Flash Economics

N° 78
July 4, 2025

The rise in Germany's public deficit: good news for Europe or bad news for France?

Chancellor Merz has announced an increase in Germany's infrastructure spending (transport and digital) of 1.5% of GDP per year, along with a rise in military expenditure reaching 1.4% of GDP by 2030.

Germany's public deficit (2.8% of GDP in 2024 and likely 2.9% in 2025) is therefore expected to increase significantly, heading towards 4% of GDP by 2030.

Two possible outcomes must be considered regarding the effects of Germany's increased public deficit:

- Either European investors choose to retain their savings within Europe, ceasing to lend part of it to the rest of the world—particularly to the United States. This would be good news for Europe, as it would imply that all domestic savings are used for domestic investment. It would also prevent financial tensions arising from Germany's growing public deficit;
- Or European investors remain attracted by the returns on investments in the United States and continue to lend the same amounts abroad. In this case, the appeal of German public debt would create a financing issue for France's public deficit, as there would be no additional savings available to lend to governments. This would lead to a sharp increase in interest rates on French public debt.

Patrick Artus
Senior Economic Advisor
patrick.artus-ext@ossiam.com
@PatrickArtus
Patrick Artus

Marketing communication: this document is a marketing presentation. It has not been prepared in accordance with legal requirements designed to promote the independence of investment research; and it is not subject to any prohibition on dealing ahead of the dissemination of investment research.

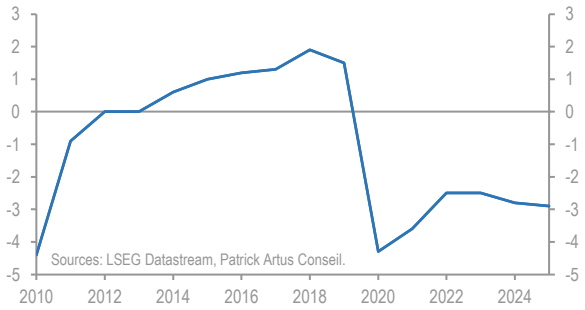
The announcement of a significant increase in public spending in Germany

Chancellor Merz has announced that Germany:

- Will invest an additional 1.5 percentage points of GDP in infrastructure (transport and digital);
- Will increase its military spending from 2.1% of GDP today to 3.5% of GDP by 2030.

In total, it can be estimated that **Germany's public deficit—at 2.8% of GDP in 2024 and likely 2.9% in 2025—will reach at least 4% of GDP by 2030** (**Chart 1**).

Chart 1
Germany: Fiscal surplus or deficit (as % of nominal GDP)

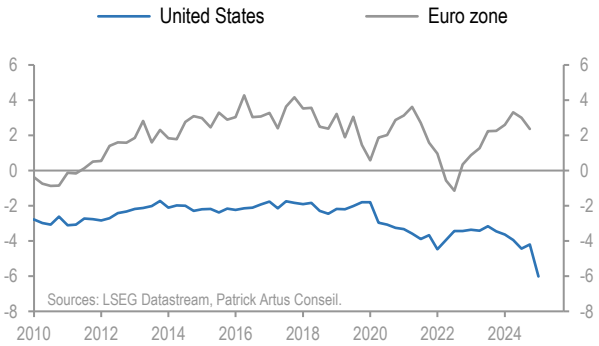


This increase in Germany's public deficit could have two very different effects on European countries—particularly on France—depending on how it influences the use of European savings.

The favourable scenario for Europe: Germany's rising public deficit is financed by European savings that would otherwise have been lent to the rest of the world

The euro area has a significant current account surplus (**Chart 2**), which is currently used to invest in or lend to the rest of the world—particularly to the United States, which runs a very large current account deficit.

Chart 2
Current account balance (as % of nominal GDP)



In the favourable scenario for Europe, the euro area's savings—previously lent to the rest of the world—would, in future, be lent to Germany to finance its public deficit. This would result in:

- A reduction in the euro area's current account surplus;
- Increased difficulty for the United States to finance its public and external deficits;
- No additional tensions on the euro area bond market.

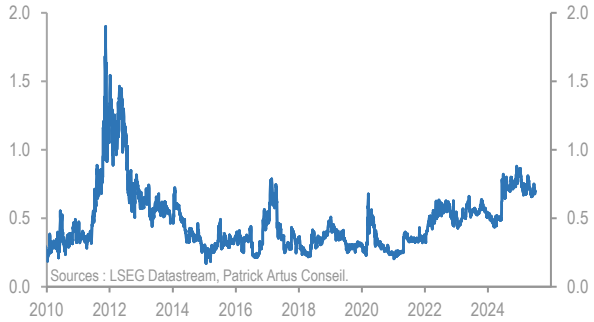
The unfavourable scenario for France: Germany's rising public deficit does not lead Europe to retain its savings within Europe

In the unfavourable scenario, Germany's increase in its public deficit does not result in Europeans keeping a greater share of their savings within Europe.

They remain particularly attracted to the returns on investments (in bonds and equities) in the United States.

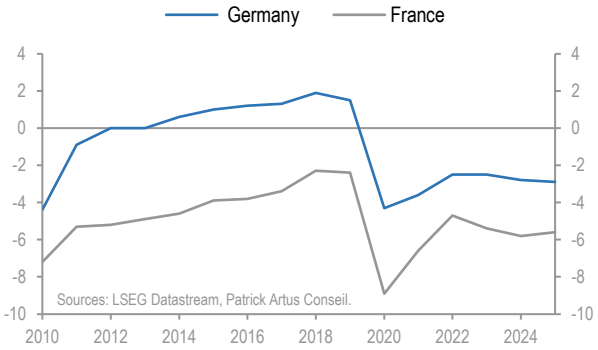
This scenario could be very unfavourable for France. If increased public deficits must be financed with an unchanged amount of savings, and **if investors prefer German public debt over French public debt, investment will shift from French to German sovereign bonds, leading to a rise in the interest rate spread between France and Germany** (**Chart 3**).

Chart 3
France: Yield spread on country's 10-year government bonds against Germany (as % point)



In recent years, the low level of Germany's public deficit had facilitated the financing of France's large public deficit (**Chart 4**).

Chart 4
Fiscal surplus or deficit (as % of nominal GDP)



Summary: the rise in Germany's public deficit will have one victim—either the United States or France

If Germany's increased public deficit leads Europeans to keep in Europe the savings they previously lent to the rest of the world, it will become more difficult to finance the United States' public and external deficits. In that case, the victim of Germany's higher public deficit will be the United States.

But if this rise in Germany's public deficit does not change the allocation of European savings—if Europeans remain attracted to US assets—then the increased German deficit will lead to a reallocation of savings from French public debt to German public debt, due to the latter's higher quality. This will result in a widening of the long-term interest rate spread between France and Germany; in this case, the victim of Germany's higher public deficit will be France.

Disclaimer

Ossiam, a subsidiary of Natixis Investment Managers, is a French asset manager authorized by the Autorité des Marchés Financiers (Agreement No. GP-10000016). Although information contained herein is from sources believed to be reliable, Ossiam makes no representation or warranty regarding the accuracy of any information of which it is not the source. The information presented in this document is based on market data at a given moment and may change from time to time. This material has been prepared solely for informational purposes only and it is not intended to be and should not be considered as an offer, or a solicitation of an offer, or an invitation or a personal recommendation to buy or sell participating shares in any Ossiam Fund, or any security or financial instrument, or to participate in any investment strategy, directly or indirectly. It is intended for use only by those recipients to whom it is made directly available by Ossiam. Ossiam will not treat recipients of this material as its clients by virtue of their receiving this material. All performance information set forth herein is based on historical data and, in some cases, hypothetical data, and may reflect certain assumptions with respect to fees, expenses, taxes, capital charges, allocations and other factors that affect the computation of the returns. Past performance does not predict future returns. Any opinions expressed herein are statements of our judgment on this date and are subject to change without notice. Ossiam assume no fiduciary responsibility or liability for any consequences, financial or otherwise, arising from, an investment in any security or financial instrument described herein or in any other security, or from the implementation of any investment strategy. This information contained herein is not intended for distribution to, or use by, any person or entity in any country or jurisdiction where to do so would be contrary to law or regulation or which would subject Ossiam to any registration requirements in these jurisdictions. This material may not be distributed, published, or reproduced, in whole or in part.