

German Election: Disappointing Result but Europe's Recovery Still on Track

Key takeaway:

Despite the diminishment of the Merkel- led centrist CDU/CSU and the SPD in the 2017 election, they remain the most powerful parties in German politics. The rise of the AfD party is worrying, but as is the case in the Netherlands, the extremists remain locked out of government and Germany remains dominated by parties that are strongly pro-EU and socially progressive. Therefore, while this election may slow some of the more ambitious EU integrationist reform policies, it is unlikely to undermine financial stability or derail the economic recovery.

- Angela Merkel's centrist CDU/CSU bloc came out on top in Germany's federal elections, giving her a fourth term as Germany's Chancellor. Despite the win, large vote share losses compared to the 2013 election by her party and centre-left coalition partner SPD, mean Merkel will have to cobble together a coalition of smaller parties with diverse policy platforms.
- A less cohesive coalition will likely reduce Merkel's room for manoeuvre and may hinder her ability to work proactively with French President Macron and other proponents of more aggressive EU policy integration.
- The rise of fringe parties, particularly the anti-immigrant far-right AfD party, caused CDU/CSU's share of the vote to drop to 33% compared to 42% in the last election, its lowest share since 1949. Meanwhile the SPD saw its share of the vote drop to 21% from 27%, prompting leader Martin Schulz to announce it will no longer be part of a "grand coalition" with the CDU.
- As Merkel has ruled out working with the AfD (13% of the vote), unless the SPD has a change of heart, the most likely coalition is CDU/CSU with the liberal FDP party (11% of the vote) and the Green party (9% of the vote).
- The FDP and Green parties are both pro EU but their views on German policy and how the EU should work diverge. The FDP is wary of any policies that might be construed as making German tax payers pay for policy mistakes/weaknesses in other parts of Europe, making it unlikely they will support Macron's ambitions for a sizeable single Eurozone budget and a banking union.
- The Greens are aligned with Merkel on opposing an upper limit on refugees, but this policy is becoming increasingly unpopular even with the CDU/CSU. With the AfD now in parliament, differences on immigration policy at a national as well as EU level are likely to become more apparent and may distract from progress in other areas of reform.

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