

German elections: Wirtschaftswunder 3.0 still far out

Germany is heading towards another revival of the grand coalition as its political landscape grows increasingly fragmented



Signing of the parliamentary group of the CDU and CSU by Friedrich Merz and Markus Söder, Berlin

The results of the elections are well-known by now: the CDU/CSU led by Friedrich Merz came in as largest party, followed by the far-right AfD, SPD, Greens and Linke. The FDP and BSW didn't make it into parliament.

Besides the results themselves, there are a few important observations: the 84% voter turnout was the highest since reunification, and the three parties of the collapsed government coalition lost some 18 percentage points of their 2021 votes, with the SPD and the FDP suffering severe losses. At the same time, far-right and far-left parties gained almost 20ppt compared with 2021, reaching almost 30% of the total votes. And there is more – despite winning the elections, Merz's CDU had the second weakest result ever, and the SPD had its worst result ever.

Towards a revival of the grand coalition

Given that the CDU/CSU strictly ruled out a coalition with the AfD, the only possible government coalition is a revival of the grand coalition between the CDU/CSU and SPD. Still, coalition talks won't be straightforward. After its worst election result ever, the SPD will not easily move into a

government coalition as junior partner to the CDU/CSU. The party is likely to now enter a new era of political leadership and another existential crisis. Also, any coalition agreement will probably have to pass a grassroots vote, with members who are traditionally more left-wing than their party leaders.

Still, we think that eventually the SPD will budge, as a grand coalition is the only feasible option for the CDU/CSU to form a government and the SPD has proven often enough not to shy away from the responsibility to join a government. The only other option would be a coalition with AfD; a scenario Friedrich Merz had strictly ruled out.

In the first days after the elections, Friedrich Merz already learned that being the leader of an opposition party is something different than becoming the next chancellor. Promises made in an election campaign are not that easily implemented in a government coalition.

After complicated coalition talks, a revival of the grand coalition could bring some tax cuts for households and corporates without cuts in social expenditures, as well as some deregulation. The coalition will probably also agree on investments in infrastructure and defence, either via a special purpose vehicle or changes to the debt brake. Germany might support increased European efforts to fund defence and infrastructure spending. However, significant reforms, such as changes to the pension system, seem highly unlikely. Additionally, achieving lower and more stable energy prices should not be taken for granted.

How to pay for it?

The biggest challenge will be financing any new plans. During the campaign, the CDU/CSU presented plans with a significant funding gap. Joining a coalition with the SPD will make this funding gap even larger as cuts on social expenditures are less likely to happen. However, it was always suspected that the CDU/CSU would shift its stance on the debt brake after the elections. Whether this is really happening is a different story. Suggestions made by Friedrich Merz after the elections for possible changes to the debt brake were corrected a few hours later.

With the Left and the Greens, there is now a two-thirds majority in parliament for outright changes to the debt brake, although the Left would not support such a debate for increased defence spending. There is a narrow window to reform the debt brake by using the next 30 days – during which the current parliament is still in place – to secure the votes of the SPD, Greens, and CDU.

The CDU, however, has now ruled out these outright changes. Still, a special funds for additional defence spending might still be announced with the help of the 'old' parliament. What's more is that the CDU/CSU has manoeuvred itself into a difficult position. While probably open for more substantial changes to the debt brake for infrastructure investments, the tough talk during the election campaign will keep the CDU/CSU from pushing too hard for these changes. It doesn't want to suffer reputational damages. Promises made, promises kept.

Some cyclical improvement without Wirtschaftswunder 3.0

German voters will get what they want the most: soft and gentle change but no disruption. Some cyclical recovery without getting close to any Wirtschaftswunder 3.0. In fact, the biggest risk next to simply delaying overdue reforms is a further strengthening of the far-right and far-left (as we saw previously whenever the CDU/CSU and the SPD were in a coalition). Therefore, a lot of the success of the next government will depend on the willingness of individual parties and leading

politicians to leave personal and party interests behind and focus on getting the economy out of its structural stagnation. This would also require leaving some political holy cows behind.

Author

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.