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## FOUR GERMAN QUESTIONS

### Berenberg Macro Flash

As Germany's political situation evolves, it is worth to ponder four questions:

#### ARE REPEAT ELECTIONS INEVITABLE?

New elections between February and April are quite possible, more likely than a prolonged period of a minority government. They are not yet inevitable, though. The German constitution sets high hurdles for repeat elections, making it comparatively easy for a caretaker or minority government to stay in office. According to the constitution, the federal president ought to propose a candidate for the chancellorship to the Bundestag. If the candidate is not elected by a majority of Bundestag members, parliament then has two further weeks to vote in a new chancellor with a majority of its members. If that fails, as it probably would after an inconclusive first round, the federal president can decide whether to appoint a candidate who has achieved a plurality (but not majority) of votes in the Bundestag or dissolve parliament for new elections within 60 days. In a first comment today, president Steinmeier seemed to counsel against repeat elections.

After the failure of the four-way coalition talks, we now have to watch the reaction of the various parties and their political bases. Germans are not natural fans of instability, minority governments or immediate repeat elections, to put it mildly. Parties may pore over the substance at stake again, although that may not yield any significant change in their positions, especially on the most contentious issue of migration. More importantly, we have to watch whether the political basis of the FDP, who walked out of the negotiations, supports that decision. Otherwise, the FDP may find a face-saving way to return to negotiations after a period of reflection for new talks on a possible "Jamaica" coalition. Whereas it is not impossible that the SPD reconsiders its position and joins Merkel as a junior partner in a renewed "grand coalition", this seems very unlikely. SPD leaders may believe that – after their heavy losses at the 23 September election, they can't fall much further and may have a chance to recover some support instead at repeat elections.

#### WOULD REPEAT ELECTIONS CHANGE MUCH?

Opinion polls are no reliable guide to an election outcome. For what they are worth, current polls project that repeat elections would yield a result similar to that of the 23 September vote (CDU/CSU 32.9%, SPD 20.5%, FDP 10.7, Greens 8.9%, Left Party 9.2%, AfD 12.6%). The other parties including the right-wing AfD and the left-wing Left Party may hope to benefit from the failure of the CDU/CSU, FDP and Greens to form a government. Even in that case, it would be highly unlikely that votes shift so strongly to make a government against the CDU/CSU possible, that is an SPD, Green-Left Party coalition. In September, the protest parties had done well partly because most voters considered the outcome of the vote a done deal, Merkel wins anyway, and felt free to cast a protest vote. In a politically charged atmosphere of repeat elections, the mainstream parties CDU/CSU and SPD may be better able to mobilise their usual base. Chances are that the AfD will not gain many further votes.

Regardless as to whether the AfD wins or loses votes in repeat elections, it would not be included in any government.. The FDP, having now walked out of talks largely because of their disagreement with the Greens, would not support a SPD-Green alliance. In brief: new elections may not change much.

#### WILL MERKEL STAY ON?

If she wants to, she can probably stay on. The election result and the failure of the coalition talks have weakened her position. However, she has no obvious rival or successor in the CDU. An outright challenge to



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her from within her own party ahead of potential early elections still seems unlikely. In the not very likely case that Merkel were to withdraw on her own initiative, a potential young successor could be Jens Spahn, a somewhat conservative deputy finance minister. Of course, other names may get mentioned as potential candidates to replace her on an interim basis, for instance old CDU stalwarts such as Ursula von der Leyen, Wolfgang Schäuble or Thomas de Maizière etc. But would the CDU really want to go into possible repeat elections with an interim leader? So far, it still seems more likely that Merkel stays on. If the CDU really needed a new leader in the end, it would probably opt for a fresh new face such as Spahn.

Of course, the SPD may be tempted to try to topple Merkel, offering the CDU/CSU to join a coalition if Merkel withdraws. There may be some talk about this option. However, the CDU would most likely reject such a demand unless Merkel were to withdraw on her own. Also, the SPD might first want repeat elections and possibly enter coalition talks with the CDU/CSU from a potentially stronger basis, perhaps with a demand that Merkel should not stay on as chancellor. It does pose a potential risk to Merkel. On balance, I expect Merkel to remain chancellor for a fourth term.

### **WOULD GERMAN POLICIES CHANGE WITHOUT MERKEL?**

Not much under any realistic scenario. For the time being, the current government stays on a caretaker basis without a time limit. By and large, German policies reflect a consensus of those parties currently in government (CDU/CSU and SPD) and those wielding a veto in the upper house of parliament (the Greens). The most radical change after new elections would be an SPD-led alliance with the Greens and the Left Party. However, such alliance remains so far behind in opinion polls that this seems very unlikely. Such an alliance would stand for significantly more social spending and a modest re-regulation of the labour market. It would also take a softer line on European issues. But as most decisions on European issues would have to be approved by the upper house of parliament where CDU/CSU would have a veto, changes would be limited even in such a case. Other potential governments, notably a renewed CDU/CSU-SPD coalition, would not stand for major changes in policy except for modest increases in social and infrastructure spending. Any government including the FDP would go further with income tax cuts whereas a government without the FDP would put less emphasis on tax cuts. However, the differences between various political options are modest.

Eight weeks after the German election, chancellor Angela Merkel's attempts to form a new government for a fourth term fell flat last night. The liberal FDP pulled out of 4-way coalition talks with Merkel's CDU, the CSU and the Greens, citing a lack of trust between the would-be partners. Although the talks had proved to be very difficult in the last few days already, the failure of these talks is still a significant surprise. The consequences could be a renewed attempt to form such a coalition after a period of reflection, a Merkel-led minority government or - after quite a while - even repeat elections. Merkel and her current CDU/CSU-SPD government stay on in a caretaker position for now, with no given time limit. While it remains likely that, one way or the other, Merkel will be able to govern for a fourth term in the end, her position is now potentially at risk.

For Germany, this is a significant political upset. The consequences should be very limited, though.

- The economy is in such good shape with 2.5% growth, strong business confidence, full employment and a fiscal surplus that few major decisions need to be taken for the time being. Businesses will not curtail investment growth by much, growth can rumble even in a political limbo.



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- In Europe, Germany will be too pre-occupied with its domestic affairs to agree and drive an ambitious reform agenda with French president Emmanuel Macron. This is a pity. But in the absence of an acute crisis, this is not dramatic. As the agreement of most EU members to cooperate more closely on defence has shown two weeks ago, Europe can make progress even if Berlin has just a caretaker government.
- In foreign policy, all mainstream parties in Berlin are so close and so willing to cooperate that the current political uncertainty will not make a major difference.

The way ahead should become clearer over the next few days. The SPD has ruled out joining Merkel in a renewed "grand coalition" (while still staying on in the current caretaker government). Repeat elections and a minority government are unprecedented on the federal level in Germany. Judging by opinion polls, repeat elections may not yield a different outcome anyway, forcing the same parties to negotiate a new government again. After repeat elections, a new "grand" coalition may be an additional option, though.

Due to Germany's specific history with the unstable Weimar republic, Germans don't value minority governments and repeat elections. Still, repeat elections in early 2018 are now an option. The pressure on the major parties to form a stable arrangement will be immense in coming days.

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