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Merz tests Germany's patience

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With the economy mired in its longest period of stagnation since the second world war and the far-right AfD gaining in popularity, the chancellor is under pressure to deliver his promised reforms. Friedrich Merz should have felt at ease in a room full of Germany's leading tool and machinery makers — the pride of the country's postwar export miracle and natural allies of his pro-business conservative party. Instead of praise, however, the German chancellor received a stinging reprimand.

“The mood in our industry is not merely tense. It is furious and it is disappointed,” said Bertram Kawlath, chair of VDMA, the German engineering trade association, at its annual gathering in Berlin last month. “Entrepreneurs sit with their employees and have to cut jobs while politicians postpone the necessary reforms.”

After railing against everything from taxes and regulation to high energy prices and labour costs, Kawlath turned to his guest speaker: “You have the chance to show this government can act. Minor corrections are no longer enough.”

The chancellor could not hide his unease: “It feels like we're 30 metres underground here,” he remarked as he took the stage.

Since assuming office in May, Merz has projected a newfound sense of German assertiveness abroad, travelling to Kyiv and Washington to shape Europe's response to Russia's war on Ukraine and to Donald Trump's trade tariffs. But at home, with the economy still mired in its longest period of stagnation since the second world war, the Christian Democratic leader is facing an impatient and sceptical nation.

Merz is not the only leader navigating a weak economy and a fraught political climate; both the UK's Keir Starmer and France's Emmanuel Macron are grappling with similar, if not more serious, issues. But many had hoped Berlin's new government — with its loosened purse strings and tradition of compromises — could provide an antidote to the populism and economic turbulence rising across Europe.

“Expectations are high for this coalition, but it doesn't stand on strong footing,” says Andrea Römmele, a professor at the Hertie School in Berlin.

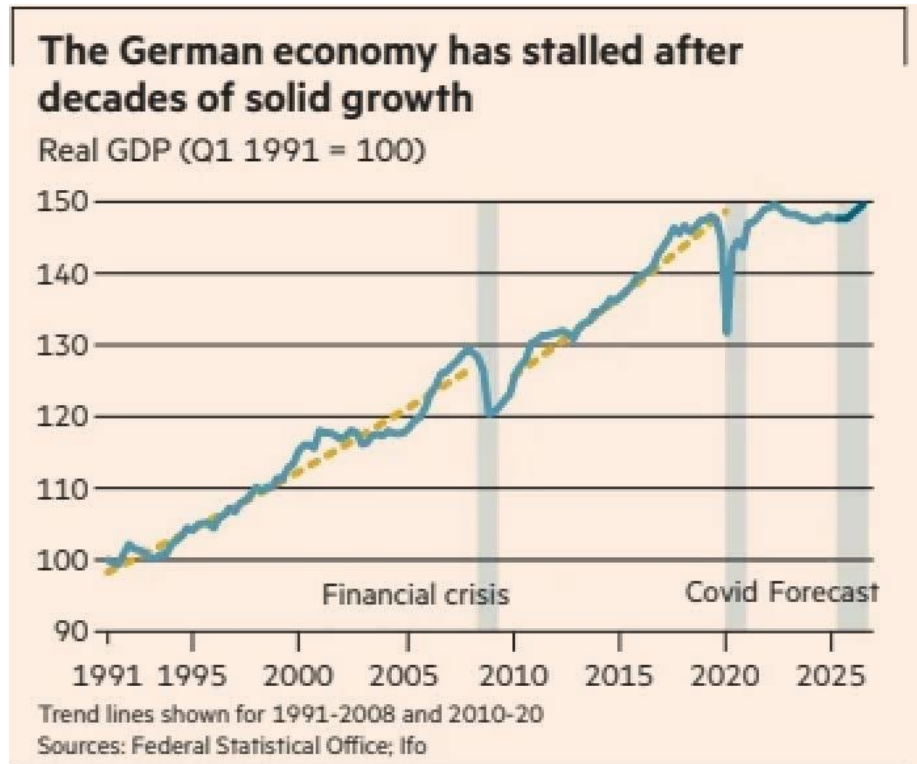
Merz campaigned on a promise to reform Europe's largest economy, which has ground to halt for the past three years and is shedding industrial jobs at fast pace.

The 69-year-old dubbed his economic plan “Agenda 2030”, a nod to Gerhard Schröder’s “Agenda 2010” — the labour market reforms of the former Social Democratic (SPD) chancellor that helped transform Germany in the 2000s from the “sick man of Europe” into an export powerhouse. The plan signalled political courage to pursue contentious measures even if they could prove electorally damaging.

Since his party’s victory in February’s federal elections, however, the reality of coalition politics has set in. Merz formed a government with the SPD, which has disowned the Schröder legacy and campaigned on a big-spending plan to stimulate the economy. He presented the alliance as the centre’s last chance to halt the rise of the far-right Alternative for Germany, which secured more than a fifth of seats in the Bundestag.

Overcoming his party’s reluctance for public debt, Merz devised a Keynesian spending plan unseen since reunification. Identifying Vladimir Putin’s Russia as the biggest security threat to Europe and alarmed by Trump’s desire to disengage from Nato, he struck a deal with the SPD and the Greens to relax the constitutional borrowing cap, introduced under former chancellor Angela Merkel, to upgrade the German armed forces. In exchange for SPD support, he agreed to borrow an additional €500bn over the next 12 years to repair Germany’s crumbling infrastructure.

Households and companies would feel an uplift “by the summer”, Merz declared.



Nearly six months on, the economy shows few signs of revival and frustration is mounting. The Munich-based Ifo Institute expects GDP growth of just 0.2 per cent this year, followed by a modest rebound to 1.3 per cent next year thanks to public spending. After a brief spell of optimism, busi-

ness sentiment has slumped again, and industrial woes have deepened. “Any glimmers of hope that had emerged among capital goods manufacturers have faded,” Ifo noted.

Meanwhile, the AfD has climbed to about 25 per cent in national polls. Last month, the party, classified as “far-right extremist” by intelligence agencies, tripled its vote in municipal elections in North Rhine-Westphalia, Germany’s most populous state, making inroads into the SPD’s industrial bastions of the Ruhr valley.

According to pollster Insa, two-thirds of Germans now say they are dissatisfied with the ruling coalition — a 20 point increase from June. Merz, never especially popular, is bearing the brunt: he has slipped to 18th place in Bild’s ranking of preferred politicians, trailing six of his coalition ministers and AfD coleader Alice Weidel.

In response, Merz has promised an “autumn of reforms” tackling Germany’s bureaucracy and welfare system. But speaking in parliament this month, Weidel said the much-touted reform wave was instead turning into “a cold season of disappointment for German entrepreneurs”.

“He has been travelling a lot, but that is not what he was elected to do,” says Andreas Busch, a political scientist at Göttingen university. “Alongside migration, the economy was the main issue for voters — they are still waiting.”

Disquiet runs deep even in wealthier, traditionally conservative regions, home to many of the country’s small and medium-sized Mittelstand companies. In Paderborn, a CDU stronghold of 150,000 people in North Rhine-Westphalia, a Benteler factory hums with life, emitting fumes and loud bangs as it shapes red-hot steel tubes and other components for the car industry. Founded in 1876 and still family-owned, Benteler is the town’s largest employer. But Thomas Michels, a top executive in the company’s steel division, is today fighting an existential storm.

Michels is sceptical a new €500bn infrastructure fund or higher defence spending can solve his industry’s deeper woes: a flood of much cheaper Chinese steel and car imports on one side; and 50 per cent US tariffs on EU steel on the other.

Core German industries are shrinking, he laments. German steel output declined 12 per cent in the first half of this year compared with last year. And car manufacturing plants, which produced nearly 6mn vehicles in 2017, three-quarters of which were for export, now produce 4mn. A pick-up in defence production is unlikely to compensate fully, he says: “A tank is not a consumer product — it’s a deterrent. You build one and that’s it.”

Michels lists familiar grievances — labour costs inflated by rising social contributions; high electricity prices; bureaucracy and lower working hours than elsewhere. He had nurtured hopes Merz

would break the gridlock that had plagued Olaf Scholz's previous three-party coalition. But "the new government is still bogged down in many debates", he says.

Paderborn, a quiet Catholic town founded in the 8th century by Charlemagne, has been governed by the CDU for nearly eight decades. But for the first time in its postwar history, during local elections last month, the party's mayoral candidate was forced into a run-off round with the Green party candidate after losing votes to the AfD.

"People used to say you could just put a broomstick on the square, paint it black [the colour of the CDU] and it would get elected," says Stefan-Oliver Strate, the newly elected CDU mayor. "That is no longer true."

Strate, a political newcomer, had hoped to ride a wave of enthusiasm after Merz's election. Instead of "a tailwind", he says he felt "side and headwinds". During his campaign, about one in 10 Paderborn residents he met complained to him about Berlin or Merz.

In Paderborn, the AfD has been converting CDU voters. Its mayoral candidate Marvin Weber, a 32-year-old college dropout flagged as extremist by intelligence agencies for antimigrant statements, secured 15 per cent of the municipal vote last month, more than tripling his 2020 result. One of his campaign strategies was to cast his party as the original CDU — criticising Merkel's "U-turn" to let in more than 1mn refugees in 2015 and accusing Merz of breaking his promise of fiscal discipline by lifting the debt brake. "Those who voted for the CDU are getting green and red policies," he tells the FT.

In Berlin, Merz has himself admitted as much. "I am not alone in this government," the chancellor told a primetime television show when pressed to address watered-down campaign pledges.

In his first months in government, Merz has hardly remained idle, however. His coalition passed two budgets — including one on which the previous government could not agree, leading to its downfall last year.

In addition to establishing the €500bn infrastructure fund, which is earmarked for decaying bridges, schools and hospitals, it announced corporate tax breaks for the purchase of equipment and outlined electricity price subsidies for energy-intensive industries. Merz has named an investment tsar, former Commerzbank chief Martin Blessing, to promote Germany to foreign investors.

He has defended his travels as a matter of "war and peace", saying that foreign and security policy along with economic policy could "no longer be separated from each other".

But meanwhile the new US tariffs on EU goods have hit Germany's key car and steel industries just as the coalition moves to the politically trickier reforms of the welfare state.

“He would like to be the next Schröder and pursue a bold reform agenda,” says Uwe Jun, a political scientist at Trier university. “But on welfare, half of the SPD in parliament won’t follow him. He must compromise.”

Campaigning so explicitly on Schröder-style reforms may not have been tactically wise, analysts say. Schröder’s reputation has been tarnished by his Kremlin ties; he joined the board of Russian state-owned oil group Rosneft and lobbied for the building of Nord Stream’s second gas pipeline. Within the SPD, his so-called Hartz labour reforms, which spawned lowpaid minijobs and triggered high-profile party defections that helped to create the leftist Die Linke party, remain a toxic legacy. “Most believe these reforms are responsible for the party’s decline,” Jun says.

The SPD — which in February recorded its worst election result since the late 19th century, with a 16 per cent share of the vote — has spent the past two decades seeking to roll them back. These efforts led to a minimum wage in 2015 and culminated with the Bürgergeld, the latest version of a tax-funded basic income for the jobless or underemployed, introduced in 2023.

Merz campaigned to overhaul the Bürgergeld, arguing it was too generous and discouraged work. But the SPD has pushed back. After late-night negotiations earlier this month, the government agreed to rebrand the scheme and slash benefits for recipients refusing job offers or skipping appointments — steps that experts say are unlikely to deliver the billions in savings initially touted by the CDU.

The unrest extends inside Merz’s own camp, with senior CDU figures openly criticising him. Some disagreements have centred around a €30bn budget gap projected for 2027. While the debt brake, which limits public borrowings to 0.35 per cent of GDP on any given year, was relaxed for infrastructure and defence, it still applies elsewhere.

In July, Markus Söder, Bavaria’s 58-year-old prime minister and leader of the CDU’s Bavarian sister party, the CSU, erupted when Merz and SPD finance minister Lars Klingbeil agreed to limit electricity tax cuts to large groups, breaking a coalition promise to include households and small companies. In August, the chancellor flew back from his holiday by Lake Tegernsee for crisis talks at the Chancellery after a backlash against his decision to suspend arms exports to Israel over Gaza.

The move angered conservative heavyweights, including Söder and Hesse prime minister Boris Rhein, who saw it as a breach of Germany’s unwavering postwar solidarity with Israel, rooted in the country’s Holocaust legacy.

Party insiders have blamed Chancellery chief Thorsten Frei, a Merz ally with no prior government experience, for lack of co-ordination and communication. Others point to the chancellor’s solitary governing style. “He decided on policy without consulting his own party on very fundamental issues for us,” a CDU MP said.

Political scientist Andreas Rödder, who is close to the CDU's socially conservative wing, says distrust is growing after Merz's abrupt decisions on the debt brake and Israel: "Merz seems to think that having the power means he alone decides," he says. "But he underestimates how much credibility he is losing within his own ranks."

Unlike Helmut Kohl, chancellor from 1982-98, and Merkel, Merz, who spent a decade outside politics after being sidelined by Merkel, "lacks deep roots in the party", says Busch. Potential rivals are already positioning themselves, he adds. This makes for a fraught backdrop as Merz faces tough negotiation over ballooning pension, health insurance and eldercare costs — all requiring painful decisions, such as benefit cuts or higher contributions.

With a parliamentary majority of just 13 seats, the coalition's tensions and lack of discipline are fuelling legislative uncertainty. The pressure will only mount on both coalition partners, with five federal states holding elections next year, including two former communist states — one ruled by the CDU, another by the SPD — which the AfD is predicted to win.

"The coalition deal was hammered out in six weeks, leaving many of the details to be worked out," says Henning Meyer, a public policy professor at Tübingen university who is close to the SPD.

"The risk is piecemeal reforms focused on cuts and savings without a broader vision, which is essential."

Others warn that a strained debate on welfare risks obscuring the larger structural challenges: global technological and geopolitical shifts that threaten Germany's export-oriented manufacturing model.

"Reforming the welfare state is important but won't make Germany's old industries competitive against Chinese rivals," says economist Philippa Sigl-Glöckner, head of Dezernat Zukunft, a Berlin think-tank.