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GERMAN POLITICS: WHAT IF?

Berenberg Macro Flash

On Sunday, Germany's centre-left SPD will decide whether to enter into formal coalition talks with chancellor Angela Merkel's CDU/CSU. We expect some 60% of the 600 delegates to approve a renewed "grand coalition" (GroKo). Germany's influential trade union federation DGB has endorsed the outlines of a coalition agreement presented by CDU/CSU and SPD leaders a week ago. The SPD delegates will probably shy away from torpedoing virtually their entire leadership who is campaigning for a renewed coalition with Merkel and run the risk of new federal elections. If the SPD were to get the blame for triggering repeat elections, the party may sink even well below the disastrous 20.5% it had scored last September. Of course, it could go the other way. Many in the SPD are afraid of losing out to Merkel again if they stay in government and long for a spell in opposition to sharpen the party's profile. Just in case, we thus need to discuss the "what if".

If the SPD refuses to join Merkel in government, Germany would have three options:

- 1) a new attempt to forge a "Jamaica coalition" between Merkel's "black" CDU/CSU, the liberal "yellow" FDP and the Greens,
- 2) a Merkel-led minority government that has to enlist support from the SPD, FDP or Greens on a case-by-case basis,
- 3) repeat elections.

Jamaica again? This option seems least likely. The FDP had walked out of such talks in November, citing a "lack of trust" rather than any genuine reasons. This suggests that party leader Christian Lindner prefers to stay in opposition. He has occasionally hinted that the FDP may reconsider if Merkel were to resign. However, Merkel seems to be in firm control of her party with no sign that she may want to throw in the towel to please the FDP. If the FDP were to reconsider its stance now and join Merkel, parts of the public may try to pin the old label of "turncoat party" on the FDP again, something which the party would like to avoid.

Minority government? Many in the SPD and a few lonely voices in the CDU/CSU seem to prefer this option. It works in some other countries including Spain and is a regular occurrence in Scandinavia. Some in the SPD believe that it would give them the chance to extract one concession after the other from Merkel over time, maximising their influence on policies without ever getting the blame for things that may go wrong since they would not formally be in power in Berlin. For these very reasons, the CDU/CSU is largely against it. It does not suit Germany's "stability"-oriented political culture, least of all that of the centre-right CDU/CSU which tends to put even more emphasis on stability than other parties. Interestingly, a chancellor heading a minority government once in power would be difficult to remove mid-term as the Bundestag cannot dismiss a chancellor without electing a new one (with absolute majority), and the Bundestag cannot be dissolved without the chancellor actively aiming for it. But a minority government may find it difficult to pursue a consistent set of policies.

Repeat elections may not change much. Opinion polls suggest that the result would be close to the outcome of 24 September, probably with some gains for the Greens at the expense of the FDP and the SPD. In a new campaign, Merkel's CDU/CSU could advance a little by pinning the blame for repeat elections on the FDP and the SPD. After new elections, the same mainstream parties (CDU/CSU, SPD, FDP, Greens) would still face the task of forming a government. As Merkel's CDU/CSU would almost certainly attain the biggest share of seats again, she would most likely lead such a new government. After repeat elections, the FDP



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may think again and might reluctantly to join a “Jamaica” coalition – after having tried the alternative with little success.

Much would depend on the German president Frank-Walter Steinmeier. After two failed attempts to elect a chancellor with a majority of seats in the current Bundestag, Steinmeier would have to decide whether to (i) appoint the candidate with a plurality of votes as chancellor heading a minority government or (ii) dissolve the Bundestag and call new elections within 60 days. Steinmeier would like to avoid new elections. Still, if the CDU/CSU were to argue strongly for repeat elections, he would likely have to go along with it after the two attempts to build a stable coalition (Jamaica or GroKo) had failed. On balance, the pendulum might swing to new elections. But the decision would not be clear-cut.

POTENTIAL IMPACT

Uncertainty hurts. Still, Germany’s economy is in such robust shape that the economic expansion would likely continue unabated even if new elections would extend the phase of political uncertainty by another three months. The expected modest fiscal stimulus through small-scale tax cuts and some extra federal spending would probably be delayed. On the European level, Germany would not be able to make major commitments. As a result, the EU’s June 2018 summit may not yet be able to take first decisions on completing the Eurozone banking union and turning the European Stability Mechanism ESM into a European Monetary Fund (EMF). Background discussions to prepare such decisions could still make significant progress, though. In last Friday’s draft coalition paper between the CDU/CSU and the SPD, the more conservative parts of the CDU/CSU had signed up to a number of ideas to reform Europe, including a European Monetary Fund, some instrument to help countries cope with asymmetric shocks, more investment and more German money for the EU budget. The paper was de facto Germany’s response to Emmanuel Macron’s reform proposals. On this basis, negotiations could proceed.

All in all, the damage which prolonged political uncertainty in Berlin would inflict on Germany and Europe would be very limited. Germany’s fundamental pro-European orientation and its overall policy stance (modest fiscal stimulus at home) would not be in doubt. More likely than not, the issue will not arise anyway as we see a better than even chance that the SPD party convention will endorse coalition talks on Sunday –and that the SPD rank and file will then approve the result of such talks, which may last a few weeks, at some time in early or mid-March.

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