

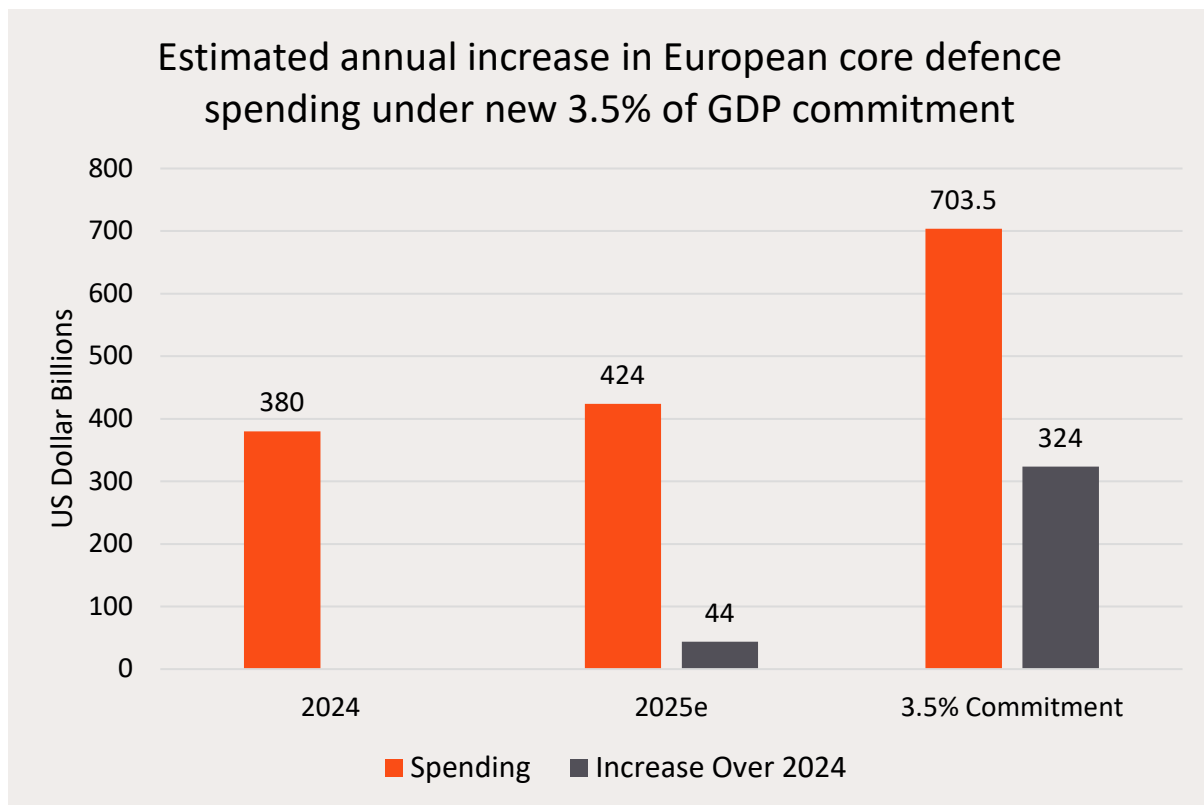
NATO's 5% commitment

NATO's summit in The Hague went largely to script last week, ushering in a new era of European defence spending, reaffirming the US's commitment to the alliance and furthering support to end the war in Ukraine. For investors, the focus will now shift to how and when new spending commitments will be met and the companies set to benefit the most.

The highlight of the summit was the unanimous signing of a declaration committing to new spending targets. By 2035 NATO members will be expected to spend a total of 5% of GDP, up from the 2% target expected to be met for the first time by all members just this year, on defence split between core defence requirements (3.5%) and defence and security related spending (1.5%) - think critical infrastructure and cybersecurity.ⁱ Promisingly, for both the US and European defence industries, the declaration also states that members will work towards eliminating defence trade barriers amongst allies.

Ultimately it is promising to have the new declaration signed however governments will now need to figure out how they can balance increased defence spending with high debt levels and other fiscal priorities. It is important to note that there was pushback to the new requirement from some governments, namely Spain, Slovakia, and Belgium, and despite signing the declaration early indications are that these nations will not meet the target by 2035 but instead aim to meet NATO's Capability Target goals with lower levels of spending.

We expect Germany to lead the way for the region's defence spending, having the fiscal capacity and indicating that it will reach the 3.5% core target by 2029ⁱⁱ, driving Europe in aggregate to reach 3% of GDP within the next five years, or an additional US\$223bn per year spent on defence (based on 2024 GDPs). Meeting the 3.5% target would see Europe spend an additional estimated US\$324bn per year.



Source: Goldman Sachs Investment Research, Company Filings, European Council, ECB Data Portal. 2025e are estimates. Scenarios are based on percentage of GDP spending using 2024 EU GDP. Actual results may differ materially from estimates and scenarios.

The next most important item on NATO's agenda was reaffirming the US government's commitment to the organisation and in particular Article 5's principle of collective defence; *an attack on one is an attack on all*. The US government has not shied away from criticising NATO's European members for their reliance on the US defence capabilities and lack of spending. However, with Trump getting European members to commit to his desired 5% of GDP spending target, and conspicuous deference from NATO Secretary General Mark Rutte during the summit, the US, along with all other members, reaffirmed their ironclad commitment to NATO's principles.

No doubt Trump will continue to be vocal about European defence spending as commitments develop into plans and action however the summit will be marked as a big victory for the organisation in changing the tone of the US administration as well as a promising step for continued large US defence exports to European nations.

Finally, Ukraine remained heavily on the agenda but was no longer centre stage. The Ukrainian administration was reassured of the commitment of allies with US\$45 billion pledged in aid to Ukraine so far this year. They will also be pleased with the improved relations between Trump and Zelensky, marked by a meeting following which Trump was uncharacteristically critical of Russian leader Vladimir Putin and sympathetic toward Ukraine's position. Trump's goal remains to end the war in Ukraine, however he is finding Putin harder to deal with than expected. Beyond these events, there were no major developments towards further Ukraine support or solutions to ending the war.

Investment implications:

These recent developments could generate sustained demand for defence contractors, cybersecurity firms and companies specialising in critical infrastructure.

Companies that are headquartered in NATO or closely aligned countries, including the US, Germany, the UK and France will be at the forefront of implementing the 5% GDP defence spending commitment. Companies like Rheinmetall, Lockheed Martin, Palantir, and BAE Systems are some of the largest defence companies across those regions and therefore are poised to receive significant procurement contracts from increased spending.

These defence companies are uniquely positioned to potentially benefit from a range of long-term structural defence initiatives that go beyond just the increased 5% NATO military spending announced over the weekend. These include:

- The EU's €800 billion "Readiness 2030" initiative, which pools funding for infrastructure modernisation, weapons systems interoperability, and shared logistics to strengthen Europe's defence readiness by the end of the decade. This plan prioritises procurement from trusted, NATO-aligned contractorsⁱⁱⁱ.
- Permanent Structured Cooperation (PESCO), a binding EU defence pact involving 26 member states, supports joint projects in air defence systems, drone swarms, cyber defence networks, and military transport corridors. Companies such as Rheinmetall, Thales, and Leonardo are among the industrial beneficiaries of these collaborations.^{iv}

These multinational programmes are not short-term budget cycles but are embedded into national security doctrines and industrial policy. As such, they underpin a consistent and durable pipeline of spending and a bullish outlook for defence stocks ahead.

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ⁱ NATO, https://www.nato.int/cps/en/natohq/topics_49198.htm

ⁱⁱ <https://www.reuters.com/business/aerospace-defense/germany-raise-defence-spending-35-gdp-by-2029-sources-say-2025-06-23/>

ⁱⁱⁱ https://commission.europa.eu/document/download/e6d5db69-e0ab-4bec-9dc0-3867b4373019_en?filename=White%20paper%20for%20European%20defence%20-%20Readiness%202030.pdf

^{iv} <https://www.rheinmetall.com/en/media/news-watch/news/2024/10/2024-10-15-leonardo-and-rheinmetall-establish-joint-venture>

https://www.thalesgroup.com/en/worldwide/defence/press_release/land-tactical-collaborative-combat-latacc-project-accelerates