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GERMAN POLITICAL UPDATE: SMALLER PARTIES GAIN SOME GROUND

Berenberg Macro Flash

One week ahead of the German election on 24 September, three smaller parties including the right-wing AfD are gaining a little ground in opinion polls at the expense of chancellor Angela Merkel's centre-right CDU/CSU and the centre-left SPD of challenger Martin Schulz. After the unexciting TV duel (or was it a "duet"?) on 3 September, some voters have apparently drawn two conclusions:

- (1) As Schulz failed to make any headway in the TV debate, Merkel looks set to win a fourth term as chancellor. Because her CDU/CSU remains so far ahead of the SPD, it feels safe for some potential CDU/CSU voters to switch to smaller parties such as the FDP to strengthen one of Merkel's potential coalition partners or to the right-wing AfD to register a protest vote.
- (2) Because Merkel and Schulz correctly came across as being rather close on many issues including the future of Europe, some voters looking for an alternative to Merkel are moving from the SPD to protest parties such as the AfD and – to a lesser extent – to the left-wing Left party.

As a result, support for the CDU/CSU has slipped from 38.5% two weeks ago to 36.5% in the last five polls whereas the SPD is down from 23.3% to 22.3%. While the AfD has risen by two points from 8.6% to 10.6%, the Left Party (up from 8.8% to 9.7%) and the liberal FDP (from 8.7% to 9.1%) have also gained some ground. As the last of the four smaller parties likely to clear the 5% threshold to get seats in the Bundestag, the Greens have stagnated around 7.6% - see chart below. In the race to be No. 3, the AfD had now edged slightly ahead. But the lead over the Left Party and the FDP is well within the margin of error.

COALITION OPTIONS

The modest changes in sentiment in the last two weeks need not be a precursor of the election result. Polls are unreliable and can still shift. In recent state elections, the CDU/CSU often did better than projected. But that was under conditions that seemed competitive, not in a situation where the centre-right looked set win anyway. For what these modest moves in national opinion polls are worth, they suggest three things:

- (1) Schulz has probably missed his last chance to replace Merkel as chancellor.
- (2) Among the three realistic options (CDU/CSU-SPD, CDU/CSU-FDP and CDU/CSU-FDP-Greens), the probability that conservatives and liberals will gain enough seats to form a two-way coalition has receded a little.
- (3) Although neither the "black" CDU/CSU nor the "yellow" FDP or the Greens see a black-yellow-green "Jamaica" coalition as their preferred option, such a three-way alliance remains possible. By default, it may even have become slightly more likely.

SPD: TO SERVE OR NOT TO SERVE UNDER MERKEL?

Facing likely defeat in the race for the chancellorship, the SPD is torn between two strategies. The top party leaders in Berlin apparently want to stay on as junior partners in a coalition with Merkel. That would allow them to shape policy and keep attractive jobs. However, many mid-level and regional party SPD stalwarts as well as many ordinary members worry that the SPD would continue to lose support in a further alliance with Merkel. Instead, the party should renew itself in opposition. Also, joining a grand coalition could mean that the right-wing AfD ends up as not just the loudest but also the biggest opposition party in the Bundestag.



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Much will probably depend on the precise result for the SPD. If the party gets close to its 25.7% share of the vote of 2013, the SPD will likely feel confident enough to renew the coalition with Merkel. However, if the SPD falls even well below its historic low of 23.0% of 2009, the party's rank-and-file may rebel against party leaders and vote for a stint in opposition. If so, a "Jamaica" coalition named after the black, yellow and green colours of the Jamaica flag could be the only option. For Merkel, a new coalition with the experienced SPD would likely be more convenient than an alliance with two smaller prickly partners, FDP and Greens, who might devote some of their energy to jockey for position against each other even in government.

Forming a new government in Berlin may take a while after 24 September. The Greens, the FDP as well as the SPD may be reluctant to make the compromises needed to join Merkel in a coalition ahead of early state elections in Lower Saxony on 15 October 2017. Although the pressure on all parties to clarify the outlook for the national level as soon as possible will be huge, the decisive stage of coalition talks in Berlin may only start in mid-October. In 2013, forming a government took until December. It probably won't be much faster this time.

WOULD IT MAKE A BIG DIFFERENCE?

As we have argued before, policies would not change dramatically in any of the realistic coalition scenarios. 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. If Merkel forms a new coalition with the SPD, 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.

Many observers have pointed out that the FDP seems less comfortable with the European agenda of French president Emmanuel Macron than Merkel, the SPD and the Greens. If the FDP enters government, discussions about common funds for the Eurozone or other European reforms may initially be more rocky than otherwise. While not wrong, this argument is often overdone, though. First, many FDP positions on EU/Eurozone issues do not seem to be too far from those of CDU finance minister Wolfgang Schäuble, a powerful force within the current and probably the future government. Some variety of views within government would not be new. Second, the FDP itself is split on the issue, with a strong wing that seems to share Merkel's fondness of Macron. Third, FDP views would likely evolve if and when it settles into the role as party of government rather than extra-parliamentary opposition.

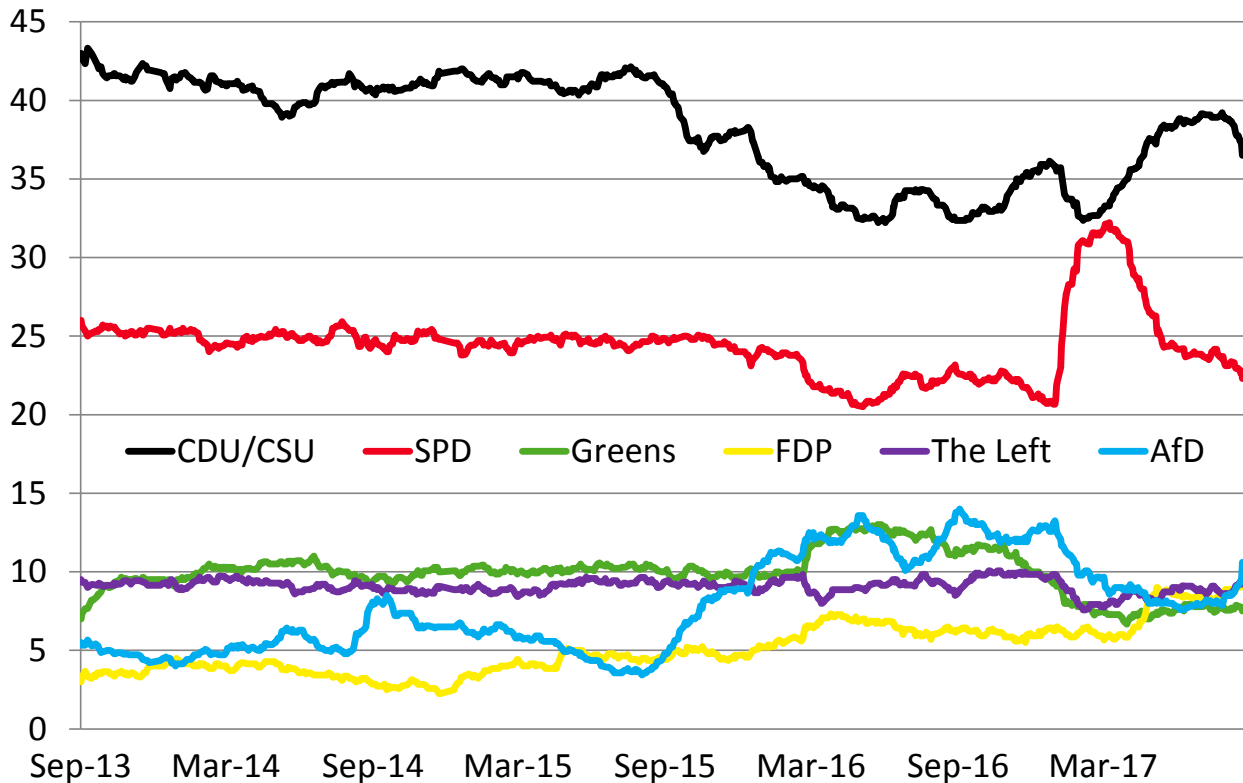
The election and subsequent choice of coalition matter. But the differences between the various options are modest rather than stark, especially when it comes to issues that matter for European politics and global markets.

We will take a closer look at the party platforms and the policies which potential coalitions may pursue in a separate message in a few days.



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The message of the polls: support for German political parties, in %



Centre-right CDU/CSU, centre-left SPD, centre-left Greens, liberal FDP, ultra-left The Left and radical right AfD, support in %, average of 7 latest available opinion polls; last entry for 16 September 2017 is average of five most recent polls. Source: Allensbach, Emnid, FGW, Forsa, GMS, Infratest dimap, INSA, Berenberg calculations.

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