Economic Situation and Strategy

6 March 2025

Turning point 'Whatever it takes', part 2

We are delighted that Friedrich Merz and his colleagues from the CDU/CSU are among our readers. Last week, in our weekly newsletter "Konjunktur & Strategie", we called on German politicians to do the same as Mario Draghi, because Germany urgently needs a "whatever it takes" moment and courageous decisions like those taken by the then ECB President in July 2012. With the OMT program (Outright Monetary Transactions), the central bank specified its willingness to buy unlimited amounts of government bonds from crisis countries if necessary. The announcement of this programme alone stabilized the euro and the markets at the time.

How the economic turnaround is to succeed

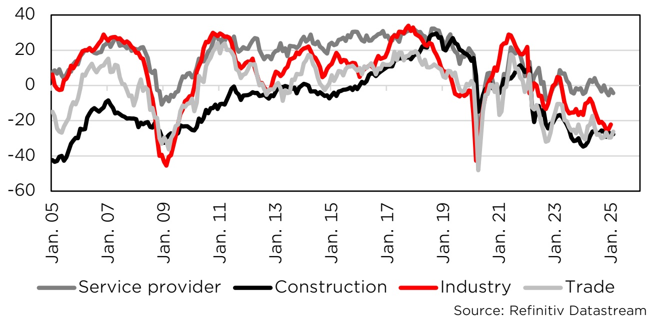
Less than a week after our appeal, Mr. Merz announced three milestones for future fiscal policy in the presence of the SPD leadership, which could mean the end of the previous political credo "We will not incur debt". The proposals in detail:

1. Defense spending of more than one percent of gross domestic product (43 billion euros) should no longer fall under the debt brake in future. Similar to the OMT, which provided for the unlimited purchase of government bonds (and was never activated), there is no longer a fixed upper limit for future defense spending. In order to achieve the target of two percent of economic output for national defense, around 50 billion euros in additional spending per year would be necessary, or around 100 billion euros per year for three percent of economic output.

2. A special fund of 500 billion euros with a term of ten years is created for urgently needed investments in transport, energy and digital infrastructure. These investments could modernize Germany's ailing infrastructure and strengthen competitiveness.

3. For the federal states, which were previously not allowed to incur new debt due to the debt brake, the leeway is to be increased to 0.35% of gross domestic product.

Germany: Ifo business climate by economic sector



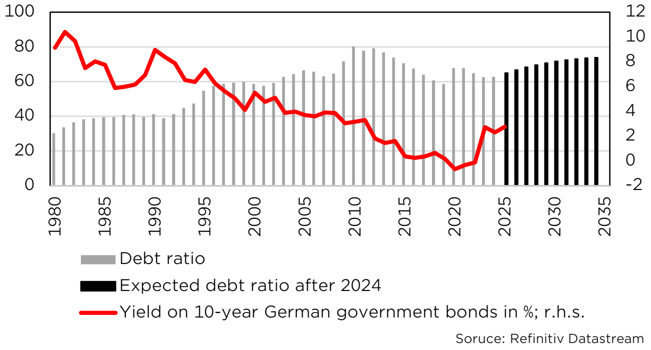
These are all still plans, nothing has been decided yet. But we believe that all these considerations are right and important in order to overcome the ongoing economic lethargy. Nevertheless, as always in Germany, there is also a lot of criticism of the plans. For many people in Germany, sound public finances and economic stability are inextricably linked. But subordinating internal and external security to budgetary discipline makes no sense. After all, you can also save yourself to death. Low debt is not an end in itself when it comes to being a secure, modern and liveable country. A 2/3 majority in the Bundestag and Bundesrat is necessary to implement the announcements. At least 490 out of 735 votes are required in the "old" Bundestag. The CDU/CSU and SPD together have 403 votes, the missing 87 would then have to come from the Greens (118 MPs), the FDP (91) or the Left (39). The AfD (83 seats) will most likely not vote in favor. In the “new” Bundestag, the AfD and the Left Party together have a blocking minority, making it easier to pass these plans in the “old” Bundestag, which is why a vote could take place as early as next week.

What economic effects can be expected?

If we make the simplifying assumption that an additional EUR 50 billion will be spent on infrastructure and an additional EUR 50 billion on defense each year over the next 10 years, this corresponds to a good two percent of nominal GDP. The positive growth impulse of the government program would therefore be considerable, even if it must be assumed that the actual growth effect will be lower, as the money will also be used for additional imports (e.g. US weapons systems). The German business model, which was previously based on the ability to export high-quality goods abroad and which has come under increasing pressure from Donald Trump's trade policy and China's increased competitiveness, could therefore be put on a new footing and benefit from stronger domestic demand in the future.

However, higher debt also means higher interest rates. If Germany were to take on 200 billion euros more debt each year over the next ten years, the national debt would rise from the current 2.7 trillion euros to 4.7 trillion euros. Assuming a conservative growth forecast of three percent per year in nominal terms, the debt-to-GDP ratio could rise from its current level of just over 60 percent to around 80 percent over the next ten years. In a more positive growth scenario of four percent per year in nominal terms, however, the debt ratio would only rise to 74 percent. However, this would still be below the previous high of 80% in 2010, so we expect interest rates to rise moderately overall. However, we can no longer maintain our forecast that the yield on 10-year German government bonds will fall to below two percent by the end of the year due to further interest rate cuts by the ECB, a weak economy in the eurozone and an inflation rate moving towards the two percent target. Although the pressure on bond prices is likely to remain high for the time being, we expect the bond market to calm down considerably by the end of the year and yields to reach 2.4%.

Germany: Public debt and interest rates



Because one thing is also clear: decisions on special funds and higher defense spending are easier to make than to implement ¬ even if they are passed as announced. Despite a slight increase in unemployment, it is likely to be difficult for German companies to find new staff. Many people in the construction industry have a migrant background, and it will be particularly difficult to find new staff in light of the current developments, which are expected to severely restrict immigration. And then there is the bureaucracy, which could make the awarding of contracts as tough as chewing gum. Anyone expecting the package of measures to have a rapid impact on the real economy could be disappointed.

Conclusion: These proposals mark a possible paradigm shift in German economic policy. After years of austerity policies and adherence to the “black zero”, an investment-oriented approach could revitalize the German economy. The combination of defense spending and infrastructure investment could be the right mix to lead Germany out of economic stagnation. Germany needs this “whatever it takes” moment - the plans are on the table, now political courage is needed to implement them!

Carsten Klude

Market data

Stock marktes	As of 07.03.2025 09:59	Change versus 28.02.2025 -1 week	06.02.2025 -1 month	06.12.2024 -3 months	06.03.2024 -1 year	31.12.2024 YTD
Dow Jones	42579	-2,9%	-4,8%	-4,6%	10,1%	0,1%
S&P 500	5762	-3,2%	-5,3%	-5,4%	12,9%	-2,0%
Nasdaq	18069	-4,1%	-8,7%	-9,0%	12,7%	-6,4%
DAX	23068	2,3%	5,3%	13,2%	30,2%	15,9%
MDAX	29704	5,0%	9,8%	8,8%	13,5%	16,1%
TecDAX	3808	0,8%	-0,5%	7,9%	10,4%	11,4%
EuroStoxx 50	5461	-0,1%	1,9%	9,7%	11,1%	11,5%
Stoxx 50	4677	-1,8%	0,3%	5,9%	8,4%	8,5%
SMI (Swiss Market Index)	12899	-0,8%	2,2%	9,5%	11,7%	11,2%
Nikkei 225	36887	-0,7%	-5,6%	-5,6%	-8,0%	-7,5%
Brasilien BOVESPA	123358	0,5%	-2,3%	-2,1%	-4,3%	2,6%
Indien BSE 30	74348	1,6%	-4,8%	-9,0%	0,4%	-4,9%
China CSI 300	3944	1,4%	2,6%	-0,7%	11,1%	0,2%
MSCI Welt	3731	-2,0%	-3,4%	-3,2%	11,1%	0,6%
MSCI Emerging Markets	1131	3,1%	2,6%	2,4%	10,1%	5,2%
Bond markets						
Bund-Future	127,02	-617	-639	-738	-646	-642
Bobl-Future	116,79	-111	-102	-264	33	-107
Schatz-Future	106,57	-36	-34	-32	140	-42
3 Monats Euribor	2,50	4	-3	-36	-144	-21
3M Euribor Future, Dec 2025	2,14	22	22	-69	-86	25
3 Monats $ Libor	4,34	2	0	-8	-113	-3
Fed Funds Future, Dec 2025	3,60	-7	-30	-89	-96	-31
10 year US Treasuries	4,25	5	-19	10	11	-32
10 year Bunds	2,81	42	46	70	50	45
10 year JGB	1,51	14	24	46	79	42
10 year Swiss Government	0,70	23	34	47	-4	42
US Treas 10Y Performance	609,55	-0,7%	1,5%	-0,1%	2,7%	3,0%
Bund 10Y Performance	543,53	-3,9%	-4,1%	-5,6%	-2,0%	-3,7%
REX Performance Index	447,02	-2,1%	-1,7%	-2,1%	1,2%	-1,3%
IBOXX AA, €	3,30	37	37	47	-6	26
IBOXX BBB, €	3,70	38	35	43	-28	24
ML US High Yield	7,50	11	12	23	-41	-15
Commodities						
MG Base Metal Index	433,28	3,0%	3,3%	3,3%	12,8%	6,8%
Crude oil Brent	70,30	-4,4%	-5,4%	-2,6%	-16,4%	-5,9%
Gold	2922,19	2,5%	2,4%	10,8%	36,2%	11,3%
Silver	32,73	5,3%	1,9%	5,0%	35,2%	10,3%
Aluminium	2708,39	3,3%	3,2%	5,4%	23,6%	7,2%
Copper	9747,77	4,4%	6,5%	8,2%	14,9%	12,7%
Iron ore	101,24	-5,3%	-4,7%	-2,8%	-13,4%	-2,3%
Freight rates Baltic Dry Index	1286	4,6%	62,2%	10,2%	-40,9%	29,0%
Currencies						
EUR/ USD	1,0848	4,2%	4,7%	2,5%	-0,2%	4,4%
EUR/ GBP	0,8394	1,6%	0,5%	1,3%	-1,9%	1,5%
EUR/ JPY	159,80	1,8%	1,2%	0,3%	-1,8%	-2,0%
EUR/ CHF	0,9520	1,3%	1,4%	2,5%	-1,0%	1,1%
USD/ CNY	7,2355	-0,7%	-0,8%	-0,6%	0,5%	-1,0%
USD/ JPY	147,97	-1,8%	-2,3%	-1,4%	-1,0%	-5,9%
USD/ GBP	0,77	-2,5%	-3,9%	-1,4%	-1,3%	-3,1%

Source: Refinitiv Datastream

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