

EcoFlash

German election: a government by Easter?

The result of the German election reveals a clear winner: the CDU/CSU. Only five parties were able to enter parliament, thereby reducing the fragmentation of the Bundestag. A grand coalition with the SPD is possible. Negotiations should begin soon to establish a common roadmap. When they come to an end, changes are to be expected: a German government that takes more initiative in European affairs, more public investment, increased defence spending and, as a result, a German budget deficit and public debt that could increase.

1. The return of the grand coalition. The CDU/CSU won the election with 28.5% of the vote, a result slightly below the polls. However, the limited number of parties that have crossed the 5% threshold allows for the formation of a majority grand coalition with the SPD. Although the AfD, which achieved an historical score of 20.8%, is now the second largest political force, Friedrich Merz has ruled out an alliance with this party. An alliance with the SPD is therefore the most likely scenario. Will it be operational by Easter as Mr Merz hopes? This will depend on the negotiations that are about to begin.

2. A blocking minority that will limit the potential for major reforms. The previous coalition broke up over the issue of reforming the debt brake, which the FDP opposed. According to a Forsa-DGAP survey, public opinion is now in favour of such a debt brake. However, the need to mobilise a two-thirds majority to reform the debt brake will complicate its adoption, insofar as the AfD and Die Linke together obtained more than a third of the seats. On the other hand, the protectionist measures that Donald Trump could announce against the European Union could motivate the activation of an exception clause, which only requires a simple majority.

3. More budgetary leeway, but for what, and when? The CDU/CSU programme should be the main source of guidance for the future coalition's policies. A reduction in taxation (on businesses and households), the fundamental precept of their programme, is therefore likely. A coalition with the SPD and the difficult economic context in which the country finds itself (industrial crisis, risk of new US tariffs, probable rise in unemployment) could give the economic programme a more social slant. Finally, this coalition should agree on a greater effort in favour of public investment, in particular to modernise infrastructures. Regarding the implementation of these reforms, the majority should be effective from 2026 in the next budget, although it is possible that some of them could be implemented sooner, in particular if an exception clause to the debt brake can be introduced.

4. Towards a Germany that will issue more debt and take more initiative at European level? The activation of an exception clause would give more budgetary leeway than a reform of the debt brake. Indeed, the reform of the brake would probably only allow a structural deficit of 1 to 2 points of GDP, as opposed to the current 0.35%, whereas a derogation, albeit temporary, would make it possible to go beyond that. The coalition's economic measures and the prospect of an increase in the defence budgets of European states to around 3% of their GDP (the likelihood of which is increasing with a German government that is set to be more proactive in this area) should require additional budgetary resources. Likewise the depletion of the German special defence fund (by 2028 at the latest). The likely increase in German debt could have an initial effect: pushing German rates up.

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