The Investment Institute
by UniCredit

Coffee Break

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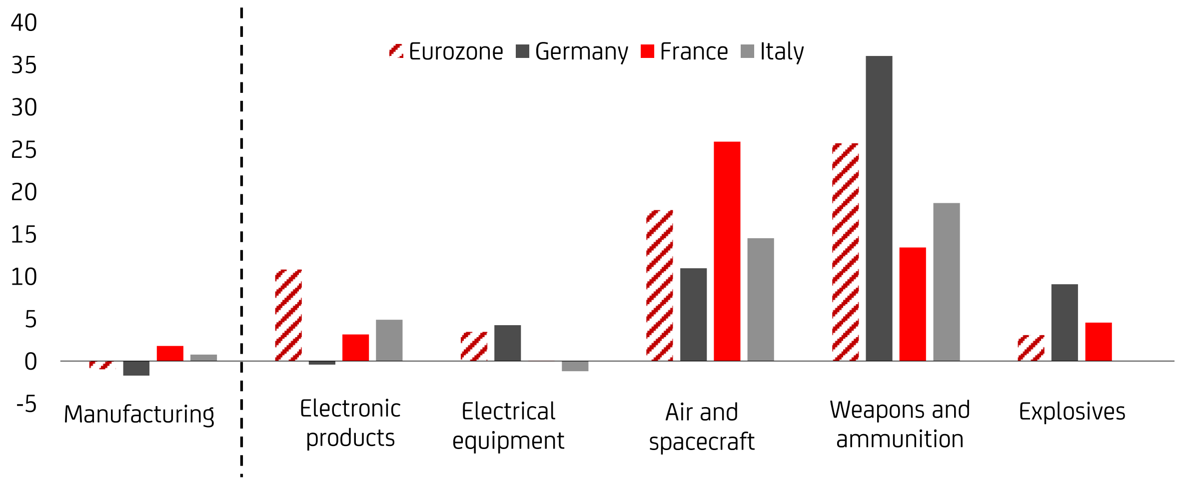
Eurozone defence spending is starting to be reflected in manufacturing data

28 August 2026

Spillovers from defence spending are becoming visible in the data, but their contribution to overall manufacturing remains limited as long as Europe's defence industry operates through fragmented national markets.

OUTPERFORMANCE OF DEFENCE-RELATED INDUSTRIES

(% CHANGE SINCE MARCH 2025)



Source: Eurostat, The Investment Institute by UniCredit

Note: The defence-related manufacturing basket comprises NACE codes 20.51 (explosives), 25.40 (weapons and ammunition), 26 (computer, electronic and optical products), 27 (electrical equipment) and 30.3 (air and spacecraft and related machinery). Latest data refer to June; performance is measured relative to March 2025, when the European Commission launched its rearmament initiative, Readiness 2030, which aims to boost defence spending and support an increase in military expenditure towards 3.5% of GDP by the end of the decade. The initiative was soon followed by Germany's announcement of a major national fiscal and defence package, reinforcing expectations of a sustained increase in military spending and defence-related investment across Europe.

THE CONTEXT

Eurozone economic activity continues to hold up well. Second-quarter GDP data exceeded expectations, while the latest business surveys point to persistent resilience in economic activity despite the energy shock faced by the region and heightened geopolitical uncertainty. Much of this resilience is likely linked to the fiscal impulse from the Next Generation EU (NGEU) economic recovery package, as member states accelerate public investment spending ahead of the programme's expiry at the end of 2026. However, evidence from the ECB and S&P Global surveys of non-financial firms suggests that the global AI investment boom and spending associated with Europe's rearmament drive since early 2025 have also become increasingly important sources of support. The manufacturing PMI output index for August released last week rose to its highest level since Russia's invasion of Ukraine, driven by robust demand for AI-related technology goods and rising equipment spending linked to higher defence expenditure, particularly in Germany. Notably, this resilience was recorded despite renewed tensions in the Middle East during the month.

THE DATA

Our chart tracks the performance of a defence-related manufacturing basket across the eurozone and its largest member states. Performance is measured relative to March 2025, when the European Commission launched its rearmament initiative, Readiness 2030, followed by Germany's national fiscal and defence package shortly thereafter. The manufacturing basket includes weapons, ammunition and explosives, along with other sectors likely to be directly affected by the rearmament cycle. This reflects the fact that modern defence capabilities increasingly rely on complex technology and supply chains spanning electronics (sensors, radars and guidance systems), electrical equipment (power systems, communication and defence infrastructure) and aerospace (drones, aircraft and satellites). Although weapons and explosives have posted the largest increase in output, their small weight (i.e. less than 1%) limits their impact on overall manufacturing. By contrast, the solid performance of aerospace and electronics, together with more moderate gains in electrical equipment, support overall manufacturing activity more meaningfully.

OUR VIEW

The emergence of broader industrial spillovers from defence spending, coupled with forward-looking survey evidence pointing to further gains ahead, is an encouraging development for the euro-area economy, as it points to a potentially important and durable source of growth. The impact on overall manufacturing remains relatively limited for now. However, this is consistent with the widely expected backloaded nature of the rearmament cycle, reflecting implementation lags, capacity constraints and the slow transmission from budget allocations to manufacturing output.

The real game changer for the eurozone's industry will be member states' ability to build a truly integrated and modern European defence industrial base. While nearly 80% of EU defence procurement has recently taken place outside the union, the Draghi report on EU competitiveness argues that this cannot be explained solely by gaps in Europe's defence offering. Administrative simplicity, better visibility of available products through US procurement channels, fragmented European demand and the desire of some member states to maintain close interoperability with US forces have all played an important role.

As a result, the main obstacle may not be the absence of European industrial capabilities as such but rather the lack of an integrated European defence market able to aggregate demand, provide visibility to buyers and support large-scale production. In this respect, initiatives such as Security Action for Europe (SAFE), albeit still in its infancy, could help to address some of these shortcomings. By promoting European sourcing and joint procurement, the program may encourage the development of cross-border supply chains, production capacity and procurement networks, thereby supporting the gradual integration of Europe's defence industrial base.

OTHER THINGS TO NOTE

Fitch set to review France's sovereign rating

Fitch is due to review France's sovereign credit rating today, which is currently at A+ with a stable outlook. While the agency may strike a more cautious tone on the sovereign's fiscal outlook amid rising debt-servicing costs, we do not expect a change to the stable outlook. Fitch already stated in March that meaningful fiscal consolidation ahead of the 2027 presidential election appeared unlikely. In addition, although French GDP growth is likely to undershoot the assumptions underpinning the previous review, uncertainty around the 2027 outlook remains elevated given the geopolitical backdrop. If confirmed, Fitch's rating would remain in line with S&P's and one notch below Moody's Aa3 rating, which carries a negative outlook. (T. Bucco)

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