

Yield shockwaves amid the 2025 German debt brake reckoning

Catalin Dragomirescu-Gaina, Andrea Monticini, Tommaso Tornese*

Università Cattolica del Sacro Cuore, Largo Gemelli 1, 20123 Milano, Italy

*Corresponding author. Email: tommaso.tornese@unicatt.it

Abstract

Amid heightened uncertainty surrounding the 2025 German elections, the media became a platform for policy debates. When the newly elected leadership abandoned prior fiscal orthodoxy, bond markets moved sharply. We find long-term yield reactions to economic media coverage consistent with higher real interest rates in Germany, in line with theoretical predictions. While recent cuts in ECB rates have lowered sovereign yields across the board, we see significant risk spillovers to large bond markets like France and Italy that could hamper the transmission channel and pose challenges for future monetary policy.

JEL: D80; E44; G14

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1. INTRODUCTION

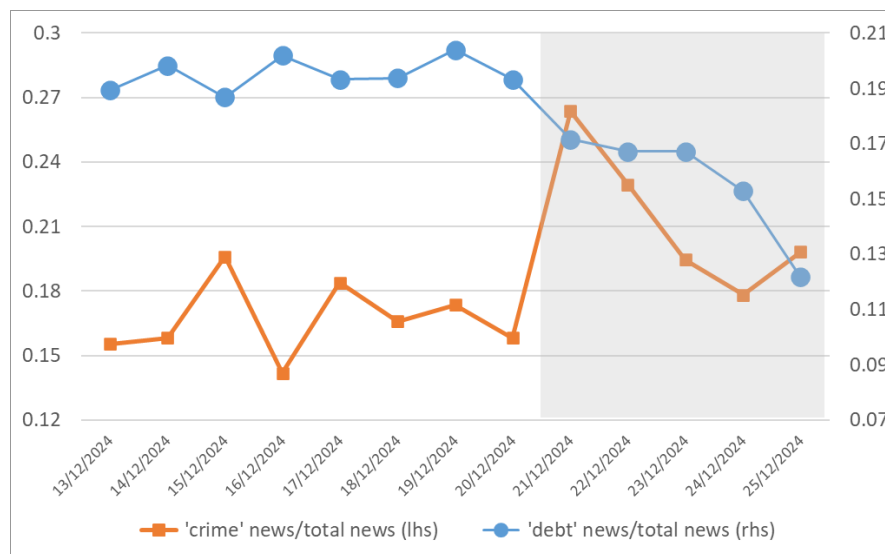
Amid concerns over stagnating growth, excessive migration, rising geopolitical tensions, and the need for significant investment in defence, German public opinion on the constitutional debt brake began to shift in early 2025. First implemented in 2009, the German debt brake once served as a model for the EU's response to the 2012 sovereign debt crisis; its removal might have wider consequences since similar constraints, with varying levels of strictness, are enshrined in the current constitutions of Italy, France, Slovenia, the Czech Republic, and even Switzerland, outside the EU. In January 2025, a survey by the German Council on Foreign Relations found that a clear majority of Germans now supports amendments to the debt brake — a stark departure from prior fiscal orthodoxy.¹ Rumours and discussions in political and economic spheres intensified gradually in the media, upending financial markets. After winning the February 2025 federal elections, the conservative alliance led by Friedrich Merz pushed through a constitutional amendment easing the German debt brake in March.

And so, in just three months, markets saw a substantial increase in long-term German yields, sending shockwaves across the entire Eurozone curve. We study these market reactions to shifting political support for the debt brake reform, as reflected in media coverage. We consider the extensive media margin, counting only topic-specific news volumes in local media outlets. According to Boczkowski and Mitchelstein (2013), people like to read news about sport, entertainment, weather and crime, with *economic*-related news typically receiving less interest. To infer causality, we exploit the exogenous variation in the volume of 'crime'-related news to identify the impact of 'debt'-related or *economic* news — a relevant information source for investors. It is well-established that negative news attracts media attention, and we are not the first to use terrorism, crime, or high-impact events for identification purposes (see Baker et al., 2024). Figure 1 displays the German media topic shares around the Magdeburg Christmas market attack from 20 Dec. 2024 — the deadliest most recent terrorist attack in Germany, with six fatalities and 299 injuries.²

¹ Survey results are available (in German) at <https://dgap.org/de/forschung/publikationen/mehrheit-der-deutschen-unterstuetzt-aenderungen-der-schuldenbremse>. Section A of our online Appendix provides a relevant timeline of the 2025 German relevant events in the political realm.

² The 2025 election results were largely driven by the rise of the extreme right, which in turn is closely linked to the increase in migration fears and number of terrorist attacks.

Figure 1: Daily German media coverage around the Magdeburg Christmas market attack



Note: Topic shares are based on news volumes extracted from GDELT; see section 2 for data construction details. The Magdeburg Christmas market attack occurred at 19:04 CET on Friday 20 December 2024.

In this letter we ask whether economic media coverage offers enough details to guide investors amid the uncertain outlook for German fiscal policy unfolding in early 2025. Our results provide a first account of bond market responses to what is likely to become a pivotal event for the Eurozone, which appears to be awakening to the implications of a significant fiscal expansion that media has already referred to as a fiscal ‘bazooka’.

2. DATA AND METHODS

We disregard short maturity yields to try instead capturing the long-term, structural change in market expectations in reaction to this fiscal shock. Besides German sovereign yields with maturities ranging from 5 to 30 years, we look at similarly long maturity yields for German green bonds and inflation-linked bonds.³ We also add French and Italian sovereign bonds – the largest two European sovereign bond markets in terms of notional outstanding. Such diverse bond characteristics should help us interpret the observed market reactions. A comparison between green bond yields and sovereign yields would help identify the role of

³ Germany currently has six green bond issues with maturities between 5 and 26 years, and three inflation-adjusted bond issues with remaining maturities between 5 and 21 years. See section B in the Appendix.

risk premia. Comparing inflation-linked bond yields with sovereign yields could tell whether ‘debt’-related news affects inflation expectations or real rates. Finally, contrasting French and Italian with German sovereign yields could help quantify the risk spillovers triggered by the suspension of the debt brake.

To extract media news, we use GDELT (i.e. Global Database of Events, Language, and Tone), an online archive set up with support from Google, designed to track global media coverage and analyse trends in news reporting. Our main explanatory variable is the (log) volume of ‘debt’-related news in local German media, which we instrument with the (log) volumes of local ‘crime’-related news (see section B in the online Appendix for the exact list of keywords).

Our sample starts in mid-December 2024 (the week of the Magdeburg Christmas market attack) and ends on March 31, just before the Trump’s tariff announcement that rattled global financial markets.

Yield curves are typically modelled using a combination of latent and macroeconomic factors (Ang and Piazzesi, 2003). Since for long-maturity yields the persistency of latent factors dominates, we look at yield changes to understand the underlying factors driving the bond markets. For each bond type, we set up a system linking daily changes in yields across various maturities that we estimate with SUR methods, with each equation specified as:

$$\Delta yields_{t,m} = \beta_0 + \beta_1 m + \beta_2 News_t + \beta_3 (News_t \# m) + \beta_4 X_t + \varepsilon_{t,m}$$

where m denotes maturity, β ’s are coefficients, $News$ denotes media news volumes (in logs), the $\#$ captures interactions, while X is a vector of dummies that control for important dates and weakly trading patterns. The estimator we apply is a GMM estimator with an optimal weighting matrix (see Wooldridge, 2002, Sec. 8.3).

3. RESULTS

A high first-stage F-stat supports the relevance of our instrument, which is based on German local ‘crime’-related news. Table 1 displays our main estimates, offering three insights. First, note that the coefficients associated with the $News$ variable suggest a statistically significant impact of economic media coverage on all long-term yields; the significance levels are rather conservative, although this is likely due to our short sample. Within the German fixed income

space, a stronger news impact can be observed for inflation-adjusted bonds (rather than for green and sovereign bonds); the size and significance of these coefficients suggest markets are expecting higher real interest rates – a result which is theoretically consistent with the effects of fiscal expansionary shocks (see Barro, 1974).

Table 1: Long maturity yields explained by German ‘debt’-related news

SUR estimates (standard errors are in parentheses)	German sovereign bonds	German green bonds	German inflation- adjusted bonds	Italian sovereign bonds	French sovereign bonds
constant	-0.2551* (0.1461)	-0.2571* (0.1474)	-0.3287** (0.1457)	-0.3093* (0.1785)	-0.3300** (0.1649)
Maturity	0.0047 (0.0034)	0.0049 (0.0035)	0.0088 (0.0056)	0.0051 (0.0034)	0.0038 (0.0031)
News	0.0354* (0.0202)	0.0357* (0.0203)	0.0455** (0.0202)	0.0429* (0.0246)	0.0457** (0.0228)
News # Maturity	-0.0006 (0.0005)	-0.0007 (0.0005)	-0.0012 (0.0008)	-0.0007 (0.0005)	-0.0005 (0.0004)
dummy (5 March)	0.2630* (0.1473)	0.2694* (0.1451)	0.0814 (0.1265)	0.1362 (0.2140)	0.1451 (0.1965)

Note: Daily data from 16 Dec. 2024 – 31 Mar. 2025. The # denotes interactions. Instruments used: log of German ‘crime’-related news (in absolute levels), 4 day-of-the-week dummies, and a dummy for 5th of March (see Appendix A). The first-stage F-stat of 12.7643 is estimated from a separate regression where ‘debt’-related news is regressed against ‘crime’-related news, and including all the above-mentioned dummies. Exact maturities for each system of equations are provided in section B of the Appendix. In parentheses, we report the asymptotic standard errors of the GMM estimator, which are robust to the presence of heteroskedasticity and correlation of errors across maturities. Results from Breusch-Godfrey tests show that the null hypothesis of no auto-correlation of errors across periods cannot be rejected at any reasonable significance level for all maturities. The ***, **, * denote statistical significance at 1, 5, and 10%.

Second, note that the constant term in Table 1 is always statistically significant and negative, although we report an average across all available maturities. This result must be seen in the context of the two interest rate cuts operated by the ECB at its January and March 2025 meetings; the subsequent downward tendency in bond yields was then carried into the

negative constant appearing in our estimates. Given that the (log) average *News* value is 3.2 over our sample, a back-of-the-envelope calculation suggests that the daily impact of media news is substantial, though lower than the estimated constant term; the direct implication of this exercise is that the two ECB cuts may have, for now, compensated the impact of the announced fiscal expansion on long-term nominal rates, although the next ECB moves could have lower effects.

Third, sovereign yields for Italy and France also react to the same news about German fiscal expansion but with larger (and statistically significant) coefficients. This proves financial markets expect substantial risk spillovers from Germany to other Eurozone countries. Moreover, the 5th March dummy is not significant in the case of Italy and France, confirming that the observed yield reactions reflect *indirect* contagion effects from Germany.

CONCLUSIONS

As German public attitude toward the debt brake began shifting in early 2025 ahead of federal elections, the media provided a platform for debates, sharing survey results and public opinions, which markets followed for policy signals. Despite a short sample, our analysis reveals German bond market reactions to *economic* news consistent with higher future real interest rates. This impact was largely compensated by the recent cuts in ECB rates, but whether next monetary policy moves can offset the resulting upward pressure on nominal long-term yields remains an open question. We also notice larger reactions in French and Italian sovereign bonds, which raises the risk that ECB transmission mechanism could be disrupted once again by a potential divergence in Eurozone yields. While ECB may deploy its newly available *Transmission Protection Instrument* (TPI) scheme to lower unwarranted sovereign spreads (and so limit the impact to Germany), it risks incentivising fiscal profligacy in the rest of the Eurozone and even lead to market confusion, blurring the already delicate boundary between fiscal and monetary policies.

There is also an interesting parallel with US sovereign bond reactions after Trump's tariff announcement from April 2025 that could warrant further investigation. Markets today are increasingly volatile and sensitive to news, shifting sentiment, and political signals, so overreactions cannot be excluded. However, the possibility that in the first months of 2025

bond markets correctly recognize the Eurozone-wide implications of the German fiscal ‘bazooka’ at such an early stage cannot be entirely dismissed.

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Online Appendix

Section A: Germany, Main Political Events Timeline, 2025

10-14 January: The *Forsa-DGAP* (where DGAP stands for the German Council on Foreign Relations) pool on easing the constitutional debt brake is conducted.

27 January: Pool results are published by DGAP; available in German at: <https://dgap.org/de/forschung/publikationen/mehrheit-der-deutschen-unterstuetzt-aenderungen-der-schuldenbremse>.

30 January: ECB cuts interest rates by 25 basis points.

23 February: Federal elections held. CDU/CSU leader Friedrich Merz and outgoing Chancellor Olaf Scholz agree to reform the debt brake by amending the Basic Law to exempt defence spending exceeding 1% of GDP and to establish a €500 billion infrastructure fund.

4 March: Merz holds a late evening press conference and proposes a significant increase in defence spending, stating, "Germany and Europe must quickly strengthen their defence capabilities." Financial markets reacted strongly next morning, on the 5th of March.

6 March: ECB cuts interest rates again by 25 basis points.

11 March: In coalition negotiations, the Greens secure €100 billion from the infrastructure fund for a climate and economic transformation fund and advocate for enshrining climate neutrality in the federal constitution.

13 March: The Greens party announce their support for the debt brake amendment, contingent on the agreed-upon climate-related provisions.

18 March: The Bundestag votes 512-206 in favour of the debt brake amendment, sending it to the Bundesrat for approval.

21 March: The Bundesrat passes the amendment 53-16, achieving the necessary two-thirds majority to become law.

25 March: The new Bundestag convenes, with Julia Klöckner elected as president.

Section B: Data construction details

The following benchmark maturities are used for German, French, Italian sovereign bonds: 5-year, 10-year, 20-year, and 30-year. There are currently 5 issues of German green bonds outstanding, with the following maturities: August 2030, August 2031, February 2033, August 2050, and August 2053; there are also 4 issues of German inflation-adjusted bonds outstanding, out of which 3 have maturities above 5 years: April 2030, April 2033 and April 2046. Residual maturities (considering February 2025 as a starting point) are calculated for green and inflation-adjusted bonds and used as regressors in our system of equations.

To extract news series from GDET we use specific keywords for each topic, as described in the table below, and limit our selection to German outlets. Besides ‘crime’-related news, we have experimented with ‘sport’-related and ‘entertainment’-related news as instruments with similar results. For the sake of completeness, it’s worth noting that ‘debt break’ and ‘fiscal policy’ are each expressed as single compound words in German: *Schuldenbremse* and *Finanzpolitik*, respectively.

Topic	Keywords used in GDET
‘debt’-related news	‘debt’, ‘deficit’, ‘borrowing’, ‘debt break’, ‘fiscal policy’
‘crime’-related news	‘crime’, ‘rape’, ‘murder’, ‘criminal’, ‘thief’, ‘accident’, ‘victim’, ‘terrorist’, ‘terrorism’, ‘incident’, ‘robbery’, ‘robber’

Note: At least one keyword must be present in the news, so there is an OR logical clause linking the keywords

Next figure displays the daily volumes of German news, by topic. In the analysis, Saturday and Sunday news are averaged together and reported with Monday’s news volumes.

