



**BERENBERG**

PARTNERSHIP SINCE 1590

Holger Schmieding, Chief Economist | [Holger.schmieding@berenberg.com](mailto:Holger.schmieding@berenberg.com) | +44 20 3207 7889

## GERMAN POLITICAL UPDATE: MERKEL'S CHOICE

### Berenberg Macro Flash

Seven weeks ahead of the German election on 24 September, chancellor Angela Merkel can take it easy. She looks set to comfortably win a fourth term in office. The real questions are (i) which coalition partner she will choose and (ii) whether that choice will make any difference. For some aspects of domestic policy, the choice may matter a little. But the German approach to the bigger questions of foreign and European policy including European reforms and Brexit will probably not change in any major way regardless of Merkel's choice of coalition partner.

#### THE MESSAGE OF THE POLLS

In opinion polls, support for Merkel's centre-right CDU/CSU has stabilised around 39%, 15 points ahead of the centre-left SPD led by Merkel's challenger Martin Schulz (see chart below). Four other parties are on course to clear the 5% threshold and enter the federal parliament with roughly 8% each: the centre-left Greens (7.9% support on the average of the last seven polls), the ultra-left Left Party (8.7%), the liberal FDP (8.4%) and the right-wing AfD (8.1%).

As all other parties will shun the AfD, some combination of the other parties will form the next federal government. A coalition will need just above 47.5% of the popular vote for a majority of seats in parliament. The two hypothetical alternatives to a Merkel-led government, a SPD-Green alliance with either the Left Party or the FDP, would command only 40.1% or 39.8% of the vote, respectively. They would thus fall at least seven points short of a majority. In the absence of an unusual summer upset, such a shift in voting intentions looks unlikely. And even if it were to happen, chances are that Schulz may still not become chancellor as the FDP may refuse to join him while parts of the SPD may shy away from teaming up with the radical Left Party at the federal level.

#### COALITION OPTIONS FOR MERKEL

This leaves four realistic options:

- 1) Merkel could continue her current **"grand" coalition** with the centre-left SPD. This is quite possible, although it would probably not be her first choice. Parts of the SPD may also prefer to rejuvenate their party in opposition rather than supporting Merkel once again.
- 2) Merkel could lead a **"Jamaica" coalition** between her "black" CDU/CSU, the "yellow" liberal FDP and the Greens. As the liberal FDP and the statist Greens disagree on many issues of economic and social policy, forming such a government would be a challenge. But with such a coalition now working in one of Germany's 16 federal states, Schleswig-Holstein, it would be an option.
- 3) On current polls a **CDU/CSU-Green coalition** would be 1.8 points short of a majority. A small shift in the polls during the remainder of the campaign could turn it into an option. After the 2013 election, preparatory talks between Merkel's party and the Greens ended within days as the Greens simply were not ready for it. But the Greens have aged and become more mainstream since then. Also, for the current generation of Green leaders, it might be their last chance to become federal ministers in Berlin. According to some observers, an alliance with the Greens may be Merkel's preferred option. Of course, she is wise enough to not weaken her bargaining position by discussing such potential preferences ahead of time.



## MACRO NEWS

- 4) With 47.5%, a **conservative-liberal coalition** is currently only marginally behind the combined tally of all other parties likely to make it into the Bundestag (48.1%). With just a marginal shift of voting intentions over the next seven weeks, CDU/CSU and FDP may jointly win a majority. Having governed together in the past, such a coalition may look like a natural choice. However, as the FDP believes that it was short-changed by Merkel and Wolfgang Schäuble in their joint government during Merkel's second term, coalition talks might be rocky. For example, the FDP (and perhaps the SPD) may insist that it controls the finance ministry this time (with Schäuble possibly moving on to be the speaker of parliament in such a case).

### WOULD IT MATTER? - NOT MUCH

Egged on by her centre-left coalition partner SPD, Merkel has presided over a few reform reversals in her third term, introducing a minimum wage, restraining the scope for temporary work contracts slightly and making some pension entitlements more generous. Over time, such steps will make the German economy slightly less dynamic. If Merkel forms a new coalition with either the **SPD** or the **Greens**, expect more of the same, namely a few small steps backwards that will place additional burdens on the German economy over the years without restraining the current upswing significantly. If she teams up with the **FDP** instead, expect some small-scale structural reforms including a modest income tax reform instead. However, as parts of the FDP may be less comfortable with the European agenda of French president Emmanuel Macron, discussions about common funds for the Eurozone or other European reforms may initially be a little more rocky until the FDP has settled into the role as party of government rather than extra-parliamentary opposition.

### THE GERMAN CONSENSUS MACHINE

German politics works largely by consensus. For two reasons, we should not look for major policy changes after the election:

- 1) The four mainstream parties (CDU/CSU, SPD, Greens, FDP) largely agree on the overall direction of German foreign and European policies. As things are going well enough at home, the desire to make major changes in domestic policies is not very pronounced either.
- 2) Because of the special role of Germany's upper house of parliament, the mainstream parties usually need to find a consensus anyway. As the chamber of the 16 federal states, the **Bundesrat** will not be elected anew on 24 September, except perhaps for an early state election in Lower Saxony. The Bundesrat needs to pass most major laws including most laws that affect spending and taxes and major European commitments. The CDU/CSU, SPD and Greens are represented in so many state governments at the moment (9, 11 and 10, respectively) that either of these three parties could veto any law in the Bundesrat. This would not change even if the possible early state election in Lower Saxony were to bring down the current SPD-Green government in favour of a potential CDU-FDP coalition in that state. The power of the Bundesrat forces the mainstream parties to strive for a consensus on many issues.

### POLICY OUTLOOK

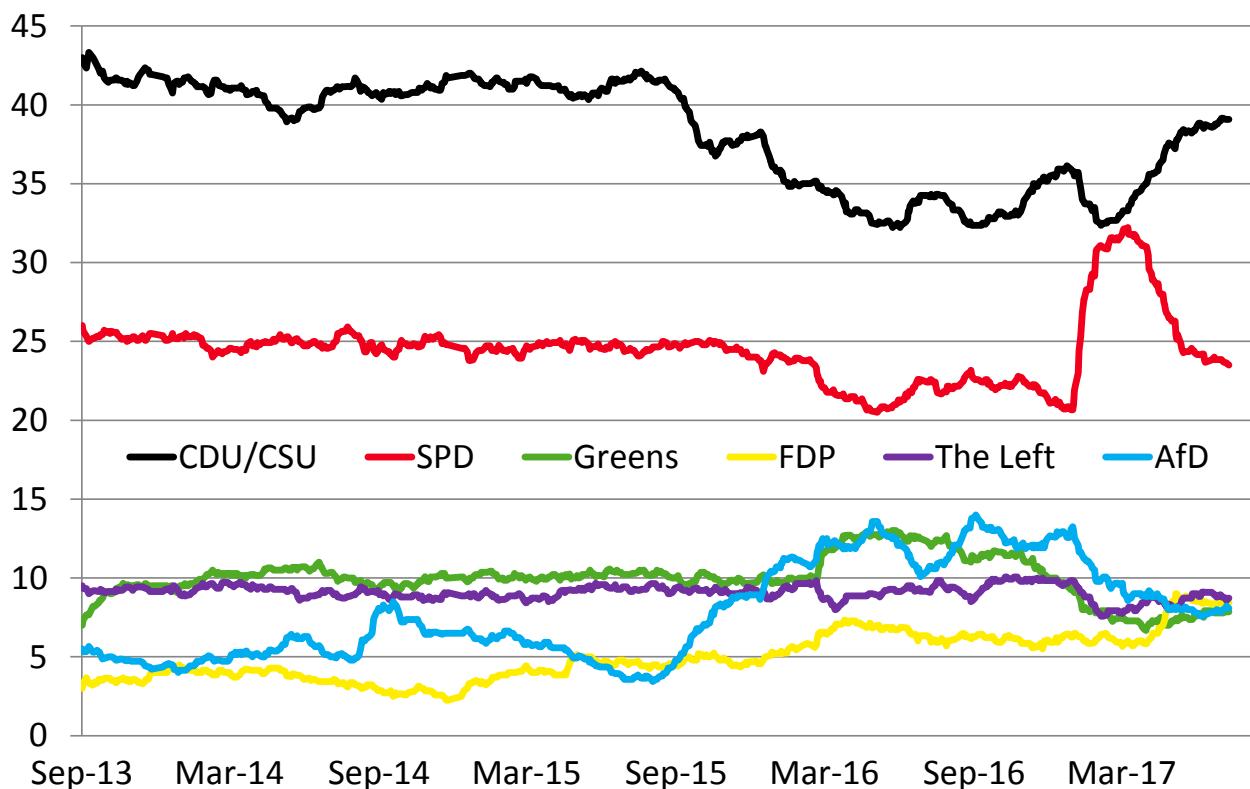
Regardless of the precise shape of Merkel's future coalition, expect a **further gradual increase in federal spending** for infrastructure, defence and the integration of the recent wave of migrants and refugees. The new German government will work constructively with Macron and its other European partners **to strengthen the cohesion of the EU27 and the Eurozone**. A genuine Eurozone budget passed solely by a Eurozone parliament at the proposal of a Eurozone finance minister is beyond the scope of what Berlin can accept. However, upgrading the European Stability Mechanism (ESM) to a European Monetary Fund and providing significantly more money for common funds (infrastructure, defence, possibly for aspects of social policy) would be possible as long as major decisions on the use of such funds remain subject to a veto by the German Bundestag and the representatives of other big member countries, as is currently the case for the ESM.



## MACRO NEWS

The attitude to Brexit will not change: the UK has filed for divorce and has to face the predictable fall-out from its decision. While trying to preserve close relations with a post-Brexit UK, Berlin will fully support the EU27 consensus that the UK will have to honour the financial obligations it has incurred as an EU member and will not be allowed any cherry-picking upon agreeing its future relationship with the EU. As before, the conditions of access for German industry to the UK market will play virtually no role in the **German Brexit position**. Put differently, don't expect any breathtaking policy change from Berlin.

### Advantage Merkel: German opinion polls



Centre-right CDU-CSU, centre-left SPD, centre-left Greens, liberal FDP, ultra-left The Left and radical right AfD, average of 7 latest available polls. Source: National opinion polls, Berenberg calculation.

This message has been produced for information purposes for institutional investors or market professionals, it is not a financial analysis within the meaning of § 34b or § 31 of the German Securities Trading Act (Wertpapierhandelsgesetz), no investment advice or recommendation to buy financial instruments. The message does not claim completeness regarding the information on the developments referred to in it. On no account should it be regarded as a substitute for the recipient's procuring information for himself or exercising his own judgements. The message may include certain descriptions, statements, estimates, and conclusions underlining potential development based on assumptions, which may turn out to be incorrect. Berenberg and/or its employees accept no liability whatsoever for any direct or consequential loss or damages of any kind arising out of the use of this message or any part of its content. -- For full economics reports please visit our website or contact [capitalmarkets@berenberg.de](mailto:capitalmarkets@berenberg.de).

Joh. Berenberg, Gossler & Co. KG  
60 Threadneedle Street  
London EC2R 8HP  
Phone +44 20 3207 7878  
[www.berenberg.com](http://www.berenberg.com)  
[holger.schmieding@berenberg.com](mailto:holger.schmieding@berenberg.com)