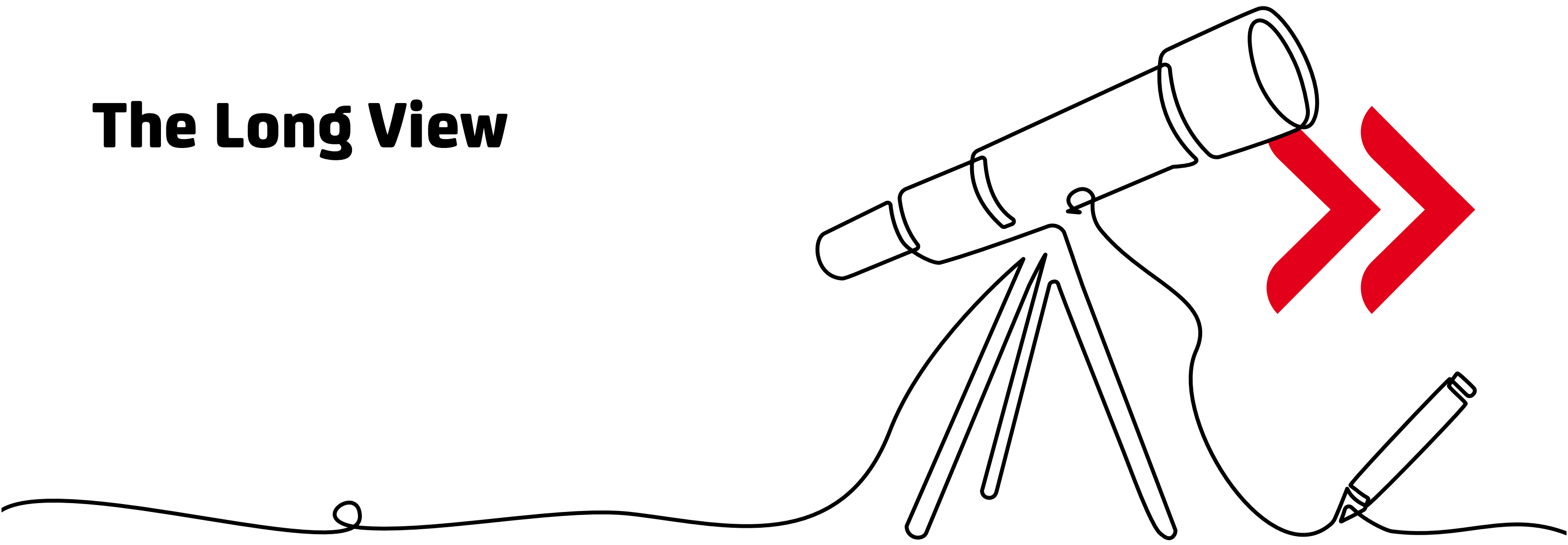
The Long View



The Long View is our publication offering insights on key global issues that will shape tomorrow's world.

Where's the boost?
A guide to Germany's fiscal bazooka

10 December 2025

The fiscal bazooka is finally loaded.
Will it hit its target and deliver higher trend growth for Germany?

1. After the historic pivot from fiscal austerity to authorising enormous funds in early 2025, the big task now is execution. Germany must prove that it can spend big and spend smart.
2. The bazooka is likely to deliver modernisation and renewed confidence in Europe's largest economy. We expect potential growth to rise to 1-1¼%, from about ½% currently.
3. Infrastructure funds are targeted at crucial needs, such as reducing transport bottlenecks and supporting digitisation. Higher defence spending could trigger technological spillover effects in civil sectors.
4. However, economic success will not come overnight. We expect the bazooka's impact to gradually unfold from 2026, gathering speed in subsequent years.

When will the fiscal bazooka start firing?

In a historic U-turn from austerity in early 2025, the German government enacted sweeping measures to loosen the constitutional debt brake und to pump enormous funds into defence and infrastructure. In light of a rapidly changing geopolitical order and years of underfunding, a broad consensus across the political spectrum on the urgent need for these investments has been built. However, the debate on the execution and safeguards continues. Investors have been eagerly waiting for Germany's "fiscal bazooka" to start firing and bolster the economy. Critics worry about efficiency and transparency, while supporters argue that this historic chance must not be missed.

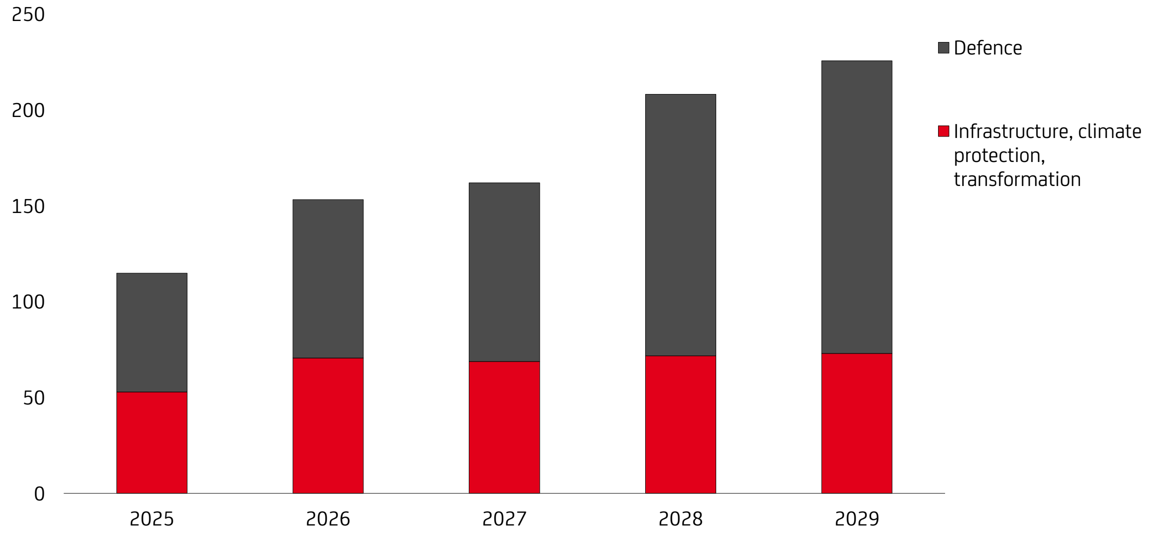
In this *Long View*, we assess where things stand with Germany's fiscal bazooka, the challenges associated with its implementation and the outlook for success – vital not only for Europe's largest economy but also for the future of European security. We start with a brief overview of the fiscal bazooka and its firepower.

The fiscal bazooka in a nutshell

Germany's fiscal package rests on three key pillars:

- **Defence spending exemption:** The constitutional debt brake has been relaxed to exclude defence and security expenditure above 1% of GDP. Notably, the definition extends beyond the core defence budget to include civil protection, intelligence, cybersecurity and aid to allies under attack. As Chancellor Friedrich Merz put it, the goal is to build the "strongest conventional army in Europe". Hence, Germany's defence budget is set to more than double to over EUR 150bn by 2029 (see Chart 1) to reach the NATO goal of 3.5% of GDP.
- **EUR 500bn fund:** Alongside defence, the government has created a massive special fund for public investment in infrastructure, climate transition and technology. This fund, on top of regular budgets, allows up to EUR 500bn of extra borrowing over 12 years. Of this, EUR 300bn is earmarked for federal infrastructure projects, including the modernisation of roads, rail networks and energy systems; EUR 100bn will feed into the Climate and Transformation Fund to largely drive the carbon-neutrality goal; and the remaining EUR 100bn will go to federal states and municipalities.
- **Looser debt constraints for federal states.** The reform gives all 16 federal states collectively the same borrowing allowance as the federal government under the debt brake, i.e. a structural deficit of 0.35% of GDP. Previously, federal states were required to run balanced budgets, aside from cyclical adjustments. Now they can together incur roughly EUR 15bn of net new debt per year for their own investments, expanding the subnational fiscal space.

CHART 1: THE FEDERAL GOVERNMENT'S SPENDING PLAN
IN EUR BN; 2026 DEFENCE FIGURE EXCLUDES EUR 26BN FROM THE 2022 SHADOW BUDGET



Source: German finance ministry, The Investment Institute by UniCredit

The fiscal bazooka is a multi-year commitment, as the additional money will be made available over the next 12 years. However, the precise appropriation amounts and disbursement schedules, among other details, need to be approved by the Bundestag each year with a simple majority. Technically, the funds are governed through an economic plan, which is annexed to the annual Federal Budget Act.

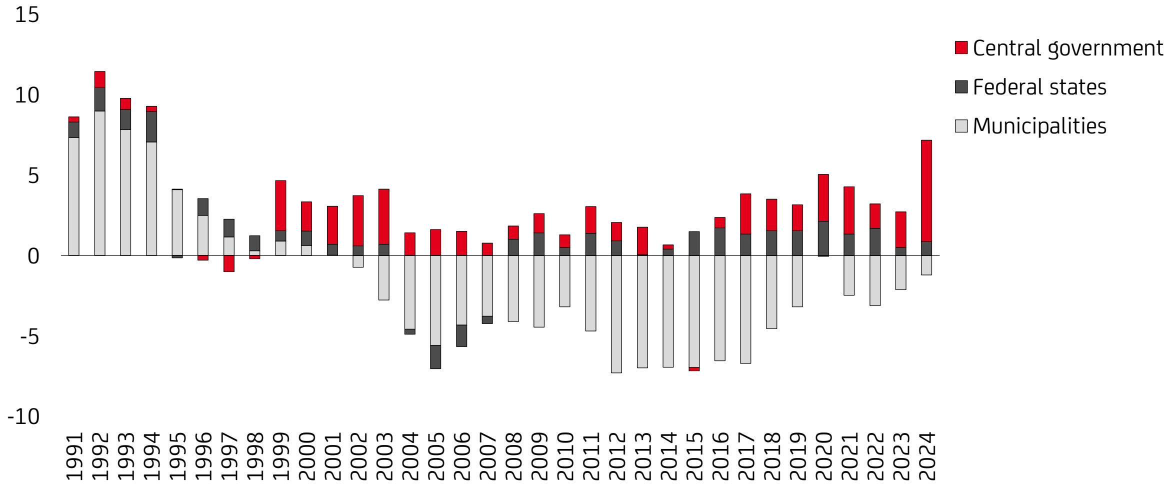
Who does what? Germany's federal structure and spending roles

One complexity in rolling out the fiscal bazooka is Germany's decentralised governance. Germany is a federal country with spending responsibilities shared among the central government, 16 federal states, and about 11,000 municipalities. While defence spending is purely a centralised task of the government in Berlin, public investment is a joint effort – all levels of administration play a role in infrastructure. In fact, the bulk of everyday public infrastructure is managed at the subnational level. Over half of Germany's public fixed assets, such as buildings, roads and utilities belong to municipalities, roughly a quarter to the federal government and the rest to the federal states. This means that while Berlin raises the funds, it often relies on local authorities to plan and execute projects on the ground.

The EUR 100bn allocated to the federal states and municipalities is therefore a linchpin of the bazooka's design. These funds will be channelled from the central government to the federal states, which will, in turn, pass a large share to its municipalities. The distribution of the money among the 16 states follows the familiar "Königsteiner Schlüssel", a formula roughly based on tax revenue and population shares. For example, Hesse, with a population of about 6mn, is slated to receive about EUR 7½bn over the 12-year period, while more populous states such North-Rhine Westphalia will get over EUR 20bn. Each federal state government is currently working out how much to forward to its municipalities. There was debate in Berlin about mandating that at least 60% of the funds reach the local level. Although that specific quota was dropped from the final law, political pressure remains: many state leaders have publicly committed to giving the lion's share to their cities and counties. The goal is clear: the money should trickle down to local communities, where infrastructure renewal has been lagging for years.

CHART 2: UNDER-INVESTMENT BY MUNICIPALITIES

NET FIXED CAPITAL FORMATION (CONSTRUCTION) BY PUBLIC SECTOR ENTITY, IN EUR BN



Source: Destatis, The Investment Institute by UniCredit

Germany's investment backlog is indeed most acute in municipalities (see Chart 2). In the last 20 years, many local governments have struggled with tight finances, leading to chronic under-investment. In fact, net investment by municipalities has been negative every year since 2002. In other words, they invested less in new assets than the depreciation of their existing assets. Over the last 20 years or so, this under-investment has amounted to a cumulative EUR 90bn, which would be more than the EUR 60-70bn that municipalities are likely to get over the next 12 years. In other words, a quality gap in local infrastructure is likely to remain despite the fiscal bazooka, unless the central government or federal states allocate even higher funds to municipalities.

Implementation challenges: will the money reach its target?

With the fiscal firepower enshrined in legislation, the big question now is execution. Investors and economists are watching closely to see whether Germany can overcome implementation barriers. Below, we discuss the main challenges and the outlook for infrastructure and defence.

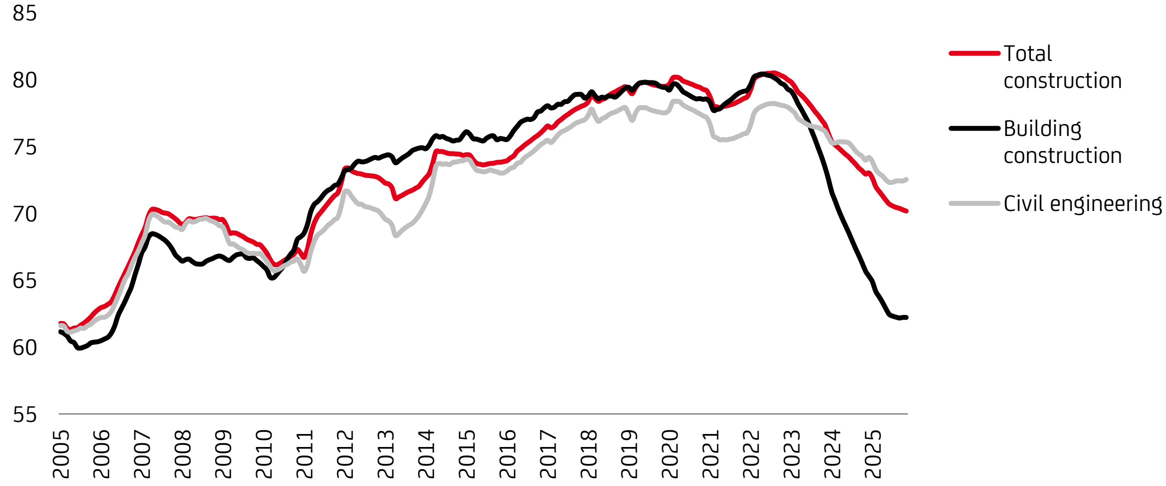
1. INFRASTRUCTURE: BUREAUCRACY AND INDUSTRY CAPACITY

Germany's infrastructure push faces a dual challenge: on the one hand, there is huge need for investment, but on the other, it has limited capacity to execute projects quickly. Years of tight budgeting and complex regulations have left planning agencies and the construction industry ill-prepared to suddenly ramp up activity.

- **Administrative bottlenecks:** Historically, major projects in Germany have tended to take a long time, often more than ten years from planning to completion for highways and up to 20 years for new rail lines, largely due to lengthy planning and approval procedures. The government has acknowledged that the "big lever" for faster infrastructure rollout is streamlining these processes, and it is planning to implement what it calls an "infrastructure turbo" to cut red tape and reduce legal delays. The government is also pushing the digitisation of approval processes to speed things up and is exploring ways to consolidate responsibilities so that fewer agencies need to sign off on projects. While these reforms could significantly shorten project lead times, they will take time to be implemented and bear fruit.
- **Construction industry capacity:** Another concern is whether the construction sector can handle a sudden surge in public projects. On a positive note, the latest downturn in housing has freed up resources and may provide some relief. In the last 12 months, capacity utilisation in building construction has been about 60%, on average, compared to 80% a few years ago, before the recent surge in construction costs and interest rates (see Chart 3). Hence, some contractors have room to take on public infrastructure jobs and could ramp up activity without immediate bottlenecks. However, this may change swiftly, as there are signs that the residential property market is bottoming out and starting to recover. Furthermore, capacity utilisation in other sub-sectors, such as civil engineering, has declined less markedly in the last two or three years. Lifting productivity in construction, which has stagnated in the last 10-15 years, could free up additional resources for public works. Experts suggest this can be achieved through the greater use of digital tools in planning and modular approaches such as prefabrication and standardisation for building schools or bridges. Countries such as the Netherlands have managed to improve productivity markedly by embracing these methods.
- **Some pipeline projects:** Encouragingly, there are some "shovel-ready" projects that can now be accelerated. For example, plans are in place to fast-track critical highway expansion projects and railway corridor refurbishments. The government's new "Deutschlandnetz" initiative is rolling out thousands of electric vehicle fast-charging stations across the country.

CHART 3: CAPACITY CONSTRAINTS?

CAPACITY UTILISATION, IN % (12-MONTH MOVING AVERAGE)



Source: Ifo, The Investment Institute by UniCredit

2. DEFENCE: RAMPING UP WITHOUT FALLING BEHIND

On the defence side of the bazooka, the challenge is equally formidable. Germany is attempting to rapidly strengthen its armed forces after decades of underfunding and to do so in a way that also benefits its economy. However, additional capacity in the defence sector cannot be built overnight.

- **Defence industrial base constraints:** Germany's defence industrial base is relatively small, as decades of low military spending mean that production lines are limited. The security and defence industry generated nearly EUR 50bn in revenue in 2024, or roughly 1% of GDP. The industry structure is fragmented. While Germany has a few big players, much of the output comes from a long tail of more than 1300 medium-sized suppliers. This "Mittelstand" strength means that Germany's capabilities are often hidden inside other countries' end products.

  However, it also means that scaling production is complex, as it requires hundreds of specialized suppliers to expand in concert. The government's challenge is to provide long-term certainty to give these firms the confidence to invest in new factories, training for workers and R&D. Encouragingly, the new policy does exactly that by essentially guaranteeing a significantly higher level of defence spending for the foreseeable future. Tellingly, nearly 45% of German defence companies stated in a recent survey that their expected business focus in the next 10 years would be Germany (see Chart 4). In 2014, less than 10% said so, with 60% stating that business coming from the rest of the world would likely dominate. Of course, there will be tensions between the speed of delivery and endeavouring to produce content domestically. Buying established military systems from the US or other countries can fill capability gaps quicker but means money flowing out of the country. Navigating this will be essential as policymakers aim to balance plugging urgent gaps in military capability, even through imports, with building up domestic production for the medium term. Pooling industrial resources with European allies, investing in European projects and pursuing common procurement schemes will also be crucial.

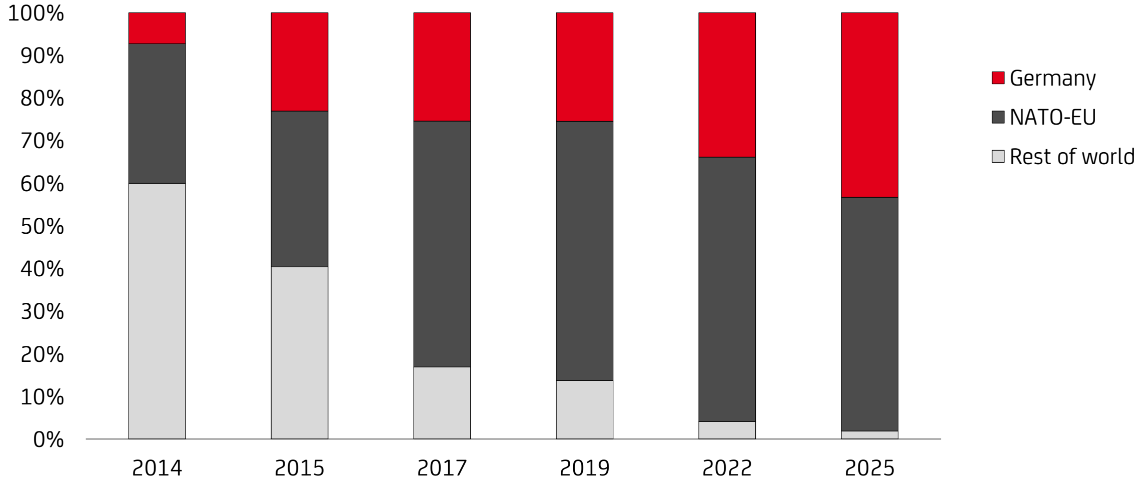
- **Pivoting industry and workers from autos to arms:** One positive for meeting defence goals without solely relying on imports is the recent push to leverage parts of Germany's struggling automotive industry as a source of capacity for defence production. Some companies have already started to re-purpose idle facilities and retrain workers. However, some bottlenecks remain, such as the need for security clearance for workers shifting into defence jobs and different skills requirements. Hence, training programs are crucial, possibly supported by government measures, as has recently been considered. In summary, while Germany has dormant manufacturing capacity and talent that can be repurposed, this "Zeitenwende" (turning point) in industry is just beginning.

- **Procurement and bureaucratic reform:** Germany's defence procurement process has a reputation for slowness and red tape. The government has acknowledged this and has started cutting through the bureaucracy. Already in 2022, as part of the initial EUR 100bn defence fund, the Bundestag passed a Procurement Acceleration Act that streamlined contracting rules. The law allows larger combined tenders to be submitted, instead of having to split orders into many small lots for SMEs, and limits legal challenges that can stall deals. It has also made it easier to invoke an EU national-security exception to speed up the process by bypassing some normal procurement rules. Further legislation ("Rüstungsturbo") is being drafted to extend and broaden the streamlining procedures through 2026 and beyond.

To sum up, the outlook for the defence component of the bazooka is a mix of urgency and patience. In the next few years, we will see further spikes in defence procurement orders. Some of the smaller-volume orders will probably translate into deliveries quickly, providing economic stimulus. However, big-ticket items such as fighter jets and warships will take longer and still require the involvement of foreign suppliers, which means that the domestic GDP impact will be muted initially. However, as domestic industry expands capacity, supported by the auto-to-defence reallocation and government-contract certainty, we should see a larger domestic impact in the medium to longer term.

CHART 4: GERMAN DEFENCE INDUSTRY'S SHIFTING FOCUS

SURVEY: WHAT WILL THE BUSINESS FOCUS BE IN THE NEXT TEN YEARS? SHARE OF RESPONDENTS



Source: *Defense Industry Compass 2025,* The Investment Institute by UniCredit

Economic impact: enough bang for the buck?

What can be expected in terms of GDP growth? Will this become a crowding-in effect that lifts Germany out of stagnation or could it overheat parts of the economy such as construction? While the jury is still out, several points are coming into focus.

- **Growth impact and multipliers:** If implemented as intended, the fiscal bazooka is likely to provide a significant lift to GDP over the coming decade. The combination of public investment in infrastructure, technology and defence raises both demand in the short run and productivity in the long run (see below). However, uncertainty about the precise effects is high. For instance, infrastructure investment might attract complementary private investment and reinforce the positive effects (crowding-in), or it might not. Much will also depend on the reaction of interest rates. So far, markets have digested the fiscal shift, as German bond yields ticked up only slightly in response to the higher issuance plans.

- **Productivity gains and higher potential growth:** The additional funds for infrastructure are explicitly targeted at longer-term needs of the German economy, such as reducing transport bottlenecks, furthering the clean-energy transition and supporting digitisation.

For instance, by reducing travel times and logistics costs, better transportation networks improve the flow of goods and labour across the country. Another pillar of Germany's investment plan is digital infrastructure, which covers expanding high-speed broadband, rolling out 5G/6G wireless networks, modernising government IT systems and supporting digital transformation in health care and education. Importantly, while public administration may not be as headline-grabbing as purchasing fighter jets, it is the operating system of the economy. Encouragingly, a significant portion of digital investment is likely to target the public sector directly, an area with substantial room for efficiency gains. German bureaucracy is famously paper-based and fragmented. Moving to e-government with interoperable IT systems could greatly improve productivity in public administration and would benefit the private sector. For instance, a faster process to register a business means less idle time, faster deployment of private capital and ultimately a higher longer-term cruising speed for the German economy.

- **Technology as a win-win for military and civilian purposes:** An interesting aspect of higher defence spending is the potential for dual-use innovation and technological spillover effects to other sectors of the economy. Historically, military R&D has led to innovations that have later been used commercially, GPS being a prime example. One initiative could be to unify some military and civilian infrastructure to save costs and spur innovation, such as satellite systems for Earth observation. There has also been talk of creating incubators for defence startups to bridge the gap between the military and the tech startup sector. All this would improve the long-term payoff of the fiscal bazooka.

- **Risks of crowding-out:** There are also cautionary voices amid the positivity. Some economists warn that if the government tries to do too much too fast, it could crowd out private activity or result in wasteful spending. For instance, if construction firms are at full capacity, more public contracts could simply force private projects to be cancelled or drive up construction costs.

- **Risks of misallocation:** There is also the risk of misallocation, as money could be poured into projects that have low returns or are not aligned with future needs. For example, repaving roads or refurbishing old facilities, while beneficial, might not yield as much future growth as investing in cutting-edge digital infrastructure or research facilities. Sceptics argue that the fiscal bazooka is not as investment driven as announcements indicated, citing evidence that spending involves the reclassification of existing projects and an expansion of public consumption rather than net public investment. For instance, some think tanks find that public investment originally planned in the regular federal budget is being shifted into special funds. Such shuffling of projects could mean that a share of the fiscal bazooka may replace previously planned investment rather than adding to it. Furthermore, critics fear that the regular federal budget will focus even more on social spending at the expense of public investment over time. Supporters of the bazooka acknowledge these concerns but present a more optimistic view. In particular, they emphasise that public investment is indeed being ramped up and that mechanisms are being implemented to guide the money toward productive uses. Even if some substitution occurs, the sheer size of the funds still means that public investment will rise strongly. Furthermore, contrary to claims of a blank check, the special funds are governed by rules to promote investment quality and accountability. The legal act establishing the fund limits the fund's use to investments contributing to infrastructure and climate neutrality. Importantly, the law attempts to enforce additionality at the federal level by requiring that regular federal budget investments represent at least 10% of spending each year. Only if this floor is met can special-fund projects be deemed "additional".

- **Inflation:** Finally, a typical concern with any large fiscal expansion is inflation. The timing of the bazooka is interesting, since it comes just as inflation has been tamed after the 2022-23 energy shock. Some observers warned that the huge stimulus could add further fuel to inflation and force up interest rates. However, the nature of public spending in the form of investment as opposed to consumption is key. Public investment, such as infrastructure, is typically spread over many years and is focused on improving the supply side. Hence, it is generally less inflationary than one-off stimulus measures through quickly boosting government or private consumption. In fact, by raising productivity and reducing costs in areas like green and digital infrastructure, higher public investment is disinflationary in the medium to longer term. Of course, as mentioned above, there might be some upward pressure on construction and materials prices, especially in the short run.

Conclusion: guiding the bazooka to its target

Germany's fiscal bazooka is a bold bet on the future. It is a bet that huge public investment can rejuvenate the economy and reinforce European security. As of late 2025, the foundations are laid: the legal changes are in effect, funding vehicles are largely established and implementation is gearing up. The outlook is promising, but it hinges on follow-through. In the coming years, we will find out whether Germany can overcome the planning paralysis and economic stagnation. Early signs suggest that the urgency of the "Zeitenwende" has indeed shaken things up, with substantial efforts to cut red tape, speed up procurement and engender smooth cooperation between federal and local governments. We expect the bazooka's positive impact to gradually unfold from 2026 onward, gathering speed in subsequent years as more infrastructure and defence projects break ground and bear fruit. In the longer-term, rising productivity might lift potential growth of the German economy to 1-1¼%, from about ½% currently.

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