

Post-election Germany: What next?

Germany's two major mainstream parties, CDU/CSU and SPD, have suffered substantial losses, to the benefit of the smaller political parties. Stunningly, the right-wing populist AfD came away with 12.6% of the vote and in one fell swoop will have the third-largest representation in the Bundestag. As the SPD intends to play the opposition, the most likely scenario is one in which the CDU, Greens and FDP join forces in a so-called "Jamaica coalition" to form the government. The further amalgamation of Europe will become more difficult. This poses medium-term risks.

German voters have made their decision and given the big parties a smackdown. The AfD came away the winner and is now the country's third-strongest political force. The Free Democratic Party (FDP) will of course return to the Bundestag, with the Greens and leftists holding approximately the same number of seats they won in the last election.

The outcome of the Bundestag election has given the CDU a clear list of to-dos: domestic policy issues must be dealt with in the forthcoming legislative term. This pertains to matters that are preying on people's minds, issues such as homeland care, education, housing construction and internal security. These points were at the centre of the small parties' platforms, and voters ultimately voiced their resounding approval. Angela Merkel has been occupied with crisis management in recent years – the cohesion of the eurozone has consumed a lot of time and energy. The time has now come to look after domestic policy.

The real bombshell, though, is that the SPD wants to go into the opposition, thereby ruling out a grand coalition. None of the parties can have any interest in the shilly-shally of a minority government, so what remains is a Jamaican coalition of CDU, FDP and Greens. Yet tripartite alliances are difficult to form and are generally considered unstable. This does not necessarily apply to a new German government per se, but fears of a politically less stable Germany may arise in the financial markets.

Things could become more difficult for the EU

After these clear shifts in the balance of power in Germany, the European political course could also encounter a sea change. The FDP stands for a strong EU, but the liberals will certainly not grant a free pass for further integration. This could lead to German-French tensions. Emmanuel Macron wants to move forward as quickly as possible with greater EU integration. Asked about this issue, FDP leader Christian Lindner spoke after the elections about a "red line" that he could (or would) not cross.

So Emmanuel Macron may be facing certain headwinds from Germany in implementing his plans. That would be a novelty – until now, Germany has been one of the driving forces behind Europe. It is also important to bear in mind potential crises. Previous federal governments were prepared to offer also unorthodox solutions in emergency situations; coping with the Greek crisis would hardly have been possible without this ability. With an FDP led by Christian Lindner, this becomes more difficult.

Implications for the financial markets

The financial markets have taken this news relatively calmly. Players' hopes are that there will still be reliable and stable German policymaking under a Jamaica coalition. Since the AfD will also be in the opposition, there have yet to be any significant losses seen on the tickertape.

EUR/USD and EUR/CHF

The euro has reacted with slight markdowns against both the US dollar and the Swiss franc. This is entirely justified in view of the unclear future political agenda. However, there have been no significant losses in the common currency: the best bet is that a Jamaica coalition will keep things on an even keel. If the tripartite alliance were not to be formed due to irreconcilable differences, it can be speculated that the SPD would ultimately jump in as a coalition partner.

We expect the euro to weaken in the coming weeks, both against USD and CHF. The outcome of the election tends to confirm this view. The FDP's scepticism towards a further amalgamation of the European Union offers the potential for strife. French President Emmanuel Macron favours closer cooperation and centralisation, and this could lead to tensions at European level which would become particularly apparent in the event of a crisis.

Summary

Forming a German government will be a tough slog. The possible Jamaica Alliance of CDU, FDP and Greens poses a certain potential for friction in Europe. The FDP is sceptical about a further deepening of the European Union, in contrast to the French president's wishes. This would also be a burden for EUR, thus we stand by our opinion and expect to see a weaker euro in the coming months.

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