Germany thinks big again

The possible next German government just announced plans for big fiscal stimulus

Friedrich Merz of the CDU and Olaf Scholz of the SPD, the likely coalition partners in the next German government

In a spontaneously announced press conference, the political leaders of CDU/CSU and SPD presented a significant shift in German politics and policies. The four leaders, Friedrich Merz, Markus Söder, Lars Klingbeil, and Saskia Esken, agreed on a special fund for infrastructure investments of €500 billion over the next ten years. Additionally, the likely next Chancellor, Friedrich Merz, announced an agreement to change the constitutional fiscal debt brake to allow for higher defense spending. Specifically, defense spending of more than 1% would be exempted from the debt brake. The balanced budget requirement for regional states in the debt brake will also be loosened.

For both initiatives – the infrastructure fund and the change to the debt brake – both parties aim to use the 'old' majorities in parliament to secure an agreement next week. In the 'old' parliament, which will still be active for another two weeks, CDU/CSU and SPD, together with the Greens, would have a two-thirds majority. In the newly elected parliament, they wouldn't. If there is a two-thirds majority in favour of these changes, the Federal Council would also need to approve them with a two-thirds majority.

Thinking big but with some hurdles on the way

To be clear, tonight's announcement is the result of informal coalition talks. By agreeing on crucial financing aspects, both parties preemptively removed potential stumbling blocks for the official coalition talks. They also learned an important lesson from the last German government: not openly discussing financial issues in a coalition eventually backfires. Therefore, today's announcement is a smart move and demonstrates a strong intention to establish a robust government coalition.

At face value, these two policy announcements would clearly benefit the German economy. A €500 billion infrastructure fund would address urgently needed investments, providing both short-term economic support and increasing long-term growth potential. This aligns with our previous view of additional investments of 1% to 1.5% of GDP over the coming years. However, we wouldn't rule out that the official coalition talks will still bring some expenditure cuts, which would lower the positive impact of the announced fiscal stimulus.

Importantly, the change to the fiscal debt brake to allow for defense spending is politically astute, as it allows the CDU/CSU to present the change as driven by recent developments. This approach would not deceive CDU/CSU voters who hoped for no changes to the debt brake but follows the old political principle: if the facts change, I change my mind. It is also important to note that both parties want to bring these changes to parliament next week, meaning they would not be conditional on successful coalition talks.

However, there are a few potential hurdles to implementing these almost historical changes. Not all CDU/CSU party members favour changes to the debt brake and could oppose or even vote against it. Such opposition would be a public revolution within the party and would strongly undermine Friedrich Merz's leadership. Another political hurdle could be that today's announcements might be perceived as breaking election promises, as the CDU/CSU had a strong commitment to the debt brake in its election programme. Using the 'old' parliament to push these changes through at the last minute might also not sit well with all voters and could encourage some CDU/CSU or SPD members to oppose today's proposals.

Another historical day of so many recently

All in all, Europe is in the midst of historical changes. The developments of the last few days have pushed the likely next German government to make a historical move by announcing a fiscal package that could finally mark the start of better years for the economy.

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