Global Equity Edge

Revitalising Europe's industrials sector: Assessing opportunities in the wake of Germany's fiscal stimulus

Author

Lucie Carrier
Lead General Industry Research Analyst, Europe Equity Research Team

While the European industrials sector faces significant global macro challenges, Germany's attempts to kick-start its economy look set to have a positive impact on industrials companies across the region, creating some potentially attractive opportunities for global equity investors.

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Germany's stimulus: A catalyst for industrial growth

Driven by a massive increase in defence and infrastructure spending, tax cuts, and the release of billions of euros of new corporate investment, Germany's stimulus package has provided a positive surprise to Europe's growth outlook. Defence spending is the focus, given growing military threats, with Germany's defence budget set to increase from 2.1% of GDP in 2024 to 2.5% in 2025 and 3.5% by 2029. This spending will boost demand for industrials companies, not just defence contractors, in Germany and across Europe.

Perhaps of more immediate significance for the industrials sector, however, is that EUR 500 billion of the stimulus package has been allocated to an infrastructure fund to be invested over the next 10 to 12 years. The spending will be focused on three main areas:

1. Climate and energy transformation: EUR 100 billion to be spent in EUR 10 billion increments per year over the next 10 years.
2. Regional infrastructure projects: EUR 100 billion to be spent over the next 12 years at the discretion of regional state governments (Laender).
3. Federal government projects: EUR 300 billion to be spent on rail, education, housing, roads, research & development (R&D), hospitals and digitalisation.

At the federal level, more than half of the spending is expected in the next four years. Our best estimates of where we think the funds will be spent include EUR 80 billion on rail by 2029, with EUR 9 billion up front in 2025. The rail budget is significantly up from the German government's initial 2019-2029 plan, which earmarked EUR 52 billion for the railways, providing a positive surprise to the rail sector. We also expect EUR 25 billion of federal funds to be allocated to hospitals and EUR 12 billion to be spent on housing.

Germany's EUR 500 billion Infrastructure Fund (excluding defence spend)

	EUR100bn Climate & Transformation Fund	EUR100bn for German Laenders	EUR300bn allocated by central government
Timing	10 years from 2H2025 - EUR10bn/year	12 years from 2H25 but at Laenders' discretion	12 years from 2H25 - more than half to be spent by 2029-2030
Focus	Changing priority over time - current focus on gas storage but also energy efficiency in buildings or transformation of industry	Local projects	Rail, education, housing, digitalisation, hospitals, bridges/roads, R&D
2025 Budget	EUR10bn		EUR27bn
			Rail
			c. 80bn to 2029 with c. 9bn in 2025 alone. Initial 2019-2029 plan was 52bn
			Hospitals Infra
			c. 25bn
			Housing
			c. 12bn

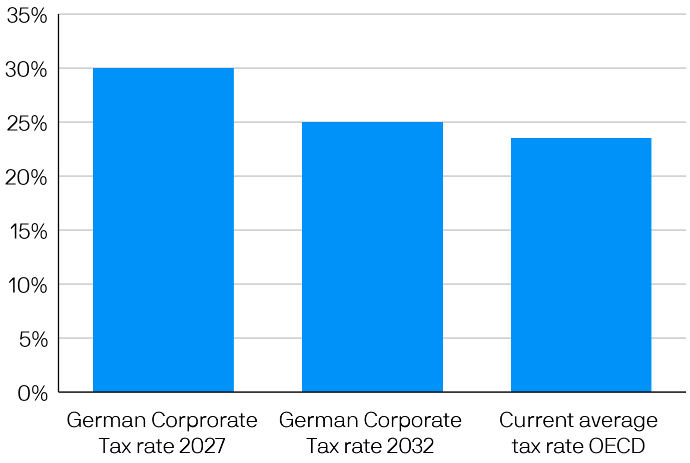
Source: J.P. Morgan Asset Management.

Corporate tax cuts: Enhancing competitiveness, boosting investment

Extra spending is only part of the fiscal expansion story. Germany's government has also announced it will cut the corporate tax rate by 1 percentage point every year for five years between 2028 and 2032, taking the rate from 30% to 25%.

While still slightly above the OECD average, the corporate tax cuts represent long-term convergence with corporate tax levels in other developed markets. Lower taxes will have a positive impact on net earnings for Germany's corporate sector and will also be expected to boost economic growth, job creation and, importantly, spark renewed capital investment as companies look to employ their extra capital.

German corporate tax rate 2027-2032



Source: J.P. Morgan Asset Management.

These fiscal measures are already helping to free up corporate investment plans. The "Made for Germany" initiative, announced in mid July, saw 61 companies, including industrial stocks (such as Siemens), commit to invest EUR 630 billon in Germany's economy by 2028 (either through new or existing capex and R&D spending), of which EUR 100 billion is deemed to be additional investment on top of already announced plans.

The Made for Germany announcement is a significant boost to the German capex budget and the German economy. Capex usually represents around 3% of sales for industrials companies, and with the manufacturing sector representing around 20%-25% of German GDP, the increase in the capex budget may be expected to boost the German economy by around 0.7 percentage points, based on 2024 GDP – providing a positive boost for the industrials sector.

The beneficiaries of German infrastructure investment

German industrials companies with strong domestic businesses are set to benefit the most from rising domestic infrastructure demand, and they will also see a boost to their profits from corporate tax cuts. But European companies based outside Germany with large exposure to the German economy could benefit as well.

While it's difficult to calculate the impact on company earnings at this stage, we are starting to reflect the improved outlook in many of the industrials stocks that we cover. Siemens, for example, generates around 15% of its revenues in Germany and has a clear number one position in German rail equipment (rolling stock, signalling and software) where a large portion of the infrastructure spending is focused. The company is also well placed to benefit from additional demand for electrical infrastructure needed as part of investment in building modernisation, data centres and grid upgrades.

With its dominant position in factory automation equipment (we estimate a market share in Germany comfortably above 50%), Siemens will also be a strong indirect beneficiary of the investment in manufacturing capacity that is needed to sustain the increase in German defence spending, as well as the additional demand from the German Infrastructure Fund and the Made for Germany initiative. Headquartered in Germany, the company will further benefit from the corporate tax reduction and accelerated depreciation scheme aimed at accelerating capex in the next two years.

The securities above are shown for illustrative purposes only. Their inclusion should not be interpreted as a recommendation to buy or sell.

Rail is a particularly strong story, given the level of investment in the German railways that has been announced. Alstom, a French company and the second largest player in the German rail equipment market after Siemens, stands to benefit. We think the company's German revenues could nearly double by the end of the decade, from around 8% currently, providing further earnings support to an already large orders backlog of around EUR 100 billion globally (compared to fiscal year 2025/26 sales that are expected to be just short of EUR 19 billion).

For many other European industrials stocks, we expect to see more of an indirect benefit from the German stimulus. Companies such as Sweden's SKF, which is the world's leading maker of ball bearings (a key component in most vehicles and most factories), should benefit from increased demand for manufacturing capacity in the aerospace & defence sector, and from the boost to general manufacturing investment.

Two other Swedish companies, Sandvik and Atlas Copco, are also well positioned to benefit from Germany's increased investments in manufacturing. Sandvik has a strong position in the supply of cutting tools and inserts, largely used for components manufacturing in the aerospace & defence industry, among other industrial applications. Atlas Copco is the global leader of industrial compressors that are used in virtually every single factory, as well as tools and machine vision equipment for industrial manufacturing.

EU investment adds to a supportive backdrop

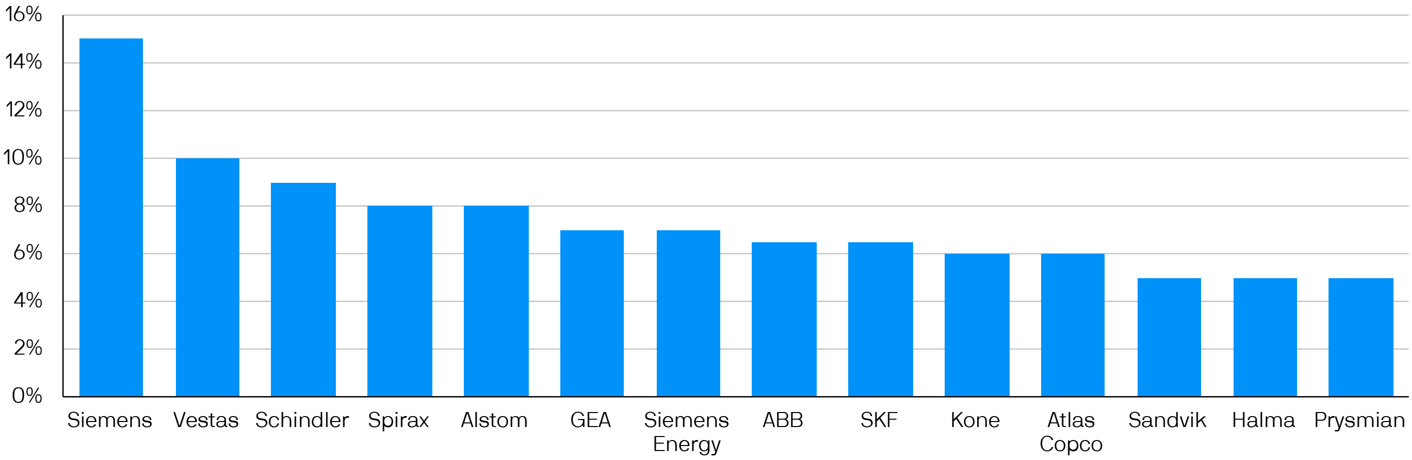
While Germany has dominated recent news coverage in the European industrials sector, regional demand is being further boosted by spending announcements at the European Union (EU) level. For example, billions of euros have been set aside by the EU to build the new data centres that are needed to support the development of Europe's artificial intelligence infrastructure – an area of crucial economic importance where Europe has been late to the party. Companies across the industrials sector are well placed to benefit.

Significant funds have also been allocated by the EU to help fight climate change and ensure energy security. Easier permitting for wind energy projects, for example, is already leading to an acceleration in demand for equipment that could benefit European industrials stocks, such as Denmark's Vestas Wind Systems, the global leader (outside of China) in wind turbines.

An improving outlook for the industrials sector

As these stock examples suggest, the outlook has improved for several European industrials stocks. While headwinds for the sector remain, not least from sluggish European growth, weaker Chinese demand, and uncertainties over the impact of US trade and tariff policies, we believe the attempts by European policymakers to revitalise industrial production could provide selective opportunities for global equity investors in today's challenging markets.

German exposure as % of sales for large European industrial/capital goods companies (2024 data)



Source: J.P. Morgan Asset Management.

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