

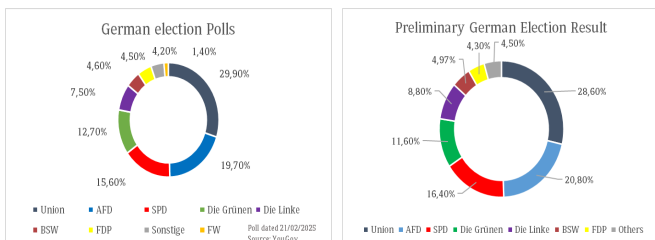
German elections – First thoughts

The election expectations vs. outcome

Before the election, opinion polls already suggested that in the absence of a significant swing, the Union party (CDU and CSU) would become the largest party in the Bundestag and that the CDU/CSU- SPD (Social Democrats) grand coalition would be able to form a government. With most of the votes counted, the Union secured 28.52% of the votes, ahead of the far-right Alternative for Germany (20.8%). The Social Democrats (SPD) followed with 16.41% and the Greens with 11.61%. Among the smaller parties, FDP won 4.33%, BSW 4.97% and Die Linke 8.77%. Only Die Linke made it above the 5% minimum threshold to enter the Bundestag.

It thus looks as if the CDU/CSU- SPD grand coalition will be able to form a government, with Friedrich Merz (CDU) as Chancellor. That is the good news. The main democratic parties, (i.e. Union, SPD and Greens) probably do not have the required two-thirds Bundestag majority to reform the debt brake. This a key source of uncertainty. Die Linke would support a relaxation of the debt brake, but they want to see reduced military spending.

FIGURE 1: THE OPINION POLLS BEFORE AND AFTER THE ELECTIONS



Source: yougov.de, ZDF - BNP Paribas

Next steps

Coalition talks focus on three topics: social spending, financing via a reform of the debt brake, and immigration. With a grand coalition, we expect key negotiations around the first two. Since 2002, the average time to form a coalition has been over 70 days.

Economic impact

Uncertainty: as political uncertainty has had a negative impact on German economic growth, removing this uncertainty should be positive for growth in the coming months.

Debt brake: at this stage, the main democratic parties (i.e. Union, SPD and Greens) do not have the required two-thirds Bundestag majority to reform the debt brake or put-up off-budget funds. As mentioned, Die Linke advocate a relaxation of the debt brake, but they want to see reduced military spending.

We see support for higher spending via dedicated off-budget vehicles as more likely than a total reform of the debt brake. Obtaining support for temporary, purpose-oriented public spending should be easier than an open-ended increase in borrowing. There does not yet appear to be a consensus on how to spend the extra borrowing, and details matter.

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Fiscal stimulus: depending on the possible agreement to loosen the debt brake, we foresee a 0.7% of GDP increase in investment spending on an annual basis. This should lead to an increase in real GDP growth of around 0.3%. Depending on the policy mix, the effects may be larger in the medium term if coupled with supply-side reform such as a reduction in red tape for businesses. New debt via off-budget vehicles could, however, take 12–18 months to become available.

Lower energy prices: the 3 main democratic parties all support measures to reduce energy prices. This factor, combined with the end of the Ukraine conflict could lead to a substantial fall in energy costs for specific industries but also households.

Conclusion

The outcome of the German election is supportive for markets as it reduces uncertainty, and it raises the prospect for higher government spending with potentially high multiplier effects. The fact that the main democratic parties (Union, SPD and Greens) do not have the sufficient two-thirds Bundestag majority to reform the debt brake or put-up off-budget funds remains a source of uncertainty. The other main obstacles are the lack of consensus on how to spend the extra borrowing, and details matter. Major progress on such a consensus is still needed to evaluate the full impact and timing of a recovery in Germany. In such a scenario, Germany could also lead the way to more consensus at the EU level leading to a breakthrough in terms of large public investments, especially in defence and infrastructure.

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