a strengthening of the country's position as a business location. This is especially true against the backdrop of the further significant increase in US national debt. Nevertheless, the global expansion of government bonds is likely to push up their interest rates and then be felt in the form of **higher interest payments** in public budgets. However, our long-term forecasts for 10-year German government bonds assume a moderate increase in interest rates to around 3%.

The impact of the fiscal package depends on the investment priorities

The question of **debt sustainability** also depends on the impact of debt-financed investments. Distributing the sum of 500 billion euros over twelve years results in financial scope for **additional investment** of almost 42 billion euros, which corresponds to approximately 40% of current public investment spending. The 100 billion euros distributed directly to states and municipalities would enable an average of 8.3 billion euros in additional investment, corresponding to approximately 11% of the current investment level. These figures illustrate that the amounts are not sufficient to cover all needs but are large enough to trigger a significant investment stimulus.

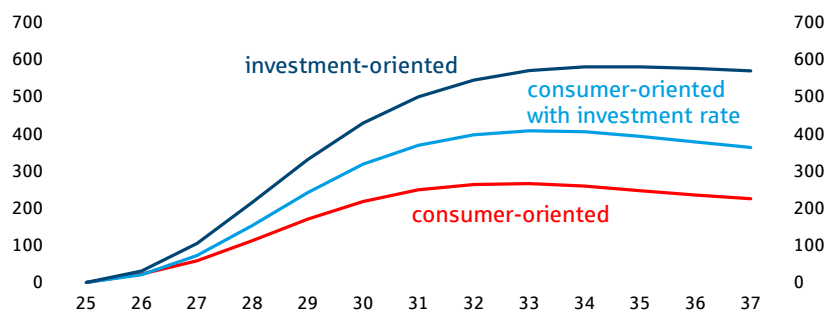
For Germany, many economists see a **positive effect** from debt-financed investment expansion. However, the effect depends heavily on the actual investment priorities. The **German Council of Economic Experts (SVR)** presented various model calculations in its 2025 Spring Report. If the special fund's resources were diverted to consumption, the overall economic effect would be significantly worse than if consistent investment were made in key infrastructure areas. The fiscal package provides the economy with urgently needed economic stimulus

The SVR concludes that the expansionary stimulus provided by the fiscal package will contribute to Germany's economic recovery starting in 2026, with the package's isolated effect on GDP expected to be 0.5 percentage points. In addition to the expected real economic impact, the SVR also notes that the announcement of the fiscal package has already improved economic expectations. These signals are important, as many economic actors are holding back on investments due to the weak economic situation and high global uncertainty. The first concrete plans for the additional government investment can therefore create confidence and **improve the general business climate**.

There is also the potential for so-called **multiplier effects** through public investment. This means that every euro spent by the government generates more than one euro of economic growth. In the case of public investment, this is primarily due to knock-on effects in the private sector, which follows suit with its own investments. Estimates of the magnitude of the multiplier vary, but most economists see a clearly positive effect under the current conditions in Germany.

Special infrastructure funds: different economic growth rates possible

Additional GDP, billion euros*



*cumulative per year in real terms, according to three model calculations
Sources: German Council of Economics Experts, Helaba Research & Advisory

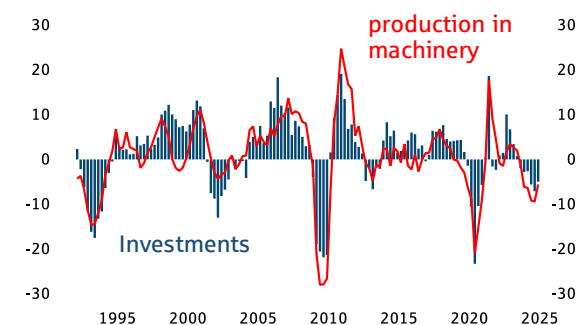
Higher investments as a result of the fiscal package – with the aforementioned use of the funds being crucial – can contribute to increasing the low **production potential** of the German economy, currently well below 1%, in the long term and **strengthening competitiveness**. This would not be expected if the funds were primarily used for consumption. However, even additional government consumption spending could have a **positive economic effect**, as it would support private consumption, which is only slowly recovering.

Different effects of the financial packages on the sectors

Sectors will benefit very differently from the fiscal package. The planned additional spending on defense is likely to have a **positive impact** on the defense sector, but also on mechanical engineering, the steel industry, and electrical engineering. With regard to the special fund for infrastructure, historical correlations between investments and the performance of the sectors can provide a rough **estimate of the expected effects**.

Synchronization of Investments*

Equipment and Mechanical engineering, % yoy



*Equipment investments and real production in machinery
Sources: Macrobond, Helaba Research & Advisory

The adjacent graph illustrates this for mechanical engineering: When equipment investments increased in the past, mechanical engineering production usually increased as well. The strength of this correlation can be calculated for the three different types of investment – equipment, construction, and other investments – for all sectors. We use these correlations to calculate a score for each sector, which provides the basis for a **ranking of the expected growth effects** of the fiscal package. This ranking is supplemented by our own economic assessments, resulting in the table below showing the sectors which are likely to benefit the most.¹

According to the **German Economic Institute (IW)**, the special fund for infrastructure is expected to **increase total investment by 7%** by 2029. However, equipment investment is only expected to grow by 0.8% as a result of the package. The largest share is likely to flow into construction investment, which is why we are assigning it a correspondingly higher weighting in our calculations.

¹The ranking primarily serves as a rough overview and classification of the most benefiting industries. The distances between the individual ranks cannot be meaningfully quantified and therefore interpreted.

Ranking* of industries benefiting from special funds for infrastructure		
Sector	Classification	Explanation
Construction	F	Benefits directly from construction investments
Metal industry	WZ 24, WZ 25	Important inputs for construction. More relevant than other sectors due to its size
Intermediate materials (e.g. glass, ceramics, cement, rubber, plastics, wood)	WZ 16, WZ 17, WZ 22, WZ 23	Manufacture of materials needed for construction. Individual economic sectors with high scores
Wholesale	WZ 41	Required materials are traded here
Mechanical engineering	WZ 28	The knock-on effects of increased investment activity are likely to have a significant impact after a time lag. Weak capacity utilization can be improved and industry profitability increased through a fiscal stimulus package
Chemicals	WZ 20	Supplies, for example, construction chemicals, basic chemicals for the metal industry, etc. As a cyclical sector, it is also likely to benefit from second-round effects
Mining	WZ 08	Here, "quarrying of stone, earth, and other mining." Supplies aggregates for concrete, asphalt, etc.
Financial services, insurance	K	Investments are likely to increase credit demand in the industries through leverage effects
Water supply, sewage and waste disposal	E	More provision of basic utilities/waste disposal if investments/production increase
Landscaping	WZ 81	Terrain modeling for construction projects, creation of green spaces or ecological compensation areas

*Ranking based on correlation scores, adjusted by own estimates. Correlation scores calculated as the weighted sum of the correlations of the annual rates of change of real industry sales and gross fixed capital formation types. Weights based on the IW forecast of investment growth and own estimates. Sources: IW, Helaba Research & Advisory

The sectors that are likely to benefit most are the construction industry, the metal industry, the intermediate industries, wholesale trade, and mechanical engineering. In the **construction industry**, the higher construction investment will have a direct impact – probably more so in civil engineering than in building construction. The **metal industry** produces a range of materials which will see a rise in demand as a result of the investment project. Various **intermediate materials** such as glass, rubber, plastics, and wood products will also be in greater demand. Increased demand is likely to be noticeable in **wholesale trade** due to the stimulated economic activity.

Mechanical engineering will primarily benefit from equipment investment, which is expected to increase only moderately as a result of the special fund for infrastructure. However, on one hand, construction investments will help the mechanical engineering sector through increased demand for construction and building material machinery. On the one hand, this sector would benefit greatly from second-round effects resulting from an improved industrial economy. The increased spending on defense, on the other hand, will boost mechanical engineering significantly more in the short term, which is why the fiscal package as a whole will particularly support this sector.

Conclusion: Fiscal package can provide positive economic stimulus if the funds are invested wisely

With the fiscal package, policymakers have embarked on a **paradigm shift in public debt**. The government is now accepting considerable liabilities in exchange for higher public investments. The prospect of a **modernized public infrastructure** is positive in several respects. Large parts of the economy will benefit from the additional spending, some sectors more than others. The bottom line is a positive economic stimulus, which will hopefully encourage further private investment.

The prerequisite for this, however, is that the investment projects are specified promptly. Experience has shown that planning alone takes a long time, so it will probably take several years before most investment projects begin or even are completed. However, the special fund, provides a certain degree of **planning security** through its extended lifetime. This should help to gradually increase limited capacities, for example in the construction industry or public administration, and thus as efficiently as possible. This is the only way to prevent investment spending from leading to excessively high prices or from not being used at all due to a lack of implementation options.

If the additional investments can be channeled into meaningful projects and implemented promptly and effectively, Germany will have excellent opportunities to both **improve its competitiveness** and make **progress on major societal challenges** such as climate protection and digitalization. In order to sustainably manage the long-term follow-up costs of the fiscal package and the investments initiated, these opportunities must be seized. Then the package will help the country economically in the short term and structurally in the long term.



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