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German Federal Elections 2025
Market commentary

CDU/CSU and SPD coalition with a stable majority

Germany has voted – the distribution of seats in parliament has been determined and, on the capital markets, many are hoping for a business-friendly government. In the run-up to the election, it was not clear whether five, six or seven parties would make it into parliament, and even yesterday evening, it was unclear for a long time whether the FDP and the BSW would . In the case of the BSW, it was a close call, but the upshot is that no three-way coalition will be needed to form a government. This will make coalition negotiations easier. Friedrich Merz is aiming to form a government before Easter.

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High expectations – what do investors expect from the new government?

Many German companies have been able to decouple themselves from weak economic developments in Germany in the recent past, which is reflected in the profits and share price performance of the companies listed on the DAX (2024 +19%, 2025 (as of 21 February 2025) +12%). However, DAX companies still generate around 20% of their sales in Germany, on average.

A business-friendly government coalition should ensure improved location factors in the medium term and initiate a revival of domestic demand.

The oft-cited demand for competitive energy and electricity costs is particularly important for energy-intensive German industry. This goes hand in hand with investments in a more efficient infrastructure for electricity transmission and many other infrastructure areas. Further investment needs are emerging in the defence sector. However, the "best" investment is in education, with a simultaneous promotion of knowledge transfer to the economy. A more attractive environment for start-ups or research and development in general can also lead to innovations achieving commercial success.

These necessary expenditures in education, infrastructure and defence are not compatible with the debt brake. However, a relaxation of the debt brake carries the risk that higher spending will not be targeted towards the necessary investments for the future. Would targeted "special funds" be a better approach here than a reform of the debt brake? A "special fund" is a debt-financed, but also earmarked, auxiliary budget. If the state were a company, we would address the existing "balance sheet capacity" as equity investors and demand more active use of it. One possible approach would be three special funds of EUR 100 billion each for defence, infrastructure and education.

From the capital markets' perspective, these are all important aspects and the formation of a coalition will be closely monitored in this context.

Germany on the road to a "grand coalition"

We expect Friedrich Merz to be elected as the next Chancellor.

Since the FDP and the BSW have missed out on entering the Bundestag, it is expected that there will be a black-red CDU/CSU-SPD coalition. Such an alliance, formerly known as a "grand coalition" has existed several times, most recently under Chancellor Angela Merkel. However, a possible reform of the debt brake would require a 2/3 majority in the Bundestag – so this coalition would either have to rely on the support of the opposition or other measures such as "special funds" would have to be used to get important future investments off the ground. This route is also challenging and requires a 2/3 vote in parliament or the narrow legal framework of an emergency situation. Compromises must therefore now be found. The current CDU leader and potential new Chancellor Friedrich Merz campaigned on a business-friendly programme of lower taxes, less regulation and fewer social benefits. However, it is also necessary to look at the SPD's objectives. In its manifesto, it placed particular emphasis on social justice, investment in education and infrastructure, and reducing energy costs.

It is anyone's guess as to what points the parties will converge on here. However, we can already see areas that could benefit from a new grand coalition: both parties emphasise the importance of investing in infrastructure, which could benefit companies in the construction and energy infrastructure sectors. The SPD places a high value on renewable energies, while the CDU also supports measures to promote this sector. The modernisation of the education system and investments in digitalisation are high priorities for both parties.

One controversial aspect of a 'grand coalition' between the CDU and SPD would be the SPD's focus on social justice, which could lead to higher social spending and stricter regulation of the labour market. This is a less capital market-friendly aspect and it remains to be seen to what extent the CDU will go along with this. Particularly in the area of foreign policy, the CDU and the Greens appear to have more in common.

Significance for the capital markets

A new German government with a business-friendly agenda could provide much-needed new impetus for the struggling German economy. This would be particularly true if the government actually acts to deregulate and seeks to reduce the tax burden. This would also revive German consumer spending and thus German economic growth.

We expect the new government to also take a stronger leadership role in the EU and the world. Not least because of the presidency of Donald Trump in the US, Europe needs new answers to open questions, such as the security architecture and the positioning towards the important trading partner China. In the EU, but also in Germany, there is an urgent need for reform to relieve citizens and companies of the costs of bureaucracy and to strengthen the competitiveness of the EU and Germany. During his election campaign, the potential new chancellor emphasised that overregulation was impairing the EU's productivity compared to the US and China. He spoke of a "one in, two out" principle, according to which two old regulations would have to be abolished for every new one introduced. Small and medium-sized enterprises (SMEs) in particular should benefit from the reduction in bureaucracy, as their reporting requirements will be reduced.

From an equities perspective, the following sectors should see their prospects improve:

- Small and medium-sized companies, where a portion of fixed administrative costs are spread across a lower sales base and reducing bureaucracy would help accordingly

- Small caps, where a revival of domestic demand would have a stronger positive impact
- Companies in the digital and energy infrastructure sectors and in capital goods in general
- Companies that benefit from better framework conditions for new technologies such as AI and that focus on the digitalisation of value chains in the healthcare and construction sectors, as well as in public administration, offer services in these areas or are well positioned in their segments when it comes to digitalisation
- Companies in the defence sector, but also in security in general – including cybersecurity – driven by rising defence budgets.

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