Is Germany at an inflection point? Post-election implications

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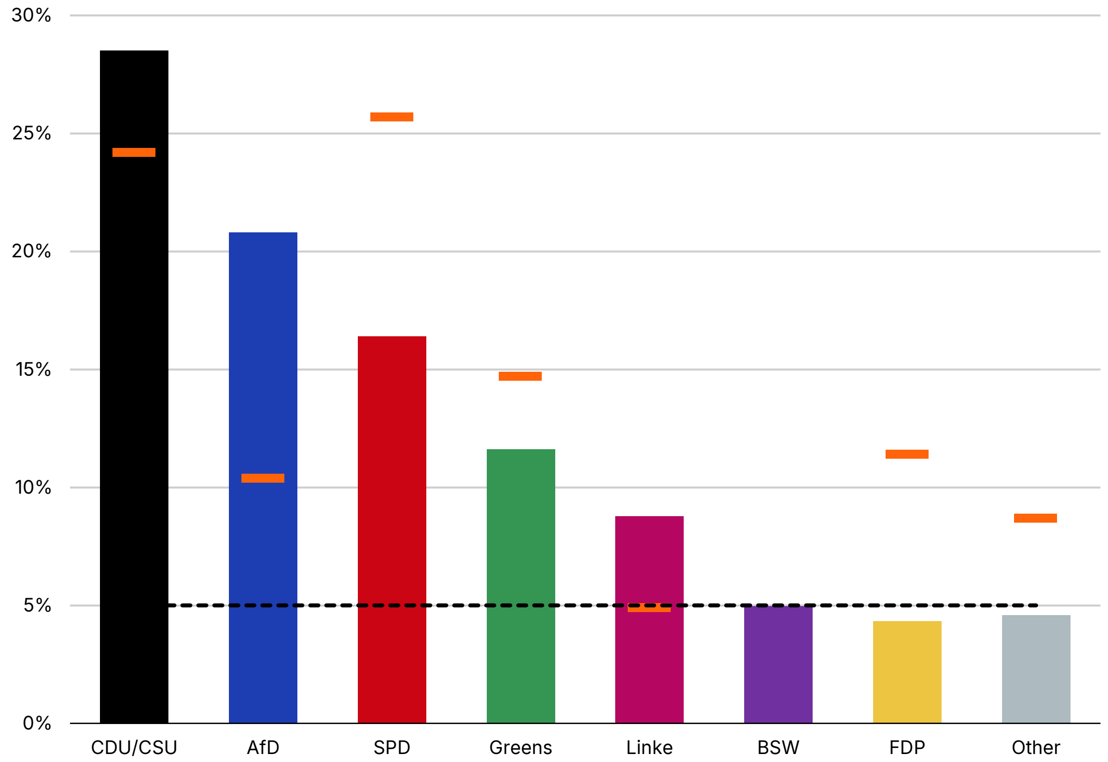
2025 election results

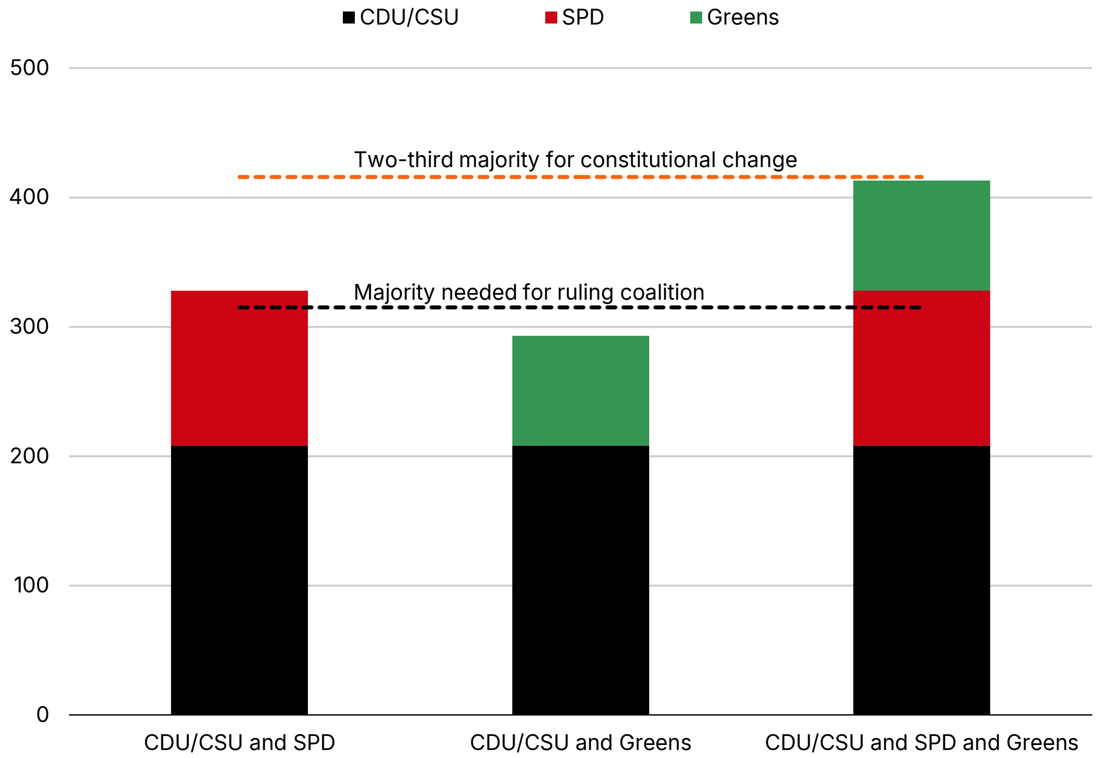
→ Expected coalition will include CDU/CSU and SPD; the centrist parties (CDU/CSU, SPD and Greens) are just short of a 2/3 majority
→ Friedrich Merz may attempt to secure military spending before the first sitting of the new parliament

Election results 2025 vs 2021



Source: Scope Ratings

Most likely coalition options



Source: Scope Ratings

Coalition talks to focus on strengthening the economy, migration and fiscal policy

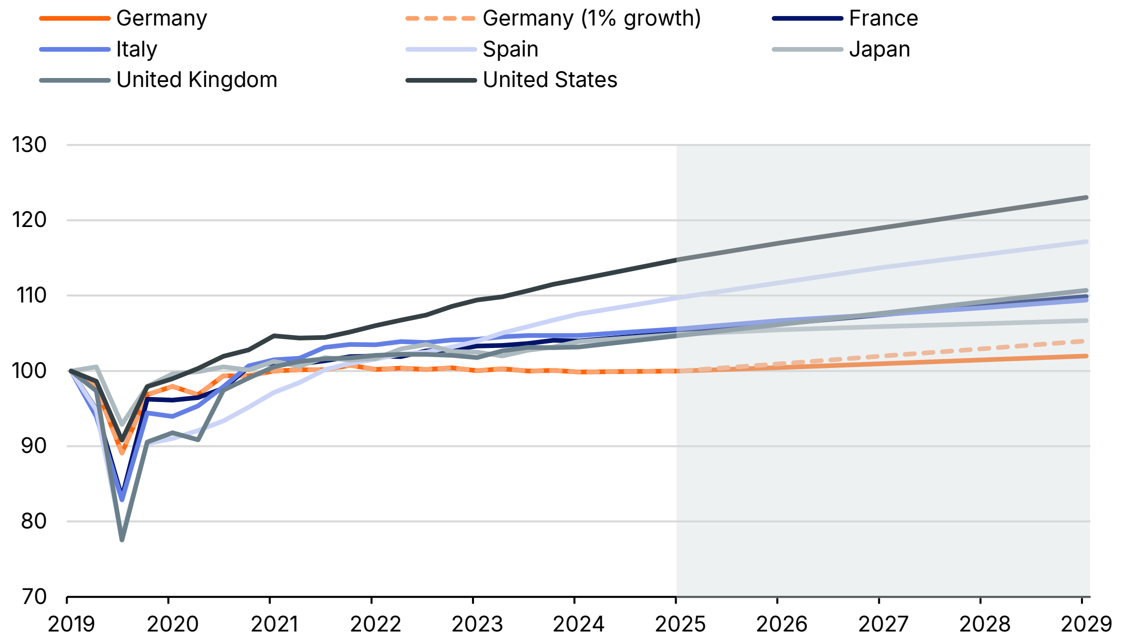
→ Kick-starting economic growth will be crucial for the next government as Germany's economy continues to stagnate
→ Policy agreement on lowering energy prices, restricting migration, raising military spending and limited reform of the debt brake

	Policy proposal	CDU/CSU	SPD	Greens
Economy	Industrial policy: promotion of key industries			
	Lowering energy prices			
	Restart nuclear in energy mix			
	Reducing bureaucracy			
	Incentives to work beyond retirement age			
	More restrictive migration policy			
	Reducing the corporate tax burden			
Fiscal	Reforming the debt brake			
	Off-budget fund for infrastructure investment			
	Off-budget fund for defence			
EU reform and geopolitics	2% NATO spending target as lower bound			
	Long-range missiles for Ukraine			
	Full switch to QMV in EU Council			

Source: Deutsche Bank, Scope Ratings

Germany's economic output is falling behind in the post-Covid recovery

GDP, 2019 = 100



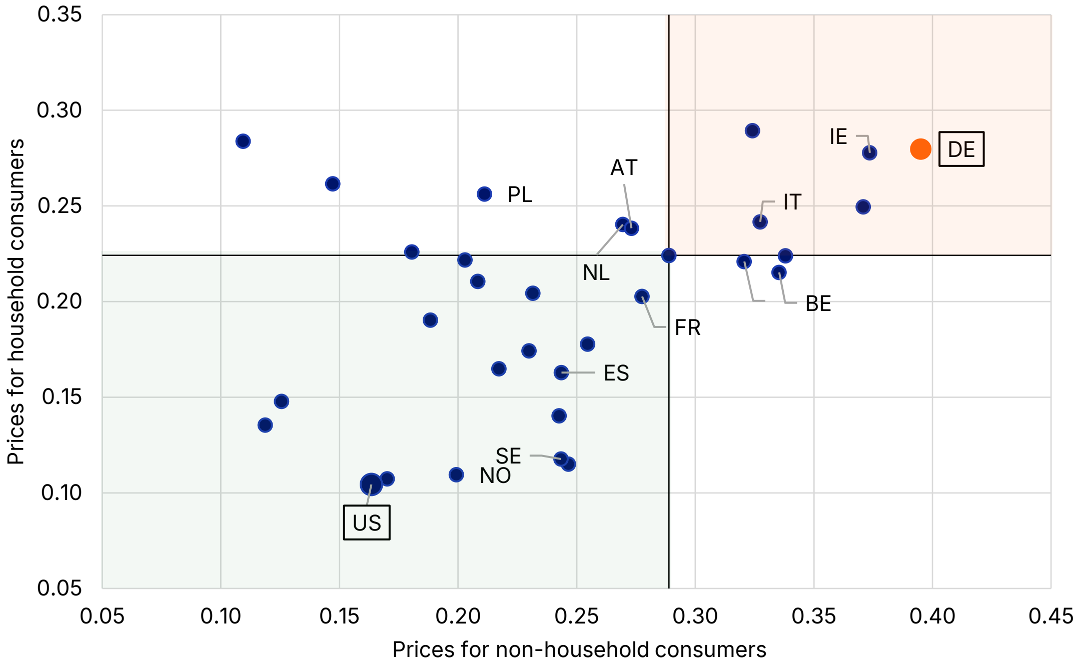
Source: IMF, Scope Ratings

Companies and households face high energy prices and bureaucracy

→ High natural gas and electricity prices are a challenge for German industry which faces a difficult export environment and competition from China
→ All parties agree that bureaucracy must be reduced, but progress is likely to be slow

Electricity prices are high in international comparison

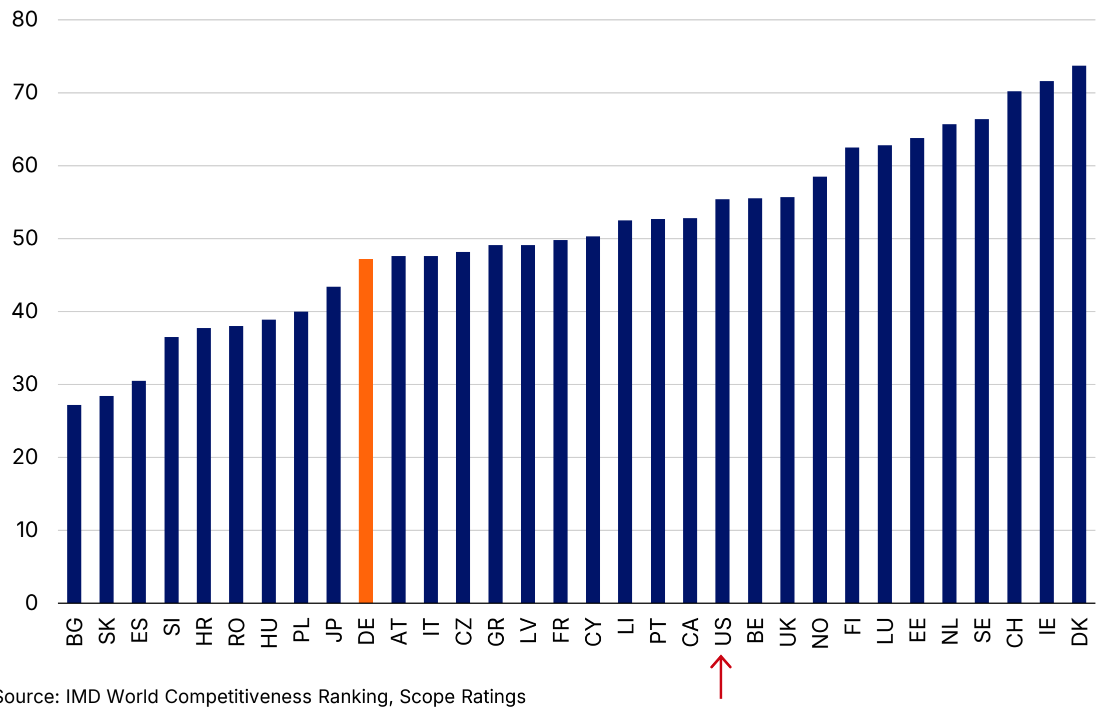
Household and non-household electricity prices, EUR/kWh



Source: Eurostat, US Energy Information Administration, Scope Ratings.
Highlighting 10 largest EU economies and the US. Midpoint refers to EU average.

Bureaucracy reduction: room for improvement in ease of doing business

IMD World Competitive Index, Business Legislation



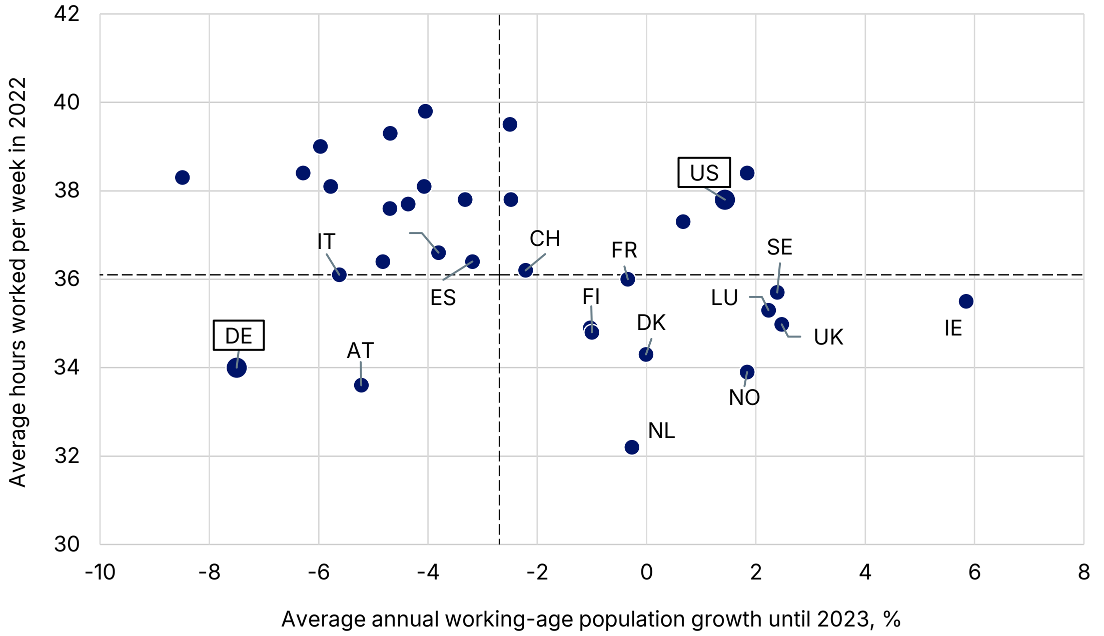
Source: IMD World Competitiveness Ranking, Scope Ratings

Labour market reforms are needed to address rapid demographic shift

→ Germans work relatively few hours – reforms focused on re-skilling and improved childcare could raise participation rates
→ Migrants are indispensable for future economic growth given the rapid demographic shift and their integration in the labour force is essential

Shorter working hours intensify Germany's demographic challenge

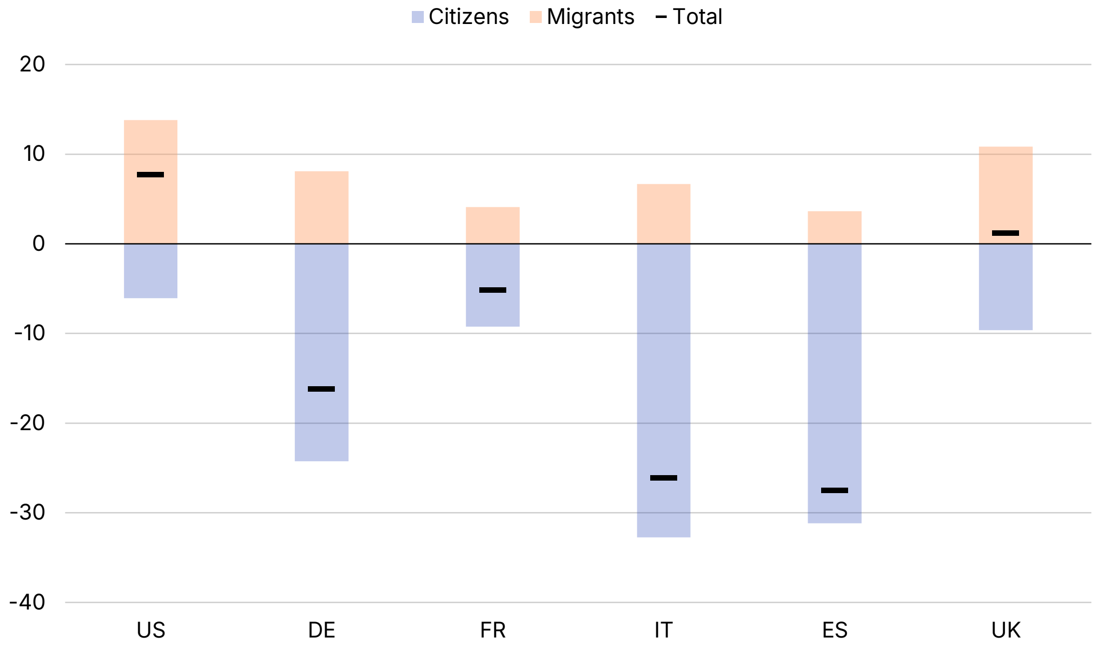
Hours worked per week, working-age population growth %



Note: Dashed lines show EU-27 averages. Highlighted countries include those rated AA and above by Scope Ratings, France, Italy, Spain and Japan. // Source: UN, ILO, Scope Ratings

Working-age population set to decline

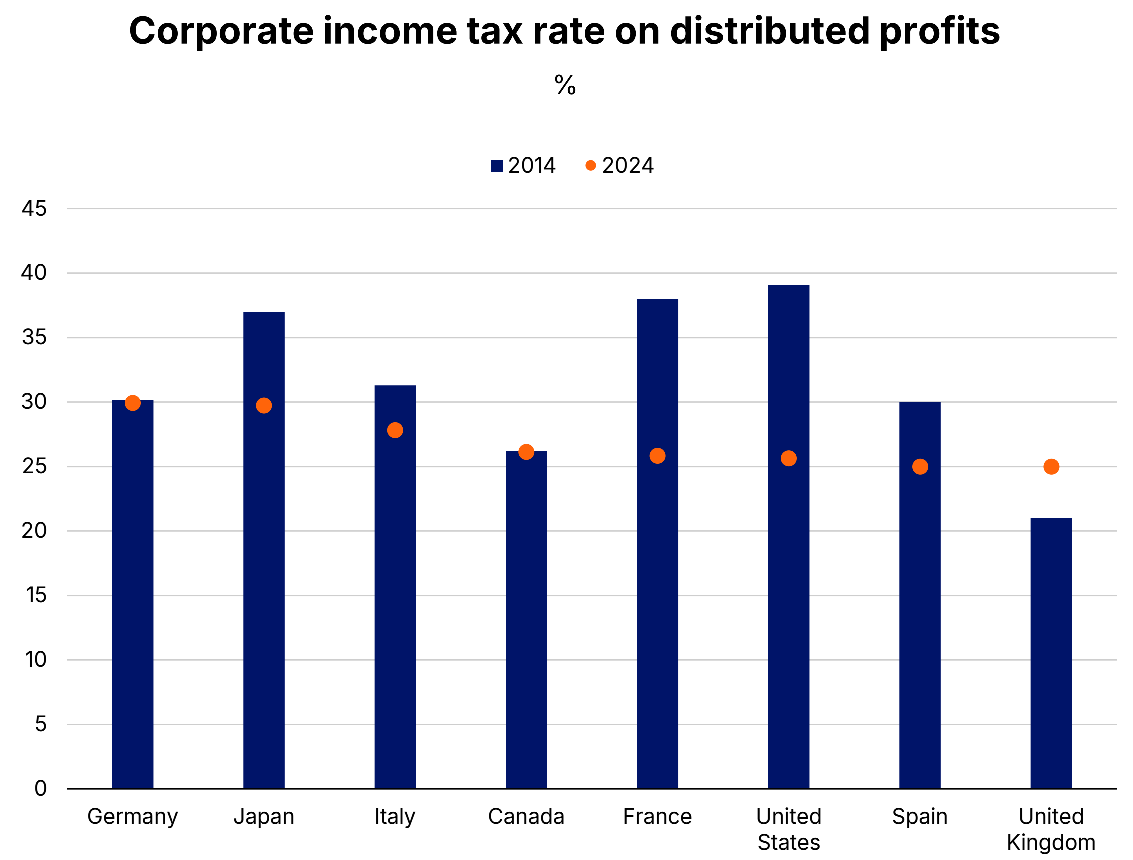
Change in working-age population, 2024-50, % of 2024 working-age population



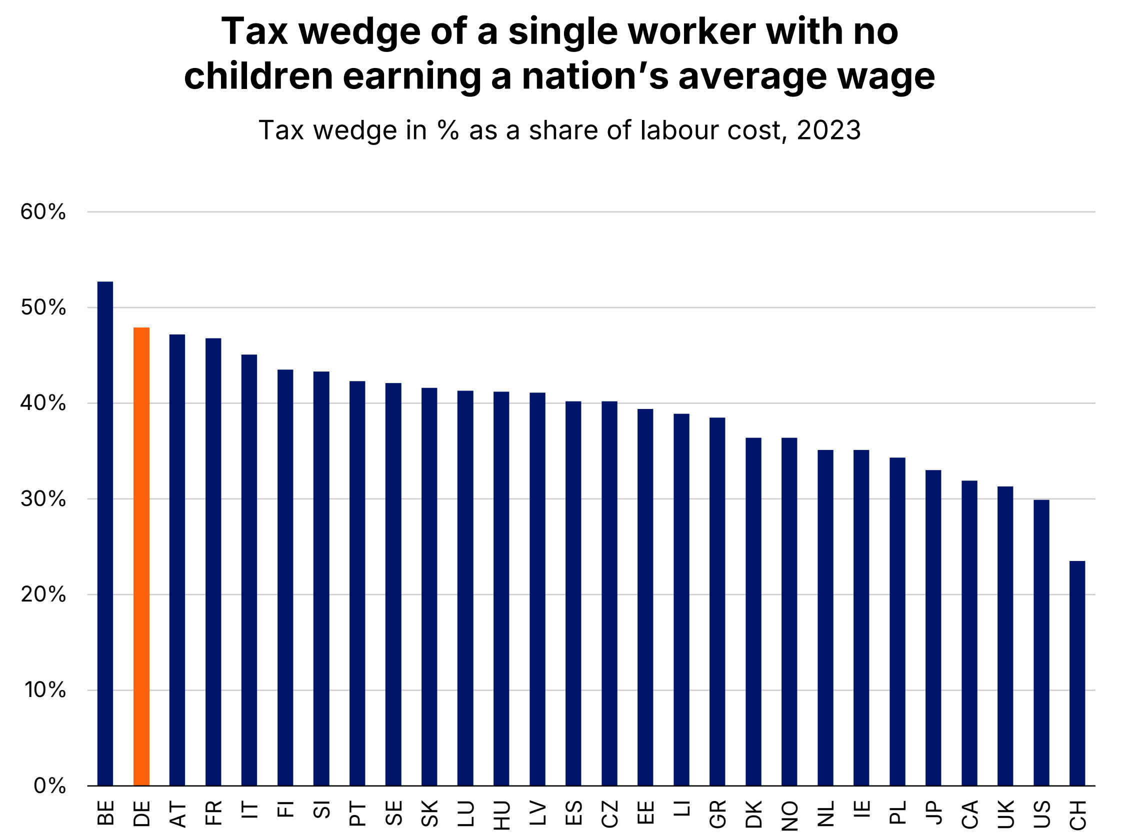
Source: UN, Scope Ratings

Taxes are high in international comparisons

→ Corporate tax rates at almost 30% have remained largely unchanged in the past decade while most other developed economies have reduced taxes
→ German workers are relatively expensive to hire for companies



Source: Tax Foundation, Scope Ratings



Source: OECD, Tax Foundation, Scope Ratings

Economy & Energy: Summary

	Policy proposal	CDU/CSU	SPD	Greens
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Source: Deutsche Bank, Scope Ratings

Summary

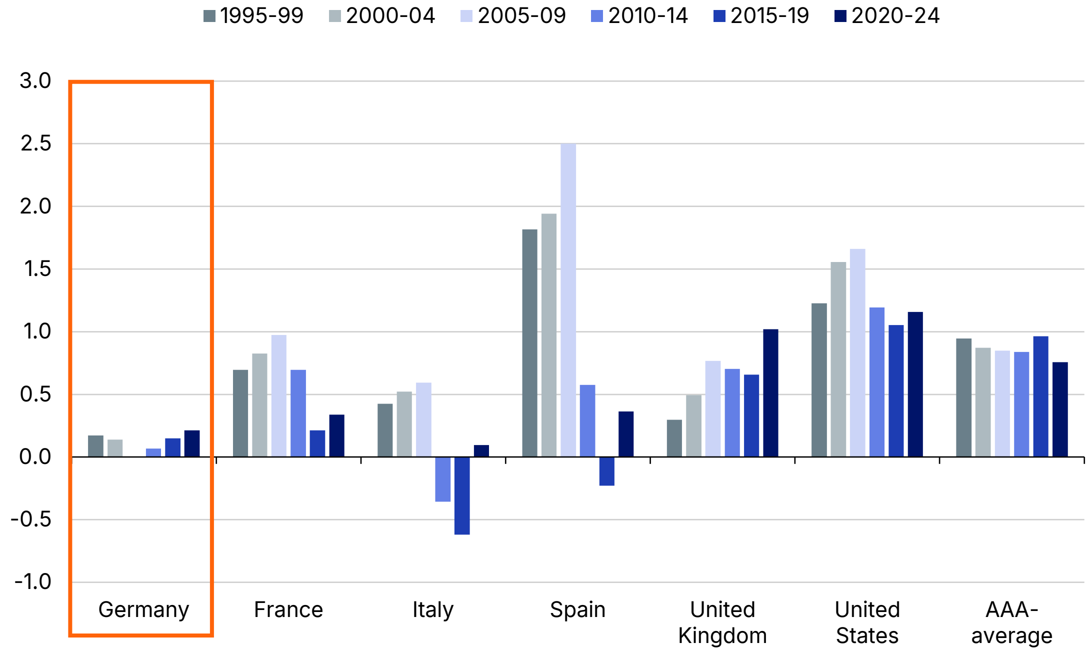
- → **Energy costs**: there is some scope to lower electricity prices; gradual shift towards higher value-added production needed
- → **Bureaucracy**: broad agreement to reduce bureaucracy, but likely to take time
- → **Labour market**: reforms needed to raise participation rate and allow for increased re-skilling
- → **Migration**: continued migration is essential for Germany's long-term growth; any reforms must not discourage skilled migration
- → **Tax policy**: lower corporate taxes and targeted income tax reform could encourage increased business investment and innovation

Debt brake reform could help address investment gap

→ Public investment among lowest of developed countries, investment gap of EUR 400bn
→ Higher public investment would contribute to higher growth

Public sector investment has fallen behind other developed economies

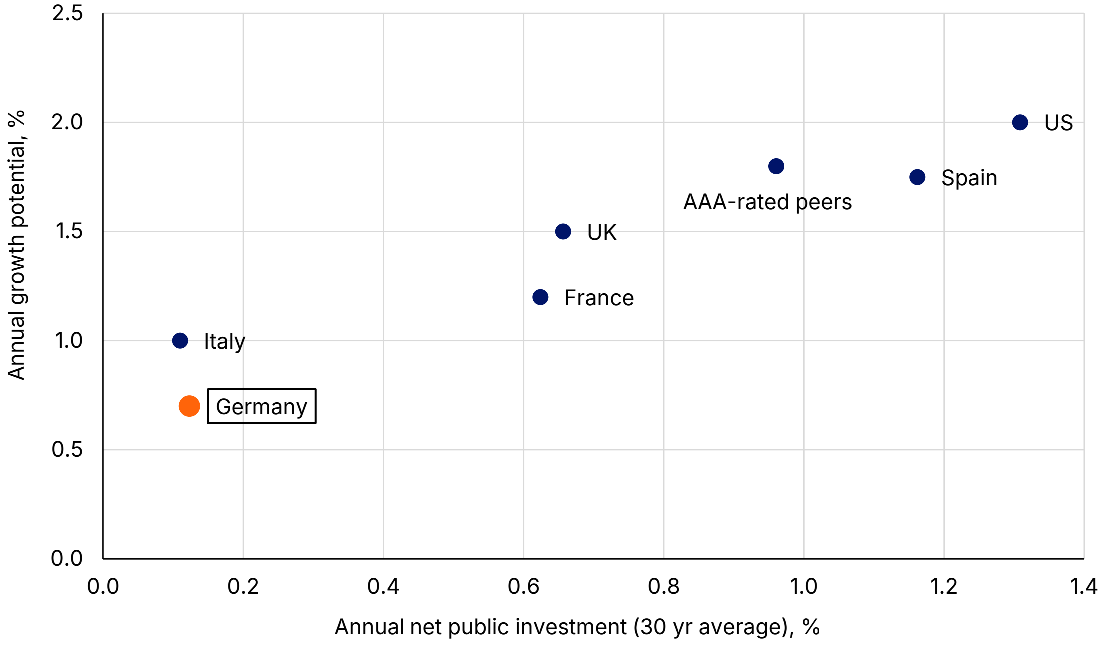
Net fixed capital formation, % of GDP



Source: European Commission, Scope Ratings

Low German public sector investment contributes to its low growth potential

Growth potential, % and general government net fixed capital formation, % of GDP



Source: European Commission, Scope Ratings

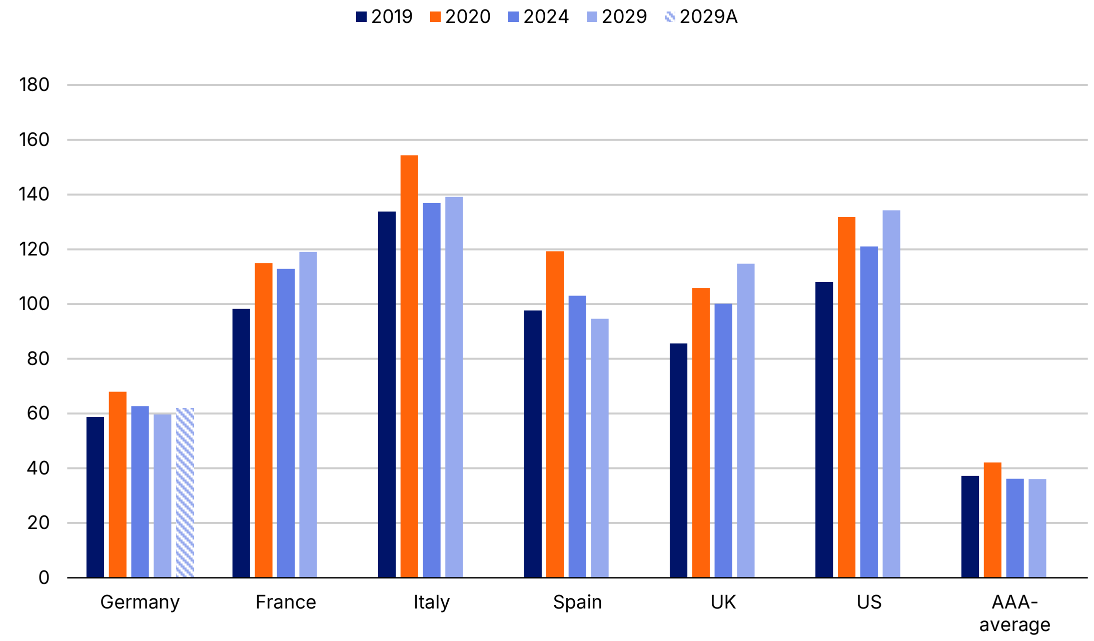
Germany retains fiscal space to address growth challenge

→ Germany's projected debt ratio on a broadly stable trend at around 60% of GDP
→ The government retains some fiscal space, especially for growth-enhancing investments

Reform option	**Additional borrowing** per year, % of GDP	**Growth impulse**
Constitutional special funds	Potentially very large, EUR 200bn mentioned for defence (4.7% of GDP)	Moderate
Borrowing limit raised (e.g. for Länder)	Potential range of 0.15%-0.35% of GDP	Low
Golden Rule (favourable investment treatment)	Up to ~1.8% of GDP	High

Germany's debt-to-GDP ratio expected to remain broadly stable

% of GDP



Source: IMF, Scope Ratings

Fiscal: Summary

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Source: Deutsche Bank, Scope Ratings

Summary

→ Historically low public investment contributes to low potential growth

→ Increasing political appetite to expand borrowing, potentially reform debt brake more structurally

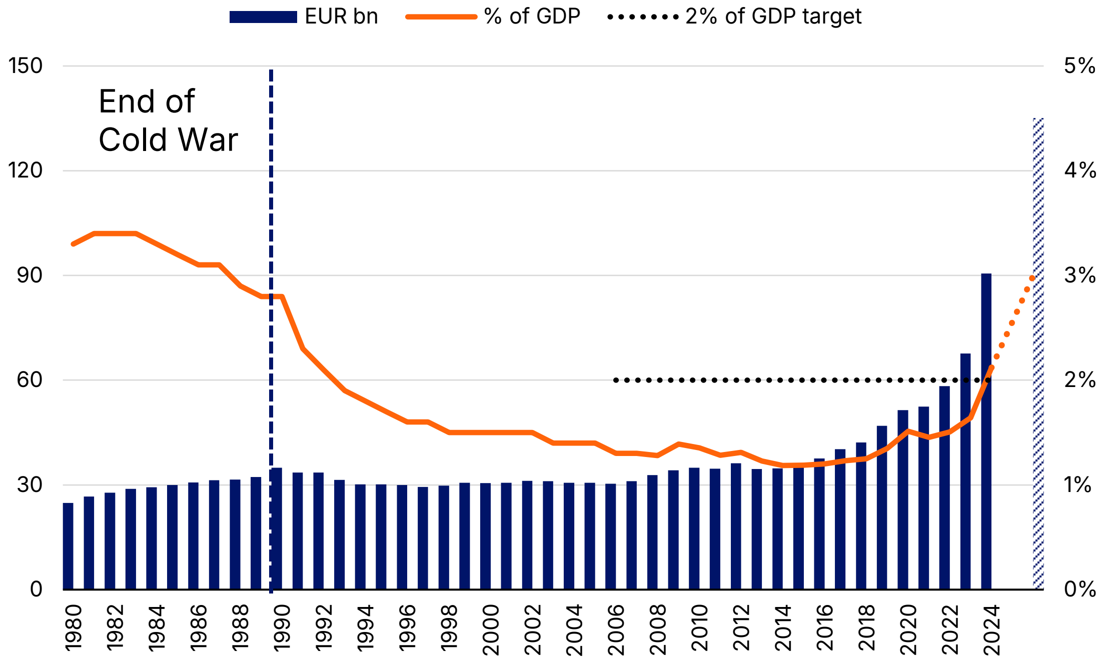
→ Germany retains fiscal space to address challenges

Will German leadership drive EU reforms and preserve Europe's geopolitical relevance?

→ Germany is the EU member state facing the greatest pressure to raise military expenditure (once EUR 100bn special fund depleted end-2026)
→ Military expenditure to return to the cold war level? Merz' proposal of EUR 200bn special defence fund

Defence expenditure history

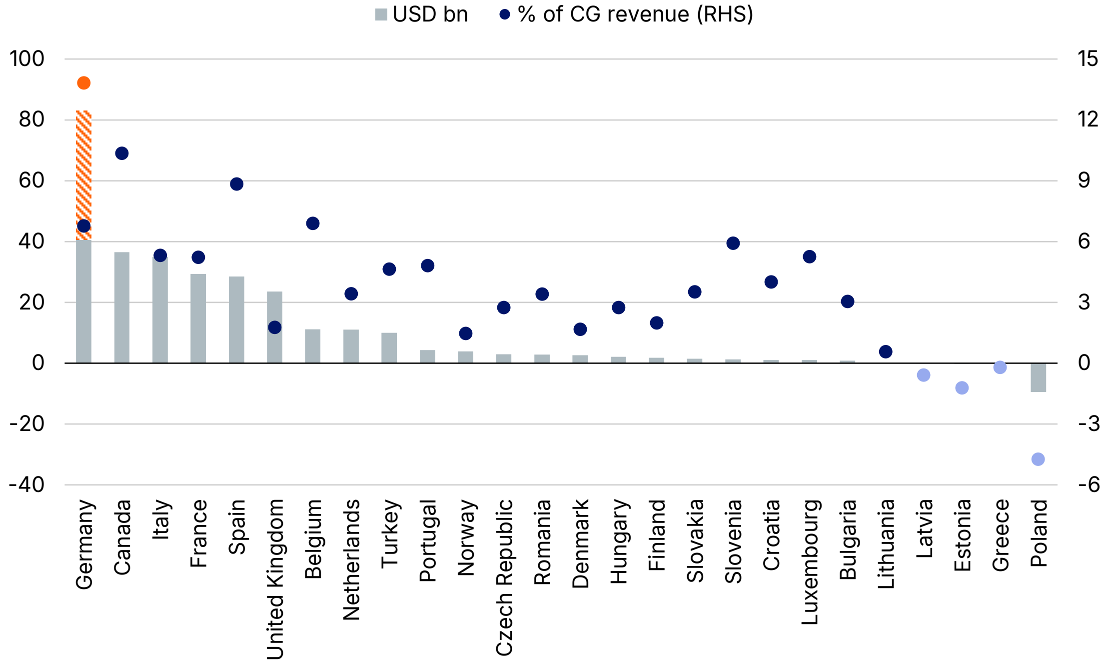
EUR bn (LHS), % of GDP (RHS)



Source: NATO, Scope Ratings

Budgetary effort required to reach 3% of GDP defence spending target

USD bn (LHS), % of central government revenue (RHS)



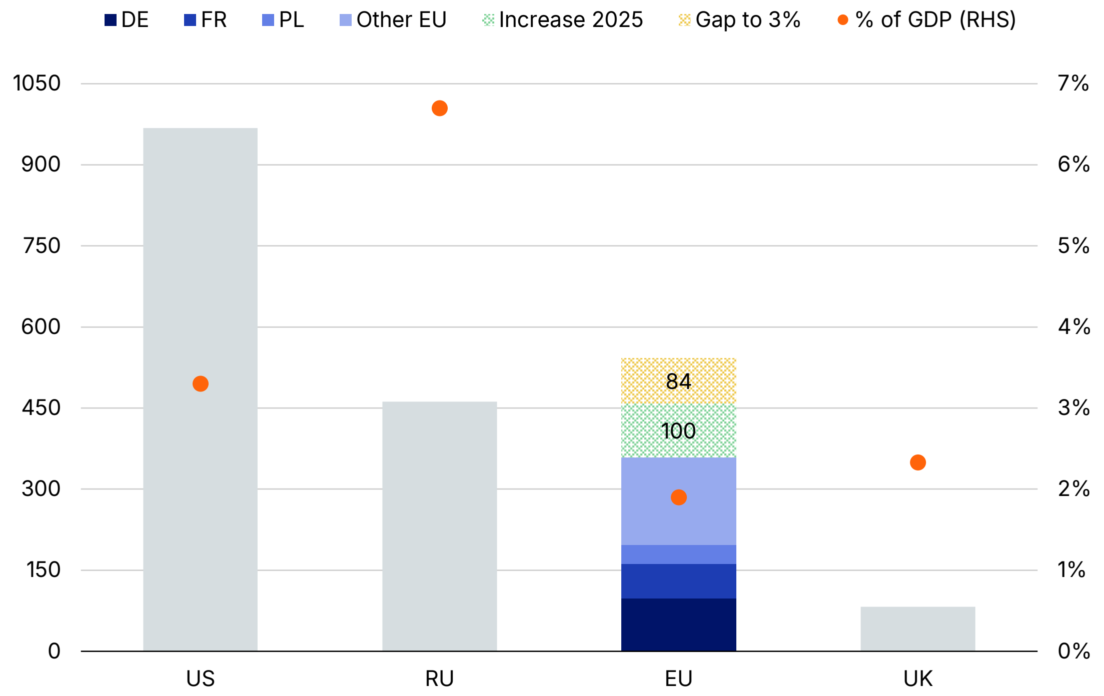
Source: NATO, IMF, Scope Ratings

Will German leadership drive EU reforms and preserve Europe's geopolitical relevance?

→ German government could support joint funding of EU defence
→ Joint borrowing more durable solution than easing fiscal rules temporarily (ECB intervention down the line?); lower risks of trade war with US?

Defence expenditure

USD bn (LHS), % of GDP (RHS)



Source: NATO, IMF, Scope Ratings

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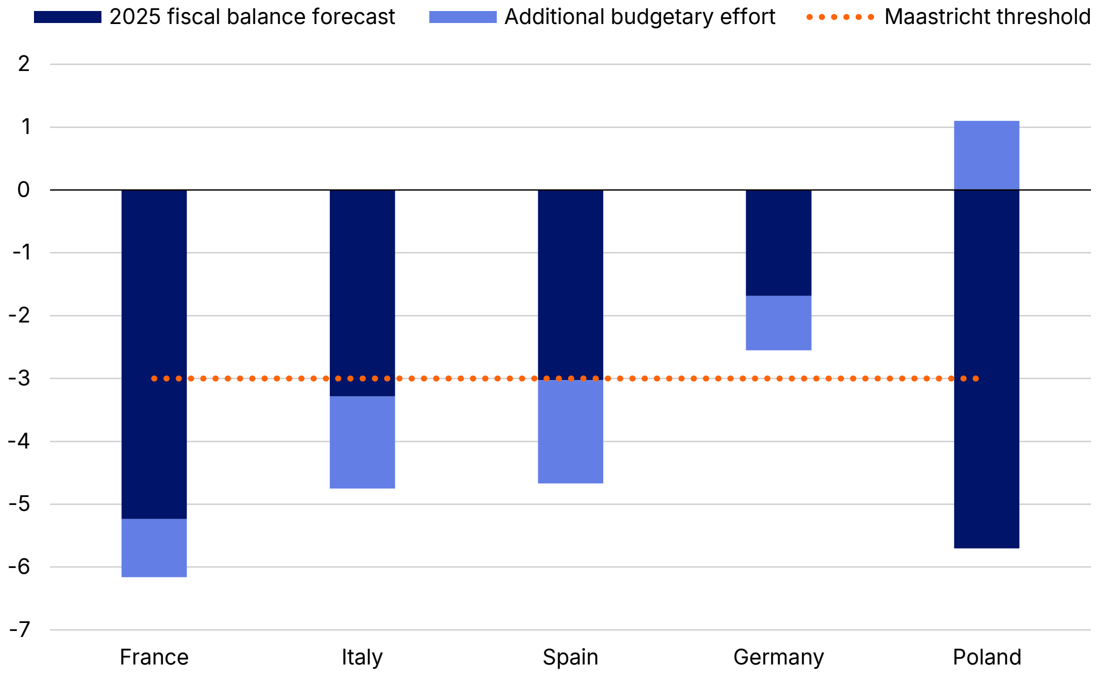


Source: NATO, IMF, Scope Ratings

Will German leadership drive EU reforms and preserve Europe's geopolitical relevance?

→ European supranationals have strong credit profiles to support defence effort and increase safe asset supply; EUR 100-300bn needed (~ 1.5% of GDP)
→ But centralized financing (+procurement and production) faces high political hurdles and requires German leadership

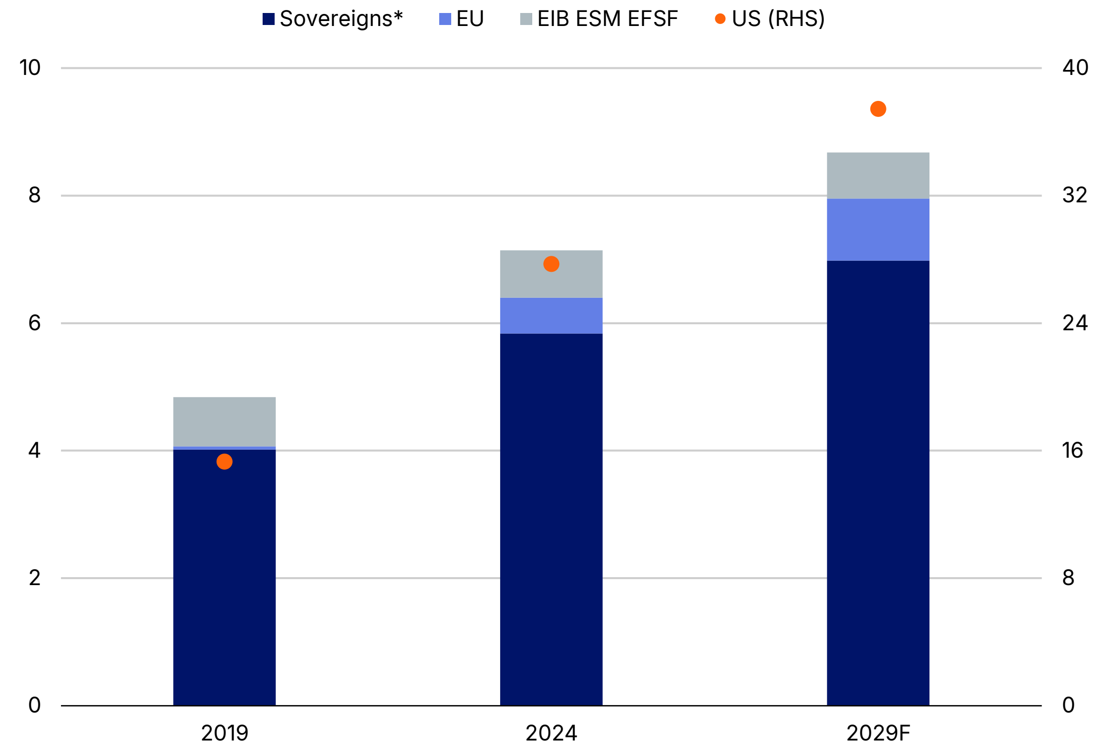
Options for joint EU defence financing

Institution		Funding sources / challenges / open questions
EU (AAA/STA)	Reprioritise / expand EU budget	Direct contribution from MS
		EU own resources / taxes
	RRF 2.0	Repurpose EUR 94bn below initial RRF allocation
EIB (AAA/STA)		Expand mandate? ESG credentials (excl. weapons, ammunition)
ESM (AAA/STA)		Expand mandate? Only euro area members
New defence fund		Guarantees? Impacts debt, not budgets Opt-in for UK & NO?

Source: Scope Ratings

Safe assets

EUR tr



*Includes EU sovereigns with minimum AA- rating.
Source: Scope Ratings

EU reform & geopolitics: Summary

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Source: Deutsche Bank, Scope Ratings

Summary

→ Higher defence expenditure needed & likely (may also reduce risk of trade war with US)

→ Joint financing of defence probable (even if Germany's defence fund increased)

→ Risk of EU-wide fiscal challenges real and not in Germany's interest

→ Defence likely to become next EU integration driver to achieve "independence from US"

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