

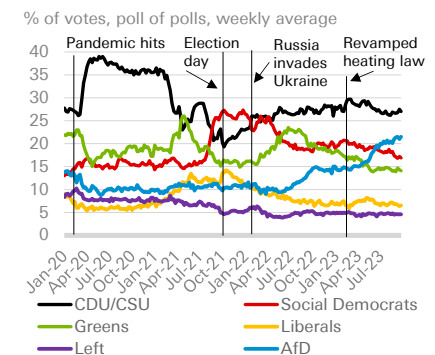


No big reform push to tackle growth malaise and regional election outlook

- How to tackle the growth malaise – no strong push for structural reforms expected.** Despite dwindling poll numbers and weak growth prospects, the government’s appetite for sweeping structural reforms appears limited. Given the still relatively robust performance of the labour market, the sense of urgency for structural reforms is only growing slowly. As the three coalition partners prefer different policy avenues to tackle the growth malaise (more industrial policy and state-led spending for the Greens vs. fiscal conservatism and supply-side reforms for the Liberals), more lowest common denominator reforms are to be expected.
- Tax reform and cutting red tape as first steps.** Recent economic policy measures, labelled as a “[10 point action plan](#)”, can be seen as a first (small) step in tackling the structural growth malaise. The renewed legislative push will likely lead to incremental progress rather than a large-scale reduction of the administrative burden.
- Rise of the far-right in current polls to lead to more policy pragmatism over the next few months.** Sticky inflation, change-fatigue and rising immigration have all contributed to rising approval rates of the far-right AfD, reaching an all-time high at 21.5% in recent weeks (Figure 1). While we do not expect the AfD to enter any government at a regional level (neither at the elections this weekend, nor next year), its strong performance is expected to influence the overall policy debate.
- Conservatives look set to win regional elections in two of Germany’s most populous states, Bavaria and Hesse.** As polls do not suggest any major shifts in the regional power structures, the regional elections will likely have a rather small effect on national policy making. But another electoral defeat of the Liberals might make it more difficult to agree on the new set of EU fiscal rules by year-end, as Finance Minister Lindner already hinted in Santiago de Compostela.
- EU fiscal reform – compromise before year-end increasingly unlikely.** The prospects of a return to the old fiscal rulebook are rising. The main sticking point still seems to be the agreement on the mechanistic debt reduction element (EC proposal: highly indebted countries with a fiscal deficit in excess of 3% are required to reduce their deficit by at least 0.5% of GDP a year, even if not under an EDP). This falls short of Germany’s initial proposal of 1% per year. Thus, next year’s excessive deficit procedures could be opened based on the old rulebook.

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Figure 1: Ruling coalition falling short of a majority in current polls



Source: Wahlrecht.de, Deutsche Bank



How to tackle the growth malaise

Weak short- and medium-term growth outlook. In 2023, Germany is set to be the only G7 economy with real GDP growth in negative territory (see Figure 2) and the medium-term growth prospects are not good either. On September 1, we downgraded our growth forecast to -0.5% yoy for this year and a meagre 0.3% yoy for next year, and estimate overall potential growth being closer to 0.5 than 0.75%.¹ The weak growth outlook has triggered a discussion of both the need for a fundamental overhaul of Germany’s growth model and/or the need for short-term stimulus measures to prop up growth.

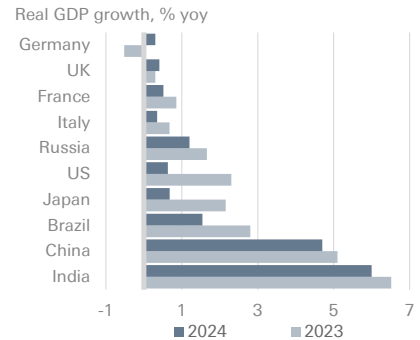
No shortage of policy advice – but which proposals are politically feasible to be adopted? Over the past couple of weeks, plenty of reform advice on how to kickstart the economy has been published by German research outlets, politicians and media. In most of the 7 to 10 point reform plans,² the following proposals feature prominently: (1) lowering corporate tax rates, (2) speeding up digitalization (e.g. more digital public services), (3) increasing domestic green energy supply, (4) cutting red tape, (5) facilitating immigration of qualified labour and (6) negotiating additional trade and investment agreements. However, as the partners of the three-way coalition prefer different policy avenues to tackle the growth malaise (more industrial policy and state-led spending for the Greens vs. fiscal conservatism and supply-side reforms for the Liberals), lowest common denominator rather than sweeping structural reforms are to be expected.

Growing sense of urgency for structural reforms – but unemployment is still low and the 2025 elections are on the horizon. Chancellor Scholz has changed his narrative from “green economic miracle” in May to “national tour de force”³ in September that is needed to tackle the current growth malaise. Still, the appetite of the ruling coalition for sweeping structural reforms appears limited. Given the still relatively robust performance of the labour market, the sense of urgency for structural reforms is only growing slowly. Consensus on some policy measures emerged at the cabinet offsite in Meseberg in late August, but the cabinet remains divided on many other issues, for example the subsidized electricity price for the energy-intensive industry. Recent economic policy measures, labelled as a “[10 point action plan](#)”, can be seen as a first (tiny) step in tackling the structural growth malaise.

Non-expansionary 2024 budget to be finalized soon, off-budget funds to support green investment spending. The government is on track to approve its first non-expansionary budget (EUR 445.7 bn in the core budget, 30 bn less than last year). On September 6, the [draft budget law](#) was presented to parliament in a first reading. But wrangling about some spending items will continue over the next couple of weeks (e.g. how to use built-in fiscal buffers for lowering electricity taxes for the energy-intensive industry). The tax estimate on October 26th is the next milestone to watch and the 2024 budget will finally be approved by the Bundestag only in November (see Figure 3). For 2024, we project a fiscal deficit of 1.4% of GDP.

- **Tax reform entered the legislative process - would provide EUR 7 bn relief**

Figure 2: Germany - the growth laggard



Source: Deutsche Bank

Figure 3: German budgetary process



Source: Federal Ministry of Finance, Deutsche Bank

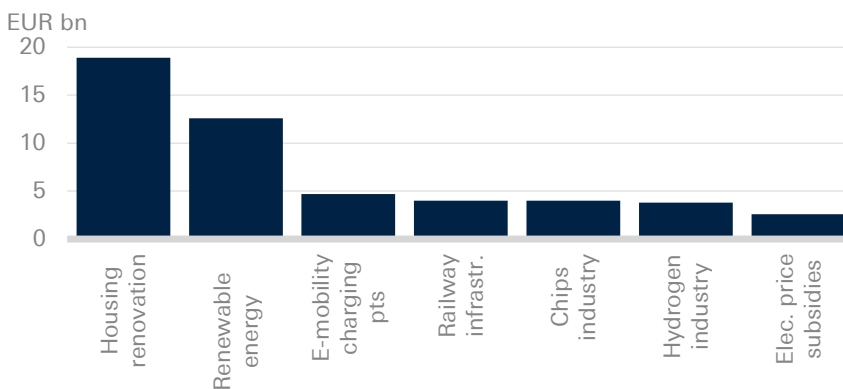
1 See [Focus Germany](#) on supply bottlenecks; other recent research finds sees potential growth having fallen to only 0.4% for 2026-2028 see: [IfW, Mittelfristprojektion für Deutschland, September 2023](#).
 2 10 Punkte für den Wirtschaftsstandort Deutschland, Fitnessprogramm von Friedrich Merz, 7-Punkte Plan für mehr Wachstum vom Handelsblatt.
 3 [SZ, 6 September 2023](#), Scholz fordert in Ruck-Rede nationale Kraftanstrengung.



for corporates each year. FinMin Lindner's [Opportunity-for-Growth-Act](#) was approved by the cabinet at the end of August and is scheduled to have its first reading in parliament on October 12. It includes CAPEX subsidies for green technologies and energy efficiency measures, notably in the form of an investment premium in the amount of 15% of the green investments or max. EUR 30 m. The Länder, whose tax revenues are also affected by the law, still have to approve this law in the Bundesrat and are likely to request some modifications before they would be willing to approve it.

- EUR 57.6bn in green investment spending in 2024 from the Climate and Transformation Fund.** The [financial plan](#) for investment spending from the off-budget fund was released in August and is set to be approved by the Bundestag together with the 2024 budget in November. It foresees EUR 18.9 bn to be spent for upgrading the existing housing stock (energy efficiency measures), EUR 12.9 bn to be spent for renewable energies roll-out, and EUR 4 bn state-support for the semiconductor industry (see Figure 4).
- Landing zone for a state-subsidized industrial electricity price.** In May, Economy Minister Habeck [proposed to subsidize industrial electricity price](#) to 6 cent per kWh - to be applied temporarily until 2030 for energy-intensive industries like chemicals, metals, steel, glass, and paper. Wrangling between the coalition partners over the eventual size, scope and duration of the subsidized electricity price or alternative measures is likely to continue until the next coalition committee meeting (scheduled for October 20th). As the proposal is a specific subsidy for large energy-intensive companies and there are doubts whether long-term electricity costs would decline towards 6 cents/MWh, there is strong opposition from the Finance Ministry. Among possible alternative measures, a lowering of the electricity tax for energy-intensive companies for one more year seems to be emerging as a compromise (bringing relief of about EUR 1.7 bn for corporates per year).
- Climate bonus to be paid out on a per-capita basis as early as 2025?** The Liberals have made a new push to start paying out part of the revenues generated by the CO₂ price on a per-capita basis as of 2025. The national CO₂ price could generate revenues of EUR 13 bn in 2025 and a large part of it should be paid out to citizens, according to FinMin Lindner.⁴

Figure 4: How to spend it - the 2024 Climate and Transformation Fund expenses



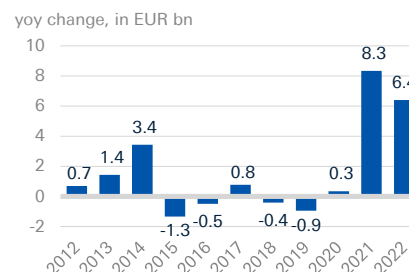
Source : Federal Government, Deutsche Bank

⁴ [Spiegel, 27 September 2023](#), Lindner stellt Klimageld ab 2025 in Aussicht.



Finally some progress in cutting red tape? Another attempt to realize “economic stimulus at zero cost”.⁵ Reducing the administrative burden has moved back to the top of the policy agenda. Surveys point to the fact that 71% of German *Mittelstand* (SME) companies regard bureaucracy as one of the key impediments to doing business (+9% yoy), ranking right after the shortage of skilled workers and high energy costs.⁶ While there is no single economy-wide metric to track and measure (inflation-adjusted) costs of bureaucracy, all available metrics seem to indicate rising bureaucracy-induced costs (despite three bureaucracy reduction acts since 2015 and the establishment of an independent oversight body called Normenkontrollrat in 2006). The cost for compliance with federal laws is estimated at a high EUR 65 bn per year (1.7% of GDP in 2022), not including regional or EU regulation-induced costs.⁷ Moreover, the overall cost of implementing bureaucratic norms (in terms of time and material expenses)⁸ has increased over the past couple of years (Figure 5).

Figure 5: The overall administrative burden has increased over the past 10 years



Source: Federal Statistical Office, Normenkontrollrat, Deutsche Bank

A renewed legislative push will likely lead to incremental progress rather than a large-scale reduction of the administrative burden. On August 30th, the government announced the [key points](#) of the fourth “Bureaucracy Reduction Act (BEG IV)”.⁹ This includes 28 measures such as allowing official digital correspondences, shortened retention periods for tax receipts or abandoning the mandatory registration of hotel guests. Overall, this could save up to EUR 2.3 bn for the economy, according to government estimates.¹⁰ In parallel, interior minister Faeser is also working on a revised “Online Administration Law” which aims at speeding up the digitalization of administrative processes. In the five years after the first “Online Administration Law” entered into force in 2017, only 19% of administrative services have been digitalized.¹¹

Signs of a green backlash might limit the speed of new environmental legislation – both in Germany and the EU. As citizens are increasingly worried about the near-term costs of green policies, anti-green parties like the Dutch Farmer-Citizen-Movement or the German AfD see their approval ratings go up. After Germany finally approved a watered-down version of its fossil-boiler ban in September, the German government is now opposing mandatory renovations for buildings with the worst energy performance as foreseen by the draft EU Buildings Directive. In France, President Macron has decided to backtrack on banning the installation of gas boilers in new buildings from 2026. Overall, we expect policy-makers at the national and the EU level to focus on implementing existing green legislation rather than pushing for new green legislation over the next couple of quarters with elections in Poland (October), the Netherlands (November), and European Parliamentary elections (June) looming. In her recent annual [State of the Union address](#), EU Commission president von der Leyen put greater emphasis on industrial and competition policies than on further advancing the green agenda – an

5 In the words of Minister of Justice, Marco Buschmann (FDP). See [Handelsblatt, 11 August 2023](#), Justizminister Buschmann warnt Ampel vor Verfassungsbruch.
6 VR Mittelstandsumfrage, in: [DZ Bank \(2023\)](#), Mittelstand im Mittelpunkt. June 26.
7 [Zeit, 9 September 2023](#), Bürokratieabbau: Womit keiner rechnet.
8 The so-called “[Erfüllungsaufwand](#)”, which includes the cost for the time spent to fulfill bureaucratic norms as well as other follow-up cost for respecting norms (e.g. for labor health and safety or animal welfare measures).
9 [WDR, 30 August 2023](#), Ampel will Bürokratie abbauen: Digitalisierung soll es richten.
10 [FAZ, 30 August 2023](#), Klausurtagung in Meseberg, Was das Kabinett beschlossen hat.
11 [Bundesrechnungshof \(2023\)](#), Bericht zur Umsetzung des Onlinezugangsgesetzes. March 29.

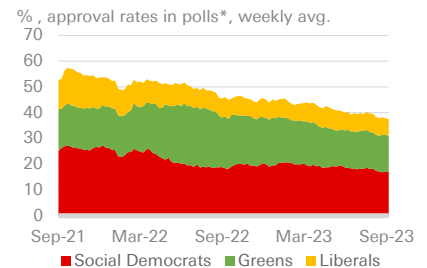


indication of policy priorities over the next few quarters.

Germany's position on key pending EU reforms (fiscal, migration, enlargement, electricity market reform). Overall, Germany is likely to push for EU institutional reforms as a precondition to further enlargement (see [recent report](#)). Finding consensus on fiscal and electricity market reform seems rather challenging.

- **Migration and Asylum Pact** - agreement in Council reached this week. After Germany dropped its opposition to the disputed Crisis Regulation,¹² inter-institutional negotiations with the European Parliament can now proceed.
- Divergent national interests are weighing on the **pending EU fiscal reform**. As a compromise before year-end looks increasingly unlikely, the prospects of a return to the old fiscal rulebook are rising. The main sticking point still seems to be the agreement on the mechanistic debt reduction element (EC proposal: highly indebted countries with a fiscal deficit in excess of 3% are required to reduce their deficit by at least 0.5% of GDP a year, even if not under an EDP). This falls short of Germany's initial proposal of 1% per year. Thus, next year's excessive deficit procedures could be opened based on the old rulebook (see [Focus Europe on Italy](#)).
- **No agreement on electricity market reform yet.** While France would like to use contracts for difference not only for new but also the refurbishment of nuclear power plants, other member states (including Germany¹³) oppose that.

Figure 6: Popularity of the government has reached its lowest level (so far)



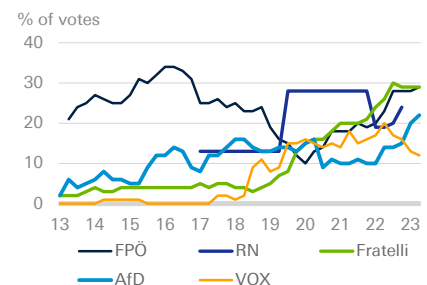
Source: Wahlrecht.de, Deutsche Bank

Rise of the far-right and regional election outlook

Government popularity reached a new low in late September - no apparent drivers for public sentiment to improve much over the next few months. The popularity of the government has taken another hit in the past couple of weeks, reaching a new low of 38% in approval rates in late September (see Figure 6). Sticky inflation, stagnant real GDP growth and continuous coalition infighting have contributed to this decline in government popularity. Given that the 2024 draft budget envisages expenditure cuts and a reprioritisation of spending (e.g. towards defense), it might not be too easy for the three-party coalition to win back disappointed voters.

Rise of the far-right to lead to more policy pragmatism. Across Europe, right-wing populist parties have become a key feature of the political landscape (see Figure 7). In Germany, the combination of dissatisfaction with policy answers provided by mainstream parties and a growing frustration over migration (see Figure 8) have contributed to rising approval rates for the far-right. But beyond short-term fluctuations of voter preferences there are some indications that a more structural shift in preferences is taking place. These are (i) ongoing change-fatigue in an age of poly-crisis/twin transformation (green, digital) and (ii) the so-called normalization of right-wing populist parties. Recent research finds that a "civic nationalist normalization strategy" has been contributing to the success of right-wing parties in Austria, France and Germany as right-wing parties also managed to attract peripheral voters by addressing their concerns with the economic impact of immigration.¹⁴ This normalization manifests itself in shifts in slower-moving

Figure 7: Surge of right-wing populist parties* across Europe



*as defined by PopuList 2.0
Source: Politico Poll of Polls, Deutsche Bank

¹² Under the new rules, border agencies will be allowed to lock migrants up in detention centers for up to 40 weeks as they process asylum claims during crises.

¹³ [Euroactiv, 18 September 2023](#), Electricity market reform and the gathering CfD storm.

¹⁴ [Friedrich Ebert Stiftung \(FES\) \(2022\)](#), Understanding right-wing populism and what to do about it.



variables like the voter potential of parties. In Germany, the share of voters that rule out voting for the AfD has shrunk to 58% from 70% in 2021 (Figure 9).

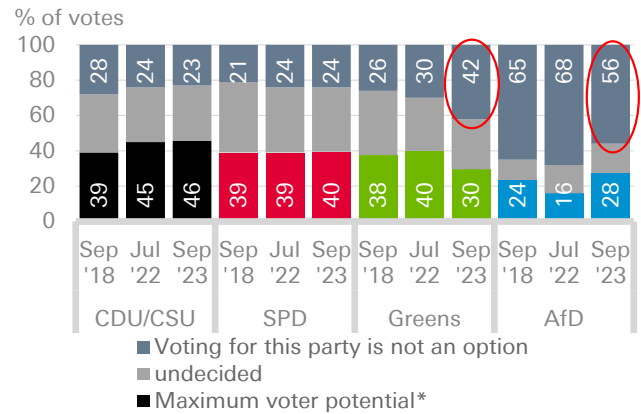
Figure 8: Rising number of applications for asylum



* Jan-Aug, excluding refugees from Ukraine

Source: BAMF, Deutsche Bank

Figure 9: Slow-moving indicators point to some structural shift



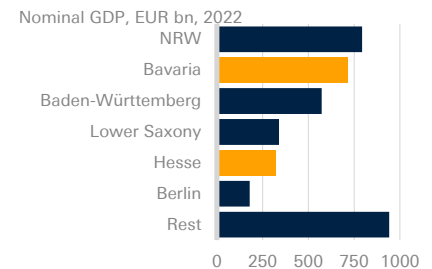
* Voters who intend to or could imagine to vote for the party

Source: INSA, Deutsche Bank

Regional election outlook for Bavaria and Hesse – conservatives likely to win in both states

Regional elections have their own dynamics, but the current weak popularity of the federal government seems to have spilt over to the regional level. With three more days to go until the elections, all eyes are on Germany's second and fifth largest states by GDP and population (Figure 10). In Bavaria and Hesse a combined 13.7 million voters are called to the ballots on Sunday (from a total population of around 20 million). The elections can be seen as an important electoral test for the federal government after two years in office, half-way through their current term. Even though regional elections usually follow their own dynamics, the current dissatisfaction with the governing coalition in Berlin (Figure 6) is likely to feed into regional electoral decisions. Many federal policy areas such as energy, climate as well as refugee and immigration policies are regarded as key issues by voters. However, policy areas like education and transport, where the Länder (states) are mostly in charge, rank high on voters' minds.¹⁵

Figure 10: Two of Germany's biggest states go to the polls



Source: Statista, Deutsche Bank

When analyzing most recent polls in Bavaria and Hesse, some common trends emerge (Figure 11 and 12): First, the Conservatives are leading the polls. Second, all three parties of the ruling coalition (at a national level) are polling below the levels reached in the 2018 state elections. Third, the far-right AfD might come second or third, but is unlikely to surpass the 20% mark currently reached in nationwide polls.

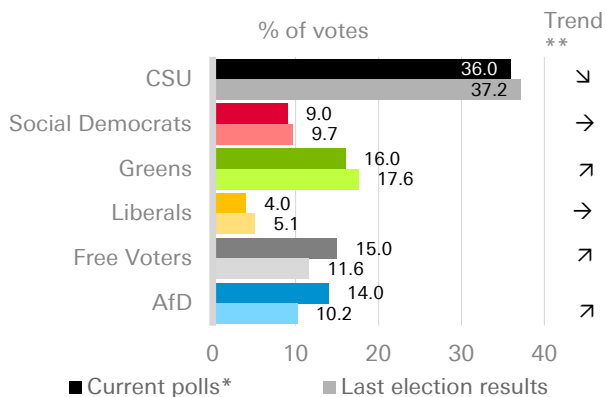
Bavaria – another term for the ruling center-right coalition. Bavaria is traditionally a conservative stronghold with the ruling CSU leading the polls by far with 36% (but slightly below the level reached in 2018). The CSU's junior coalition partner, the so-called Free Voters (FW), seems to have benefitted from the antisemitic leaflet affair at the end of August. After allegations emerged that Deputy PM Hubert Aiwanger (FW) had once been found with an antisemitic flyer in his schoolbag when he was

¹⁵ [ZDF Politbarometer Extra, 29 September 2023](#), CDU legt in Hessen zu - CSU in Bayern schwach.



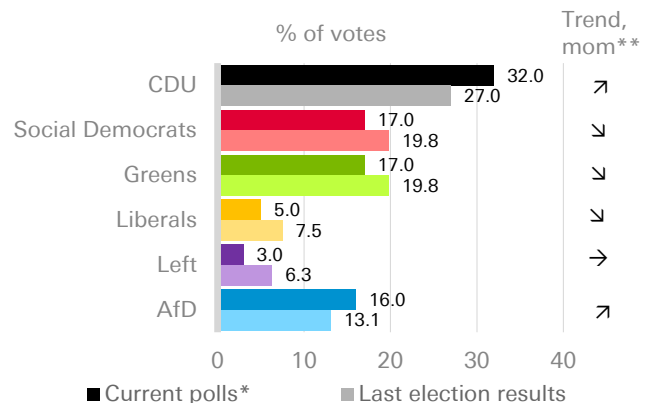
a 17-year-old schoolboy, approval rates for the Free Voters increased to 15% (Figure 11). Current polling numbers suggest that the ruling center-right CSU-FW coalition is likely to remain in power. PM Söder (CSU) has ruled out a coalition with the Greens and a CSU-SPD coalition, even if arithmetically possible, is highly unlikely.

Figure 11: Bavarian election polls - Conservatives leading by a wide margin



* FG Wahlen, Politbarometer, 29 September 2023
** Forsa poll, 2 August 2023, before antisemitic leaflet affair became public
Source: Wahlrecht.de, Deutsche Bank

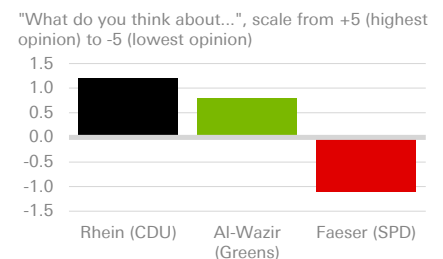
Figure 12: Hesse election polls - Conservatives in the lead



* FG Wahlen, Politbarometer, 29 September 2023
** FG Wahlen poll from 25 August 2023
Source: Wahlrecht.de, Deutsche Bank

Hesse – continuation of the current CDU-Green coalition. In Hesse, the Conservatives led by PM Rhein are ahead in the polls. Although he has only been in office since May 2022, PM Rhine is liked more by voters than his challengers (Figure 12 and 13). While the Green’s lead candidate and Deputy PM Al-Wazir enjoys widespread popularity, the SPD’s contender, well-known federal interior minister Faeser, has so far been unable to turn the polls in her favour.¹⁶ Her pitch to form a traffic-light coalition in Hesse is unpopular with voters – 65% of voters oppose this option. The SPD hopes to still persuade some of the yet undecided voters,¹⁷ estimated at 32% of the electorate. Even though the formation of a CDU-SPD government would be possible, the continuation of the current CDU-Green coalition today seems to be the most likely election outcome.

Figure 13: Hesse - popularity of lead candidates



Source: ZDF Politbarometer (29.09.2023), Deutsche Bank

Implications for federal policy making – even more fiscal conservatism at EU level? As polls do not suggest any major shifts in regional power structures, the regional elections will likely have a rather small impact on national policy making: (1) Electoral victories would not increase the political leverage of the CDU (as the main opposition party) as the composition of the Bundesrat (Upper house of parliament) is likely to remain unchanged. For the ruling federal government it would become neither easier nor more difficult to pass laws affecting the states (e.g. tax policy) in the second chamber of parliament. (2) If the series of electoral defeats continues for the Liberals,¹⁸ they are likely to further strengthen their fiscally conservative profile. This might make it more difficult to agree on the new set of EU fiscal rules by year-end, as Finance Minister Lindner already hinted in

16 ZDF Politbarometer Extra, 29 September 2023.

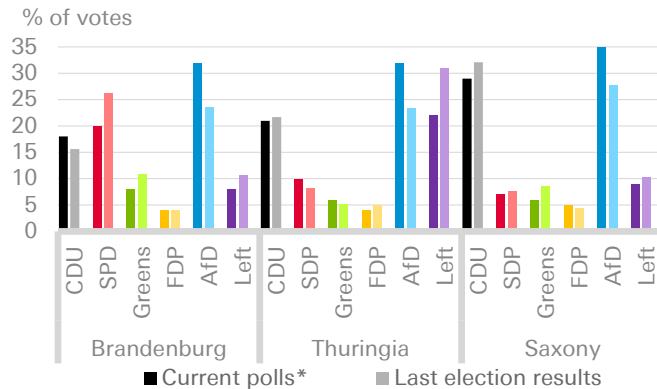
17 [Zeit, 5 September 2023](#), Nancy Faeser bevorzugt nach der Wahl in Hessen ein Ampelbündnis.

18 The FDP dropped out of the regional parliament after the elections in Berlin in February 2023 and Lower Saxony in October 2022. Moreover, the Liberals lost ground in the regional elections in Bremen (May 2023), North Rhine-Westphalia and Schleswig Holstein (both in May 2022, see Wahlrecht.de).



Santiago de Compostela.¹⁹ (3) The potentially weak performance of SPD frontrunner Faeser in Hesse, who has declared her intention to remain federal interior minister, could weigh on the SPD and the coalition. (4) The right-wing AfD could prove that it can turn strong polling numbers into real electoral gains. The mainstream parties would therefore have to deal with the question of how to keep the right-wing populists in check, especially in view of the upcoming elections in three eastern German states in September 2024 (Figure 14 and 15).

Figure 14: AfD ahead in polls in eastern German states



* August 31 and September 13/16, 2023
Source: Wahlrecht.de, Deutsche Bank

Figure 15: Upcoming regional elections 2024

Date	Regional elections in...	Government coalition*
Sept 1	Saxony	CDU, SPD, Greens
Sept 1	Thuringia	SPD, Greens, Left
Sept 22	Brandenburg	SPD, CDU, Greens (Minority government)

* political parties

CDU SPD Greens Left

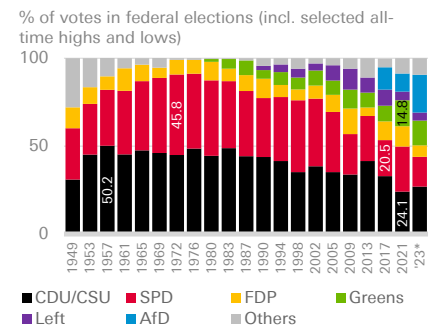
Source: Wahlrecht.de, Deutsche Bank

Changing political landscape in Germany

Increasingly fragmented party system – looming launch of a new left party? The ongoing fragmentation of Germany political landscape (Figure 16) could accelerate further, were the prominent left politician Sahra Wagenknecht to launch a new party. The party would cater to economically leftist, socially conservative (i.e. anti-migration) voters. Wagenknecht has indicated that she would announce a decision by the end of the year. The biggest challenge at the moment seems to be putting in place the party structures. The new party could then contest the European Parliament election in June 2024, before running for the Bundestag in autumn 2025.²⁰ Surveys estimate the hypothetical voter potential of the new left party at 20%,²¹ which is slightly higher than that of the existing Left party.²² As only 6% of survey respondents say that they would certainly vote for the new party, the new party might still not pass the 5% hurdle for entering parliament.

Strengthening of the political fringes would put additional pressure on the political center. The creation of a new left party would first and foremost weaken the existing Left. Departing MPs would cause the parliamentary group to falter, and the existing Left party would probably not be able to enter the Bundestag in 2025. It is rather unlikely that the new left party would weaken the far-right AfD, even if it could attract some of the AfD voters on an anti-migration platform. A strengthening of the political fringes would put additional pressure on the political center and

Figure 16: Altered political landscape



* 2023: Polls of polls as of September 30
Source: Bundeswahlleiter, Wahlrecht.de, Deutsche Bank

19 [DW, 15 September 2023](#), Lindner: Deutsche Wirtschaft trotz Rezession stark.
20 [Welt, 24 September 2023](#), „Gründe deine Partei, aber mache es jetzt“; [Augsburger Allgemeine, 24 September 2023](#), Sahra Wagenknecht – die Frau, auf die viele hoffen und vor der noch mehr zittern.
21 [Handelsblatt, 25 September 2023](#), Umfrage sieht hohes Wählerpotential für Wagenknecht-Partei.
22 [INSA](#) estimates a maximal voter potential of 15% for the Left.



make government formation even more complex. Multiparty coalitions across political spectrums have already become more likely, and Germany is likely to continue to be governed by three-way coalitions (like the current traffic-light coalition). This implies a continuation of consensus-oriented policies and a trend towards minimum common denominator compromises, reducing the likelihood of far-reaching structural reforms.



Appendix 1

Important Disclosures

*Other information available upon request

*Prices are current as of the end of the previous trading session unless otherwise indicated and are sourced from local exchanges via Reuters, Bloomberg and other vendors. Other information is sourced from Deutsche Bank, subject companies, and other sources. For further information regarding disclosures relevant to Deutsche Bank Research, please visit our global disclosure look-up page on our website at <https://research.db.com/Research/Disclosures/FICCDisclosures>. Aside from within this report, important risk and conflict disclosures can also be found at <https://research.db.com/Research/Disclosures/Disclaimer>. Investors are strongly encouraged to review this information before investing.

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