HSBC Asset Management

For Professional Client and Institutional Investor Use Only

German grand coalition?

Investment Event | 24 February 2025

Result and coalition possibilities

The German election held on February 23rd yielded a victory for the centre-right CDU/CSU, which gained 28.5% of the vote, up from 24.1% in the 2021 election. As the polls suggested, the AfD significantly increased its share of the vote, which doubled to 20.8% from 10.3%. Die Linke also saw some increase in support. The gains came primarily at the expense of the SPD, which had headed the previous coalition. It's share of the vote dropped to 16.4% from 25.7%. The FDP, a minority partner in the previous government, saw its support drop by over a half to less than 5.0%, meaning it did not reach the 5% threshold to enter parliament.

Figure 1: 2025 German elections results

Party	Vote share (%)	Seats
CDU/CSU	28.5	208
AfD	20.8	152
SPD	16.4	120
Green	11.6	85
Die Linke	8.8	64
BSW	5.0	0
FDP	4.3	0
SSW	0.2	1
Other	4.4	0
Total	***100***	***630***

Source: Macrobond, HSBC AM as of 24 February 2025

The CDU/CSU victory leaves it with 208 seats in the Bundestag, someway short of the 316 required for a majority. CDU/CSU leader Friedrich Merz, the likely next Chancellor, announced his intention to begin coalition negotiations after the regional elections in Hamburg on March 1st, with the aim of establishing a new coalition by late April.

As the CDU/CSU has ruled out working with the second place AfD, which won 152 seats, the most likely outcome is a so-called grand coalition (CDU/CSU-SPD), which would result in a bloc with 328 seats. A three-party coalition with the Greens appears less likely given the support of the Greens is not needed and there are significant policy differences between them and the CDU/CSU.

A more flexible fiscal stance?

A key aspect of the coalition negotiations will be the outcome for fiscal policy. The centre-right CDU/CSU favours capping corporation tax at 25% while abolishing the solidarity tax for higher earners. However, the SPD campaigned on tax cuts for low-income households and a higher contribution from higher income households.

Perhaps one of the most important areas for discussion between the parties will be whether and how to reform Germany's so-called "debt brake". The debt brake was introduced in 2009 under a grand coalition headed by the CDU's Angela Merkel. As the debt brake is enshrined in Germany's Basic Law (constitution), amending it requires a two-thirds majority in the Bundestag. A grand coalition would, therefore, require the support of other parties to make any changes.

The CDU/CSU itself has traditionally favoured maintaining the debt brake. More recently, its leader, Friedrich Merz, has signalled some possible flexibility to allow for increased defence spending, given increased geopolitical tensions. Indeed, following the election, Mr Merz talked of the need for Europe to "achieve independence from the USA". However, whether this results in looser fiscal policy or reform of the debt drake is unclear, as Merz favours exploring expenditure restraint in other areas first.

The SPD and the Greens both favour some reform of the debt brake to allow for greater public sector investment. Indeed, the SPD, has proposed a EUR 100bn (over 2% of GDP) investment fund. Even if the CDU/CSU, SPD and Greens opt to change the debt brake in some way, they would fall seven seats short of the 420 needed to pass the amendment. Given opposition to working with the AfD and the AfD's unwillingness to reform the debt brake, support from the Die Linke will be needed. Die Linke favours changes that allow for greater public investment but opposes increasing defence spending.

Ultimately, Germany has the fiscal space to increase borrowing for productive projects if a political agreement can be reached. The European Commission estimates Germany's general government debt at just over 60% of GDP in 2024 with a general government deficit of c. 2% of GDP. Both compare favourably to the eurozone average (Figure 2 & 3) and are considerably lower than the figures for the US and UK.

The CDU/CSU won the German election. A grand coalition with the SPD appears the most likely outcome

The grand coalition would require support of other parties to reform the German debt brake

German and eurozone equities have increased relatively quicky recently, so some near-term caution may be warranted

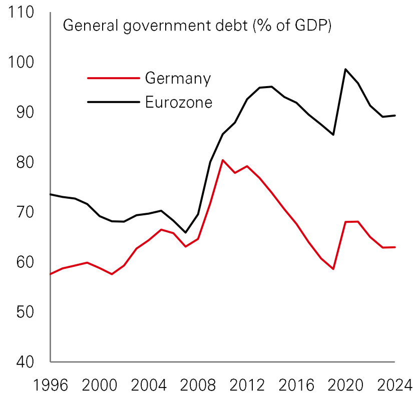
Nonetheless, with eurozone equities trading at a larger than normal discount to the US, any positive European growth or policy surprises could further extend the recent outperformance

Follow us on:

Linkedin:
HSBC Asset Management

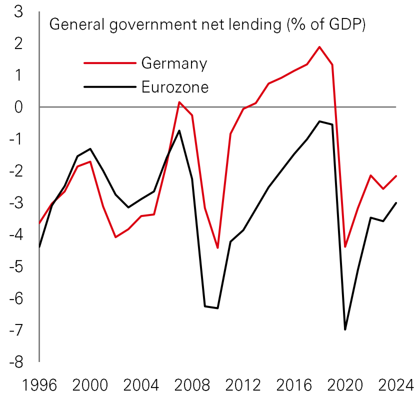
Website:
assetmanagement.hsbc.com

Figure 2: Government debt



Source: Macrobond, HSBC AM as of 24 February 2025

Figure 3: Government budget balances



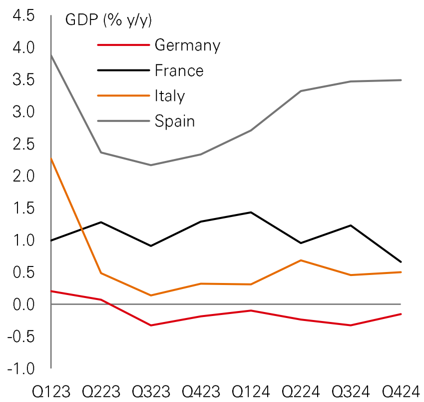
Source: Macrobond, HSBC AM as of 24 February 2025

German macro backdrop

Increased discussion over relaxing fiscal rules stems from Germany's soft growth performance in recent years and, more recently, concern that Europe will need to pursue a more self-sufficient defence policy, which will require higher levels of spending.

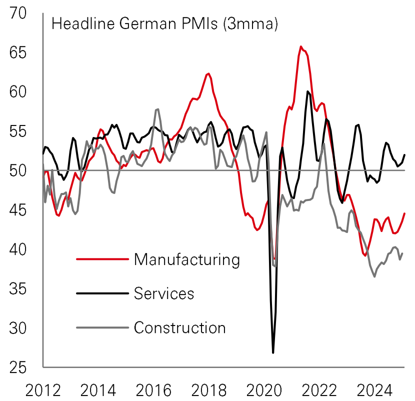
Germany has underperformed other major eurozone economies in the post-pandemic period (Figure 4), in part reflecting its greater exposure to the weak global manufacturing cycle. However, construction has also been a source of weakness (Figure 5). The lagged impact of ECB interest rate cuts should provide these rate-sensitive sectors with some relief in 2025, although trade policy uncertainty remains a headwind for manufacturing. An uplift in public investment spending in the coming years, if agreed, could provide some support for the construction sector.

Figure 4: GDP growth



Source: Macrobond, HSBC AM as of 24 February 2025

Figure 5: German PMIs



Source: S&P Global, HSBC AM as of 24 February 2025

While some improvement in growth is expected, it is likely to be gradual. The Bloomberg consensus forecast is for German GDP to rise by only 0.3% in 2025 following a 0.2% contraction in 2024. This is notably below the expected eurozone growth rate of close to 1.0%.

European reform agenda

More widely, lacklustre economic performance and increased geopolitical tensions could prompt a renewed focus on structural reforms in Germany and across the eurozone.

Former ECB President Draghi's latest report warned a combination of low investment and low productivity has undermined EU competitiveness. Europe relies too much on bank financing, suffering from fragmented capital markets. Regulatory hurdles are also stifling innovation in the digital sector.

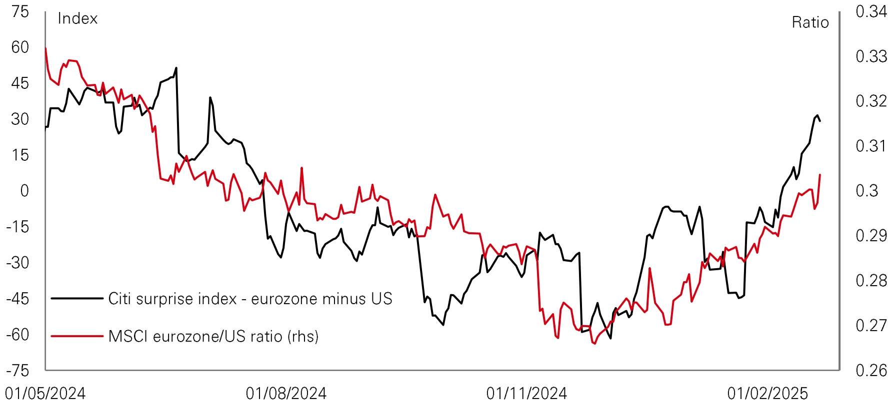
Mr Draghi's recommendations included increased financial market integration, an overhaul of regulation and a more flexible governance framework. This would facilitate the adoption of new technologies, helping to reverse the EU's long-term underperformance versus the US.

Investment implications

The initial market reaction to the election result has been limited with little change in German bund yields, which at just under 2.50% are around the middle of the range seen in recent weeks. At the time of writing, the DAX was up by 0.9%, partially recovering some of last week's declines. The Eurostoxx is also trading marginally higher on the day.

The relatively muted market reaction is consistent with a two-party grand coalition being a familiar situation for Germany. In addition, the likelihood that any significant change to the debt brake will require four parties to reach an agreement means negotiations on this issue may take some time and the precise outcome is uncertain at this stage.

Figure 6: Eurozone data surprises and equity performance versus the US



Source: Macrobond, HSBC AM as of 24 February 2025

Although the initial reaction to the election result has been relatively muted, German and eurozone stocks have risen a long way relatively quickly in recent weeks, as macro data have surprised to the upside (Figure 6). Some near-term caution may, therefore, be warranted. Nonetheless, with eurozone equities trading at a larger than normal discount to the US, any positive policy surprises, such as the SPD, Greens and Die Linke convincing the CDU/CSU to agree to more substantial changes to the debt brake in face of the structural and geo-political challenges to Germany and Europe, could further extend the recent outperformance. Similarly, expectations for 2025 German growth remain subdued, potentially implying a low bar for further upward data surprises.

Important Information

For Professional Clients and intermediaries within countries and territories set out below; and for Institutional Investors and Financial Advisors in the US. This document should not be distributed to or relied upon by Retail clients/investors.

The value of investments and the income from them can go down as well as up and investors may not get back the amount originally invested. The performance figures contained in this document relate to past performance, which should not be seen as an indication of future returns. Future returns will depend, inter alia, on market conditions, investment manager's skill, risk level and fees. Where overseas investments are held the rate of currency exchange may cause the value of such investments to go down as well as up. Investments in emerging markets are by their nature higher risk and potentially more volatile than those inherent in some established markets. Economies in Emerging Markets generally are heavily dependent upon international trade and, accordingly, have been and may continue to be affected adversely by trade barriers, exchange controls, managed adjustments in relative currency values and other protectionist measures imposed or negotiated by the countries and territories with which they trade. These economies also have been and may continue to be affected adversely by economic conditions in the countries and territories in which they trade.

The contents of this document may not be reproduced or further distributed to any person or entity, whether in whole or in part, for any purpose. All non-authorised reproduction or use of this document will be the responsibility of the user and may lead to legal proceedings. The material contained in this document is for general information purposes only and does not constitute advice or a recommendation to buy or sell investments. Some of the statements contained in this document may be considered forward looking statements which provide current expectations or forecasts of future events. Such forward looking statements are not guarantees of future performance or events and involve risks and uncertainties. Actual results may differ materially from those described in such forward-looking statements as a result of various factors. We do not undertake any obligation to update the forward-looking statements contained herein, or to update the reasons why actual results could differ from those projected in the forward-looking statements. This document has no contractual value and is not by any means intended as a solicitation, nor a recommendation for the purchase or sale of any financial instrument in any jurisdiction in which such an offer is not lawful. The views and opinions expressed herein are those of HSBC Asset Management at the time of preparation, and are subject to change at any time. These views may not necessarily indicate current portfolios' composition. Individual portfolios managed by HSBC Asset Management primarily reflect individual clients' objectives, risk preferences, time horizon, and market liquidity. Foreign and emerging markets. Investments in foreign markets involve risks such as currency rate fluctuations, potential differences in accounting and taxation policies, as well as possible political, economic, and market risks. These risks are heightened for investments in emerging markets which are also subject to greater illiquidity and volatility than developed foreign markets. This commentary is for information purposes only. It is a marketing communication and does not constitute investment advice or a recommendation to any reader of this content to buy or sell investments nor should it be regarded as investment research. It has not been prepared in accordance with legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of its dissemination. This document is not contractually binding nor are we required to provide this to you by any legislative provision.

All data from HSBC Asset Management unless otherwise specified. Any third party information has been obtained from sources we believe to be reliable, but which we have not independently verified.

HSBC Asset Management is the brand name for the asset management business of HSBC Group, which includes the investment activities that may be provided through our local regulated entities. HSBC Asset Management is a group of companies in many countries and territories throughout the world that are engaged in investment advisory and fund management activities, which are ultimately owned by HSBC Holdings Plc. (HSBC Group). The above communication is distributed by the following entities:

- In Australia, this document is issued by HSBC Bank Australia Limited ABN 48 006 434 162, AFSL 232595, for HSBC Global Asset Management (Hong Kong) Limited ARBN 132 834 149 and HSBC Global Asset Management (UK) Limited ARBN 633 929 718. This document is for institutional investors only, and is not available for distribution to retail clients (as defined under the Corporations Act). HSBC Global Asset Management (Hong Kong) Limited and HSBC Global Asset Management (UK) Limited are exempt from the requirement to hold an Australian financial services license under the Corporations Act in respect of the financial services they provide. HSBC Global Asset Management (Hong Kong) Limited is regulated by the Securities and Futures Commission of Hong Kong under the Hong Kong laws, which differ from Australian laws. HSBC Global Asset Management (UK) Limited is regulated by the Financial Conduct Authority of the United Kingdom and, for the avoidance of doubt, includes the Financial Services Authority of the United Kingdom as it was previously known before 1 April 2013, under the laws of the United Kingdom, which differ from Australian laws;
- in Bermuda by HSBC Global Asset Management (Bermuda) Limited, of 37 Front Street, Hamilton, Bermuda which is licensed to conduct investment business by the Bermuda Monetary Authority;
- in Chile: Operations by HSBC's headquarters or other offices of this bank located abroad are not subject to Chilean inspections or regulations and are not covered by warranty of the Chilean state. Further information may be obtained about the state guarantee to deposits at your bank or on www.sbif.cl;
- in Colombia: HSBC Bank USA NA has an authorized representative by the Superintendencia Financiera de Colombia (SFC) whereby its activities conform to the General Legal Financial System. SFC has not reviewed the information provided to the investor. This document is for the exclusive use of institutional investors in Colombia and is not for public distribution;
- in Finland, Norway, Denmark and Sweden by HSBC Global Asset Management (France), a Portfolio Management Company authorised by the French regulatory authority AMF (no. GP99026) and through the Stockholm branch of HSBC Global Asset Management (France), regulated by the Swedish Financial Supervisory Authority (Finansinspektionen);
- in France, Belgium, Netherlands, Luxembourg, Portugal, Greece by HSBC Global Asset Management (France), a Portfolio Management Company authorised by the French regulatory authority AMF (no. GP99026);
- in Germany by HSBC Global Asset Management (Deutschland) GmbH which is regulated by BaFin (German clients) respective by the Austrian Financial Market Supervision FMA (Austrian clients);
- in Hong Kong by HSBC Global Asset Management (Hong Kong) Limited, which is regulated by the Securities and Futures Commission. This video/content has not be reviewed by the Securities and Futures Commission;
- in India by HSBC Asset Management (India) Pvt Ltd. which is regulated by the Securities and Exchange Board of India;
- in Italy and Spain by HSBC Global Asset Management (France), a Portfolio Management Company authorised by the French regulatory authority AMF (no. GP99026) and through the Italian and Spanish branches of HSBC Global Asset Management (France), regulated respectively by Banca d'Italia and Commissione Nazionale per le Società e la Borsa (Consob) in Italy, and the Comisión Nacional del Mercado de Valores (CNMV) in Spain;
- in Malta by HSBC Global Asset Management (Malta) Limited which is regulated and licensed to conduct Investment Services by the Malta Financial Services Authority under the Investment Services Act;
- in Mexico by HSBC Global Asset Management (Mexico), SA de CV, Sociedad Operadora de Fondos de Inversión, Grupo Financiero HSBC which is regulated by Comisión Nacional Bancaria y de Valores;
- in the United Arab Emirates, Qatar, Bahrain & Kuwait by HSBC Global Asset Management MENA, a unit within HSBC Bank Middle East Limited, U.A.E Branch, PO Box 66 Dubai, UAE, regulated by the Central Bank of the U.A.E. and the Securities and Commodities Authority in the UAE under SCA license number 602004 for the purpose of this promotion and lead regulated by the Dubai Financial Services Authority. HSBC Bank Middle East Limited is a member of the HSBC Group and HSBC Global Asset Management MENA are marketing the relevant product only in a sub-distributing capacity on a principal-to-principal basis. HSBC Global Asset Management MENA may not be licensed under the laws of the recipient's country of residence and therefore may not be subject to supervision of the local regulator in the recipient's country of residence. One of more of the products and services of the manufacturer may not have been approved by or registered with the local regulator and the assets may be booked outside of the recipient's country of residence.
- in Peru: HSBC Bank USA NA has an authorized representative by the Superintendencia de Banca y Seguros in Perú whereby its activities conform to the General Legal Financial System - Law No. 26702. Funds have not been registered before the Superintendencia del Mercado de Valores (SMV) and are being placed by means of a private offer. SMV has not reviewed the information provided to the investor. This document is for the exclusive use of institutional investors in Perú and is not for public distribution;
- in Singapore by HSBC Global Asset Management (Singapore) Limited, which is regulated by the Monetary Authority of Singapore. The content in the document/video has not been reviewed by the Monetary Authority of Singapore;
- in Switzerland by HSBC Global Asset Management (Switzerland) AG. This document is intended for professional investor use only. For opting in and opting out according to FinSA, please refer to our website; if you wish to change your client categorization, please inform us. HSBC Global Asset Management (Switzerland) AG having its registered office at Gartenstrasse 26, PO Box, CH-8002 Zurich has a licence as an asset manager of collective investment schemes and as a representative of foreign collective investment schemes. Disputes regarding legal claims between the Client and HSBC Global Asset Management (Switzerland) AG can be settled by an ombudsman in mediation proceedings. HSBC Global Asset Management (Switzerland) AG is affiliated to the ombudsman FINOS having its registered address at Talstrasse 20, 8001 Zurich. There are general risks associated with financial instruments, please refer to the Swiss Banking Association ("SBA") Brochure "Risks Involved in Trading in Financial Instruments";
- in Taiwan by HSBC Global Asset Management (Taiwan) Limited which is regulated by the Financial Supervisory Commission R.O.C. (Taiwan);
- in Turkiye by HSBC Asset Management A.S. Turkiye (AMTU) which is regulated by Capital Markets Board of Turkiye. Any information here is not intended to distribute in any jurisdiction where AMTU does not have a right to. Any views here should not be perceived as investment advice, product/service offer and/or promise of income. Information given here might not be suitable for all investors and investors should be giving their own independent decisions. The investment information, comments and advice given herein are not part of investment advice activity. Investment advice services are provided by authorized institutions to persons and entities privately by considering their risk and return preferences, whereas the comments and advice included herein are of a general nature. Therefore, they may not fit your financial situation and risk and return preferences. For this reason, making an investment decision only by relying on the information given herein may not give rise to results that fit your expectations.
- in the UK by HSBC Global Asset Management (UK) Limited, which is authorised and regulated by the Financial Conduct Authority;
- and in the US by HSBC Global Asset Management (USA) Inc. which is an investment adviser registered with the US Securities and Exchange Commission.
- In Uruguay, operations by HSBC's headquarters or other offices of this bank located abroad are not subject to Uruguayan inspections or regulations and are not covered by warranty of the Uruguayan state. Further information may be obtained about the state guarantee to deposits at your bank or on www.bcu.gub.uy.

Content ID: D041290_V1.0; Expiry Date: 24.08.2025