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Amundi ASSET MANAGEMENT

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GERMAN ELECTIONS: INVESTMENT VIEWS

INVESTMENT TALKS

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What is your view on the German election outcome?

Perrier: The German election outcome does preserve leadership continuity, but is nonetheless very disappointing for Chancellor A. Merkel. The far-right's high score sends a clear warning. As expected, Merkel's center-right CDU/CSU party came first by a wide margin, which should secure her 4th term as chancellor. However, the CDU/CSU's score was significantly below forecast, as was the result of its main opponent (and incumbent government coalition partner) the center-left SPD, that obtained its worst result since the creation of the Federal Republic of Germany. The gains went to smaller parties, first and foremost the anti-immigrant and Eurosceptic AfD, whose almost 13% vote is significantly more than predicted by the polls. The AfD therefore asserts itself as the country's 3d party and will enter the Bundestag for the first time, which will give it a platform to make its voice heard louder in political debate. To a lesser extent, the pro-market FDP, the Greens also did better than forecast.

Building a government coalition will take time. After the SPD's disappointing result, this party has announced that it will not go in coalition again with the CDU/CSU. As the CDU/CSU will not want to form a coalition with the AfD, this leaves a 3-way coalition of the CDU/CSU, the Greens and the FDP as the only possible option for majority. This will not be easy as these parties' agendas include significant differences, which will probably take many weeks of negotiations to bridge.

What are the major implications of the vote on the German economy?

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Perrier: The prospects for the German economy will not change dramatically, although there will be a moderate fiscal stimulus. The agenda of all mainstream parties include tax cuts, while the amount and details will depend on the outcome of the negotiations to form a government coalition. These parties also plan new public spending efforts, although they disagree on priorities (infrastructure, social and/or defence). It is to be noted that, even though many external observers call on Germany to boost infrastructure investment, the CDU/CSU appears more inclined to do so by removing bureaucratic hurdles than by committing more federal money. Despite tax cuts and spending measures, we are not expecting Germany's economy to expand more rapidly next year as the current pace is already quite strong (more than 2% per year in real terms). Longer term, the details of the government coalition may affect the way Germany tries to address major challenges such as the rebalancing of an economy that relies too much on external demand, the issue of rapid population ageing and the perceived rise in social inequalities despite the ultra-low unemployment rate. The electoral success of the anti-immigrant AfD also means that the new government will not take the risk of repeating the open-door policy of 2015 any time soon.

What does the German elections result mean for Europe?

The German approach towards Europe could become slightly more cautious.

Perrier: The German approach towards Europe will not change significantly, although it could become slightly more cautious. There remains a large pro-European majority in the German Parliament. As the FDP insists on clear limits to European solidarity, it could be argued that the necessity to include this party in government will reduce Germany's appetite for new or strengthened Eurozone institutions. However, this view must not be exaggerated as the FDP will only be a junior partner of a coalition dominated by the CDU/CSU that will also probably include the very euro-friendly Greens. The new German government will probably not fully close the door to new initiatives to strengthen the Eurozone (such as the transformation of the ESM into a European Monetary Fund, or the creation of a Eurozone Ministry of Finance and budget, recently proposed by France). Yet the German approach will be all the more prudent, preserving the country's veto right when it comes to risk sharing among Eurozone members. A German preoccupation will continue to be that strengthened European institutions must send the "right" incentives by not making it easier for other countries to overspend their budget or avoid necessary reforms. Moreover, the electoral success of the Eurosceptic AfD (even though this party has recently been more outspoken against immigration than against Europe) sends a warning to mainstream politicians that they need to take the time to explain and any new advances in European construction very carefully to the population.

The outcome and composition of the Federal Government will have a very significant signaling effect for the markets.

What are the likely implications of the electoral result on European equity markets?

Franzin: The outcome of the German elections has, in our view, been in line with investors' expectations. Ms Merkel represents to investors an element of strong continuity in terms of both domestic and European policy, however the larger than expected rise of AfD might create some uncertainty in investor's minds and could curb the recently affirmed trend of anti-European protest vote fading away in terms of political relevance. The outcome and composition of the Federal Government will have a very significant signaling effect for the markets. In any case, with Ms Merkel at the helm, political risk premia should remain low, further strengthening the case for European equities. While some consolidation of performance might be possible in the short-term, we would expect the market to be supported by strong earnings growth and attractive relative valuation compared to other developed markets.

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Where do you see the major opportunities in European equities?

Franzin: With Europe's two largest economies now being led by two pro-European coalitions, we expect the cyclical recovery to continue. We anticipate a positive performance of the more value orientated parts of the market such as Banks, Energy, Industrials, and Telecoms as the economy improves further. At a later stage, should the European Union pursue a strong and deeper integration, this cyclical recovery could extend beyond these industries and act as a catalyst for a further market re-rating. In the meantime, we believe stock-selection will remain key for equity investors.

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