MARKET COMMENTARY

German Reform Momentum Builds — Pensions Next in Line

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- **Germany's pension reform has shifted from diagnosis to decision: Chancellor Merz (CDU) and Labour Minister Bas (SPD) both back the commission's package and want agreement within weeks.**
- **The package would make the system more sustainable by combining later retirement, a broader contributor base, a reactivated sustainability factor and a new capital-market-funded pillar, curbing the need for higher payroll taxes or budget transfers.**
- **The reform keeps the 50:50 split between employers and employees. Relative to the status quo it brings some relief to today's younger workers and future entrants while ending generous early-retirement privileges.**
- **For markets, the clearest implication is a rise in long-term savings flows: the proposed 2% mandatory funded contribution could eventually channel roughly EUR 30bn-35bn a year into capital markets, phasing in from about EUR 8bn in 2028.**
- **Passed without major dilution, the overhaul would confirm building reform momentum in Berlin — healthcare is already advancing — while a broader income-tax package remains the missing piece.**

Germany's pension reform has moved from the expert phase into the political arena. The government-appointed commission has proposed a broad overhaul. At its core sits a new mandatory, Swedish-style funded pillar that complements the pay-as-you-go system, financed through individual capital accounts and an extra 2% contribution shared by employers and employees. The package also widens the contributor base — gradually adding groups such as the self-employed and parliamentarians — and targets a minimum 70% net replacement rate for average earners over time.

In economic terms, the proposals point in the right direction. Instead of leaning ever harder on contribution hikes or tax transfers, they spread the cost of demographic ageing across four levers: later retirement, more contributors, a reactivated sustainability factor and a new funded component. From 2031, the statutory retirement age would track life expectancy; on current median assumptions, that lifts it only gradually, from 67 to 67.5 by 2041. The plan also replaces the current 'retire at 63' route with targeted protection for long-contributing workers who can no longer stay in their jobs for health reasons.

Relief for the younger workers. The near-term burden falls on current workers, above all younger and mid-career cohorts. The clearest losers are those who counted on generous early-retirement routes such as the pension at 63 ("Rente mit 63"). Relative to the status que the reform tentatively brings some relief ot young and future workers.

This should strengthen the system's long-run sustainability and, over time, ease pressure on the federal budget. The catch is timing: the benefits build only slowly, while the costs arrive sooner — through higher labour costs, longer working lives and the fight over scrapping early-retirement privileges. Critics say the package loads too much adjustment onto workers in physically demanding jobs, and employers warn that the funded pillar will lift non-wage labour costs. However, simulations done by the expert group show that implementing all measures leads to smaller projected increase of the pay-as-you-go contribution rate than otherwise in the medium to longer term. Starting from a current rate of 18.6%, it is set to rise to 20.9% by 2035 and 21.4% by 2040 whereas the reform measures imply rates of 20.5% and 20.2%.

Politically, the reform enjoys unusually broad backing at the top of government. Chancellor Friedrich Merz (CDU) has endorsed the package as a whole and wants its elements implemented swiftly rather than cherry-picked; Labour Minister and SPD co-head Bärbel Bas has likewise pledged to enact the report in full. That points to support from both coalition partners despite the issue's sensitivity. Outside government, the proposals stay contested — unions and parts of the left see later retirement and the end of the early-retirement route as socially regressive. No detailed legislative roadmap exists yet, but reporting suggests the coalition wants to agree the package by July 1, with legislation likely over the autumn.

For financial markets, the clearest implication is a rise in long-term savings flows. Once fully implemented, the extra 2% mandatory contribution could channel around €30-35bn a year into funded retirement saving. The maths is simple: €285.0bn of compulsory contributions in 2025 at the 18.6% rate implies a contributory wage base near €1.53tn, and a 2% levy on that base yields annual inflows of roughly €30.7bn. That equals about one-fifth of the German fund industry's 2025 net inflows and some 0.6% of assets under management. Crucially, the flow is unusually predictable because the scheme is mandatory, not opt-in: phase-in starts according to the reform proposal near EUR 8bn in 2028, rises to about EUR 16bn-17bn in 2029 and reaches its full run rate by 2031. For investors, this argues for a slow, structural tailwind for European equities and the asset-management industry rather than a near-term market mover — its weight depends on the eventual equity allocation.

Big implementation questions remain open. Germany has no public pension-fund manager of this kind, the asset allocation is still unspecified, and the market impact hinges on whether the vehicle follows the Swedish model's strong equity bias or a more conservative, bond-heavy approach. The recently agreed tax-favoured private product (Altersvorsorgedepot), effective from 2027, offers a guide: with effective costs for the standard option capped near 1.0%, a low-cost design could become the political benchmark for the statutory funded pillar too.

More broadly, the pension package fits a tentative but visible reform push in Berlin. Healthcare has already moved beyond announcements: an initial package to stabilise statutory health-insurance contributions has cleared the Bundesrat, and the wider reform is now working through parliament. Pensions look set to be the next big file. That leaves tax policy as the missing pillar of the government's overhaul agenda.

Part of the tax story is already in place via last year's 'growth booster': 30% accelerated depreciation through 2027, incentives for corporate e-mobility and a phased cut in corporation tax from 15% to 10% from 2028. The harder piece — a broader income-tax reform — is still missing. Discussion seems to centre on targeted relief for low- and middle-income households, possibly worth EUR 10bn-20bn, paired with offsets such as a higher levy on top earners, a higher threshold for the 42% bracket and perhaps inheritance-tax changes. For now, that part of the agenda stays unresolved — and, with it, the final test of whether Berlin's reform push extends from spending to the tax side.

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