

Not quite a sweeping mandate

Germany has voted. Tackling **the country's big structural economic problems** still looks like a daunting task.

IN A NUTSHELL

- While Christian Democrats came in first, they fell well short of the sweeping mandate to reform Germany that their chancellor candidate Friedrich Merz had hoped for. This may be slightly disappointing for equity markets in the short term, however, in the medium term, the actual policy implications will matter more than the election results.
- There is now a tangible sense of urgency among mainstream policy makers, not least in the face of international pressure. This could pave the way for a relatively smooth coalition formation, which might come as a modestly positive surprise for markets.
- As of the early morning hours of February 24, we consider a "grand coalition" between the Christian Democrats and the Social Democrats to be the most likely outcome.

Germany has voted

After a heated election campaign centered around migration, with a stagnant economy and geopolitical tensions a somber backdrop, Germany has voted. Based on preliminary official results, however, the voters' verdict won't make tackling the country's big structural economic problems easy.

Starting with the winner, the center-right Christian Democratic Union (CDU) and its Bavarian sister party, the Christian Social Union (CSU); we will refer to them collectively as the Christian Democrats. Under the leadership of Friedrich Merz, they were hoping for a strong mandate, in the region of 30%-35%. Instead, they appear to have come in at about 28.6%¹, the second worst result since 1949², and only a few points up from its nadir in 2021.² The center-left Social Democratic Party (Sozialdemokratische Partei Deutschlands -- SPD) of outgoing chancellor Olaf Scholz saw its support collapse to 16.4%.¹

"Grand coalition" most likely outcome

For much of election night, it was unclear whether Germany's two traditional governing parties (CDU/CSU and SPD) would even have a combined majority in the new Bundestag, Germany's lower house of parliament, as that depends on which of the smaller parties get in. That turned into a bit of a cliffhanger, with the economically liberal Free Democratic Party (FDP), which brought down the outgoing government, eventually falling short of the 5% threshold for parliamentary representation. "Bündnis Sahra Wagenknecht" (BSW), which combines left-wing populism on economic issues with cultural conservatism,

¹ Source: Preliminary official election result, Die Bundeswahlleiterin, as of 2/24/25 4:10am CET

² Source: Deutscher Bundestag, „Bundestagswahlergebnisse seit 1949 – Zweitstimmen“ as of 2/24/25

will, according to preliminary results of the Bundeswahlleiterin (the Federal Electoral Officer), not make it into the Bundestag, either.¹

Meanwhile, the Greens, prioritizing environmental issues, sustainability and social equality, signaled they would be willing to join Christian Democrats and Social Democrats in talks to form a three-party coalition (often referred to as “Kenya,” based on the parties’ colors), which would provide it with a comfortable governing majority in the next Bundestag. Teaming up with the Greens has consistently been ruled out by the CSU, which outperformed in Bavaria compared to the overall result and will probably see its influence strengthened in the new Bundestag; we would caution, however, that it usually takes a few days after results are in for parties to digest the results.

Assuming the BSW doesn’t make it into the Bundestag, we consider a so-called “grand coalition” between the Christian Democrats and the Social Democrats to be the most likely outcome. In any case, however, any Merz-lead government would need support of the Bundesrat, Germany’s upper house. In practice, this will mean working with the Greens, and also Die Linke (The Left), which stands for democratic socialism, anti-capitalism and pacifism. The party made a strong comeback in the final stretch of the campaign, thanks in part to its strong appeal to young voters.³ Finally, the far-right Alternative for Germany (AfD), which has gained traction through its populist rhetoric and criticism of immigration policies and the EU, roughly doubled its vote share to 20.8%.¹ They are unlikely to participate in the next government’s formation, however, as all other major parties have ruled out any governing arrangement with them.

Policy and market implications

It may take at least a few days for the implications of these results to sink in, not least in terms of who will negotiate with whom and on what timetable, also given possible changes in party leadership. In terms of economic policy implications, three points stand out.

- First, the new government is likely to find it very tricky to get any constitutional amendments through both houses of parliament. This is because the centrist parties (CDU/CSU, SPD and Greens) together will not have the required two-thirds majority in the Bundestag. At least in the short term, that limits the scope for changes to Germany’s self-imposed fiscal rules known as the debt brake. In the longer term, though, the need to presumably include The Left in such discussions could potentially open the door for more radical reforms than SPD and the Greens had been pushing for. However, Germany is likely to continue to comply with European Union (EU) law, which also limits the fiscal room for maneuver.
- Second, the need for compromises during coalition talks and beyond will limit how much Merz could deliver in areas such as cutting taxes and red tape. Tackling Germany’s major structural economic problems therefore still looks like a daunting task.
- There is now a tangible sense of urgency among mainstream policy makers, not least in the face of international pressure. A long period of uncertainty should certainly not be ruled out just yet. But this could pave the way for a relatively smooth coalition formation, which might come as a modestly positive surprise for markets.

³ For a more in-depth analysis of the German political landscape including the legislative process, see our [CIO Special “Germany’s election: what should we expect?”](#) as of 2/13/25

Asset-class implications

In light of the above, election day itself is unlikely to mark a major turning point in terms of the actual policy outlook or market sentiment. Rather, it will be the policies laid out in the final coalition agreement and, more importantly, their eventual implementation that will be decisive for markets.

Fixed income & currencies

In German and indeed European **government bonds** we expect to see only a limited impact, though a quick formation of a new government and subsequent reforms would be seen as positive for the longer-term growth outlook. Similarly, the impact on **foreign-exchange** markets looks set to be muted. For **corporate credit** we do not see any marked impact, whether or not a government can be formed quickly. Germany accounts for 14% in the iBoxx Euro Corporate Index, which is well diversified in terms of sectoral exposure.⁴

Equities

There may be some disappointment in German equity markets that the Christian Democrats did not win a stronger mandate for more deregulation and less wealth redistribution. But even such reforms would have had little immediate impact on earnings expectations. In any case, and especially for European equities more broadly, the bigger question is likely to be how quickly the continent's largest economy can form an effective government in the face of, for example, U.S. tariff threats.

Alternatives

For **infrastructure**, a quickly formed new government focused on delivering infrastructure projects would be critical. Germany is a key bottleneck in the European energy market, and so a strong government focused on delivering on infrastructure would be generally positive.

For **real estate**, we would highlight restrictions on how quickly residential rents can go up in rental hotspots (known as "Mietpreisbremse" and currently due to lapse at the end of this year). The outgoing government already planned to prolong this until 2029 on relatively favorable terms for landlords. Given the salience of rents as electoral issue, notably in terms of mobilizing support for The Left, we would not be surprised to see slightly more stringent restrictions than previously envisioned.

⁴ Source: Bloomberg Finance L.P. as of 2/21/25

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.

[Die Linke \(The Left\)](#) has its origins in the Party of Democratic Socialism in the former East Germany and stands for democratic socialism, anti-capitalism and pacifism.

The [European Union \(EU\)](#) is a political and economic union of 27 member states located primarily in Europe.

[Fiscal policy](#) describes government spending policies that influence macroeconomic conditions. Through fiscal policy, the government attempts to improve unemployment rates, control inflation, stabilize business cycles and influence interest rates in an effort to control the economy.

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 [German Bundestag](#) is the national parliament of the Federal Republic of Germany. It is the lower house of the two legislative chambers, the German Bundesrat being the upper house.

The [iBoxx Euro Corporate Index](#) includes euro-denominated corporate bonds issued by investment-grade-rated entities.

The [Sahra Wagenknecht Alliance \(Bündnis Sahra Wagenknecht, BSW\)](#) is a left-wing political party in Germany, founded in early 2024 by the former deputy leader of the left-wing party "The Left," Sahra Wagenknecht.

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.

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