



Market Commentary
March 2025

English Version

Germany: Whatever it Takes

Get guidance on investments, and the major structural factors behind your clients' portfolios.

insigneo



Mauricio Viaud
Senior Investment
Strategist and PM



Melissa Ochoa Cárdenas
Investment Strategist

Germany: Whatever it Takes

- Friedrich Merz, Germany's newly elected Chancellor, faces the task of managing a divided country with a struggling economy, geopolitical risks, and the need to balance a wide budget deficit while boosting defense spending and economic growth.
- In a significant shift from its previous stance, Merz is seeking to reform the debt brake, which would allow for higher public spending while including the creation of two Special Funds for defense and infrastructure.
- In response to the U.S. halting military aid to Ukraine, European countries, led by Germany, are ramping up defense spending, which could significantly benefit the European defense industry.
- The surge in defense budgets across Europe presents significant growth potential for defense companies, and other major players across the continent.

Friedrich Merz, Germany's newly elected Chancellor, faces a difficult road ahead. He must govern the politically divided, economically broken, and increasingly fraught with geopolitical risk, core European nation of Germany. He faces this daunting task while trying to parse together a ruling coalition that needs to thread the seemingly contradictory task of controlling a wide budget deficit, while also increasing military and defense spending and reigniting anemic economic growth. **Perhaps, most importantly, Germany must recover its lost national confidence after decades of being on the backfoot.** How feasible is this? We will attempt to unravel this fiscal quagmire, analyze the chances of success, and gauge the implications for the country's financial assets, particularly for its defense sector.

On February 23, Germans went to the ballots to cast their votes in an early federal election, after the previous German three-party government led by Olaf Scholz collapsed in November over disagreements on the 2025 budget. Even if the polls had heralded Merz's eventual victory, many were still surprised by the successful performance of the Alternative for Germany, better known as AfD for its German acronym, which came in second with 20.8% of the votes, doubling its vote share versus the 2021 tally. This result arises amidst a backdrop of soaring energy prices that have hampered manufacturers, increased migration, and increased green energy regulations. Not surprisingly, Germans harbored a stark level of pessimism about the current state of the economy, something that Merz used to his advantage as the most economically literate candidate. Merz has echoed these German fears, stating that the previous German business model is untenable given that the country's manufacturing base is crippled by regulations and costs that competitors like China do not adhere to.

One of the more sensitive issues the Merz administration will have to address is the *Schuldenbremse* – better known in English as the “debt brake.” As we highlighted in our [latest quarterly call](#), the initial CDU/CSU position towards the debt brake was to retain it and instead reduce social benefits and downsize government employment while supporting tax cuts and social spending. **However, Merz has reversed course lately, opening the door to reforming the brake and shifting Germany's fiscal outlook after President Trump's abrupt and increasingly antagonistic shift towards European tariffs and away from its security guarantee.** In a stunning shift, the CDU/CSU has been holding talks with the SPD to form a governing coalition, with fiscal expansion as its centerpiece. They have proposed the creation of two Special Funds – one for defense for EUR400bn, and another for infrastructure for EUR 400-500bn. **The inclusion of these two Funds, together with a proposal to raise the permissible structural net borrowing under the debt brake, is estimated to increase**

the permissible structural net borrowing by more than 2% of GDP per year for ten years according to Barclays. Furthermore, these announcements present an almost radical change from what the CDU/CSU coalition had stated during the elections that any additional expenditure was to be absorbed by savings in other sectors. Trump may just have been the catalyst that Europe needed to awaken it from its slumber.

— “...opening the door to reforming the brake and shifting Germany's fiscal outlook after President Trump's abrupt and increasingly antagonistic shift towards European tariffs and away from its security guarantee.”

These proposals will be sent to the current Bundestag for constitutional amendments, before the new parliament is sworn in on March 25. This is important because the current parliamentary composition holds the necessary two-thirds majority if the Greens cooperate.

In regard to the brake, and against the backdrop of the European Union presenting a plan to increase its defense spending, the talks between the CDU/CSU and the SPD also rendered a proposal to reform the debt brake to allow for more public spending, which would increase permissible structural net borrowing up to 1.4% of GDP when the debt/GDP ratio is below 60%, and to 0.9% when the debt/GDP ratio is above 60%. It is worth stressing that this reform would also require a two-thirds majority that will be put to the test in the new parliamentary setup.

Furthermore, according to an analysis by the Economist Intelligence Unit, Germany was the country most likely to implement policy changes under a second Trump administration, and that is proving to be true. **Within the first 100 days of the second Trump administration, Germany has begun to implement some of the changes required to adapt to a new reality.** The current backdrop of potentially higher fiscal deficits is starting to be penciled in by German sovereign debt, with the sovereign curve exhibiting a bull steepening mostly propelled by the observed yield increase in the 10-year tenor. Aside from an expected wider deficit, market participants are forecasting higher debt issuance to finance the proposed Funds, and that expected increase in supply will probably continue to drive yields higher.

— “With the responsibility of defense spending now falling on the shoulders of the European countries, it is the time for defense companies to shine.”

The European response to ramp up defense spending comes at a time when the US has halted all military aid to Ukraine and is keen to see Europe increase spending for its own defense. **With the responsibility of defense spending now falling on the shoulders of the European countries, it is the time for defense companies to shine.**

When it comes to defense, Germany has a very im-

portant role to play, not only for itself, but for the entire continent. Out of all the countries in Europe, Germany has the second largest defense industry on the continent, behind only France. Germany’s spending on defense as a percent of GDP increased by close to 50% from 2023 to 2024, rising by more than USD 30 billion to USD 97.7 billion by the end of last year, surpassing NATO’s current spending target of 2% of GDP. **The country appears highly committed to increasing its defense spending, to the point that the government is planning to amend the Constitution to exempt military and security infrastructure spending from its fiscal spending limits and create an EUR 500 billion fund to increase spending on defense infrastructure over the next ten years, in what Merz described as a “fiscal sea-change”.** Germany is effectively leading the charge for increased spending on defense across the entire continent. In response, Europe has proposed EUR 150 billion in loans to jumpstart spending in the region. Additionally, European Commission President Ursula von der Leyen is planning to enact measures that will allow member countries to spend additional funds up to EUR 650 billion on defense over the next four years, without incurring penalties for restriction violations on budgetary spending.

The hundreds of billions of Euros that are being earmarked for defense spending are astounding in their own right. However, coupled with the relatively short time frames being discussed for the implementation of spending levels of this magnitude, this dynamic could create a meaningful and sustainable tailwind for the defense industry in Europe and around the globe. During its 2014 summit in Wales, NATO agreed that each member country should aim to spend 2% of GDP on defense, to bolster the alliance’s footing on a global scale. However, not every member was meeting this goal, with a handful of members exceeding it, while most missed the target. As pressure increases on the European members of the alliance to hold up their end of the deal, there

are talks that NATO could agree to increase its defense spending target to 3% by this summer and possibly above that level by 2027. In fact, countries such as Denmark have already agreed to meeting a new 3% target. Again, such large increases in spending in a short period of time could create powerful tailwinds for defense contractors around the world.

Unlike the United States, China and Russia, where the military-industrial complexes of these countries tend to be mostly domestically focused, Europe tends to operate with a cooperation-based “regional” defense industry mentality. In this model, different countries on the continent cooperate towards a common goal, leveraging each other’s strengths to achieve scale through a value-added driven strategy. These countries are stronger working together than alone. A case in point was the creation of Europe’s premier fighter aircraft in the 1990s, the Euro Fighter Typhoon. Defense companies in the United Kingdom, France, Germany, and Spain came together to create one of the most successful aircraft programs in the history of Europe, where each country specialized in contributing to a certain part of the program. This time, the region is likely to approach a similar strategy, on a much larger scale.

France’s Airbus will likely be the biggest beneficiary from this trend, as it is involved in multiple defense

programs across multiple countries in the region. However, other companies such as France’s Thales and Dassault Aviation, BAE Systems in the UK, Leonardo in Italy, and Saab in Sweden are also likely to benefit, coming together for a common goal. Within Germany, several companies stand to benefit from increased spending in its military-industrial complex, with the largest defense contractor in the country, Rheinmetall standing to be the biggest winner. Rheinmetall is one of the leading manufacturers of tanks and combat vehicles in the world. Additionally, the company also manufactures advanced ammunition, sensors, and electronic equipment used on weapon platforms across the globe. At the same time, a number of diversified companies in the country, such as metals producer Thyssenkrupp and engineering powerhouse Siemens, are also likely to benefit from increased spending across the continent.

The potential impact of increased defense spending in the region could prove to be a blessing in disguise for Europe. Having little choice but to stand on its own two feet, this dynamic might give the region the spending jolt that it needs to revive its economy. Germany’s incoming Chancellor Merz said it best when he recently stated that Germany is prepared to do “whatever it takes” to be able to defend itself. If so, then the rest of Europe will likely be ready to do the same. ■

House Views Matrix

	TACTICAL (UP TO 3 MONTHS)	CYCLICAL (UP TO 12 MONTHS)
Global Asset Allocation		
Equities	NEUTRAL	NEUTRAL
Fixed Income	NEUTRAL	OVERWEIGHT
Cash	OVERWEIGHT	NEUTRAL
Regional Breakdown		
US Equities¹	NEUTRAL	OVERWEIGHT
European Equities	OVERWEIGHT	NEUTRAL
Japanese Equities	OVERWEIGHT	NEUTRAL
Emerging Market Equities	UNDERWEIGHT	UNDERWEIGHT
Chinese Equities	OVERWEIGHT	NEUTRAL
US Treasuries²	NEUTRAL	OVERWEIGHT
Investment Grade Fixed Income	NEUTRAL	NEUTRAL
High Yield Fixed Income	NEUTRAL	NEUTRAL
Emerging Market Sovereign	NEUTRAL	NEUTRAL
US Dollar	NEUTRAL	OVERWEIGHT
Energy³	NEUTRAL	UNDERWEIGHT
Precious Metals	OVERWEIGHT	OVERWEIGHT

¹Relative to global equities in USD

²Relative to aggregate fixed income markets in USD

³Relative to an overall commodity allocation

Important Legal disclaimer

Insigneo Financial Group, LLC comprises a number of operating businesses engaged in the offering of brokerage and advisory products and services in various jurisdictions, principally in Latin America. Brokerage products and services are offered through Insigneo Securities, LLC, headquartered in Miami, member of the Financial Industry Regulatory Authority (FINRA) and Securities Investors Protection Corporation (SIPC) <https://www.sipc.org/>. Investment advisory products and services are offered through Insigneo Advisory Services, LLC, an investment adviser registered with the Securities and Exchange Commission. In Uruguay, advisory services are offered through Insigneo Asesor Internacional S.A., Insigneo Gestor Internacional S.A., Insigneo Asesor Latam S.A., and Insigneo Asesores de Inversion de Uruguay, SRL, in Argentina through Insigneo Argentina, SAU and in Chile through Insigneo Asesorías Financieras, SPA. Collectively, these eight operating businesses make up the Insigneo Financial Group. To learn more about the Broker Dealer including its conflicts of interest and compensation practices, please go to <https://insigneo.com/disclosures/> or www.finra.org. To learn about Insigneo Advisory Services, LLC and any conflicts related to its advisory services, please see its Form ADV and brochure which can be found at Investment Advisor Public Disclosure website <https://adviserinfo.sec.gov/>

FOR AFFILIATES LOCATED IN CHILE

Insigneo Asesorías Financieras SPA se encuentra inscrito en Chile, en el Registro de Prestadores de Servicios Financieros de la Comisión para el Mercado Financiero. Este informe fue efectuado por área de Research & Strategy de Insigneo Securities LLC. o sus proveedores, en base a la información disponible a la fecha de emisión de este. Para evitar cualquier conflicto de interés, Insigneo Securities LLC dispone que ningún integrante del equipo de Research & Strategy tenga su remuneración asociada directa o indirectamente con una recomendación o reporte específico o con el resultado de una cartera.

Aunque los antecedentes sobre los cuales ha sido elaborado este informe fueron obtenidos de fuentes consideradas confiables, no podemos garantizar la completa exactitud e integridad de estos, no asumiendo responsabilidad alguna al respecto Insigneo Securities LLC, Insigneo Asesorías Financieras SPA ni ninguna de sus empresas relacionadas.

Este material está destinado únicamente a facilitar el debate general y no pretende ser fuente de ninguna recomendación específica para una persona concreta. Por favor, consulte con su ejecutivo de cuentas o con su asesor financiero si alguna de las recomendaciones específicas que se hacen en este documento es adecuada para usted. Este documento no constituye una oferta o solicitud de compra o venta de ningún valor en ninguna jurisdicción en la que dicha oferta o solicitud no esté autorizada o a ninguna persona a la que sea ilegal hacer dicha oferta o solicitud. Las inversiones en cuentas de corretaje y de asesoramiento de inversiones están sujetas al riesgo de mercado, incluida la pérdida de capital.

La información base del presente informe puede sufrir cambios, no teniendo Insigneo Securities LLC ni Insigneo Asesorías Financieras SPA la

obligación de actualizar el presente informe ni de comunicar a sus destinatarios sobre la ocurrencia de tales cambios. Cualquier opinión, expresión, estimación y/o recomendación contenida en este informe constituyen el juicio o visión de área de Research & Strategy de Insigneo Securities LLC. o sus proveedores, a la fecha de su publicación y pueden ser modificadas sin previo aviso.

FOR AFFILIATES LOCATED IN URUGUAY

En Uruguay, los valores están siendo ofrecidos en forma privada de acuerdo al artículo 2 de la ley 18.627 y sus modificaciones. Los valores no han sido ni serán registrados ante el Banco Central del Uruguay para oferta pública.

FOR AFFILIATES LOCATED IN ARGENTINA

Insigneo Argentina S.A.U. Agente Asesor Global de Inversión se encuentra registrado bajo el N° 1053 de la Comisión Nacional de Valores (CNV) e inscripto ante la Inspección General de Justicia (IGJ) bajo el N° 12.278 del Libro 90, Tomo -, de Sociedades por Acciones. Este informe fue efectuado por área de Research & Strategy de Insigneo Securities LLC. o sus proveedores, en base a la información disponible a la fecha de su emisión. Para evitar cualquier conflicto de interés, Insigneo Securities LLC dispone que ningún integrante del equipo de Research & Strategy tenga su remuneración asociada directa o indirectamente con una recomendación o reporte específico o con el resultado de una cartera. Aunque los antecedentes sobre los cuales ha sido elaborado este informe fueron obtenidos de fuentes consideradas confiables, no podemos garantizar la completa exactitud e integridad de estos, no asumiendo responsabilidad alguna al respecto Insigneo Securities LLC, Insigneo Argentina S.A.U. ni ninguna de sus empresas relacionadas. La información base del presente informe puede sufrir cambios, no teniendo Insigneo Argentina S.A.U. la obligación de actualizar el presente informe ni de comunicar a sus destinatarios sobre la ocurrencia de tales cambios.

Este material está destinado únicamente a facilitar el debate general y no pretende ser fuente de ninguna recomendación específica para una persona concreta. Por favor, consulte con su ejecutivo de cuentas o con su asesor financiero si alguna de las recomendaciones específicas que se hacen en este documento es adecuada para usted. Este documento no constituye una oferta, recomendación o solicitud de compra o venta de ningún valor negociable en ninguna jurisdicción en la que dicha oferta o solicitud no esté autorizada o a ninguna persona a la que sea ilegal hacer dicha oferta o solicitud. Las inversiones en valores negociables están sujetas al riesgo de mercado, incluida la pérdida parcial o total del capital invertido. Cualquier opinión, expresión, estimación y/o recomendación contenida en este informe constituyen el juicio o visión de área de Research & Strategy de Insigneo Securities LLC. o sus proveedores, a la fecha de su publicación y pueden ser modificadas sin previo aviso.