MARKET *view*

November 18th, 2024

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The economic policy challenges of the next German Federal Government

> *The new elections in Germany and a possible political reorientation are unlikely to fundamentally change the difficult situation of the German economy overnight. Structural changes take time.*

Continuing differences of opinion, particularly on economic and budget policy, had long worn down the traffic-light coalition – named after the colors of the participating parties - in Berlin. The coalition's breakup was triggered by an economic paper from FDP Finance Minister Christian Lindner, which the SPD and the Greens had to take as a challenge – and which was presumably intended as such: postponing of climate targets, restrictions on social spending, reduction of corporate tax, abolition of the solidarity surcharge, adherence to the debt brake, and curbing bureaucratic costs were the "bitter pills" the Federal Chancellor was no longer willing to swallow. **The dismissal of Christian Lindner as finance minister ended the unpopular coalition.** Federal Chancellor Olaf Scholz is expected to ask the question of confidence on December 16, thus paving the way for the dissolution of the Bundestag. **According to current plans, new elections are scheduled on 23 February 2025.**

According to the latest polls, the CDU/CSU would receive around 33% of the vote, making it by far the strongest faction in the new Bundestag. The AfD would achieve around 18%, the SPD 16%. The Greens would come in at 12%, the left-wing populist alliance Sahra Wagenknecht would secure 8%. With 4%, the FDP and Die Linke would just about miss out on entering the Bundestag (see Figure 1).

If this allocation of votes even roughly reflects to the election result, **there will probably be a federal government led by the CDU with Chancellor Friedrich Merz next year.** However, the CDU will need at least one coalition partner to get a 'Chancellor's majority'. Christian Lindner's Liberals (FDP) are ideologically closest to the CDU, but even if they beat the five-percent rule, they would not carry enough weight as a sole partner. Instead of a marriage of love, it would be a marriage of convenience. As some core elements of the Greens' climate policy currently lack consensus within the Union, the Greens would probably not be considered, nor would the AfD's taboo stance. **Consequently, the CDU is likely to bring the SPD on board as a junior partner. At the moment, this is our base scenario.**

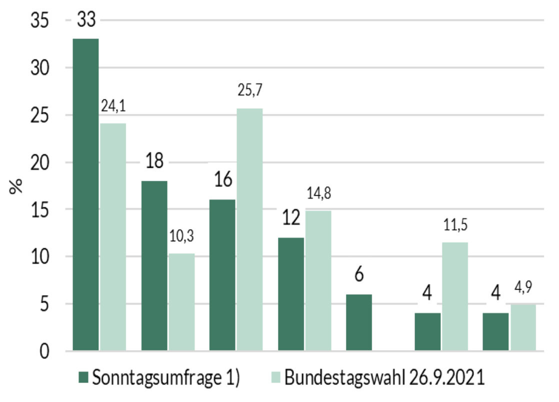
The CDU's economic policy aims to stimulate investment as well as improve Germany's international competitiveness. Core elements include (1) tax relief for companies and private households, (2) the reduction of bureaucratic costs and deregulation and (3) a pragmatic energy policy with relief on energy costs. (4) The implementation of infrastructure projects should be facilitated by more flexible financing models, while (5) the debt brake should be maintained. (6) The "Bürgergeld" (citizen's income) would be replaced by a much more restrictive basic security system.

Over the past ten years, Germany's business place has **significantly lost competitiveness and growth momentum.** The rise in energy costs plays a role in this, but in our opinion a series of growth-damaging measures by the "traffic light coalition" also does. Investment activity is languishing, productivity is stagnating. The traditional economic correlation between the USA and Germany seems to have dissolved (see Fig. 2).

The election of Donald Trump could further exacerbate Germany' and Europe's problems. Tax relief for US companies, extensive deregulation, low energy costs and the widespread introduction of import tariffs threaten to further widen the gap between the US on the one hand and Germany and the rest of Europe on the other. **Additional problems arise when considering China into the mix.** With high import tariffs in the US, Chinese exporters are likely to push even harder into the European market. Against this backdrop, we foresee growing challenges for the entirety of the manufacturing sector, especially in the automotive industry.

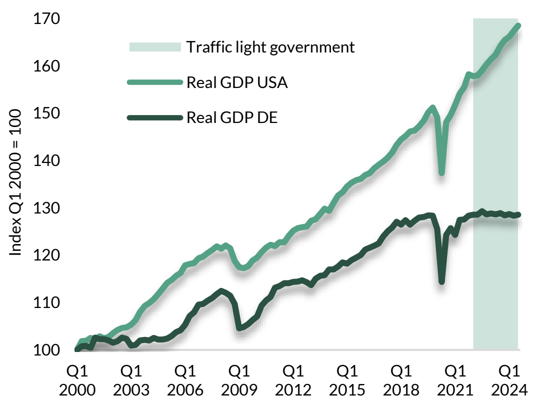
The new elections in Germany and a possible political reorientation are unlikely to fundamentally change the difficult situation of the German economy overnight. Structural changes take time. We therefore remain cautious regarding European stock markets. While it is no denying European markets feature many quality companies with strong market positions and attractive earnings prospects, we currently prefer the US market regionally. We are clearly overweight there. However, this is not so much due to the political plans of the upcoming Trump administration. The immediate advantages for US companies through tax cuts, deregulation measures and import tariffs are offset by considerable macroeconomic risks. Instead, we are convinced by the US market's significantly higher return on capital, innovative strength and its greater growth potential.

FIGURE 1: WHAT IF THE FEDERAL ELECTIONS WERE HELD NEXT SUNDAY? CURRENT POLL RESULTS



Source: Wahlrecht.de, Sunday poll; unweighted average of the polls by FORSA, Forschungsgruppe Wahlen, Infratest dimap, INSA, publication after 6 November 2024

FIGURE 2: EVOLUTION OF REALIZED GROSS DOMESTIC PRODUCT SINCE 2000



Source: LSEG Datastream; Timeline: 01.01.2000-30.09.2024; the so-called. Traffic lights coalition consisting of SPD, FDP and the Greens since December 7th 2021

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