Economics Focus

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German fiscal package: a net positive for France and Italy?

- **In this second focus on the German fiscal package, we assess whether this package is a net positive for peers, in particular France and Italy, according to three key parameters: (1) the fiscal multiplier in Germany; (2) the pass-through of the German growth shock to other Eurozone countries; and (3) the offset due to resulting higher interest rates.**

- **Simulations with median fiscal multipliers (0.3 on defence and 1.2 on infrastructures) could lead to a rise in German growth of c.50bp in 2025, 100bp in 2026 and 150bp in 2027-29 relative to the baseline.**

- **As we wrote in our focus last week, Germany's debt-to-GDP dynamics will remain perfectly benign, even under very disappointing multipliers. The German government's credit quality cannot be substantially lowered because of this package, even in a worst-case scenario.**

- **The German fiscal package is likely to be a game changer, not only for Germany but for the Eurozone as a whole. Average estimates of the German growth shock pass-through to peers' growth is around 25-40%. This implies that both France and Italy's GDP could be 150-200bp higher under the average multiplier scenario in 2028 relative to the baseline without stimulus.**

- **In terms of impact for public finances / public debt trajectories, the German growth boost will likely be net positive for all its neighbours, despite last week's rates repricing. On that front, France benefits much more than Italy due to lower rates sensitivity of public debt dynamics and a higher growth pass-through of the German shock. Much lower multipliers and pass-through would be needed *ex post* to offset this effect on average.**

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Back to the German discussion (on fiscal multipliers)

In our first reaction piece last week, we provided our first projections of Germany's deficits and debt-to-GDP ratio according to two types of fiscal multipliers. Following a deluge of questions, we decided to publish this focus, which includes more detailed discussion and analysis.

What exactly is a fiscal multiplier?

When a government increases spending, it stimulates domestic demand, which raises GDP. However, part of that demand goes to imports, benefiting trading partners. The fiscal multiplier is the ratio of GDP change to the increase in government spending.

- If the multiplier is 1, it means that a EUR1 increase in spending raises GDP by exactly EUR1.
- If the multiplier is less than 1, it suggests that part of the spending is offset by other factors (eg, savings, imports, crowding-out effects).
- If the multiplier is greater than 1, it means that the initial government spending has a ripple effect, boosting private-sector activity.

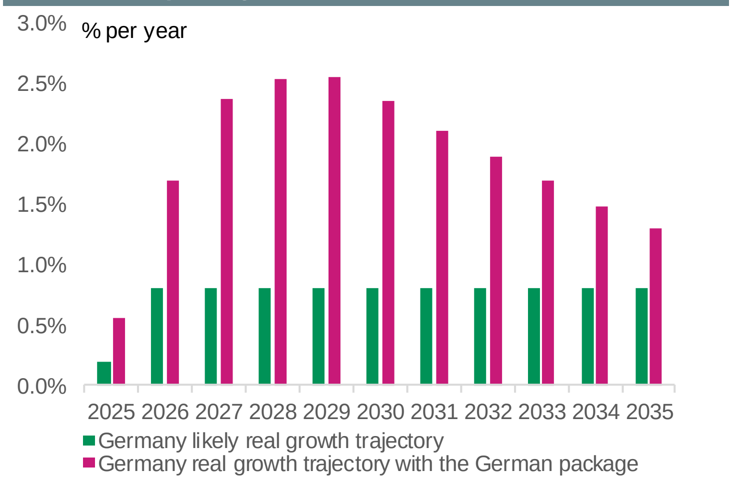
Our simulations on Germany

Last week, we provided two back of the envelope estimates of German debt-to-GDP ratio until 2028 under two general fiscal multiplier assumptions of the whole package (infrastructure & defence).

In practice, consensus estimates for fiscal multipliers largely differ between an infrastructure plan (supposed to directly increase GDP due to public investment and with a possibly large snowball effect) and a rise in defence spending (which is likely to increase imports). Under a central scenario with a 0.3 fiscal multiplier on defence and 1.2 on infrastructure:

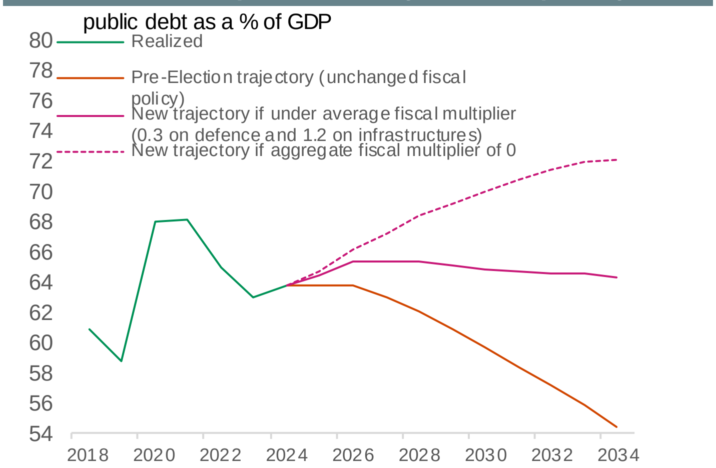
- Growth is expected to be between 30-50bp and 80-100bp higher than under the counterfactual in 2025 and 2026. This tally rises toward 150-160bp in 2026 and between 170-180bp in 2027 and 2028, and then gradually fades. This acceleration then slowly fades after 2028. GDP is around 4.5% higher in 2028 relative to the counterfactual and around 12% above at the end of the plan in 2035.
- Although public debt grow by around EUR1trn (ie, around 35% of public debt) more than under the counterfactual without the fiscal package, the debt-to-GDP trajectory remains largely benign. It is likely to stabilise slightly above 65% instead of a drop well below 60% in the counterfactual. As said last week, even under a worst case scenario of a 0 fiscal multiplier, a gradual rise in the 70-75% range in the next ten years can be expected.

Estimates of possible GDP growth boost in Germany due to the fiscal package



Source: German government, Crédit Agricole CIB

German debt-to-GDP ratio remains roughly stable under reasonable assumption following the fiscal package



Source: CBS dataset (Campiglio, Deyris, Romelli and Scalisi, 2025), Crédit Agricole CIB

Impact on peers the cases of France and Italy

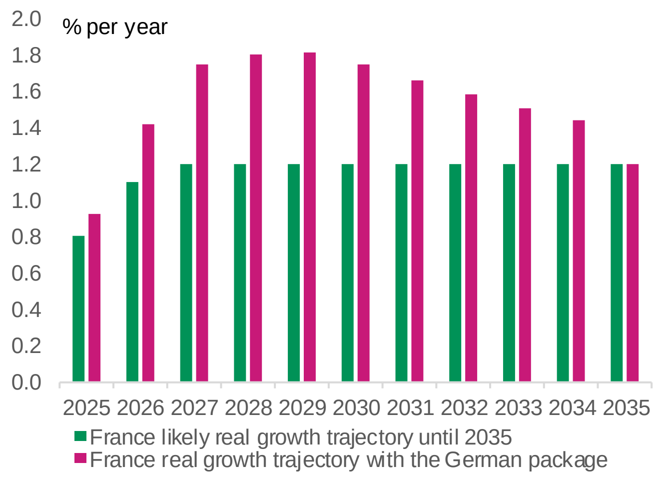
Pass-through to growth

In the Eurozone, one of the reference analyses on domestic and cross-country fiscal multipliers, albeit old now, is Beetsma and Giuliodori (2005). They find a pass-through of German growth shock to neighbours of c.12% on average. More recent studies such as Poirson and Weber, IMF (2013) and Aloza et al. ECB (2019), tend to find even higher figures. The ECB's Eagle model tends towards relatively aligned coefficients.

Consensus values are that around 40-50% of German growth shock due to higher public investment transmit to neighbouring small open economies (eg, the Netherlands and Belgium). France and Italy's multiples are lower but still high, around 35% and 25% respectively. Note that those pass-throughs are subject to considerable uncertainty and cannot be taken as a forecast in any case.

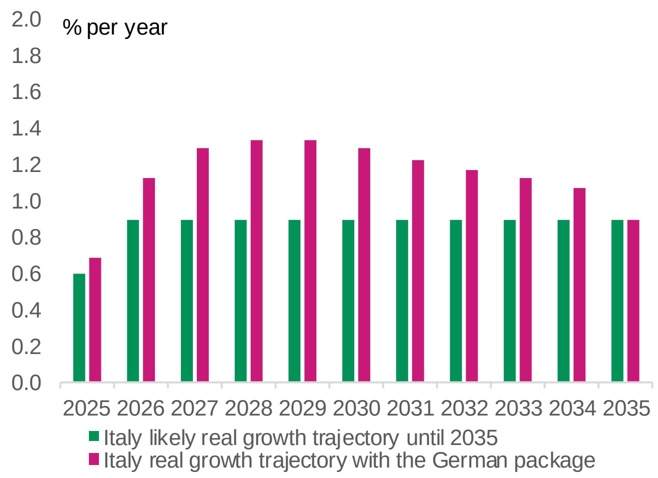
We use those reference values to compute the shocked version of our baseline growth forecasts for France and Italy under the German fiscal package plan. This underlines the massive scale of the German fiscal package as well as the degree of trade and business cycle interdependence in the Eurozone.

Baseline French growth profile and shocked version under the German fiscal package



Source: French government, Crédit Agricole CIB

Baseline Italian growth profile and shocked version under the German fiscal package



Source: Italian government, Crédit Agricole CIB

Fiscal metrics enhancement thanks to higher growth in France and Italy

Higher growth in other Eurozone countries due to the German package is a clear positive for the public finance trajectories in those countries. This is all the truer as those governments (typically France and Italy's) are often significantly more indebted than the German government.

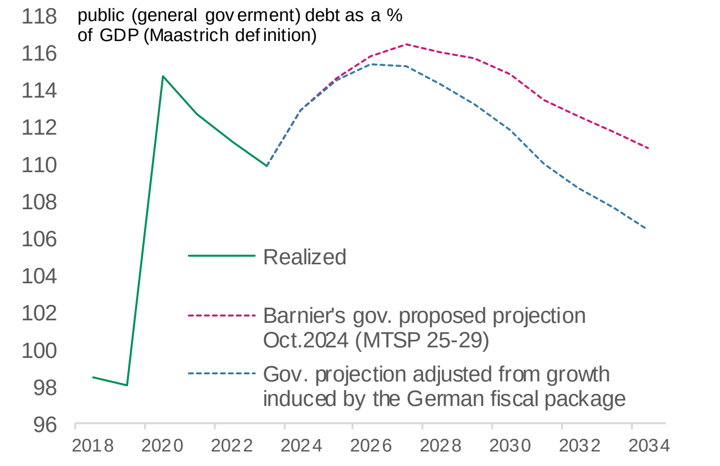
Below, we present the French and Italian public debt trajectories given the higher growth path presented above. Both are based on the long-term projection of government from autumn 2024:

- For France, public debt would be eroded by c.5ppt vs the government projection. This would make it possible to start reducing public debt in 2028 instead of 2029 and would accelerate the deleveraging path thereafter.
- For Italy, public debt would be eroded by c.4ppt vs the government projection. This would accelerate the deleveraging path from 2027 on.

Note that, while the Italian trajectory is relatively credible, in the French case, Michel Barnier's government's trajectory is excessively optimistic. That said, under a continuation of the fiscal slippage scenario, the help from higher growth would be even larger. Under a worst case scenario of unchanged fiscal policy from 2025 to 2035 (relative to 2024) the debt-to-GDP ratio would rise to north of 150% by 2035 without the growth boost. Additional growth induced by the German fiscal package would limit this rise by c.8-9ppt of GDP to slightly more than 140% though.

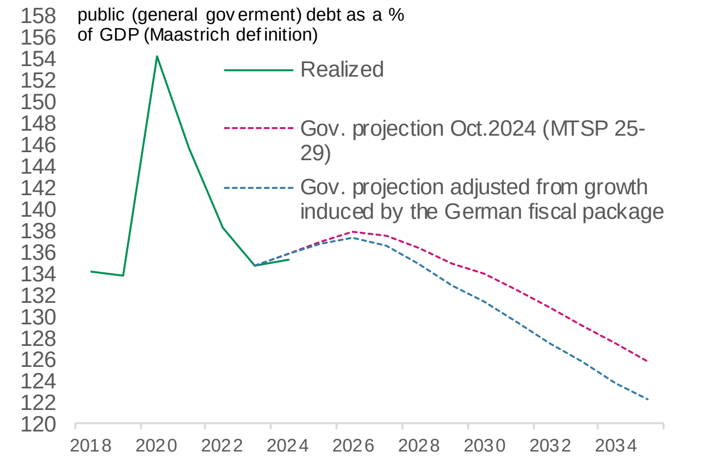
This tally is even more important than relative to the previous long-term government projection.

Simulation of French public debt reduction due to the German fiscal package



Source: French government, Crédit Agricole CIB

Simulation of Italian public debt reduction due to the German fiscal package



Source: Italian government, Crédit Agricole CIB

Quantifying the offsetting impact of higher rates

In the scenario above, we reasoned all things else equal. Given the substantial rates repricing of last week, this assumption is particularly optimistic now.

For Germany, the upside effect of higher rates on the debt-to-GDP ratio by 2035 is mostly second-round. However, for governments with much higher debt load such as France and Italy, this effect is larger, albeit small relative to the size of the growth boost generally.

For France, the 30-35bp rise offset only around 30% of the natural deleveraging coming from higher growth. We estimate than if the German fiscal package had total impulse of c.+85bp on the 10Y OAT (ie, if it had pushed the 10Y OAT above 4.10%), then it would have completely offset the positive effect for public finances due to higher growth under our previous assumption. Alternatively, if the repricing of French rates due to the German fiscal package is done now (ie, c.+30-35bp), then even an aggregate multiplier as low as 0.2-0.3 would be net positive for French public finances.

For Italy, the 30-35bp (slightly more than France) rise offset much more (around 80%) of the natural deleveraging coming from higher growth. This is due to a much higher rates sensitivity of Italian public debt dynamics and a lower growth pass through, relative to France. We estimate that if the German fiscal package had a total impulse of c.+40bp on the 10Y BTP (ie, if it had pushed the 10Y OAT above 4.00-4.05%), then it would have completely offset the positive effect for public finances due to higher growth under our previous assumption. Alternatively, if the repricing of Italian rates due to the German fiscal package is now done (ie, c.+30-35bp), then an aggregate multiplier of 0.7 is necessary to make it a net positive for Italian public finances. This is a tiny net positive for the Italian government then.

Conclusion

A lot of uncertainties remain regarding the German fiscal package. The Bundestag is set to vote on the package on 18 March, but the details of the package also remain uncertain, as some last minutes changes can be expected to ensure the support of the Greens.

Beyond that political uncertainty, the implementation will have to be monitored; more importantly, the package's impact on the German and Eurozone economies is very hard to forecast precisely.

Nevertheless, based on our working assumptions and on academic estimates, we can already be positive about several points:

- The German package will almost certainly have a strongly positive impact on German GDP growth.
- Its impact on German debt metrics will likely be very limited, as the impacts of new debt and higher rates are largely absorbed by the stronger growth.
- For France, not only will the package have a significant impact on GDP growth, but it will also improve the public finance outlook, as the impact of higher rates will be easily absorbed by the surplus of growth.
- For Italy, the growth impact will be significantly positive too, but the benefit for public finances will be slightly weaker than for France, as Italy will suffer more from higher rates.

We explained in our previous paper that this potential fiscal package was historic and that it would significantly improve German growth, with limited impact on public debt metrics. To conclude this paper, we add that this package would also improve the economic and public finance situation of other Eurozone countries.

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