



A tectonic shift?

For Merkel, winning reelection may have been the easy bit. Governing Germany is getting trickier.

Earlier this year, we warned strongly against reading too much into any one election. On Sunday, voters in Germany proved our point. Here are two contrasting ways on how you might view the latest election to the Bundestag from a market perspective.

To German TV viewers, it looked like a tectonic shift. Chancellor Angela Merkel's center-right Christian Democrats suffered a heavy defeat. Their Bavarian sister party, too, saw its vote crumple. All told, the Christian Democratic alliance of the Christian Democratic Union of Germany (CDU) and the Christian Social Union in Bavaria (CSU) won just 33%. Merkel's center-left coalition partner, the Social Democratic (SPD), saw its vote share shrink below 21%, to levels last seen during the early 1930s, in the dying days of the Weimar Republic. Add the surprisingly strong showing of the far-right, anti-immigration Alternative for Germany (AfD) at slightly under 13%, and it is easy to understand why many commentators should be concerned.

Look at the vote from a broader, European perspective, however, and the same results actually appear almost reassuring. The combined vote of AfD on the right and the Left (Die Linke), a far-left party, adds up to a little over 20%. That is less than parties with views comparable to those of the AfD habitually manage to get on their own in neighboring Austria, Switzerland and France, for example.

Merkel looks set to continue as chancellor, probably in coalition with the Liberals (FDP), a market-friendly and socially-liberal party, and the environmentalist Green Party. The Liberals were the second big winner of the evening, seeing their vote more than double to almost 11%. Negotiations will no doubt take time and there is no guarantee a deal can be reached. In Germany, a liberal, green and Christian democratic government is commonly known as Jamaica, after the party colors that resemble the Caribbean country's flag. Earlier this year, such a coalition came to power in the northern State Schleswig-Holstein. It remains to be seen whether such a three-party alliance will be able to effectively govern at the national level.

The main reason a Jamaica coalition looks most probable, is that it currently looks like the only outcome that is both politically and mathematically possible. Shortly after the first projection, the Social Democrats' leader Martin Schulz declared that his party was not willing to participate in the next government. Should the Jamaica talks stumble, it remains to be seen whether the Social Democrats will really stick to this formula.

The coming days will no doubt be filled by plenty of speculation of how the result came about. AfD candidates have proven rather

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gaffe-prone, dismaying even Frauke Petry, the party's nominal leader. On Monday morning Ms. Petry announced that she will not join her party's parliamentary delegation. According to exit polls, its strong showing appears to reflect disaffection with the rest of the political system. Main drivers included homeland security, especially refugees, as well as terrorism on which AfD ran an aggressive campaign. European integration topics did not feature much in the election campaign, nor in the exit polls. This was in sharp contrast to the 2013 election, when AfD ran mainly against the euro – and narrowly failed to clear the 5% needed to enter the Bundestag.

In the light of all this, we can only reiterate that radical policy changes look unlikely, not least given the strong role of the German Bundesrat, the upper chamber of the German parliament. This result may make it a little trickier to move towards closer fiscal integration in the Eurozone as quickly as some market participants had been hoping. That could prove slightly positive for the U.S. dollar compared to the euro. German government bonds might benefit a little, on speculation about growing uncertainty. For equities, the results should be broadly neutral.

In the longer term, two things stand out. On the one hand, Germany's reassuringly boring electoral campaign has indeed resulted in more of the same, rather than any radical changes. On the other hand, sharp regional divisions remain more than a quarter century after reunification, as the electoral strength of both the Left and AfD shows. Governing Germany will by no means be a boring task.

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Glossary

Alliance 90/The Greens

The **Alliance 90/The Greens**, also referred to as the "**Greens**", is an environmentalist political party in Germany that is considered center-left in the German political landscape.

Alternative for Germany (AfD)

The **Alternative for Germany (AfD)** is a nationally-conservative and right-wing political party in Germany.

Christian Democratic Union of Germany (CDU)

The **Christian Democratic Union of Germany (CDU)** is a Christian democratic and liberal-conservative political party in Germany that is considered center/center-right in the German political landscape. The CDU is the sister party of the Christian Social Union in Bavaria (CSU), which operates only in the state of Bavaria.

Christian Social Union in Bavaria (CSU)

The **Christian Social Union in Bavaria (CSU)** is a Christian democratic and conservative political party in Germany that only operates in Bavaria and that is considered center-right in the German political landscape. The CSU is the sister party of the Christian Democratic Union of Germany (CDU), which operates in the rest of Germany.

Free Democratic Party (FDP)

The **Free Democratic Party (FDP)**, also referred to as the "**Liberals**", is a market-friendly and social-liberal political party in Germany that advocates human rights, civil and economic liberalism and that is considered center-right in the German political landscape.

Social Democratic Party of Germany (SPD)

The **Social Democratic Party of Germany (SPD)**, also referred to as the "**Social Democrats**", is a social-democratic political party in Germany that is considered center-left in the German political landscape.

The Left

The **Left**, also referred to as the "**Left Party**", is a democratic-socialist and left-wing political party in Germany.

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