Germany

AfD's Win Raises Questions, but Federal Risks Remain Limited

OCBC Group Research

- The Saxony-Anhalt result matters less for immediate policymaking than for what it signals nationally. While the AfD's victory has limited direct federal implications, it reinforces the party's growing momentum and highlights mounting pressure on mainstream parties as further state elections approach.

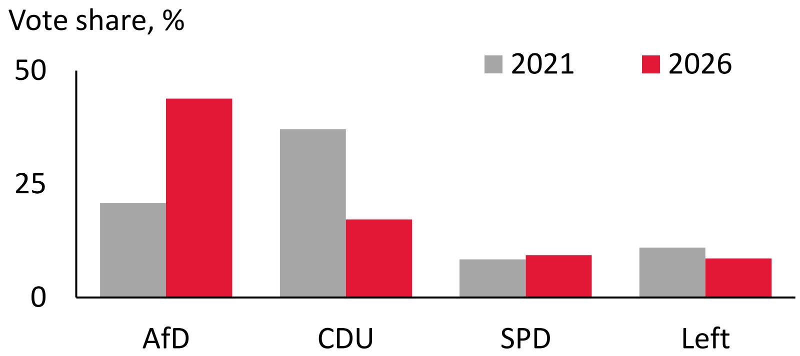
- The main risk is political fragmentation rather than an AfD-led government. As long as the "firewall" remains intact, the AfD is unlikely to enter government. However, excluding a party polling near 25%-30% nationally makes coalition formation more difficult, increasing the likelihood of broad, compromise-driven governments and weaker reform outcomes.

- Markets should watch upcoming state elections and the 2027 western election cycle closely. Strong AfD performances in Mecklenburg-Vorpommern and Saxony-Anhalt would strengthen perceptions of growing support. The more important test, however, is whether the AfD can replicate its gains in large western states, which would raise concerns about coalition formation and policy stability ahead of the 2029 federal election.

Election results a wake-up call for the establishment but not a shocking result

The far-right Alternative für Deutschland (AfD)'s provisional win in the Saxony-Anhalt election gives it 43.8% of the vote and 39 of the state parliament's 83 seats. Although it was reported as a shocking result, it did not come as much of a surprise for political observers, as major polling institutes had the AfD tracking at 40% to 42% in the days leading up to the election. Immediate implications at the federal level are also limited. Even if the AfD successfully takes power in the state, Saxony-Anhalt only holds 4 out of 69 votes in the Bundesrat. Hence, the wider importance of the result is the pressure it puts on mainstream parties ahead of further elections and difficult budget decisions.

AfD support more than doubled



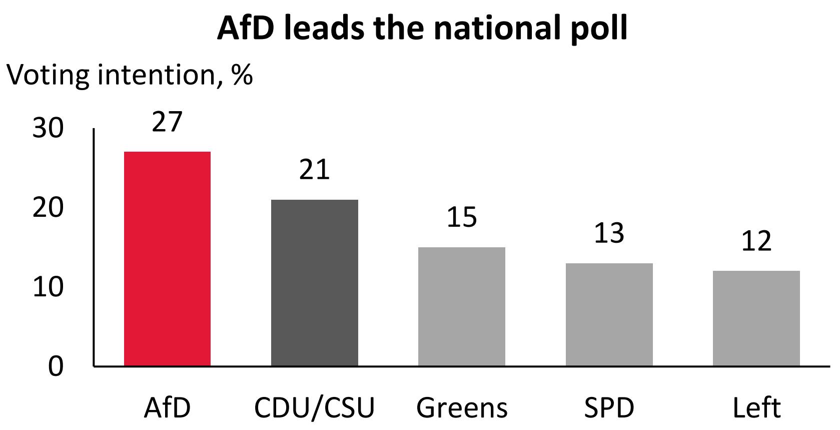
Source: State Statistical Office Saxony-Anhalt; OCBC Group Research.

AfD still short of an absolute majority; political gridlock ensues

AfD secured 39 seats, falling just three seats short of the 42 needed for an absolute majority. The remaining parliament is deeply fractured, split between 39 seats held by a coalition of traditional mainstream parties (including Chancellor Friedrich Merz's Christian Democratic Union (CDU)) and 5 seats held by the populist left-wing Bündnis Sahra Wagenknecht (BSW). Because all mainstream parties maintain a strict "firewall", refusing to govern with the far right, the BSW has become the ultimate kingmaker, holding the balance of power in an otherwise deadlocked legislature. If the BSW chooses to remain neutral and abstain, the active vote between the AfD and the mainstream parties would result in a 39-39 tie, paralyzing the state government. To break this mathematical deadlock, the center-right CDU is under immense pressure from federal leadership in Berlin to compromise on its core principles and strike a highly controversial alliance with the far-left BSW.

Impact limited at the federal level

Although the election result was shocking to the neutral observer, Saxony-Anhalt has only four of the Bundesrat's 69 votes, and its immediate impact is limited at the federal level. The greater risk lies in what this result may signal at the national level, namely whether it reflects a broader shift in political sentiment towards the far right. National polling explains why Berlin feels the pressure. Infratest's poll, published on 3 September, put the AfD at 27%, ahead of the CDU/CSU at 21%.



Source: Infratest; OCBC Group Research.

Despite the election defeat, Merz's first reaction was not to abandon reform; instead, he doubled down on it. He said that his determination to continue economic reforms was "unbroken", including reforms to pensions and the labour market. Fiscal plans are also unlikely to be changed. This is important, as a large proportion of projected growth in 2026 is attributed to fiscal spending. The German Institute for Economic Research (DIW Berlin) estimates that public consumption and investment account for roughly 70% of Germany's 2026 growth.

Assuming that the AfD "firewall" continues to hold, there is no chance that the AfD will form the government now or in the future. However, what is underappreciated is that the AfD does not have to enter the federal government to change German economic policy. If 25%-30% of parliament is effectively excluded from coalition negotiations, future governments become broader and ideologically less cohesive, which increases the risk of compromise-heavy policies, weaker reforms, and unstable coalitions. This might be more damaging than the probability of an AfD chancellor.

What to watch out for next

The 20 September elections taking place in Mecklenburg-Vorpommern and Berlin are the immediate next tests. The latest polling makes Mecklenburg-Vorpommern particularly significant. The AfD is averaging 35.9%, ahead of the SPD at 30%, while the CDU is only at 9%. The composition in Berlin is different. The CDU and the left are at around 19.7%, the AfD is at 18%, while the Greens and SPD are at roughly 13%, suggesting yet another fragmented state vote. If the AfD were to secure a clear victory in Mecklenburg-Vorpommern and gain executive power in Saxony-Anhalt, it would reinforce the impression of growing political momentum that mainstream parties would find difficult to ignore. Should national support rise above 35%, the risk of meaningful dilution of or delays to the government's 2027 budget and reform agenda would increase substantially.

While eastern state elections would provide a barometer of the AfD's popularity, the next genuinely critical phase is the 2027 western state-election cycle. If the AfD's gains remain predominantly eastern, markets can still continue viewing this as a geographically concentrated trend. However, if the same pattern starts appearing strongly in large western states, markets would start to seriously price in a 2029 coalition problem.

Disclaimers

This report is solely for information purposes and general circulation only and may not be published, circulated, reproduced or distributed in whole or in part to any other person without our prior written consent. This report should not be construed as an offer or solicitation for the subscription, purchase or sale of the securities/instruments mentioned herein or to participate in any particular trading or investment strategy. Any forecast on the economy, stock market, bond market and economic trends of the markets provided is not necessarily indicative of the future or likely performance of the securities/instruments. Whilst the information contained herein has been compiled from sources believed to be reliable and we have taken all reasonable care to ensure that the information contained in this report is not untrue or misleading at the time of publication, we cannot guarantee and we make no representation as to its accuracy or completeness, and you should not act on it without first independently verifying its contents. The securities/instruments mentioned in this report may not be suitable for investment by all investors. Any opinion or estimate contained in this report is subject to change without notice. We have not given any consideration to and we have not made any investigation of the investment objectives, financial situation or particular needs of the recipient or any class of persons, and accordingly, no warranty whatsoever is given and no liability whatsoever is accepted for any loss arising whether directly or indirectly as a result of the recipient or any class of persons acting on such information or opinion or estimate. This report may cover a wide range of topics and is not intended to be a comprehensive study or to provide any recommendation or advice on personal investing or financial planning. Accordingly, it should not be relied on or treated as a substitute for specific advice concerning individual situations. Please seek advice from a financial adviser regarding the suitability of any investment product taking into account your specific investment objectives, financial situation or particular needs before you make a commitment to purchase the investment product. In the event that you choose not to seek advice from a financial adviser, you should consider whether the investment product mentioned herein is suitable for you. Oversea-Chinese Banking Corporation Limited ("OCBC Bank"), Bank of Singapore Limited ("BOS"), OCBC Securities Private Limited ("OSPL") and their respective related companies, their respective directors and/or employees (collectively "Related Persons") may or might have in the future, interests in the investment products or the issuers mentioned herein. Such interests include effecting transactions in such investment products, and providing broking, investment banking and other financial or securities related services to such issuers as well as other parties generally. OCBC Bank and its Related Persons may also be related to, and receive fees from, providers of such investment products. There may be conflicts of interest between OCBC Bank, BOS, OSPL or other members of the OCBC Group and any of the persons or entities mentioned in this report of which OCBC Bank and its analyst(s) are not aware due to OCBC Bank's Chinese Wall arrangement. This report is intended for your sole use and information. By accepting this report, you agree that you shall not share, communicate, distribute, deliver a copy of or otherwise disclose in any way all or any part of this report or any information contained herein (such report, part thereof and information, "Relevant Materials") to any person or entity (including, without limitation, any overseas office, affiliate, parent entity, subsidiary entity or related entity) (any such person or entity, a "Relevant Entity") in breach of any law, rule, regulation, guidance or similar. In particular, you agree not to share, communicate, distribute, deliver or otherwise disclose any Relevant Materials to any Relevant Entity that is subject to the Markets in Financial Instruments Directive (2014/65/EU) ("MiFID") and the EU's Markets in Financial Instruments Regulation (600/2014) ("MiFIR") (together referred to as "MiFID II"), or any part thereof, as implemented in any jurisdiction. No member of the OCBC Group shall be liable or responsible for the compliance by you or any Relevant Entity with any law, rule, regulation, guidance or similar (including, without limitation, MiFID II, as implemented in any jurisdiction).

The information provided herein may contain projections or other forward looking statements regarding future events or future performance of countries, assets, markets or companies. Actual events or results may differ materially. Past performance figures are not necessarily indicative of future or likely performance.

Privileged / confidential information may be contained in this report. If you are not the addressee indicated in the message enclosing the report (or responsible for delivery of the message to such person), you may not copy or deliver the message and/or report to anyone. Opinions, conclusions and other information in this document that do not relate to the official business of OCBC Bank, BOS, OSPL and their respective connected and associated corporations shall be understood as neither given nor endorsed.

Co.Reg.no.: 193200032W

Additional disclosures and disclaimers applicable only to clients of Bank of Singapore Limited

This material is being made available to you through an arrangement between Bank of Singapore Limited (Co Reg. No.: 197700866R) ("BOS") and Oversea-Chinese Banking Corporation Limited ("OCBC Bank") (Co Reg. No.: 193200032W). BOS and OCBC Bank shall not be responsible or liable for any loss (whether direct, indirect or consequential) that may arise from, or in connection with, any use of or reliance on any information contained in or derived from this material, or any omission from this material, other than where such loss is caused solely by BOS' or OCBC Bank's wilful default or gross negligence.

The DIFC Branch of BOS has not conducted or produced any research contained in this material and is acting solely as a conduit in forwarding it to you.

For BOS clients in the United Kingdom:
This research has been prepared by OCBC Bank and made available to BOS. It is intended solely for informational purposes and does not constitute investment advice, a personal recommendation, or an offer or solicitation to buy or sell any financial instruments. Any payments or non-monetary benefits received or paid will be fully disclosed in accordance with applicable regulations, promptly and transparently, and will not influence the advice or services offered to you. If you would like more information about any inducements received, please contact your Relationship Manager.

Cross Border Disclaimer and Disclosures
Please refer to https://www.bankofsingapore.com/Disclaimers_and_Disclosures.html for cross-border marketing disclaimers and disclosures.