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MACRO UPDATE: GERMAN COALITION, GERMAN STRIKES, ITALIAN ELECTION, CATALONIA

Berenberg Macro Flash

GERMAN POLITICS: RISK OF AN UPSET

Could a Corbyn-style insurgency within the centre-left SPD scupper chancellor Angela Merkel's plan to form a coalition between her CDU/CSU and the SPD? Vocal SPD opponents of a new tie up with Merkel have organised a campaign to attract new members to shift the balance within the SPD against such a coalition ahead of a binding vote of SPD members on a potential deal. In the first five days of that campaign which started on 22 January, the SPD has already received more than 7000 applications for membership, the strongest influx in more than 40 years. Although we do not expect the campaign to succeed, it carries two serious risks. First, the vote might actually go against a coalition. Second, to guard against such a risk, the coalition deal which CDU/CSU and SPD want to strike by 4 February may tilt so heavily towards some SPD demands that it places significant long-term burdens on the German economy. New SPD demands on migration have reportedly made for difficult start of the formal coalition talks already.

Background: On 21 January, an SPD party convention approved coalition talks with the CDU/CSU with a narrow 56.4% majority. The negotiations started last Friday and are scheduled to last until 4 February. Roughly three weeks later, the SPD will hold its referendum on the coalition deal. This Monday, SPD leaders will set a cut-off date for new members who want to cast a vote. The cut-off date will probably validate the recent applications and may grant a few more days for would-be members to join. In a much less controversial vote on joining the previous "grand coalition (GroKo)" with Merkel in 2013, 76% of SPD members voted yes, with a participation rate of 78%.

Could the surge in new members attracted by slogans like "pay €10 to prevent GroKo", referring to the fee for a minimum period of SPD membership, tilt the balance against a coalition? The risk is not negligible. At the SPD convention on 21 January, only 52% of the ordinary delegates – that is excluding party leaders who may have a vested interest in the perks of government offices - voted for coalition talks. If the party rank-and file split in a similar way in the referendum on the eventual coalition deal, then, say, 15k new members who are highly likely to take part and vote "no" could make a decisive difference. Excluding the new joiners, the SPD has some 440k members. If 80% of them cast a ballot and that vote splits 52% to 48% in favour of a coalition, the lead of the "yes" camp would be 14k votes. 15k new members may matter.

On balance, we still think that the majority of SPD members will shy away from rebuking virtually their entire leadership and from running the risk of new elections which would probably sink the party even below its disastrous 20.5% result of last September. In recent polls, the SPD scores merely 19%. Still, the risk that the SPD may say "no" in the end needs to be watched. For a brief "what if" discussion, see also the note from 19 January.

GERMAN WAGE ROUND: STRIKES ARE LOOMING

After the breakdown of negotiations on Saturday in a key region, Germany's metal engineering industry seems to be heading for selective strikes. From Wednesday to Friday, mighty IG Metall union wants to stage one-day stoppages in more than 250 factories. The conflict is less about wages (IG Metall has demanded a 6% pay hike and would probably settle for 3.2% - or 6% spread out over two years, with a somewhat front-loaded profile). The key issue is a union demand that companies subsidise a voluntary temporary reduction of the workweek to 28 hours for selected workers such as those wanting to take care of elderly relatives or small children. Because German companies already suffer from a shortage of skilled labour, employers are very reluctant to yield on this count. This could make the current round the most difficult one since the prolonged strikes of 2003.

To some extent, small-scale strikes are part of the ritual of German wage rounds. While such industrial action makes headlines, the damage is usually recouped shortly afterwards without leaving traces in GDP statistics. In the end, the two sides will agree, probably with some modest steps towards meeting the IG Metall demands cushioned by somewhat greater flexibility to extend working hours for some employees who would like to work longer. While an IG Metall wage deal may well raise wage costs in this highly cyclical industry by a tad above 3% this year, most other sectors (notably services and the public sector) will get less. As a result, we expect German wage inflation to accelerate modestly from around 2.5% in 2017 to just below 3% this year. A slight increase in labour productivity growth can offset about 0.2 points of that increase. Even in Germany with its tight labour market, wage inflation looks stay at levels that will not raise any alarm at the ECB.

ITALY: BERLUSCONI STRONG, FIVE STARS GETTING REAL
Five weeks ahead of the election on 4 March, opinion polls suggest that the alliance of Silvio Berlusconi's centre-right Forza Italia with two right-wing parties (Lega, FdI) could garner 36%-39% of the votes, ahead of the radical Five Stars (28%) and the centre-left Democrats PD (24%). The polls did not move much last week. Although Berlusconi's fragile alliance may win 43% of the seats with 38% of the vote, he would probably need some 40% of the popular vote for a majority of seats. While this is not impossible, it still looks unlikely. More likely, Italy is heading for a hung parliament. In the end, the stalemate may be resolved by some agreement between centre-right and centre-left parties, possibly even in the form of a technocratic or minority government. PD Prime Minister Paolo Gentiloni has said that his party has no plans for a coalition with Berlusconi's bloc as that bloc is dominated by "populist and anti-EU forces". Nonetheless, some arrangement between the centre-right and the centre-left after the election seems possible if the Lega is either not part of such an arrangement or downplays its euro-scepticism, as Austria's right-wing FPÖ has done to enter the Austrian government.

According to former prime minister Mario Monti, Italy's political parties are converging somewhat ahead of the 4 March election as the Five Star Movement has not included its earlier demand to hold a referendum on euro membership in its 20-point manifesto. In addition, Five Star founder Beppe Grillo has distanced himself somewhat from the movement, leaving more room for the potentially less disruptive Luigi Di Maio to shape the policy platform. If the Five Stars continue to become more pragmatic, they might even end up in government eventually without upsetting markets and the Italian economy very much. That is a big if, though. Unlike Grillo, Di Maio seems to be open to post-election alliances with other parties. Italian parties have until the end of today to finalise their lists of candidates, which may affect how well they may do in the for the one third of seats distributed on a first-past-the post basis. As usual, party bosses seem to be placing their most loyal supporters on the list.

SPAIN: MARKETS UNRUFFLED BY CATALAN TURMOIL
After the inconclusive Catalan regional elections in December, the separatist parties are trying to use their paper-thin majority in the regional parliament to re-elect ousted Catalan leader Carles Puigdemont as their president this Tuesday. Spain's constitutional court ruled this weekend that Puigdemont needs to be present in the parliament to stand for the presidency vote. This seems unlikely as Puigdemont faces arrest as soon as he returns from Brussels to Spain. The Catalan parliament has time until 2 April to pick a president before automatic dissolution which would lead to new regional elections around May/June. The outcome of

this complicated issue remains uncertain. So far, Spanish prime minister Mariano Rajoy remains largely in control of the situation.

We still expect that, over the long-term, the separatists and Spanish unionist can achieve a compromise. But that will take time. It helps the unionists that the Spanish economy does well and the outlook for 2018 GDP growth looks promising. Rating agencies confirm the positive development. Fitch Ratings increased the Spanish rating by one notch to A- from BBB+ this month, the best rating since 2012. Financial markets agree with that view. Spanish 10 year bond yield spreads over Germany fell last week to below 80bps, the lowest level since 2010.

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