

German voters' mixed verdict

MARKETS CAN LARGELY EXPECT POLICY CONTINUITY

IN A NUTSHELL

- Among the coalition options now available, we think that one formed by the Social Democrats, plus Greens and pro-market liberal FDP, is somewhat more likely than the same combination of junior partners under a conservative chancellor.
- Both the Greens and FDP are likely to push for their priorities, which should translate into more ambitious climate change policies, but in economically sustainable ways.
- Policy continuity is likely to be appreciated by financial markets, which in any case have plenty of international issues to focus on now that the election is over.

Social Democrats ahead, both the far-left and the far-right lose, two coalition are moving into focus

Germany's voter have spoken. And, compared to other countries, traditional parties of the political center have done quite well, overall. But what government exactly the electoral verdict will translate into is likely to remain unclear for a while yet. Both the Greens and the FDP (pro-market liberal) are most likely to be junior partners in the next government coalition, under either an SPD (social democratic) or CDU (Christian conservative) chancellor. According to the preliminary result, the SPD with 25.7 percent is just ahead of the CDU and its Bavarian sister party CSU with a total of 24.1 percent. The Greens have 14.8 percent and the FDP 11.5 percent. The far-right AfD is the fifth strongest party with 10.3 percent. Since all the parties represented in parliament have excluded coalitions with AfD, it plays no role in the formation of a government. The same can now also be said about the far-left Die Linke, as it would be too weak to prop up and SPD/Green government, contrary to some fears before the elections.

In the German political jargon, which takes its inspiration from each parties colours, the mathematically viable options for a majority government have thus narrowed down to the (red) traffic lights (SPD, Greens, FDP); Jamaica (CDU/CSU, Greens, FDP, and occasionally also known as black traffic lights) and the continuation of the grand coalition (GroKo). In our opinion, (red) traffic lights appears to have the greatest likelihood of success, but perhaps, Jamaica will turn out not to be that far behind. We consider the continuation of the GroKo to be relatively unlikely, except as a last option if all else fails. As a common reading has it, the red-green camp will try to lure the FDP into coalition, while on the other hand, CDU/CSU and FDP will want to win over the Greens for an alliance. Another reading, fueled not least by the FDP's leader on the evening of the election, is that FDP and the Greens could explore their common goals together first, perhaps presenting both the SPD and CDU/CSU with joint positions on some issues. Neither the FDP nor the Greens have been in government during the last eight years.

Whatever the exact format, the coalition negotiations between three or even four parties (if CDU and CSU are counted separately) are unlikely to be easy, despite various promises on election evening of having a new government in time for Christmas. That could be feasible: it took CDU/CSU and FDP only 31 days of negotiations in 2009 and the GroKo talks took 86 days in 2013. By contrast, though talks in 2017 went on for a record total of 171 days before another GroKo agreement was reached, after earlier talks about a Jamaica coalition had failed. This time around, there might be some pressure not to dilly-dally for quite as long through the middle of the second pandemic winter, during which voters might insist on having a democratically legitimized government capable of acting.

Policy continuity looks largely likely, whatever precise coalition eventually emerges

Financial markets are likely to see the election result as slightly positive, but also somewhat ambiguous. On the one hand, they don't like uncertainty. And the uncertainty as to which chancellor and which coalition will rule Germany in the next four years could last for a few months. On the other hand, investors should also be reassured that the outer edges of the party spectrum have in some cases significantly lost (Die Linken minus 4.3 percent, AfD minus 2.3 percent). A red-red-green coalition, made up of SPD, Greens and Die Linke, which the stock markets certainly viewed critically, is thus off the table. Nor is it enough for a coalition of the traditional center-right coalition consisting of CDU/CSU and the FDP. Throughout what was by German standards an unusually volatile campaign, such a majority never looked particularly realistic. Still, if anyone in European bond markets feared such an outcome, there could possibly be some relief, since this constellation would have been seen as at least willing to spend, or tolerate debt-financed spending not just at home but among European Union (EU) partners too.

With regard to the more likely coalitions, the following considerations arise: It is very likely that the Greens and the FDP will be involved in the government, which in our opinion could at least bring about certain political changes. Neither party stands for "business as usual". Climate change is likely to be a core issue for the coming years and has long been the Greens' signature issue. Falling behind internationally agreed emission reduction targets would probably be ruled out. The FDP could take up the cause of promoting ecological change in an economically sustainable way. Many of the somewhat more radical attitudes of the two parties may well cancel each other out. This probably includes radical tax changes in either direction; FDP campaigned for the abolition of the solidarity contribution already limited to households with high earnings, the Greens envisaged the introduction of a wealth tax. In order to lure FDP into a coalition, tax increases would probably have to be ruled out in the coalition agreement.

For various reasons, however, we think that major (economic) political changes are fairly unlikely in any coalition variant. On the one hand, there is a general consensus on many topics; the differences are in the details. On the other hand, there is the role of the Bundesrat, Germany's upper chamber. The Bundesrat represents the interests of Germany's federal states and its composition is determined through rolling elections at the state level, including two on Sunday, in Mecklenburg-Vorpommern and Berlin. These days cobbling together majorities in state legislatures typically requires lengthy coalition and an ever wider array of governing parties, resulting in plenty of players with effective veto power in the Bundesrat. Although the Bundesrat's involvement can vary depending on both the precise matter under consideration and legislative tactics, effectively governing Germany will much of the time require the consent of the CDU, the SPD and the Greens, as well as, most probably, one of the smaller parties on an issue by issue basis (partly depending on how coalition talks in coming weeks go not just at the federal level, but also in the states of Mecklenburg-Vorpommern and Berlin, as well as next year's state-level electoral events). And last but not least, many pillars of economic policy are already matters decided at the EU level.

Markets are likely to react with a mixture of some relief and indifference

In the short-term, there could be some relief about the lack of electoral surprises among parties perhaps seen as extreme by some investors. Apart from that, the election result could cause nervousness in coming weeks or months, especially if the coalition talks were to drag on endlessly, even in the face of moments of crisis, requiring a response from Berlin rather than a power vacuum. This is likely to apply above all from the perspective of foreign investors, who probably would not appreciate too many months of coalition negotiations, especially as Angela Merkel was widely seen and internationally appreciated as a guarantor of stability. Apart from that, reactions of the individual asset classes should be very limited due to the uncertainty and the likely only gradual changes. The German financial markets should soon be dominated by world events, which are mainly determined in the United States and China.

Fixed Income & Currencies: Policy continuity, which looks likely given the election result, should at best lead to a slightly positive reading in the bond market. Likewise, the reactions in the foreign exchange markets are likely to be moderate, especially since foreign and economic policy were not the focus of the election campaign.

Equities: The relief from avoiding more extreme options could have a positive impact on German equities, especially if there are signs pointing towards a Jamaica coalition. Together with the recent expansion of the Dax to 40 members, this would most likely boost investor sentiment.

Alternatives: For the German real estate industry in particular, it could make a clear difference whether (red) traffic lights or Jamaica wins the race, since the SPD and the Greens are equally fond of further regulation of the housing market. It remains to be seen whether FDP might be open to concessions in that area, however.

ESG impact: Given the strong performance of the Greens, their role as a (joint) kingmaker and the widespread consensus among the political mainstream, the next government looks set take bold steps towards more ambitious policies to combat climate change. But given the equally influential role of FDP, this looks set to be done in ways that are economically sustainable as well.

Glossary

The [Alliance 90/The Greens](#), also referred to as the "Greens," is an environmentalist political party in Germany that is considered center-left in the German political landscape.

The [Alternative for Germany \(AfD\)](#) is a nationally-conservative and right-wing political party in Germany.

The [Christian Democratic Union of Germany \(CDU\)](#) is a Christian democratic and liberal-conservative political party in Germany that is considered center/center-right in the German political landscape. The CDU is the sister party of the Christian Social Union in Bavaria (CSU), which operates only in the state of Bavaria.

The [Christian Social Union in Bavaria \(CSU\)](#) is a Christian democratic and conservative political party in Germany that only operates in Bavaria and that is considered center-right in the German political landscape. The CSU is the sister party of the Christian Democratic Union of Germany (CDU), which operates in the rest of Germany.

The [Free Democratic Party \(FDP\)](#), also referred to as the "Liberals", is a market-friendly and social-liberal political party in Germany that advocates human rights, civil and economic liberalism and that is considered centre-right in the German political landscape.

The [German Bundesrat](#) is the upper house of the German parliament and is made up of representatives of the sixteen federal state governments who thereby participate directly in critical legislative decisions.

The [Social Democratic Party of Germany \(SPD\)](#), also referred to as the "Social Democrats", is a social-democratic political party in Germany that is considered center-left in the German political landscape.

The [Left](#), also referred to as the "Left Party", is a democratic-socialist and left-wing political party in Germany.

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