



By Daniel Ortwerth, CFA

June 23, 2025

Introducing Friedrich Merz, Chancellor of Germany

The last year has witnessed an extraordinary series of events in German politics. A chancellor failed a no-confidence vote. A parliament collapsed. The subsequent parliamentary election, which typically happens on a five-year cycle, was moved forward by five months. In that election, Germany's far-right party surged to a second-place finish, capitalizing on recent successes on the regional level. For the first time since World War II, a nominated new chancellor failed to receive the necessary majority in the first round of voting and required a second round to ascend to the position. Emerging from this political turbulence, we find the new chancellor of Germany, Friedrich Merz, whose background and policies now serve as a lens to better understand the largest country in Europe and third largest economy in the world.

This report begins with a brief biography of Chancellor Merz, focusing on his political career. It continues with a discussion of the political context of today's Germany that gave rise to his election, and it culminates with considerations of what we should expect from his leadership. As always, we conclude with implications for investors.

Who Is Chancellor Merz?

As chairman of the center-right [Christian Democratic Union](#) (CDU), the 69-year-old Merz (see Figure 1) will be the oldest

chancellor since Konrad Adenauer, the first chancellor of the post-war Federal Republic of Germany, who took office in 1949 at the age of 73.

Figure 1



Friedrich Merz (Source: Bundesregierung.de)

Background & Early Political Career.

Merz was [born in 1955, in Brilon, North Rhine-Westfalia](#), in northwestern Germany. His father was a judge and member of the CDU, Germany's most prominent conservative political party, and his mother came from a wealthy family of French extraction. Merz is Catholic. In 1972, he became a member of the CDU's youth wing, the Young Union. After obligatory military service (1975-76), he commenced legal studies, completing law school in 1985. His political career began in 1989, when he was elected to the European Parliament. After serving one term, he transitioned to the German legislature, the Bundestag, where he

served from 1994 to 2009, gradually rising in prominence and gaining a [reputation as a pro-business financial expert, social conservative, and advocate of a strong relationship with the United States](#). In these respects, he represented the classic policy stances of pre-unification West Germany.

Departure from Politics. Midway through this chapter of his political career, Merz encountered a formidable rival, Angela Merkel. Although nearly the same age and of the same political party, Merkel's profile sharply contrasted with that of Merz. [She is Protestant, a native of the former East Germany, and decidedly centrist in her political views](#). In the years straddling the turn of the century, she outmaneuvered Merz for positions of power in the CDU and government, serving as CDU chairwoman from 2000 to 2018, and chancellor of Germany from 2005 to 2021. Seeing no path upward for himself, Merz left politics for the private sector in 2009. From then until 2021, he worked as a corporate lawyer, serving on numerous corporate boards, the [corporate finance team of the global law firm Mayer-Brown](#), and as [chairman of Blackrock's German supervisory board](#). During these years, he was only peripherally involved in German politics until 2018 when he gradually transitioned back to a full focus on the political world.

Return to Politics. In 2018, when Merkel announced her intention to depart from politics, [Merz immediately announced his own return and resumed his rise through the ranks](#). During her tenure, Merkel had steered German policy away from the CDU's conservative roots toward the center across a range of issues, including greater integration of Germany into the European Union, permissive immigration policies, and a foreign policy that balanced traditional alliances with increased cooperation with Russia. Upon his election as leader of the

CDU in 2021, [Merz quickly distinguished himself from his centrist predecessor](#), restoring the party's long-term emphasis on Atlanticism (military cooperation between European powers and the US), as well as advocating tighter controls on immigration. Along with characterizing the Merkel era as an unfortunate deviation from core principles, Merz argued that by becoming more conservative on key issues such as immigration, the CDU could check the rise of the far-right Alternative for Germany (AfD) party, which had attracted some of the more conservative members of Merkel's voting bloc.

German Political Context

After his 2009 departure from politics, three key trends altered the German political landscape in ways that will challenge Merz's ability to apply the traditional CDU formula.

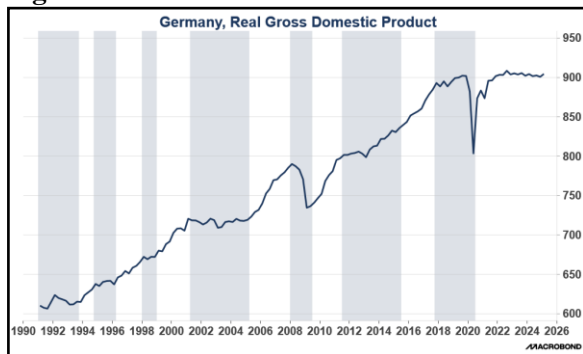
Economic Malaise. After serving as the primary engine of European economic vitality since reunification in 1990, the German economy entered an ongoing period of stagnation around 2020 (see Figure 2). [Five key developments explain the change:](#)

- **Energy Shock.** Energy costs dramatically rose due to the loss of Russian natural gas in the wake of the Ukraine war and Germany's choice to accelerate the phase-out of its nuclear power plants.
- **China.** Chinese products became more competitive in Germany, while the Chinese consumer market softened, reducing German exports to China.
- **Underinvestment.** During the decades of prosperity, Germany prioritized a balanced budget (or even a surplus) over investments in critical infrastructure such as high-speed internet and other features of high-tech industry. Now, the

country lags global competitors in terms of public investment.

- **Skilled Labor Shortage.** An aging population, lack of interest in technological fields among the youth, and rising barriers to immigration choked the supply of qualified people for increasingly critical jobs.
- **Bureaucracy.** Increasingly Byzantine regulations and permit policies hampered businesses that were trying to expand or incorporate upgrades into their processes.

Figure 2

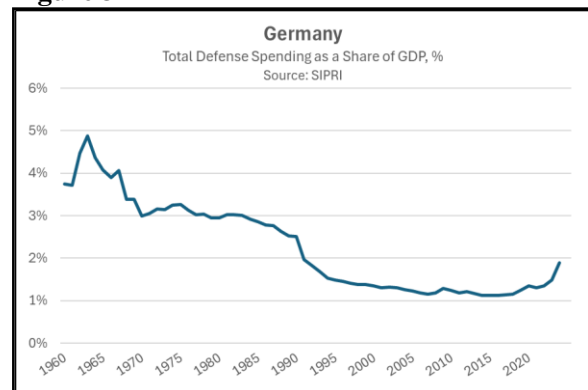


(Source: German Federal Statistical Office)

National Security Environment. The 2022 Russian invasion of Ukraine marked the first major “hot” war on European soil since the end of World War II. It also marked the end of a 31-year period following the end of the Cold War, during which European countries reduced their defense budgets and the sizes of their militaries. During the Cold War, West Germany historically spent more than 3% of its GDP on defense. From 1991 to 2021, [the defense budget of the unified Germany, with its larger economy, averaged only 1.3%](#) (see Figure 3). The Ukraine war has inspired a sense of urgency in Germany and throughout Europe to rearm. Meanwhile, US foreign policy has been evolving since the emergence of China as its main geopolitical rival under Xi Jinping, who came to power in 2013. The US is

reconsidering the scope of its global security commitments, shifting its defense priorities away from Europe toward China, and pressuring NATO countries to increase their defense budgets. Under these pressures, the traditional trans-Atlantic alliance is in jeopardy. Governments such as the one now headed by Merz will face the challenge of funding higher defense budgets.

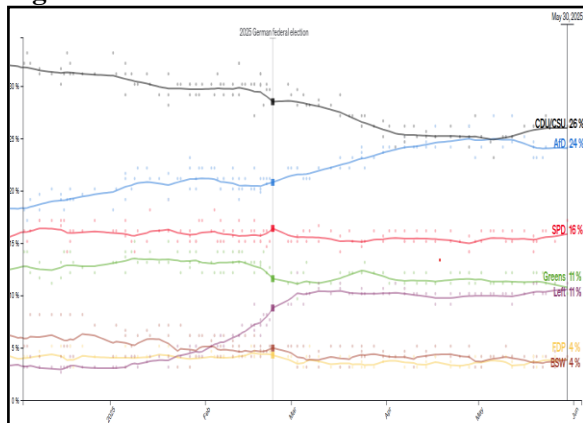
Figure 3



Rise of the Far Right. For decades after World War II, far-right political positions in Germany were heavily stigmatized, and their advocates were shunned, in reaction to Germany’s horror at its own Nazi period. [This began to change in 2013, with the founding of the AfD.](#) Originally, the AfD was not considered a far-right party at all, but rather a “protest party” of disaffected CDU members, whose [unifying advocacy was opposition to the euro and the EU.](#) Its conservative social views were the only hint of something more right-wing; however, successive leadership changes between 2015 and 2017 saw the party adopt more hardline positions, particularly on immigration, Islam, and national identity. By 2016, its platform had largely aligned with those of populist radical right parties elsewhere in Europe. The AfD’s breakthrough in the 2017 federal election shattered the status quo. Winning 12.6% of the vote and securing 94 Bundestag seats, it became Germany’s third-largest party, unlocking

viable political space to the right of the center-right CDU for the first time in the postwar era. Since then, AfD positions have continued this evolution, and its popularity has continued to rise. In the parliamentary election of February 2025, the [AfD captured the second highest vote total with a 20.8% share, trailing only the CDU's 28.6%](#). According to public opinion polls, the AfD's popularity has risen further since the election, [recently matching the CDU support of 24% before slipping back](#) (see blue line in Figure 4).

Figure 4



(Source: Politico)

What to Expect from Merz

The Merz government faces a host of challenges, not the least of which is how it will forge and implement policy with the fragile and narrow coalition the CDU has formed with its main traditional rival, the Social Democratic Party (SPD). Central to this challenge, it will have to walk a tightrope on immigration, [tightening controls enough to outmaneuver the AfD without losing support of the SPD, which favors looser immigration policies](#). We also recognize certain other critical issues, such as whether the Merz government will assume a more assertive role in the EU; however, we expect its success or failure will depend mostly on how it addresses its chief economic and security challenges.

Initial policy moves reveal a decisive strategy.

Economic Policy. The new coalition government is already moving quickly to implement a [federal budget for 2025 and 2026 that will include major infrastructure investments](#). A 500 billion EUR (\$579 billion) “special fund” has been established to start the flow of these investments, and the government has vowed to pass the laws enabling its use by this summer. The coalition has also drafted a 62-point plan to stimulate the economy through the elimination of business-related taxes and regulations. These actions are occurring on the backdrop of legislation passed earlier this year to relax the laws governing the German government’s ability to borrow. [A 2009 balanced-budget amendment to the constitution, known as the “debt brake,”](#) had placed strict limits on the government’s total debt level and the size of the annual budget deficit. Among the changes, [expenditures on defense, cybersecurity, intelligence and civil protection exceeding 1% of German GDP can now be financed with new debt](#). Along with the core elements of tax relief, deregulation, and increased government spending, [the Merz plan includes initiatives on a wide range of priorities from energy policy to protection of critical domestic industries from foreign competition](#).

Defense Policy. A top priority for the government spending unleashed by these measures will be a marked increase in defense spending. To give a sense of the potential size of the increase, the Merz cabinet has said it is [accepting, in principle, the US demand that NATO states raise their defense spending to 5% of GDP. In 2024, Germany spent just 1.9% of its GDP on defense, or \\$88 billion](#). This suggests that, over time, annual German defense outlays could rise by as much as \$150 billion. As a

further testament to this intention, Merz recently stated, [“In \[the\] future, the federal government will provide all the financial resources the Bundeswehr needs to become the strongest conventional army in Europe. This is more than appropriate for Europe’s most populous and economically strongest country. Our friends and partners expect this from us, and even demand it.”](#) The expansion of Germany’s military role is already beginning to take shape. In May, Merz oversaw groundbreaking for the stationing of a brigade of German land forces in Lithuania to reinforce defenses against a potential Russian attack. Planned for a full strength of 5,000 combat troops, [the stationing in Lithuania marks the first time that a German brigade is being based outside of Germany on a long-term basis since World War II.](#)

Policy toward the US. Merz will attempt to strike a balance between an independent approach to European security and preservation of what can be retained of the traditional transatlantic alliance. Acknowledging Washington’s waning interest in its European security commitments, Merz stated in a recent interview, [“My absolute priority will be to strengthen Europe as quickly as possible so that we gradually achieve true independence from the United States. I never thought I’d have to say such a thing.”](#) Merz has reinforced this position with his promotion of unified European defense initiatives, going so far as to advocate [“nuclear sharing”](#) with France and the UK, and strong statements on top issues, such as increased support for Ukraine and ending the Gaza conflict, that do not necessarily align with Trump administration positions.

To counterbalance this, Merz has taken the initiative to develop a constructive relationship with Washington. In a June visit

with President Trump in the Oval Office, he exhibited deference and accommodation. This elicited praise from Trump, who called Merz [“a very good man to deal with”](#) and [voiced optimism that he’d eventually reach “a good trade deal” with the European Union](#) and stated that he had [no plans to remove any of the 40,000 US troops stationed in Germany.](#) Reflecting on their meeting, Merz said, [“The question that was asked was whether he had any plans to leave NATO — I’ll paraphrase here — and it was answered with a very clear ‘No.’ There was absolutely no further comment on it, not even at the lunch afterward.”](#)

Simply put, we expect the Merz government to cultivate a continuing defense partnership with the US to the full extent that it can, but with expectations that this will prove to be much less than at any time since 1945. Hence, it will take active measures to develop and implement its own military force’s structure and strategy.

Investment Implications

The global community, but especially Europe, is heading into uncharted territory. Since the end of World War II, Germany has been militarily and geopolitically constrained by treaty alliances, the legacy of the war, the presence of US forces on its soil, and a general aversion across Europe to a rearmed Germany. As the first secretary general of the North Atlantic Treaty Organization, Lord Hastings Lionel Ismay so famously stated that the purpose of NATO was [“to keep the Soviet Union out, the Americans in, and the Germans down.”](#) For the first time in 80 years, this is changing. Not only are the Germans rearming, but their neighbors are welcoming it, which reflects the reality that the generations who fought WWII and established the post-war order have largely passed from the Earth, taking their memory

with them. We do not know what the consequences of this change will be, but it fits the emerging [pattern of global fracturing, bloc formation, and the increasing fragility of the US-led bloc that we have emphasized in recent reports](#) — higher inflation, higher interest rates, upward pressure on commodity prices (especially critical minerals used for industrial and military purposes), and negative real returns for bonds.

In light of the analysis presented here, we see specific implications for European stocks and sovereign bonds:

European Stocks. First and foremost, the political transformation in Germany represented by the election of the Merz government signals a major and sustained increase in spending by both government and business in Germany. While the most prominent spending will occur in the defense sector, it will likely spread across the German economy in areas ranging from infrastructure and energy to high-tech investments in data centers and information networks. Although Germany will prioritize its own companies for the work, the country will not be able to effect this transformation and expansion on its own. This is a rising tide of opportunity for European companies in the industrial sector primarily, but also in

materials, energy, and information technology. Although US companies in this sector could also benefit, ongoing trade tensions and security concerns suggest that the transatlantic opportunity may be muted. We expect this to translate into a tailwind for European equities across these sectors and countries, but especially in Germany and the defense sector.

Sovereign Bonds. After a long period of fiscal discipline, Germany is now going to dramatically boost its borrowing; therefore, the supply of German government bonds will substantially increase, which we naturally expect to drive down their prices. Since German bonds serve as a benchmark for European sovereign debt, and since this new supply will provide an alternative to fixed-income investors who would otherwise buy the debt of other European governments, we believe the policies of the Merz government will bring down the prices of European long-term debt across the spectrum. There is also the possibility that this effect could cross the Atlantic and put downward pressure on Treasuries; however, their unique status and the role they play as a reserve asset may insulate them.

Daniel Ortwerth, CFA
June 23, 2025

This report was prepared by Daniel Ortwerth of Confluence Investment Management LLC and reflects the current opinion of the author. It is based upon sources and data believed to be accurate and reliable. Opinions and forward-looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.

Confluence Investment Management LLC

Confluence Investment Management LLC is an independent Registered Investment Advisor located in St. Louis, Missouri. The firm provides professional portfolio management and advisory services to institutional and individual clients. Confluence's investment philosophy is based upon independent, fundamental research that integrates the firm's evaluation of market cycles, macroeconomics, and geopolitical analysis with a value-driven, company-specific approach. The firm's portfolio management philosophy begins by assessing risk and follows through by positioning client portfolios to achieve stated income and growth objectives. The Confluence team is comprised of experienced investment professionals who are dedicated to an exceptional level of client service and communication.