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GERMAN POLITICS: A MEDIOCRE DEAL AT LAST BUT IT IS NOT OVER YET

Berenberg Macro Flash

Shall we breathe a sigh of relief? Germany will likely get a new government just in time for the Easter holiday, with Easter Sunday falling on 1 April this time. After all-night talks, leaders of chancellor Angela Merkel's centre-right CDU/CSU and the centre-left SPD agreed outlines of a programme to continue their current coalition for another four year term. All in all, German policies will not change dramatically according to what is known about the deal so far. Relative to policies that would have been pursued under the alternative "Jamaica" coalition between Merkel, the FDP and the Greens, which foundered when the FDP walked out of such talks in November, Germany will apparently add a bit more to social spending over time and close down its coal power stations at a slower pace. Also, with the SPD likely to claim the German finance ministry, future negotiations about European reforms may be a bit less noisy than they might have been otherwise. In terms of substance – Germany will promote some modest EU/Eurozone reforms jointly with France – the outlook does not change much, though: Germany will agree only to those reforms which Merkel can sell to the conservative part of her own base, including the Bavarian CSU. The draft deal reportedly mentions a "European minimum wage" as one element of German proposals for Europe.

The CDU/CSU has reportedly prevailed on one key point: modest income tax cuts including a gradual reduction of the "solidarity surcharge" by €10bn until 2021 with no offsetting hike in taxes on top earners. In return, the CDU/CSU ceded ground to the SPD on other issues such as ending the cap on the contributions employers have to pay for the health-care of their employees and making some future pension entitlements a bit more generous. As expected anyway, Germany will gradually step up spending on infrastructure and the digital economy. All in all, the country will likely get a fiscal stimulus of 0.1-0.2% of its annual GDP in coming years, the same as in 2017, as Germany is spending some of the proceeds of above-trend growth. As long as the business cycle stays strong, the country will likely maintain a fiscal surplus not far below the 1.2% of GDP achieved in 2017. Names that have been mentioned in recent weeks as potential SPD finance ministers include party leader Martin Schulz (former president of the European parliament) and current foreign minister Sigmar Gabriel. However, discussions about the composition of Merkel's likely fourth government will probably have to wait until the SPD rank-and-file have endorsed the policy outlines.

IS THE DEAL GOOD OR BAD FOR THE GERMAN ECONOMY?

Success breeds complacency. The deal continues the trend away from pro-growth reforms that has been clearly visible in Merkel's previous term already. For example, the change in health-care financing reverses another element of the reforms that had once turned Germany from the "sick man of Europe" into the continent's economic powerhouse around 2004. However, relative to the concessions Merkel had to make four years ago to lure the SPD into government (minimum wage, early retirement at 63 years after 40 years of employment, restrictions on temporary work contracts), the new deal for her fourth term does not seem to spring a major negative surprise at first glance (we have not seen all details yet). While Germany will remain fundamentally strong, it will continue to gradually slip from the top to the upper middle ranks of the growth league of major European countries. Germany's current golden decade will end in the 2020s.

WILL THE SPD BASE VETO THE DEAL?

After first ruling out a new coalition with Merkel's CDU/CSU, the leaders of the centre-left SPD have performed a remarkable U-turn under pressure of events and Germany's federal president Frank-Walter Steinmeier. Whether or not the SPD rank-and-file will support the deal at a special convention of party delegates on 21 January and in a poll of all 443k party members in March remains the key question. It won't be easy. Reluctance, if not outright opposition towards a new grand coalition with Merkel's CDU/CSU, runs high among the SPD's left wing faction and its powerful youth organisation. But in the end, the SPD is more likely to say yes than no. First, SPD leaders will campaign for the deal. Whatever their misgivings, many party members will hesitate to repudiate virtually their entire leadership, throwing their party into an even worse crisis than it is in already. Second, the SPD must be afraid of repeat elections in case the party does not enter the government. The five opinion polls published so far in January show that support for parties is virtually identical to the election result of 24 September except for some shift towards the Greens at the expense of the FDP and, to a smaller extent, the SPD. With 20.1% in the polls now after a 20.5% result in September that was seen as devastatingly low already, the SPD must be afraid of falling below 20% in repeat elections, especially if the party were to get the public blame for having caused these repeat elections by not joining Merkel now.

THE TIMELINE

It will take a while. The CDU/CSU and SPD have taken a key step – but many more steps will need to follow. The path to a new „grand coalition" (GroKo) is still long, arduous and rocky. The main stumbling hurdles are the vote by the party congress on the result of the exploratory talks (21 January) and the poll by all party members on the final result of formal coalition negotiations (likely to be held in late March).

- 15 January: CSU to decide on deal and give green light to coalition talks
- 13-20 January: SPD leader Schulz tours Germany to sell the outlines of a GroKo deal to SPD party delegates
- 21 January: congress of 600 SPD party delegates to approve formal start of coalition talks
- Late January to late February: formal coalition talks
- March (likely before the 22-23 March EU summit): Germany and France to unveil common position on Eurozone reforms
- 22-23 March: EU summit on next EU/Eurozone reform ideas
- Early/mid March: poll of 443k SPD party members
- Late March: government sworn in for Merkel's fourth term
- 1 April: Easter Sunday

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