

## The German Phoenix

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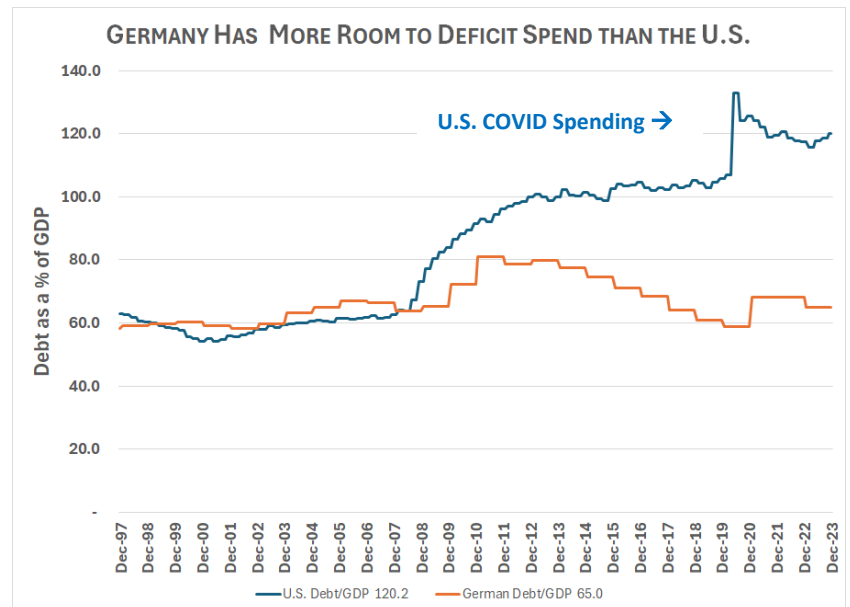
March 24, 2025

The phoenix is a mythical immortal bird that rises from the ashes of its predecessor to be born again. Last week, we saw the beginnings of a new Germany rising from the ashes of the old as German lawmakers voted to allow a huge increase in defense and infrastructure spending. This required a two-thirds majority vote of the upper and lower houses of the German parliament. It required a change in the German constitution to exempt military and some infrastructure spending from the country's strict debt limit.

This is a seismic economic and cultural change. Germany has been an exemplar of fiscal responsibility since the end of World War II. Hyperinflation ravaged the country in the 1920s, so much so that a pound of butter cost a million marks. Changing the constitution to spend massively on defense and national infrastructure is a new phoenix rising. Incoming leader Friedrich Merz said after the vote, "Germany is back."

Germany is the largest economy in the European Union (EU) and the third largest in the world, with a GDP of about \$4.5 trillion. The vote will allow for about \$1 trillion in defense and infrastructure spending over the next decade or about 22% of the German economy. Even if they spent the 22% instantaneously, their Debt-to-GDP would still be less than 90%, and still 30% below the U.S.

22% of GDP is a fiscal impulse similar in magnitude, but planned over a longer timeframe, to the U.S. COVID response, which gave us strong growth and higher inflation. We can expect a proportional impact on the German economy and, ultimately, the EU as member states follow suit and increase defense spending.



The European Union (EU) was created in the aftermath of World War II to foster economic cooperation and prevent future conflicts. They have experienced 70 years of peace among EU countries. They have benefitted from global trade liberalization and have relied on the U.S. security umbrella for their defense.

The U.S., under President Trump, has put trade relations and security guarantees in future doubt. The challenge for the EU is that it is more of a confederation than a federation with a strong central government. That said, there is nothing like an unrestrained, aggressive Russia to concentrate the mind on addressing European self-defense. The new German Phoenix is taking steps to rise to the challenge, with the rest of the EU likely to follow.

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