Europe’s defence after the ‘peace headlines’: policy over price

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Key Takeaways

- Recent talks yielded no binding deal; markets overpriced a quick settlement and underpriced the cost of credible deterrence and possible European peacekeeping.
- NATO 5% by 2035 (>3.5% core defence) and the EU’s €150bn SAFE programme hard-wire multi-year budgets.
- Readiness 2030 and EDIS/EDIP drive single market integration, industrial capacity build-out, and dual-use innovation in AI, drones and space.
- August’s sell-off looks like a valuation reset; the structural outlay path remains intact.

European defence companies were among the market’s standout themes in the first half of 2025. The defence companies rallied as Europe moved from rhetoric to action on rearmament. The August wobble, sparked by headlines about potential US–Russia diplomacy and a mooted Ukraine ceasefire, has led some to ask whether the thesis has run its course. Our view remains that the setback is cyclical while the drivers are structural. Put simply: the pullback is not the story, the commitment is.

Markets have latched on to ‘deal’ headlines, in our view overpricing the probability of a near-term settlement and underpricing the cost of deterrence even if one is struck. Even with an agreement, a credible ceasefire with robust security guarantees implies a sustained European military presence on the ground, together with stockpile rebuilds and higher readiness along NATO1. News reporting also discusses a potential European peace force, which would be expensive in its own right, with multi-year procurement and sustainment needs. In short, deterrence is capital-intensive; the recent de-rating looks like sentiment, not a change to the structural outlay path.

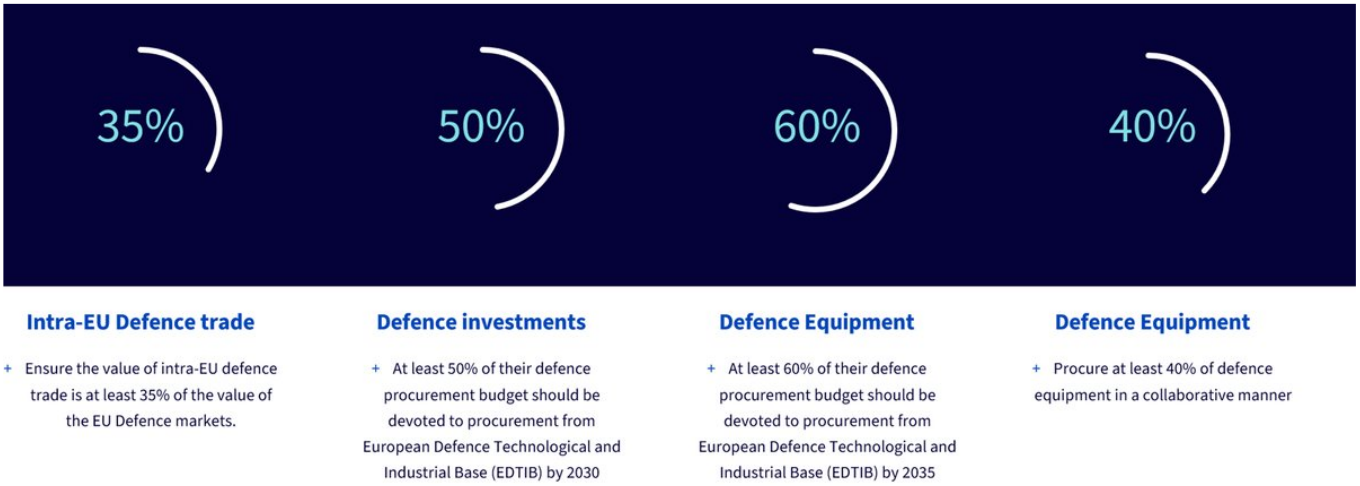
Structural commitments: what changed in 2025 is policy, not sentiment

Europe’s defence trajectory is now codified in treaty-level and EU-level frameworks. At NATO’s Hague Summit on 24–25 June 2025, allies set a new framework to lift outlays to 5% of GDP2 by 2035, including at least 3.5% for core defence3. This is a step change from the long-standing 2% yardstick and anchors a multi-year glidepath for budgets rather than a one-season spike.

Brussels has built financing and industrial scaffolding to match the ambition. On 27 May 2025, the Council formally adopted the Security Action for Europe (SAFE) instrument — providing up to €150 billion4 in EU-backed loans to co-finance joint procurement and scale priority capabilities, from air and missile defence to munitions and drones. The intent is to overcome fragmentation and to give prime contractors and their supply chains the predictable demand needed to invest at scale.

Crucially, the ramp begins from a higher base. EU members' defence outlays reached an estimated €326 billion in 2024, about 1.9% of GDP and more than 30% above 2021, evidence that rearmament has already moved from rhetoric to budgets5. Alongside the money, the European Defence Industrial Strategy (EDIS) and the associated European Defence Industry Programme (EDIP) set clear direction for a genuine single market in defence, with explicit targets to raise intra-EU procurement and collaborative buying by 2030 and to progress towards at least 60% of procurement within the EU by 20356.

Figure 1: European Defence Industrial Strategy (EDIS) objectives up to 2030 — responsibilities of member states



Source: European Commission: Joint communication to the European Parliament, the Council as of August 2024. **Historical performance is not an indication of future performance, and any investments may go down in value.**

Beyond Ukraine: durable demand

The Commission's Readiness 2030 framing is blunt: "the moment has come for Europe to re-arm" and to deliver a "once-in-a-generation surge" aimed at rebuilding deterrence, supporting Ukraine and constructing a resilient industrial base. It also characterises Ukraine as "the world's leading defence and technology innovation laboratory," reflecting an intention to integrate Ukraine into Europe's defence ecosystem over time. That logic holds even if the fighting pauses. After the largest land war on the continent since 1945, the objective is credible European force by 2030, whether the battlefield falls quiet in 2026 or 2027. Budgets built around deterrence are sticky; they are tied to treaty obligations, geopolitical necessity and an industrial strategy that will take years to deliver.

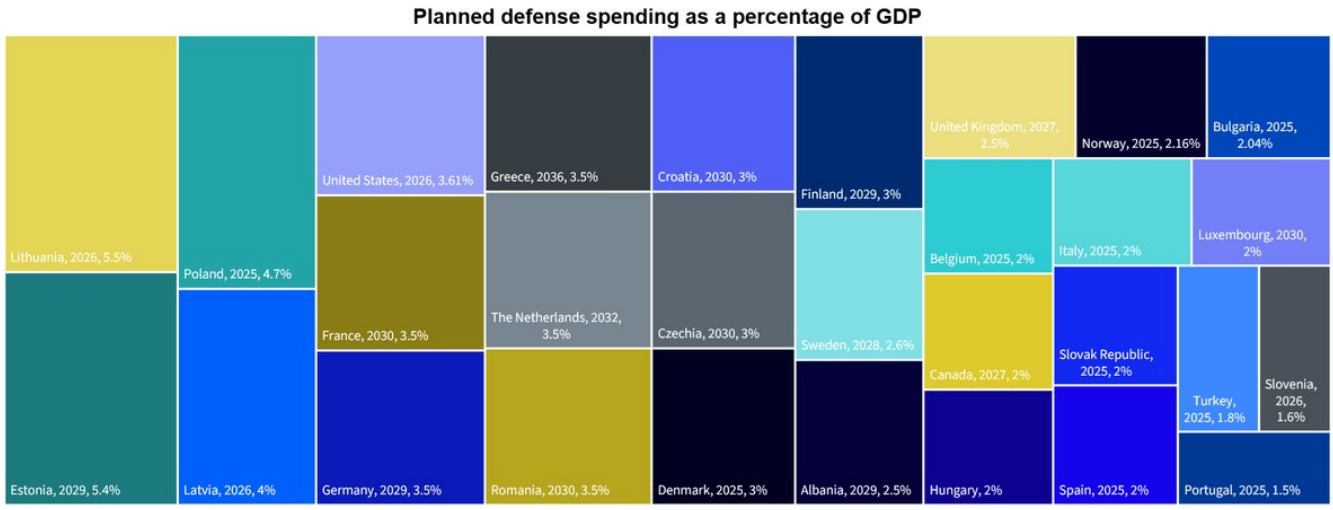
The mooted security-guarantee track reinforces the point. The April counterproposal7 seeks robust, U.S.-backed guarantees with Article-5-like features and envisages no talks on territorial concessions until a full ceasefire is in place. If such a framework were agreed, Europe would by design sit at the centre of day-to-day implementation. That implies force generation, persistent presence and sustained readiness, drivers of demand rather than a reason to retrench. Separate reporting describes European planning for potential peacekeeping contingents and a U.S. 'backstop' of air and enablers, consistent with Washington's reluctance to deploy ground forces.

Industrial upswing and technological innovation

Europe's defence turn is industrial policy as much as military policy. Longer, predictable order books are catalysing capex8, hiring and supply-chain expansion, drawing in legacy sectors such as steel, chemicals and automotive and beginning to address the historic 'scale problem' of a fragmented market. A visible case is Rheinmetall's view that Volkswagen's Osnabrück plant would be "very suitable" for conversion to defence production9 — contingent on large, sustained orders such as serial Lynx infantry-fighting-vehicle runs. That is exactly the sort of predictability a NATO 5%/3.5% pathway and the EU's SAFE loans are designed to create.

The technology dimension is equally important. Defence investment spills into AI10, robotics, space and advanced electronics — dual-use domains where Europe seeks resilience and strategic autonomy. Readiness 2030 explicitly links outlay to these frontier areas. Sustained, multi-year procurement enables the kind of capital deepening Europe's fragmented ecosystem has lacked, improving scale and competitiveness.

Figure 2: Planned defence spending as a percentage of GDP



Source: NATO, WisdomTree as of 26 June 2025. Please note: Montenegro and North Macedonia have not added any new pledge.

Prices are cyclical, policy is sticky

Markets move faster than policy. By the time Brussels announces a new initiative, investors often price it instantly; when shares 'run double in a matter of months,' the potential stage was set for pullbacks when sentiment wavers. The mistake is to read price action as policy reversal. Prices are cyclical; the budgets beneath them are durable, locked in by treaty commitments and industrial strategy. Europe's timeline is still at the beginning: Readiness 203011 implies capacity building through the end of the decade. In that framing, August's sell-off is turbulence on the runway, not the plane turning around.

Recent diplomacy strengthens a baseline scenario in which Europe assumes more of the security burden, consistent with Washington signalling a more limited U.S. role in any long-term guarantees and with NATO's new spending architecture. Various reports have even discussed a European peacekeeping presence under a ceasefire framework (still at the exploratory stage and far from agreed), which would not reduce equipment or readiness requirements.

Conclusion

The news cycle has been dynamic; the policy architecture is not. NATO's 5%-by-2035 framework, with a 3.5% core-defence floor, signals rising budgets into the next decade. The EU's SAFE instrument backs that with up to €150 billion for joint procurement and capacity expansion, while EDIS/EDIP aim to turn a patchwork of national programmes into a functioning European market for defence equipment. All of this builds on a spending base already at €326 billion, more than a third above 2021. And the most plausible settlement contours, in which Washington provides air power and enablers while Europeans shoulder an on-the-ground role under robust guarantees, suggest that even a ceasefire would sustain, not sap, demand. This remains a policy-led, long-duration theme rooted in deterrence, industrial readiness and technological spillovers. The recent pullback does not invalidate that logic; if anything, it improves entry points into an industrial and capability build-out designed to endure.

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1 North Atlantic Treaty Organization
2 Gross domestic product
3 NATO: NATO concludes historic Summit in The Hague https://www.nato.int/cps/en/nato-hq/news_236516.htm
4 European Commission: EU Member States endorse €150 billion SAFE defence loan instrument to boost European defence capabilities https://ec.europa.eu/commission/presscorner/detail/en/ip_25_1340
5 European Council https://www.consilium.europa.eu/en/policies/defence-numbers/?utm_source=chatg-pt.com
6 European Commission https://defence-industry.eu/first-ever-european-defence-industrial-strate-

gy-to-enhance-europes-readiness-and-security

7 Reuters: Ukrainian and European peace deal counterproposals to US at talks in London https://www.reuters.com/world/ukrainian-european-peace-deal-counterproposals-us-talks-london-2025-04-25/

8 Capital expenditure

9 Reuters: VW's Osnabrueck plant would be 'very suitable' for defence production, Rheinmetall CEO says https://www.reuters.com/business/aerospace-defense/vws-osnabrueck-plant-would-be-very-suitable-defence-production-rheinmetall-ceo-2025-03-12/

10 Artificial intelligence

11 White Paper for European Defence – Readiness 2030: https://commission.europa.eu/document/download/e6d5db69-e0ab-4bec-9dc0-3867b4373019_en

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