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Germany's Elections: A Win for the Center-Right

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OVERVIEW

- The center-right coalition of the conservative CDU/CSU and the pro-market FDP will form Germany's new government
- While lower taxes and a shift away from fiscal stimulus measures are a priority for both parties, the high budget deficit and slow economic recovery may restrict radical reform
- Nevertheless, the new government is expected to be positive for Germany's markets and businesses

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Germany went to the polls on Sunday, September 27, 2009, and delivered victory to a center-right alliance led by German Chancellor Angela Merkel. The conservative Christian Democratic Union (CDU), its conservative Bavarian sister party, the Christian Social Union (CSU) and the pro-business Free Democratic Party (FDP) together won 48.4% of the national vote, according to projections by state broadcaster ARD. In Germany, a parliamentary majority can be secured with the support of less than 50% if the parties in question have more support than the other leading parties combined.

Based on the colors representing the parties, the center-right coalition of the CDU/CSU and the FDP has sometimes been referred to as the Schwarz-Gelb (black-yellow) coalition. According to polls of voters by ZDF and ARD, Mrs. Merkel's new government is expected to hold a stable majority in the lower house of the parliament.

DESIRE FOR REFORM, BUT SCOPE MAY BE LIMITED

In Germany's last general elections in 2005, Mrs. Merkel and her CDU/CSU party campaigned on a strong pro-market election platform and were seen as bringing political change to Germany. Despite a comfortable lead in preliminary polls for Merkel's CDU/CSU party, the campaign for radical reform nearly lost her the election. The election night turned into a cliffhanger, which eventually resulted in what was called a 'grand coalition' between the two largest parties, the CDU/CSU and the left-leaning Social Democratic Party (SPD).

As chancellor leading this 'grand coalition', Mrs. Merkel shifted away from implementing the radical reforms she had supported earlier and moved her party toward the left, balancing pro-business policies with more welfare-oriented programs such as workers' rights and social protection for the less well-off. This year's election outcome could give Mrs. Merkel the chance to revive some of her bolder economic reform measures now that she can establish a coalition with the FDP, led by Guido Westerwelle, who favor lower taxes and fewer regulations for business—that is, if Mrs. Merkel still deems them appropriate.

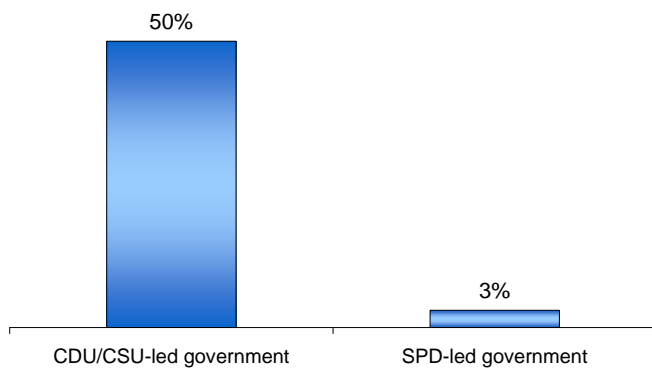
Although the FDP and, to a lesser extent, the CDU/CSU, both aim to lower taxes and would probably favor a reduction in government spending in order to create room for tax cuts, they are restricted by the spiraling budget deficit. The coalition, particularly the FDP, may also want to move away from fiscal stimulus measures, but the new government must be careful to ensure that the economy attains sustainable growth levels or risk strangling the recovery before it can take off. After governing through the deepest recession in post-war history and the biggest financial crisis since the Great Depression, Mrs. Merkel might prefer a more moderated approach to steer her new government, especially in the short term.

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POSITIVE FOR MARKETS AND INTERNATIONAL RELATIONS

Nevertheless, a center-right government is largely expected to be positive for German markets and businesses. During past legislative periods, the DAX showed an essentially better performance in the case of a conservative-liberal led government (see chart 1). Politically, for most of Germany's allies, including the United States, the election result is likely to maintain continuity in German foreign policy. While the CDU/CSU's previous coalition partner, the SPD, sometimes disagreed with U.S. policy, the FDP has long been a strong supporter of Germany's trans-Atlantic relations, including on sensitive topics such as Afghanistan.

Chart 1: DAX performance during legislative periods



Source: DZ Bank, 31 August 2009

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