



PERSPECTIVES Memo

New government will have to make compromises

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Key takeaways

- Markets are responding positively to the probability of a government being formed by the CDU/CSU and SPD. Such a coalition promises a more united approach and faster decision-making.
- The new government will require the support of the Linke to reform the debt brake or for establishing special funds. Corresponding projects therefore depend on the willingness of the parties involved to compromise.
- German stocks are only slightly influenced by the development of the German economy. The state of the global economy and U.S. tariff policy may turn out to be more important factors.

What happened?

Germany has voted. The provisional second vote result is:

CDU/CSU:	28.5%	208 seats in the Bundestag
AfD:	20.8%	152
SPD:	16.4%	120
Greens:	11.6%	85
Linke:	8.8%	64
FDP:	4.3%	-
BSW:	4.9%	-
SSW:	0.2%	1
Others:	4.2%	-

In the end, it was very close. Since neither the BSW nor the FDP made it into the Bundestag, the CDU/CSU can form a coalition with the SPD. A new government is currently assumed to be formed by Easter.

The stock markets reacted positively to the prospect of a two-party government. The Euro strengthened. The DAX, MDAX and SDAX started the new trading week positively.

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What does it mean for investors?

Following an initially positive reaction, mixed feelings are probably spreading through markets now. Although a two-party coalition may promise a more united approach after years of disagreements among the three "traffic light" coalition parties, the path to a more expansionary fiscal policy remains complicated.

The AfD and the Linke will have a blocking minority in the future and will be able to prevent constitutional changes. The reform of the debt brake hoped for by the market or another special fund tasked with increasing defence spending have therefore become less likely.

The necessary investments require that the government and the Linke show considerable willingness to compromise. The Linke has so far called for the abolition of the existing debt brake and the introduction of the so-called "Golden Rule", which allows investments to be financed through credit, while the CDU/CSU is sticking to the current debt brake at the federal level.

Most recently, however, the CDU/CSU signalled a willingness to reform for the debt regulations of Germany's individual states. At the same time, it is conceivable that the Linke could agree to a special fund or an exemption from the debt brake for infrastructure spending, for example. This would create more scope in the budget for defence spending. However, based on the parties' election manifestos, this requires a high degree of willingness to compromise, which will hopefully be demonstrated given its longstanding absence and how urgent it is now.

The market's gaze is therefore likely to shift quickly from Berlin to Brussels. Investors are wondering how the EU will finance higher defence spending and the Competitiveness Compass presented in January, which builds on the recommendations of the Draghi plan.

European Commission President Ursula von der Leyen has already announced that she will use special clauses in the EU debt rules for defence spending. Other options would be a reallocation of funds from the NextGenerationEU programme or the creation of a credit facility within the framework of the European Stability Mechanism, as it was created during the coronavirus pandemic for example. Another option is to take on joint debt. These options are likely to be hot topics of debate in the market. Higher debt in the EU, especially Germany, could lead to fluctuations in the bond markets.



After all, a two-party coalition could also present a more united front in Europe and make people forget the so-called "German vote" abstention in EU votes. Either way, the domestic and foreign policy challenges are significant, which is why a rapid formation of a new government with clear objectives seems absolutely essential.

Germany's federal election is unlikely to have much lasting impact on the German stock market. After all, these companies generate a large proportion of their sales abroad and are relatively unaffected by the state of the German economy and domestic economic policy. DAX companies generate only around 20% of their sales in their home market. The proportion is somewhat higher for the small caps in the MDAX and SDAX. Both these indices are thus likely to react more strongly. The state of the global economy and U.S. tariff policy are likely to be more decisive for the performance of German stocks. Nevertheless, German stock indices should welcome a rapid government formation.

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Glossary

The **AfD** (Alternative for Germany) is a right-wing populist party.

The **traffic light coalition** is the governing coalition of the SPD (red), FDP (yellow) and the Greens (green).

Gross domestic product (GDP) is the monetary value of all finished goods and services produced within a country's borders within a certain period of time.

Federal bonds are bonds issued by the German federal government.

The **Greens** (Alliance 90/The Greens) is a political party with a focus on "green politics".

The **CDU/CSU** is an alliance of two center-right parties, namely the Christian Democratic Union of Germany and the Christian Social Union in Bavaria.

The **DAX Index** is a leading index for the German stock market, which includes the 40 largest and most liquid companies.

EUR is the currency code for the euro.

The **FDP** (Free Democratic Party) is a liberal centre-right party.

The **Linke** (The Left) is a left-leaning party.

The **MDAX** is a German stock index that tracks the performance of medium-sized companies on the stock exchange.

The **SDAX** is a stock index that includes the 70 smaller companies listed after the 40 companies in the DAX and the 50 companies in the MDAX.

The **SPD** is a centre-left party that is currently part of a coalition government with the CDU/CSU at the federal level.

The **SSW** (South Schleswig Voters' Association) is a minority regional party in Schleswig-Holstein.

USD is the currency code for the U.S. dollar.



Appendix

Historical performance

	21.2.2020 - 21.2.2021	21.2.2021 - 21.2.2022	21.2.2022 - 21.2.2023	21.2.2023 - 21.2.2024	21.2.2024 - 21.2.2025
Performance					
10-Year German Bund	-0.9%	-4.3%	-17.3%	3.6%	2.6%
2-Year German Bund	-0.7%	-0.9%	-3.9%	2.3%	3.3%
EURUSD	11.7%	-6.5%	-5.8%	1.1%	-3.2%
DAX	3.0%	5.3%	4.5%	11.2%	30.2%
MDAX	11.7%	-0.2%	-11.2%	-10.4%	7.0%
SDAX	3.5%	15.2%	-2.2%	11.7%	28.5%

Source: Deutsche Bank AG, Bloomberg Finance L.P., LSEG Datastream; as of February 21, 2025.

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