



R&R Weekly Column  
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## Political Instability: Elections Make Another Bastion of Germany's Business Model Collapse

The [results of Germany's general election](#) on Sunday mark the end of a key pillar of Germany's business model: political stability. Friedrich Merz's CDU/CSU coalition has won the majority of votes (28.5%) and seats (208), followed by the AfD (20.8%, with 152 seats), SPD (16.4%, 120), Greens (11.6%, 85), the Linke (8.8%, 64), and SSW with 1 seat. Bündnis Sahra Wagenknecht – BSW (4.97%) and the Liberals (4.3%) didn't reach 5% and were left outside parliament. The biggest challenge for Merz now is to find a coalition to support his government in parliament.

Theoretically speaking, the CDU and the SPD may have enough seats to secure a thin majority (328 seats vs 315 needed for a majority), which could be reinforced by the presence of the Greens; but are their programs politically compatible? [The traffic light coalition that has recently collapsed](#) (SPD, Greens, and Liberals), [leading to Germany's first early elections since 1983](#), showed how unstable three-party coalitions can be. Additionally, a coalition of mainstream parties (CDU, SPD and Greens) could buy them four more years in power, but in case of disappointment by the electorate (which is likely given the heterogeneity of party programs), four years from now, the AfD would be in pole position to become the first party in parliament, as it happened to Italy's Giorgia Meloni after Draghi's large-coalition government.

On the other hand, the CDU could try to form a government with the AfD, as [both Elon Musk and Donald Trump have been pushing for in the last few months](#). But Merz saw what happened when the AfD voted for his anti-immigration plan in parliament: a revolt of his own base, as well as a tough reprimand from Angela Merkel, the former CDU chancellor.

So now Germany needs to start to learn how to live with political instability, [as France has started to do since 2022](#) when Macron was re-elected president without a parliamentary majority. Paradoxically, Italy – the undisputed European champion of political instability – has been enjoying a stable government since the victory of the centre-right coalition led by Fratelli D'Italia's Giorgia Meloni in September 2022.

With the collapse of political stability, Germany loses another bastion of its business model, [as we discussed recently in our research](#). First, its reliance on Russian gas has proven to be a critical vulnerability. With geopolitical tensions and sanctions, the supply chain has been severely disrupted, leaving Germany scrambling for alternative energy sources. Second, the decision to phase out nuclear power has compounded the energy crisis. While it was part of a move towards greener energy, the transition has not been seamless, resulting in energy shortages and increased dependence on fossil fuels.

Moreover, Germany's export-driven economy has faced significant challenges. The economic slowdown in China, one of Germany's largest markets, has led to decreased demand for German goods, impacting industries like automotive and machinery. Additionally, the value chains linked to Eastern European countries, such as Hungary and Czechia have been strained. These countries have become less stable partners, affecting the flow of goods and services critical to Germany's manufacturing sector.

Germany's reliance on the United States for military security has also been a point of contention. With shifting US foreign policies and calls for increased European defense spending, Germany faces pressure to re-evaluate its defense strategy. Furthermore, the EU German-Franco Axis, once a symbol of European unity and economic strength, is facing its own set of challenges. Political differences and economic disparities have strained this alliance, impacting Germany's influence within the EU.

Finally, the [policy of Schwarze Null \(Black Zero\)](#), aimed at maintaining a balanced budget and limiting debt, has restricted fiscal flexibility. In times of economic stress, this policy has hindered Germany's ability to respond effectively to crises.

Germany is at the heart of the European integration process. Without a strong Germany, the process is set to stall, and potentially reverse, exactly at the time when Donald Trump is trying to play "divide and conquer" within Europe and its NATO allies. All this seems to be good news only for China and Russia.

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Looking Ahead

**The Week Ahead: QoQ GDP To Advance In US, While Shrinking In Germany And France; Headline Inflation Rate To Rise In EZ**  
***In the US***, in Q4, according to the second estimate, GDP growth is expected to advance by 2.3% q-o-q (*p*: 3.1%). In February, CB Consumer Confidence is likely to edge down to 102.1 (*p*: 104.1). In Q4, PCE and core PCE prices are seen rising by 2.3% q-o-q (*p*: 1.5%) and 2.5% q-o-q (*p*: 2.2%) respectively.

***In the EZ***, in January, headline inflation rate is expected to increase by 2.5% y-o-y (*p*: 2.4%), while core inflation is likely to remain at 2.7% y-o-y. In February, consumer confidence is likely to increase to -13.6 (*p*: -14.2). Among largest EZ economies, according to final estimates, in Q4, the economy is seen: *i*) contracting by 0.2% q-o-q (*p*: 0.1%) and 0.2% y-o-y (*p*: -0.3%) in Germany; *ii*) shrink by 0.1% q-o-q (*p*: 0.4%) and rise by 0.7% y-o-y (*p*: 1.2%) in France.

**The Quarter Ahead: US-Russia Relations Thaw; Ukraine Mineral Deal Agreement Near; General Elections in Germany**

***US and Russia Started To Normalize Relations.*** The US and Russia agreed to restore embassy staffing. Secretary of State Rubio said talks included pathways to ending the Ukraine war and potential geopolitical and economic cooperation. The meeting took place in Riyadh with top Russian officials, including Foreign Minister Lavrov. The meeting aimed to set the stage for a Trump-Putin summit.

***Ukraine Mineral Deal Is Close.*** The Trump administration was nearing a deal for US mineral rights in Ukraine after pressuring Kyiv. Trump claimed the agreement could bring \$500 billion, while Zelensky confirmed talks were ongoing and that \$250bn of rare earths are in fact located in Ukrainian territories occupied by Russia.

***2025 Germany Elections.*** Polls show the CDU/CSU has won the 2025 General Election with the AfD also making large gains, while overtaking the SPD, which has collapsed under Scholz. The Greens have also lost ground.

Last Week's Review

**Real Economy: Inflation Rose in UK, France And Italy; QoQ GDP Growth Increased In Japan**

***In the EZ***, in February, ZEW Economic Sentiment Index edged up by 24.2 (*c*: 24.3; *p*: 18). In January, largest EZ economies, headline inflation rate: *i*) increased by 1.7% y-o-y (*c*: -0.1%; *p*: 0.2%) in France; and *ii*) increased by 1.5% y-o-y (*c*: 1.5%; *p*: 1.3%) in Italy.

***In the UK***, in January, headline and core inflation rose by 3.0% y-o-y (*c*: 2.8%; *p*: 2.5%) and 3.7% y-o-y (*c*: 3.7%; *p*: 3.2%). In December, unemployment rate stood at 4.4% (*c*: 4.5%; *p*: 4.4%). In January, retail Price Index increased by 3.6% y-o-y (*c*: 3.7%; *p*: 3.5%). In February, GfK Consumer Confidence rose to -20 (*c*: -22; *p*: -22).

***In Japan***, GDP growth rate advanced by 0.7% q-o-q (*c*: 0.3%; *p*: 0.4%). Annualized GDP growth rose to 2.8% y-o-y (*c*: 1.0%; *p*: 1.7%).

**Financial Markets: Stock Prices Declined; UST Yields Fell; Dollar Virtually Unchanged, While Oil Prices Fell; Gold Prices Rose**

***Market Drivers:*** Stocks drop on geopolitical tensions and consumer worries. US stock markets react to Trump's tariff plans and Ukraine peace talks. European stocks follow Wall Street lower; Germany's DAX dips 1% before Sunday's election.

***Global Equities:*** Decreased w-o-w (MSCI ACWI, -1.1%, to 874.54). The US S&P 500 index decreased (-0.2% w-o-w, to 6,013.13). In the EZ, share prices decreased (Eurostoxx 50, -0.3% w-o-w, to 5,475.85). In EMs, equity edged up (MSCI EMs, +2.0%, to 1,147.30). Volatility rose to 18.30 (VIX S&P 500, 52w avg.: 15.6; 10y avg.: 18.8).

***Fixed Income:*** w-o-w, the 10-year US Treasury yields fell (-5 bps to 4.43%). The 2-year US Treasury yields decreased (-6 bps to 4.20%). The German 10-year bund yields edged up (+4 bp to 2.46%).

***FX:*** w-o-w, the US Dollar Index is virtually unchanged (DXY, -0.0%, to 106.61; EUR/USD -0.3%, to 1.05). In EMs, currencies increased (MSCI EM Currency Index, +0.3% w-o-w, to 1,754.67).

***Commodities:*** w-o-w, oil prices decreased (Brent, -0.4% to 74.74 USD/b). Gold prices increased w-o-w (+1.8% to 2,953.20 USD/Oz).



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**Abbreviations, Acronyms and Definitions**

a	Actual	LN	Northern League, Italy
AKP	Justice and Development Party, Turkey	MSS	Five Star Movement, Italy
ann.	annualized	m-o-m	Month-on-month
ARS	Argentinian Peso	mb	Million barrels
avg.	Average	mb/d	Million barrels per day
bn	Billion	MENA	Middle East and North Africa
BoC	Bank of Canada	MHP	Nationalist Movement Party, Turkey
BoE	Bank of England	mn	Million
BoJ	Bank of Japan	MPC	Monetary Policy Committee
bpd	Barrels per day	NAFTA	North-American Free Trade Agreement
bps	Basis points	NATO	North Atlantic Treaty Organization
BS	Balance sheet	OECD	Organization for Economic Cooperation and Development
c	Consensus	Opec	Organization of Petroleum Exporting Countries
C/A	Current account	p	Previous
CB	Central bank	P2P	Peer-to-peer
CBB	Central Bank of Bahrain	PBoC	People's Bank of China
CBK	Central Bank of Kuwait	PCE	Personal Consumption Expenditures
CBT	Central Bank of Turkey	PE	Price to earnings ratio
CDU	Christian Democratic Union, Germany	PM	Prime minister
CNY	Chinese Yuan	PMI	Purchasing managers' index
CPI	Consumer Price Index	pps	Percentage points
DJIA	Dow Jones Industrial Average Index	pw	Previous week
DJEM	Dow Jones Emerging Markets Index	QCB	Qatar Central Bank
d-o-d	Day-on-day	QAR	Qatari Riyal
DXY	US Dollar Index	QE	Quantitative easing
EC	European Commission	q-o-q	Quarter-on-quarter
ECB	European Central Bank	RE	Real estate
ECJ	European Court of Justice	RBA	Reserve Bank of Australia
EIA	US Energy Information Agency	RRR	Reserve Requirement Ratio
EM	Emerging Markets	RUB	Russian Rouble
EP	European Parliament	SWF	Sovereign Wealth Fund
EPS	Earnings per share	tn	Trillion
EU	European Union	TRY	Turkish Lira
EUR	Euro	UAE	United Arab Emirates
EZ	Eurozone	UK	United Kingdom
Fed	US Federal Reserve	US	United States
FOMC	US Federal Open Market Committee	USD	United States Dollar
FRB	US Federal Reserve Board	USD/b	USD per barrel
FX	Foreign exchange	UST	US Treasury bills/bonds
FY	Fiscal Year	VAT	Value added tax
GCC	Gulf Cooperation Council	VIX	Chicago Board Options Exchange Volatility Index
GBP	British pound	WTI	West Texas Intermediate
GDP	Gross domestic product	WTO	World Trade Organisation
IMF	International Monetary Fund	w	Week
INR	Indian Rupee	w-o-w	Week-on-week
IPO	Initial public offering	y	Year
IRR	Iranian Rial	y-o-y	Year-on-year
JPY	Japanese yen	y-t-d	Year-to-date
k	thousand	ZAR	South African Rand
KSA	Kingdom of Saudi Arabia	2y; 10y	2-year; 10-year