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# Market View

## Galvanising Europe into action

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At a glance

- The German elections have concluded with the Christian Democrats winning a majority.
- Europe is making moves to increase defence spending.
- Defence stocks have moved higher along with the broader European market.

It has not been an easy year for European politicians. In addition to facing a rise in popularity from what were once fringe, far-right parties, they must also now adapt to the US's shifting approach to foreign policy.

Case in point was US Vice President JD Vance's speech at the Munich Security Conference on 14 February. In his speech, Vance urged European leaders not to disregard far-right parties across the continent. It stunned politicians, diplomats and analysts who had gathered in Munich expecting to hear Vance outline the Trump administration's plans to end the war in Ukraine and discuss Europe's defence against Russia. Instead, the leaders listened in silence as Vance spoke of embracing these once-fringe political movements. Vance singled out the German hosts, telling them to drop their objections to working with far-right parties. He did not mention the Alternative for Germany (AfD) by name but referred to the longstanding agreement by German politicians to exclude the group.<sup>1</sup>

European leaders had been furious with Elon Musk leading up to the election, as he had endorsed the German far-right party, AfD, on X. However, whether these feelings are shared by the Trump administration is more nuanced, as President Trump has neither supported nor rebuked Musk.

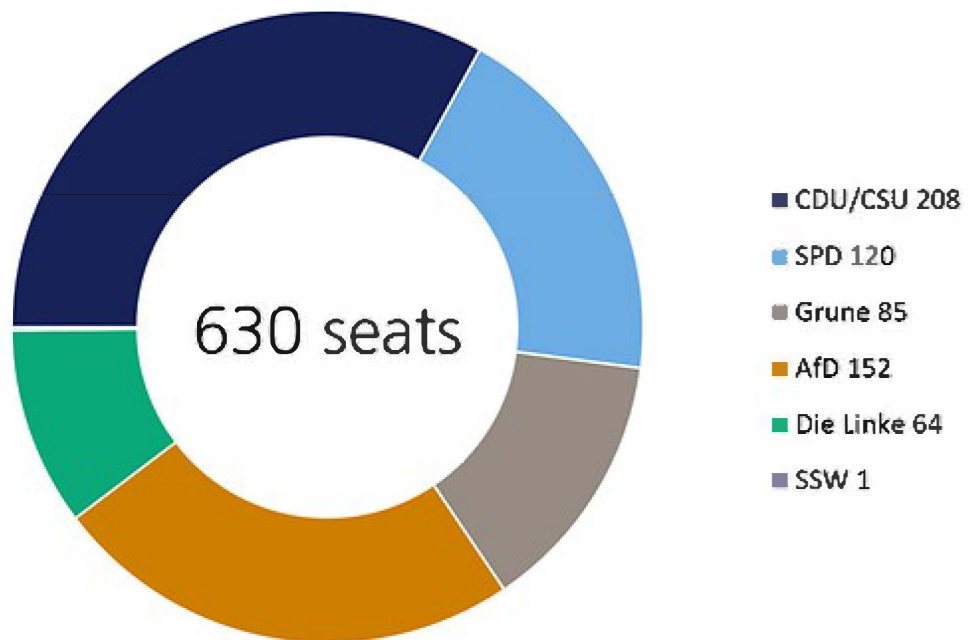
Further uncertainty for Europe follows as US politicians met with Russian counterparts in Saudi Arabia to discuss ending the war in Ukraine, without the presence of Ukraine or any other European nation. This prompted European leaders to meet in Paris to forge a strategy for Ukraine's defences and their own security.

European defence stocks have risen strongly on the back of these talks, as they did in Trump's first term when he rebuked Europe for not spending enough on defence. This momentum also moved more broadly across European stocks, as an end to the conflict in Ukraine may help put focus on reconstruction efforts in the country, potentially giving a boost to European manufacturers. A deal between Russia and Ukraine may also result in lower energy prices, which would bring some stability to European energy markets.

## Germany reassembles post election

Meanwhile, Friedrich Merz and his centre-right party Christian Democrats won a majority in the election in Germany. Their immediate priority will be to form a government with the former-leader Olaf Scholz's third-placed Social Democrats.<sup>2</sup> The far-right AfD party came in second place with just over 20% of the vote, double its share from the 2021 election. During the recent election campaigns, Merz caught attention by declaring the US is indifferent to Europe's fate, favouring a strengthening of Europe. He also questioned the future of NATO and demanded Europe boosts its own defences quickly.<sup>3</sup>

## Distribution of seats at Bundestag election 2025



Source: The Federal Returning Officer<sup>4</sup>

Merz's coalition will be small, which raises questions about whether the new German government will be able to circumvent or stop the debt brake, a rule put in place by Angela Merkel in 2009 that limits Germany's annual borrowing to 0.35% of GDP. Economists think that it may not be long before this constitutional handbrake is relaxed to help give Europe's largest economy a boost and increase defence spending. However, reforming the debt brake requires two-thirds majority in the Bundestag—the federal parliament in Germany—as it forms part of the German constitution.

## Defence spending responds to the new world order

The shifting of the Western alliance has led European nations to announce plans to increase their military spend, something Trump has been pushing for since his first term. UK Prime Minister Sir Keir Starmer pledged to increase defence spending to 2.5% of GDP by 2027,<sup>5</sup> with further plans to increase defence spending to 3% of GDP by 2033. The pledge will be funded by cutting foreign aid from 0.5% of national income to 0.3%.<sup>6</sup>

In addition to increasing military spend, European politicians are now openly discussing how to tackle the threat of a nuclear attack without the safety net of US military support. Merz said Europe must find new ways to defend itself, urging both France and the UK—the two European nuclear powers—to act as nuclear deterrents.<sup>7</sup>

## Conclusion

The German election proved to be less controversial compared to expectations. While the far-right AfD gained second place in vote share, the two main political parties are set to form a coalition which should result in a more cohesive German government. As for Europe overall, the road ahead is bumpy. As always with the continent, the path to getting deals done remains challenging given the sheer number of nations involved in the bloc. Nevertheless, the odds of the Eurozone breaking up imminently have diminished materially, which is positive for markets. European stocks have experienced strong performance so far this year, and this trend could continue. We will continue to monitor the evolving geopolitical landscape whilst engaging in company-level research to identify companies able to benefit from a united Europe.

[1] New York Times: <https://www.nytimes.com/2025/02/14/world/europe/vance-europe-immigration-ukraine.html>

[2] BBC: <https://www.bbc.com/news/articles/cvgenlw94n3o>

[3] BBC: <https://www.bbc.com/news/articles/cpv4n0dg3v3o>

[4] The Federal Returning Officer: <https://www.bundeswahlleiterin.de/en/>

[5] Gov: <https://www.gov.uk/government/news/prime-minister-sets-out-biggest-sustained-increase-in-defence-spending-since-the-cold-war-protecting-british-people-in-new-era-for-national-security>

[6] Times: <https://www.thetimes.com/article/20d94e8f-2357-4cfe-9dd8-2187f65c11be?shareToken=69bc38fb687655e48b0182fc812aee18>

[7] Politico: <https://www.politico.eu/article/europe-nuclear-weapons-nato-donald-trump-vladimir-putin-friedrich-merz/>

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