

German election remains open, with an eye on the green transition



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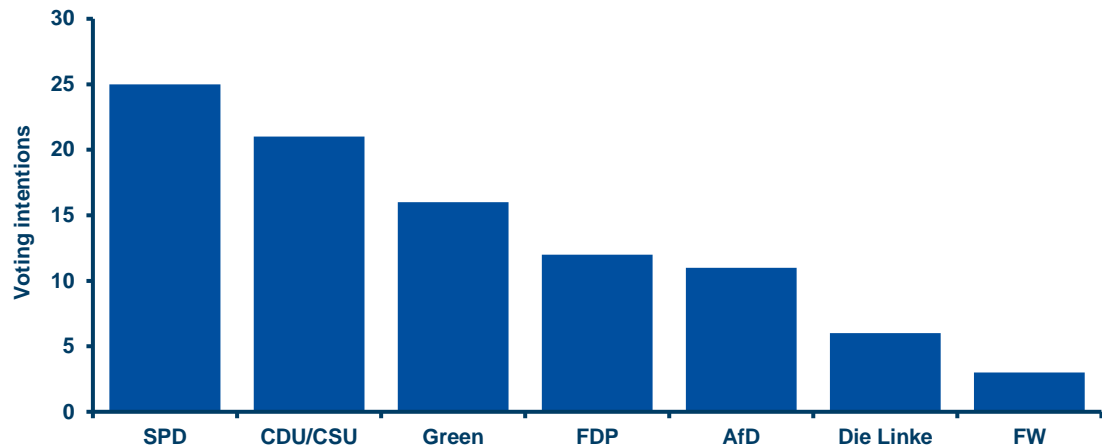
- **Election outcome:** The most likely winner in terms of votes and seats will either be the Social Democratic Party (SPD) or the conservative Christian Democratic Union/Christian Social Union (CDU/CSU). Likely scenarios include the **‘traffic-light’ coalition** (SPD-Greens-pro-market Liberal Democratic Party, FDP) or the **‘Jamaica’ coalition** (CDU/CSU-Greens-FDP). However, other combinations are possible.
- **Focus of the new government:** The new German government will have to **deal with short-term economic challenges and with the need for long-term economic transformation**. On the economic front, we should not expect abrupt changes, as the views of major parties are not particularly far apart on most economic topics and coalition logic implies consensus-based decisions. There is likely to be more appetite for fiscal spending than in the pre-Covid-19 era due to the need for higher public investment. At the margin, **the nature of the coalition will matter in determining the speed with which Germany returns to a balanced budget, as well as regarding the details of the tax, spending and reform priorities**.
- **On the European front**, we should expect continuity in the German approach, that is openness – yet very cautious – for further European integration. Renewed progress might be achieved on the capital market union and the completion of the banking union. On fiscal matters, an SPD-led government might show higher tolerance for fiscal deficits in European partners and more openness to a revamp of European fiscal rules than the CDU/CSU would. Regarding foreign policy, Germany needs to determine where it stands against the backdrop of the intensifying United States/China competition. Mainstream German political parties are fully committed to NATO, but the strong business linkages that Germany has with China are a factor to take into account.
- **Investment implications:** With **the CDU/CSU in the lead, we expect a more favourable combination for corporates and equities**, as the party aims to reduce the tax burden and sponsor private investments on the road towards the green transition. A ‘traffic light’ outcome is probably priced in, while the emergence of a ‘Jamaica’ coalition might favour the German equity market, although only in the short term. With the CDU/CSU in the lead, there might be more willingness towards higher interest rates, especially if Friedrich Merz becomes finance minister. **Since the Greens are likely to be part of any ruling coalition, we expect an acceleration of the ESG focus**. On the other hand, this might make it more difficult to find an EU-wide ESG standard, as traditionally the Greens are against nuclear power. We believe that German assets could offer appealing investing opportunities to global investors, primarily in the equity market, **with a focus on those industries that are transitioning towards the net-zero goal by 2045. More generally, sectors such as green energy and automotive might be attractive, given the focus on the transition towards e-mobility**.

ELECTION OUTCOME

Possible scenarios and government formation

Almost certainly, either the SPD – if its recent surge in the polls is to be trusted – or the conservative CDU/CSU will come first in terms of votes and seats, unless the Greens manage an unexpected comeback. However, as has happened in previous elections, no party will secure a majority in the Bundestag by itself. **Polls indicate that for the first time a three-party coalition will be required to form a majority government.**

German election polls



Source: Amundi Research, Politico.eu. Data is as of 17 September 2021.

“Likely coalition scenarios include the ‘traffic-light’ coalition and the ‘Jamaica’ coalition.”

The need for three parties may add to the complexity of coalition-forming negotiations, for which there is no formal process. Things could settle quickly or could take weeks or even months (negotiations for the current government majority took several months in 2017-18). Meanwhile, Merkel’s government will remain in a care-taker position. **Likely coalition scenarios** include the **‘traffic-light’** coalition (SPD-Greens-FDP) and the **‘Jamaica’** coalition (CDU/CSU-Greens-FDP). The latter appears likely especially if the SPD does not come first in the election. Alternative combinations where the CDU/CSU and SPD would rule together are less likely, as it would require one of these parties to be the other’s junior partner, something that both seem reluctant to do. A **‘red-red-green’** coalition (SPD-Greens-Die Linke, the far-left party), while theoretically possible, would require bridging the wide gap between the views of the very moderate Olaf Scholz (Germany’s current Vice Chancellor and Finance Minister and SPD candidate) and those of Die Linke. In any case, **the new government will have to deal with short-term economic challenges** (e.g., managing the Covid-19 aftermath, notably the withdrawal of emergency measures), as **well as with the need for long-term economic transformation**, which includes safeguarding the country’s competitive edge, re-thinking the position of its large car sector, further greening the economy and dealing with an ageing population. These topics are intricate and closely linked with other EU and Eurozone topics under discussion, in which the German government can play a pivotal role.

Potential coalition scenarios

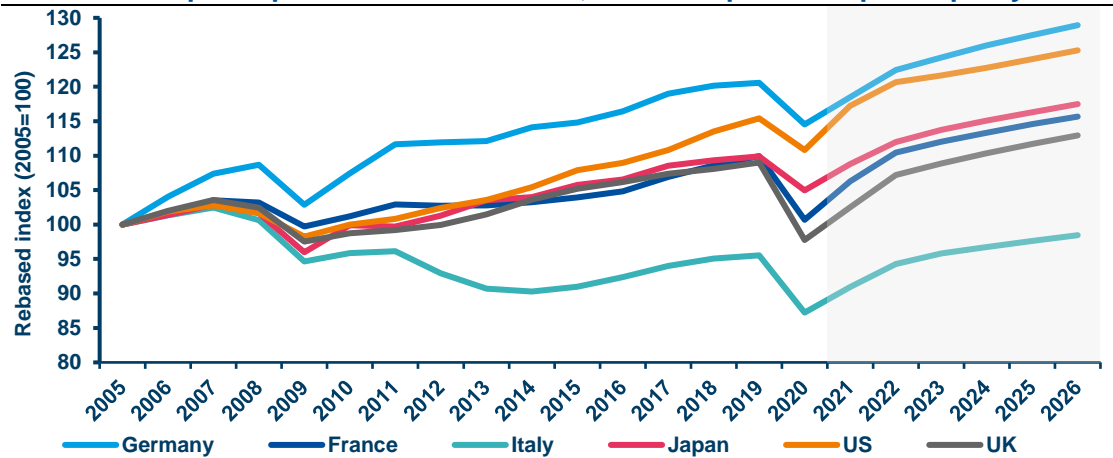
Senior	Junior	Add	Implications
SPD	Green	FDP	Slightly easier fiscal policy (at both the German and Eurozone level), more green friendly
CDU/CSU	Green	FDP	Continuity, yet more green friendly
SPD	CDU/CSU	FDP	Marginally easier fiscal policy (at both the German and Eurozone level)
CDU/CSU	SPD	FDP	Continuity
SPD	CDU/CSU	Green	Slightly easier fiscal policy (at both the German and Eurozone level), slightly more green friendly
CDU/CSU	SPD	Green	Continuity, yet slightly more green friendly
SPD	Green	Die Linke	Significantly easier fiscal policy (at both the German and Eurozone level) and green friendly, reversal of pro-business policies

Source: Amundi Research as of 20 September 2021.

Implications for the German economy

Since Angela Merkel took office in 2005, Germany's real per-capita GDP has risen faster than its peers. Today, German unemployment sits near a 20-year low, with the highest rate of female labour force participation among G7 countries, helped by improved childcare.

Rebased real per-capita GDP and forecasts, based on purchase-power parity



Source: Amundi, Bloomberg. Data is as of 20 September 2021. Forecasts are by the IMF.

“We should not expect abrupt changes in German policies as the views of major parties are not widely apart on most economic topics and coalition logic implies consensus-based decisions.”

However, Germany's economy remains largely reliant on the export-oriented manufacturing sector, which accounts for some 40% of all Eurozone output. As such, the country is exposed to China's slowdown. The incoming Chancellor will need to address this issue, among other challenges, which include the low rate of public investment that has led to low penetration of high-speed broadband and a large urban-rural divide, and the country's still heavy reliance on coal power. Against such a background, we should not expect abrupt changes in German policies as the views of major parties (CDU/CSU, SPD, and Greens) are not widely apart on most economic topics and coalition logic implies consensus-based decisions. Moreover, the German political system has powerful checks and balances: many decisions need to be approved by the Bundesrat (the country's upper chamber), where a *de-facto* unanimity of major parties is required, with the Constitutional Court as another important moderator. Whatever the coalition, **there is likely to be more appetite for fiscal spending than in the pre-Covid-19 era, due to the need for higher public investment.** However, a 'Jamaica' coalition is likely to be more restrictive on the *debt brake rule* than a 'traffic light' one. The nature of the coalition will matter, especially over time, in determining the speed with which Germany returns to a balanced budget, as well as regarding the details of the tax, spending, and reform priorities. We believe it is more likely to have higher debt and a weaker balance sheet under an SPD-led government than under a CDU/CSU-led one.

Implications for European policy

We should expect continuity in the German approach, that is openness, yet very cautious, for further European integration. The approval of the Next Generation EU (NGEU) plan, financed by the issuance of euro bonds, was a major step. Going forward, new advances are to be expected on major pre-Covid-19 directions, notably **the capital market union and the completion of the banking union.** On fiscal matters, **an SPD-led government is likely to show more tolerance for fiscal deficits among European partners** – even more so if there's a major role for the Greens – and more openness to a revamp of European fiscal rules, especially to safeguard investment, than the CDU/CSU would (and even more so for the FDP). However, there is a consensus in Germany that, now that the first NGEU transfers have been paid, the ball is in the camp of countries on the receiving end, who need to show they can make a productive use of the funds and accompany them with reforms. **Real discussions on whether the NGEU can lead to a permanent fiscal sharing instrument are not imminent.**

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Foreign policy implications

Like the rest of Europe, Germany needs to determine where it wants to stand against the backdrop of intensifying United States/China competition. After Donald Trump’s unilateralism, the Biden administration is reaching a hand out to other Western democracies for a tighter alliance. Germany is likely to respond positively, yet moderately. Mainstream **German political parties are strongly committed to NATO and military cooperation with the United States when it comes to security in Europe, although the Greens have a lot more nuances regarding the former and reject the 2% of GDP defence spending target.** Germany’s prudence when it comes to playing a larger political and military role in the world arena is only likely to change slowly. **The strong trade and business linkages that Germany has with China are also a factor to be taken into account.** More generally, whether the United States/China rivalry can work as an incentive for Europe to build its own common position and speak with a united voice in world affairs is possible, yet very uncertain. Finally, the composition of the future German government coalition may matter regarding policies towards Russia, against a backdrop of rising energy costs. In particular, the Greens tend to favour a tougher stance and want to scrap the Nord Stream 2 pipeline, while Die Linke is friendlier to Russia than other parties.

INVESTMENT IMPLICATIONS

With the CDU/CSU in the lead, we expect a more favourable combination for corporates and equities, as the party aims to reduce the tax burden, as well as sponsor private investments, primarily for the green transition. All in all, **a ‘traffic light’ outcome is probably already priced in, while the emergence of a ‘Jamaica’ coalition might favour the German equity market, although only in the short term.**

From a long-term perspective, we would expect that the interest rate differential to other EU countries might diminish, as fiscal austerity is probably over even in Germany. This, coupled with higher inflation globally, might lead to higher interest rates. Under both scenarios, **we do not expect mounting pressure for the ECB to taper in order to rein in inflation,** especially in the case of an SPD-led coalition. With the CDU/CSU in the lead, there might be more willingness towards higher interest rates, especially if Friedrich Merz becomes finance minister.

Since the Greens are likely to be part of the ruling coalition under both scenarios, we expect an acceleration of the **ESG focus** following the election. Even so, this might make it more difficult to find an EU-level ESG standard, as traditionally the Greens are against nuclear power. This might build up some tensions against those EU countries which rely on nuclear energy.

In summary, we believe that German assets could offer appealing investing opportunities to global investors, primarily in the equity market, with a focus on those industries that are transitioning towards the **net-zero goal** by 2045. More generally, sectors such as **green energy and automotive** might be attractive, given the focus on the transition towards e-mobility.

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Definitions

- **Debt brake rule:** Rule which limits the annual federal borrowing as a share of GDP.

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