Economic Research

Economic Briefing

Germany – New debt gives the economy a boost

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Dr. Ralph Solveen [AC]

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The German government plans to take on new debt amounting to €143 billion this year, with even higher deficits planned for the coming years. A closer look at the details reveals that only part of this will be used for additional investment. This casts doubt on whether the additional spending made possible by the new debt will actually improve the competitiveness of the German economy in the end. However, it will give the economy a significant boost next year at the latest, helping the German economy to grow noticeably in the coming year.

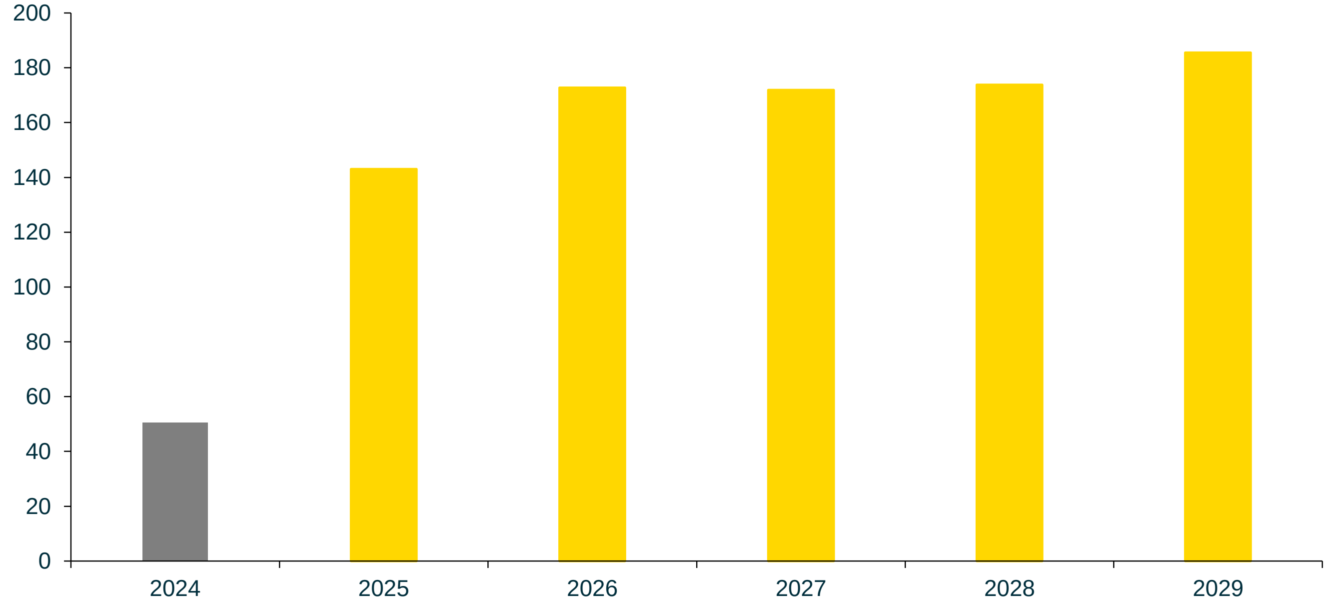
Constitutional amendments facilitate agreement on federal budget

Today, the German government approved the draft federal budget for the current year. It is to be passed by the Bundestag in September. This puts the new coalition one step ahead of its predecessor, which collapsed over a dispute about this year's budget.

A look at the figures published today shows that the new government has made its work much easier by amending the constitution in the spring before taking office. The Federal Minister of Finance is planning new federal debt of €143 billion, which is about twice as much as the previous government had envisaged in its draft. Further new debt is planned for the following four years (Chart 1).

Chart 1 - Federal government plans much new debt

New federal debt according to the draft federal budget for 2025 and financial planning until 2029, in billion euros



Source: Federal government, Commerzbank Research

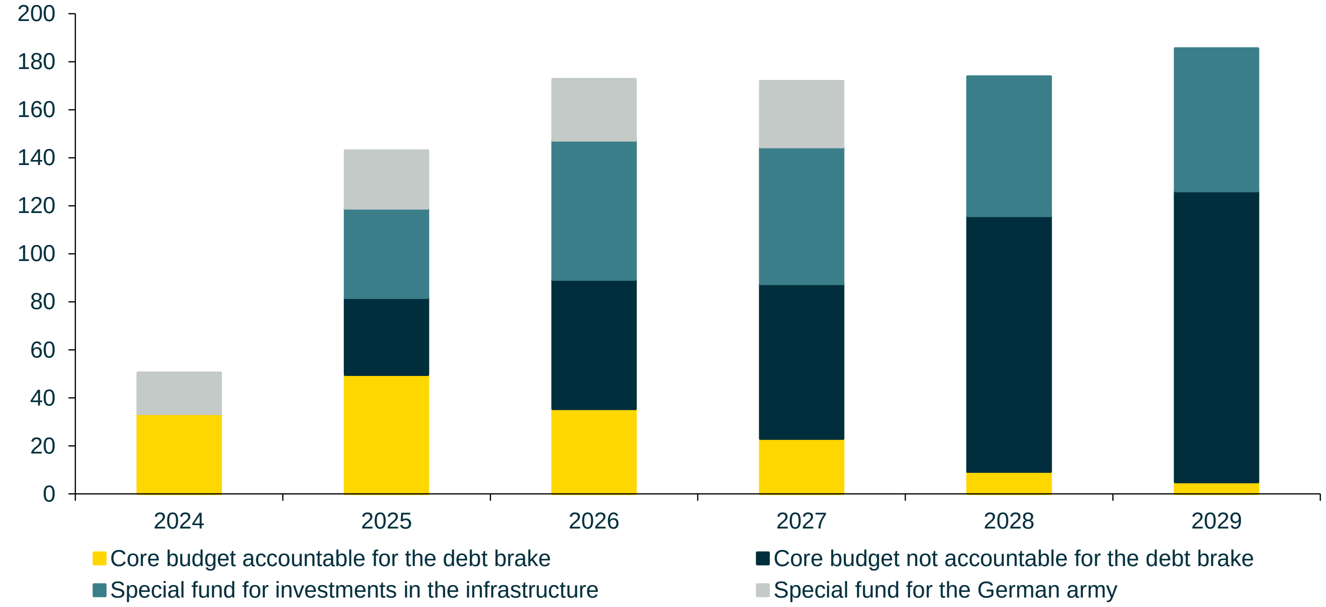
Defense spending is driving new debt, …

Only part of the new debt is being incurred within the official federal budget (hereinafter referred to as the “core budget”). Just under €82 billion in new debt is to be taken on this year, and this amount is set to rise to more than €126 billion by 2029 (Chart 2). Following the amendments to the constitution, this is compatible with the debt brake, as most of the new debt is to be used for higher defense spending, which is to amount to 3.5% of gross domestic product by 2029, thereby meeting the new NATO target. Following the amendment to the constitution, only 1% of GDP – around €43 billion this year – will have to be counted toward the debt brake.

Without spending in excess of this amount, the core budget deficit is expected to fall from just under €50 billion this year to around €5 billion in 2029, in line with the provisions of the (significantly relaxed) debt brake.

Chart 2 - Additional defense spending is driving new borrowing

New federal debt according to the draft budget for 2025 and the financial planning for 20256 to 2029, in billion euros



Source: Table media, Federal government, Commerzbank Research

... but the first funds from the special infrastructure fund are also starting to flow

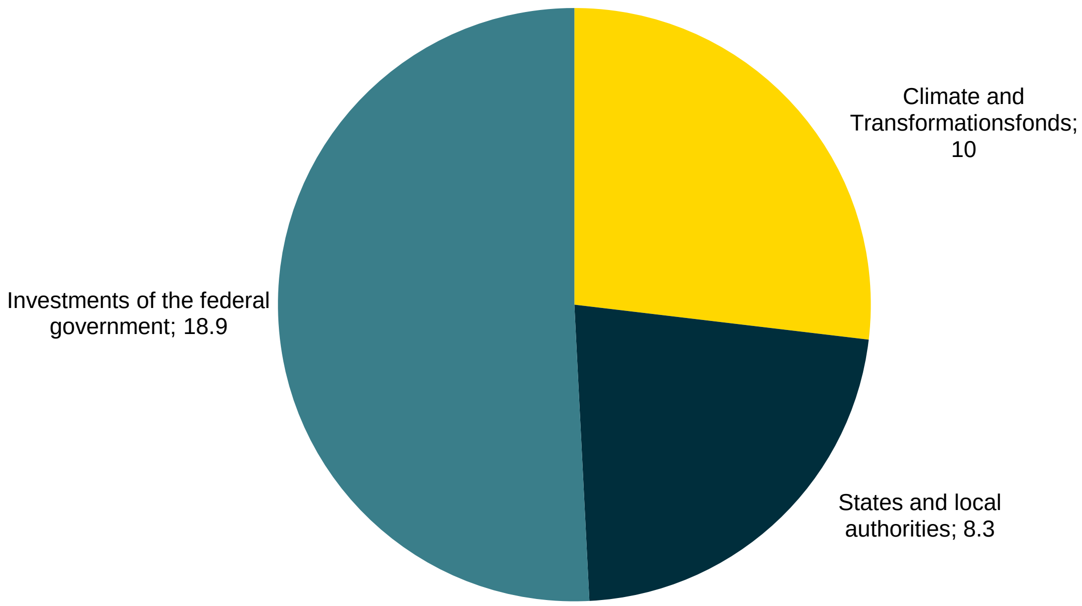
In addition to the new debt taken on via the core budget, a further €60 billion is to be raised via the two special funds. Of this, a good €24 billion will go to the special fund for the German armed forces, the Bundeswehr, (total volume €100 billion) set up a good three years ago, and a good €37 billion to the special fund for infrastructure investment (total volume €500 billion) created in the spring.

The latter is particularly surprising given that the "Act on the Establishment of a Special Fund," which is supposed to regulate the use of these funds, is not due to be passed until the fall, leaving very little time for the funds to be used. However, €10 billion of this €37 billion will go to the Climate and Transformation Fund (Chart 3) to close financing gaps, meaning that no new projects will be financed here. The same appears to apply to the lion's share of the approximately €19 billion earmarked for direct investments (or investment grants) by the federal government. This is because the draft budget has reduced the investment ratio in the core budget – i.e., the share of investment in total federal spending – to exactly the 10% required by the constitution, meaning that numerous projects previously financed from the core budget will now be paid for from the special fund. For example, in the future, the lease fees for liquefied gas terminals, which amount to around €1 billion, will no longer be paid from the budget of the Ministry of Economic

Affairs, but from the special fund. The same applies to the maintenance of motorways, which is estimated at €2.5 billion. This means that hardly any new projects are likely to be launched on a significant scale this year.

Chart 3 - Means of the special fund flow in different directions

Use of special fund resources for infrastructure investments in 2025, in billion euros



Source: Federal government, Commerzbank Research

Shifting of spending make it easier to close budget gaps

Shifting projects to the special fund helps to close the gaps in the previous government's draft budget. In addition, the fact that only part of defense spending now has to be counted toward the debt brake provides further relief. According to our estimates, this will ease the budget burden by around €23 billion compared with the previous government's draft budget. [1] Together, this creates new leeway of around €40 billion, which the federal government appears to have used primarily to close the aforementioned budget gaps and to support social security systems, which had recently been running deficits. [2]

Strong fiscal stimulus ahead!

Despite all the shifts between the core budget and the special fund, the fact remains that the federal government will take on extensive new debt in the coming years to finance additional spending. How this money is spent will determine whether these expenditures will actually strengthen Germany's competitiveness. The numerous transfers from the core budget to the special fund that have already been made this year and are likely to continue in the coming years suggest that the positive effect is likely to be smaller than the bare figures suggest.

However, what is crucial for short-term economic development is that the government spends more or is less forced to make fewer savings. By next year at the latest, fiscal policy should therefore give the economy a noticeable boost and help the German economy grow by 1.4% in 2026, the first significant increase in a long time.

[1] Defense spending of €32.1 billion will no longer be taken into account in the debt brake in 2025. However, defense spending will increase by a good €9 billion compared with the previous government's first draft, resulting in a reduction in the core budget of around €23 billion. (back to text)

[2] This will also make it easier for the federal government to compensate the states and municipalities for the tax losses threatened by the planned improved depreciation options, as agreed today. (back to text)

Analysts

Dr. Ralph Solveen AC
Senior Economist
+49 69 9353 45622
ralph.solveen@commerzbank.com

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60327 Frankfurt	London, EC2P 2XY	NY 10281-1050	Singapore 189773
Tel: + 49 69 136 21200	Tel: + 44 207 623 8000	Tel: + 1 212 703 4000	Tel: +65 631 10000