

State elections in Germany and political outlook

RESEARCH NOTE:

Germany's political landscape amidst the rise of populist parties and increasing uncertainty for businesses and investors

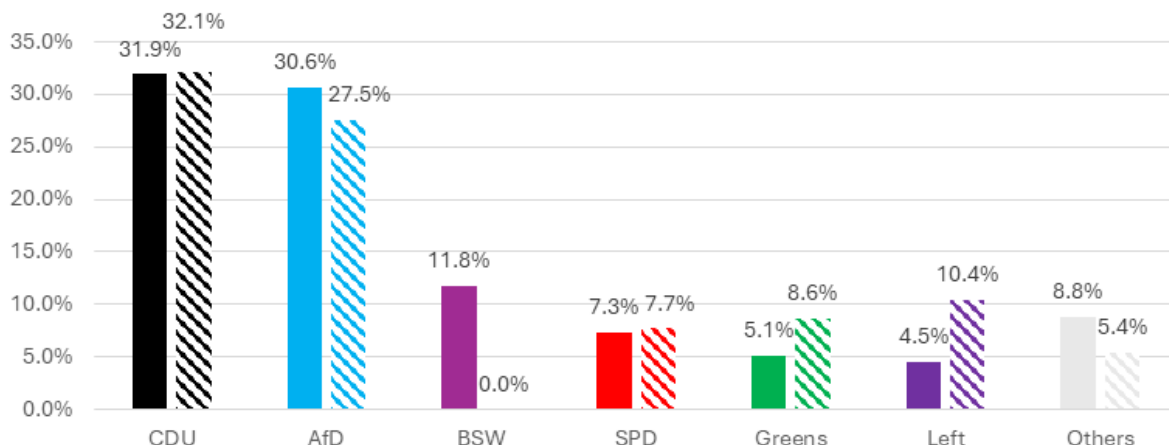
The political landscape in Germany has entered a period of profound change. Recent state elections in Thuringia, Saxony, and Brandenburg further deepened existing divisions between Eastern and Western Germany. In the wake of these elections, both the far-right Alternative für Deutschland (AfD) and the newly formed left-populist Sahra Wagenknecht Alliance (BSW) have gained substantial ground. This marks a shift in voter sentiment that complicates coalition-building efforts for established parties like the Social Democrats (SPD) and Christian Democrats (CDU).

These developments come at a time of significant

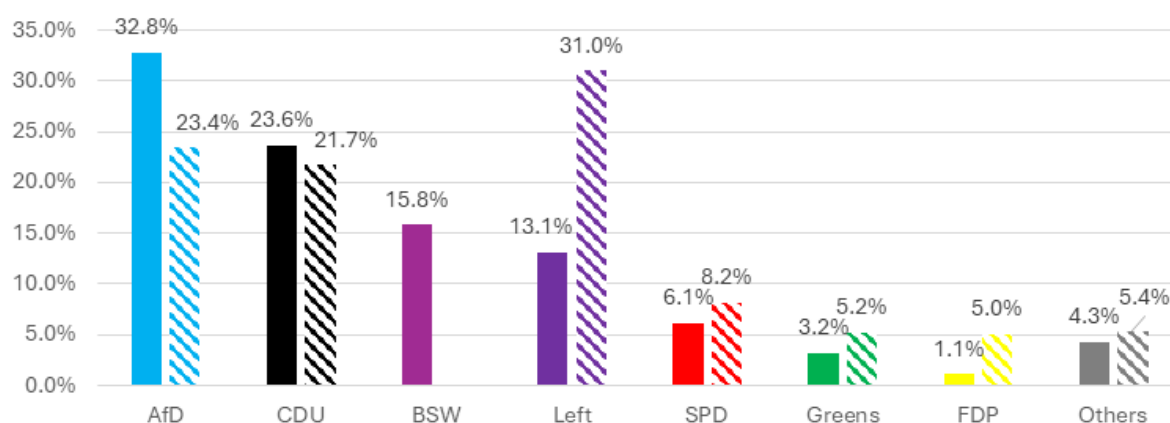
economic and political uncertainty, both domestically and internationally. Germany has struggled with multiple crises in recent years, from the COVID-19 pandemic and the war in Ukraine to energy shortages and inflation. In Eastern Germany, these challenges have led to a stronger sense of dissatisfaction with the federal government, along with deep-rooted concerns about immigration and fears of cultural alienation and economic marginalisation. The rise of populist forces in these regions reflects this discontent, as voters increasingly turn to parties that promise to prioritise local interests. These parties' agendas further complicate matters for businesses and investors.

State Elections in Thuringia, Saxony, and Brandenburg

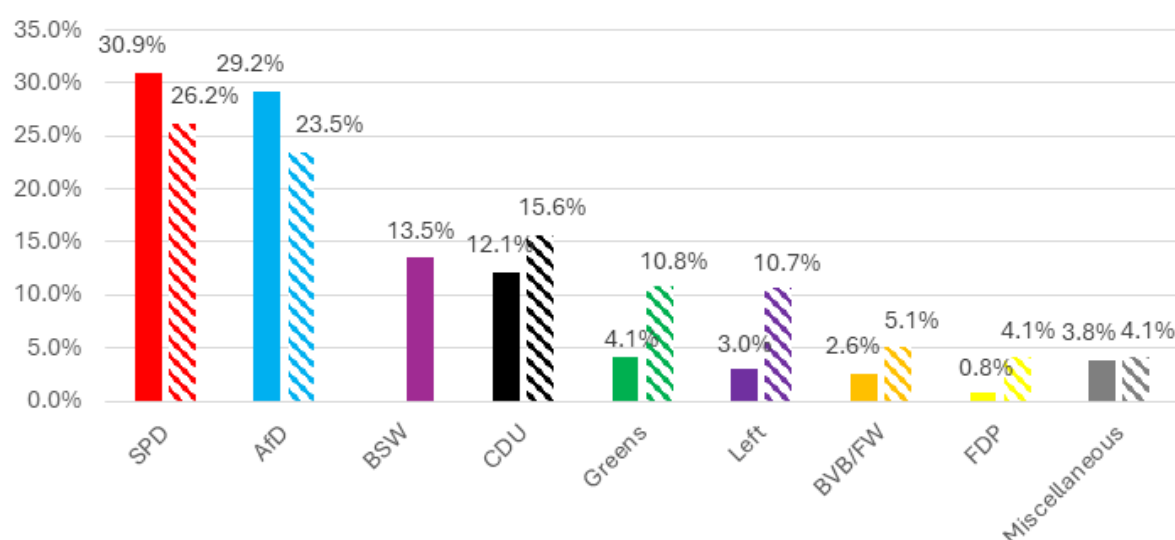
SAXONY: ELECTION RESULTS 2024 (LEFT) VS. ELECTION RESULTS 2019 (RIGHT) IN %



THURINGIA: ELECTION RESULTS 2024 (LEFT) VS. ELECTION RESULTS 2019 (RIGHT) IN %



BRANDENBURG: ELECTION RESULTS 2024 (LEFT) VS. ELECTION RESULTS 2019 (RIGHT) IN %



Along with this year's European elections, the state elections in Thuringia, Saxony and Brandenburg were the first elections in which the newly-founded Sahra Wagenknecht Alliance (BSW) participated. The party was founded as a splinter group from the Left Party because of ideological differences on migration and so-called "identity politics". It combines anti-migration policies with a strong scepticism of military aid to Ukraine, social conservatism, and leftist labour market policies with a strong welfare state.

All three elections were marked by a strong showing by the AfD, which won the election in Thuringia and came in a close second in both Saxony and Brandenburg. Meanwhile, the BSW came third in all three contests and is now seen as a kingmaker for potential coalitions in these states. Despite the AfD's successes, it remains politically isolated, as all other parties refuse to form a coalition with them. In Thuringia and Saxony, the CDU will lead the governments and form coalitions with both SPD and BSW, though in Thuringia the situation is the

most complicated. The CDU will likely have to form a minority government there, as the CDU, SPD and BSW do not collectively form a majority. The CDU does not want to enter a coalition with the Left Party because it has a federal "incompatibility resolution" with the party. Instead, the coalition would have to seek occasional support from the Left Party in order to pass legislation.

In Brandenburg, the SPD emerged as the winner, but the party's victory was largely seen as an "Anti-Scholz" victory, because popular Minister President Dietmar Woidke chose not to campaign with Chancellor Scholz. It was also the result of tactical voting, as many Green and CDU voters cast their votes for Woidke and the SPD in order to prevent an AfD victory. Like its counterparts in Thuringia and Saxony, the SPD faces coalition-building difficulties. The Greens, as well as the FDP, failed to secure any seats, making it impossible to continue the previous SPD-CDU-Greens coalition.

In the week after the election, the Brandenburg CDU has announced that it will not participate in a potential coalition between the SPD and the Sahra Wagenknecht Alliance (BSW). This leaves an SPD-BSW coalition as the only viable option. While coalition negotiations involving BSW in Thuringia and Saxony are stalled, partly owing to uncertainties about the BSW's political approach, Brandenburg's BSW-head Robert Crumbach, a former SPD member with strong local ties, is considered a more promising partner. In general, there is a looming threat of ungovernability across East Germany. This started with the rise of the AfD and the CDU's incompatibility resolution with the Left Party, and is now being amplified by the emergence of the BSW.

One of the most significant issues in coalition-building are the deep ideological differences between the CDU and BSW on issues like military support for Ukraine.

While foreign policy is not a state issue, BSW has made clear the party would only participate in a state government that clearly takes a national political stance in favour of diplomacy and against what the party calls "participation in war", referring to military aid to Ukraine.

The success of both the AfD and BSW has already had effects on other parties, too: the CDU in East Germany has been calling for much stricter migration laws, while the SPD in Brandenburg has questioned social benefits for Ukrainian refugees. Notably, parties that oppose military aid to Ukraine have garnered up to 70% of the vote in these three states, including the AfD, BSW and the CDU, whose state parties in East Germany are markedly different on this issue from the federal party. In Thuringia, over 80% of voters chose parties that in one form or another reject military aid to Ukraine.

The strength of the Far-Right AfD

To understand the AfD's popularity with voters in Eastern Germany, it is important to understand the feeling of being left behind and a perceived neglect by the federal government that many East Germans experience, despite significant economic improvements over the past decade. A perception of stagnation, particularly among AfD supporters, contrasts with the actual progress made in employment and wages. The unemployment rate in East Germany fell from 9.5% in 2013 to 7.8% in 2023, with 74 of the 76 districts in the region seeing notable improvements. Median wages also rose, with a larger increase in the East than in the West.

However, subjective perceptions are different. A study reveals that 69% of East Germans view local developments more negatively than the reality suggests. This pessimism is more pronounced in rural areas, where 83% underestimate progress, and among party affiliation, with 79% of AfD supporters and 75% of BSW voters having a negative outlook. Demographic challenges contribute to this sentiment, as East Germany's population shrank by 2.2% between 2012 and 2022. At the same time, larger cities like Leipzig and Berlin grew, which means that population shrinkage outside urban centres is even more pronounced. The shrinking population in rural areas is correlated with heightened levels of economic pessimism, both in East and West Germany. This sense of being left behind has fuelled the success of parties like the AfD and BSW in East Germany. Economic progress alone does not seem to counter these feelings of exclusion.

The AfD has been able to tap into deep-rooted concerns about immigration and to capitalise on fears of cultural alienation and economic marginalisation. This intensified in the wake of the Russian-Ukrainian war

and the resulting energy crisis, which hit Germany hard owing to its reliance on Russian energy. Its appeal in Eastern Germany is also tied to a broader frustration with the perceived inefficiency of democratic processes, especially the compromises required for effective governance in a coalition-driven system. In Thuringia, the AfD secured a blocking minority in the state parliament, allowing it to hinder major decisions, such as constitutional amendments and judicial appointments. Although the AfD remains isolated politically, with no other party willing to form a coalition with it, its ability to disrupt governance through this blocking power represents a significant challenge to both state and national politics.

In Thuringia, the AfD is classified as a right-wing extremist party by the German domestic intelligence agency. The extent of the party's extremism was evident during the first session of the new Thuringian state parliament in Erfurt on September 26, 2024, when chaos ensued, largely owing to the disruptive actions of Jürgen Treutler, the AfD's senior member, who presided over the session as the oldest parliamentarian. Treutler used his temporary authority to delay proceedings and refuse to allow a vote on the agenda. His actions provoked outrage from the other parties, especially the CDU, whose parliamentary manager, Andreas Bühl, accused Treutler of attempting a "seizure of power", a clear reference to the Nazi's seizure of power from 1931 - 1933. The session ended without resolution, and a decision had to be made by the state constitutional court, which ruled that Treutler must allow a vote on a revised agenda, which allowed the CDU, SPD and other parties to submit candidates for the presidency of the state parliament, something the AfD had claimed for themselves as the biggest parliamentary group.

Political and Economic Outlook for Germany

The results of the state elections in Thuringia, Saxony, and Brandenburg have significant implications for Germany's broader political landscape, as well as for the country's investment climate. At the national level, the strong showing of the AfD and the BSW will likely continue to fuel political uncertainty, making it increasingly difficult for the federal government to maintain stability.

The SPD-Greens-FDP "traffic light" coalition, already under strain, will face even more pressure in the coming months as it navigates the complexities of federal budget negotiations and growing dissatisfaction among voters in all of Germany. Internal divisions within the coalition are likely to deepen, with the FDP openly considering the possibility of early federal elections. Meanwhile, the CDU, under Chancellor candidate Friedrich Merz, must recalibrate its strategy to address the growing influence of populist parties while maintaining its commitment to centrist policies, looking to win the federal elections scheduled for September 2025.

From an economic perspective, the rise of the AfD and BSW poses a potential challenge for foreign investors. Both parties have unclear and at times protectionist economic policies, which could introduce uncertainty into the regulatory landscape, particularly for businesses relying on stable investment conditions and clear regulatory frameworks. For instance, the approval and regulation of construction projects are governed by state building codes, and federal states also play an important role in approval procedures, for example

by having the ability to issue additional environmental regulations that may be relevant to investors. In Eastern Germany, where major companies such as Tesla, TSMC and Intel have either invested heavily or plan to invest, concerns over the influence of the AfD and BSW on future investment decisions are growing. Anti-immigration sentiments, a central theme of both parties, could also hinder the flow of skilled labour into the region and exacerbate labour shortages in key industries, which is critical for sustaining economic growth in sectors such as manufacturing and green technology.

While Brandenburg's current SPD-led government under Minister-President Woidke is likely to continue providing broad policy continuity favourable to businesses, the political dynamics in Thuringia and Saxony are far less clear. The potential for minority governments, particularly in Thuringia, could create political instability, further complicating the investment landscape in these regions.

Looking ahead, the outlook for Germany's political stability remains uncertain, with the potential for early federal elections and likely continued fragmentation of the political landscape. For businesses and investors, the key will be navigating this uncertainty while closely monitoring the policy developments at both the state and national levels. The rise of populism in Eastern Germany is a trend that shows no sign of abating and will continue to shape the country's political and economic future for years to come.