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GERMAN POLITICS: THE CRISIS COMES TO A HEAD

Berenberg Macro Flash

- **In the bitter dispute between the CDU and the Bavarian CSU, CDU leaders seem to be largely rallying around Chancellor Angela Merkel. According to Merkel, the results of the 28-29 June EU summit and the bilateral deals she has struck with individual EU countries suffice to restrain migration into Germany. She continues to reject any unilateral German action that would add to the problems faced by other EU countries such as Italy.**
- **CSU leader Horst Seehofer, who wants to take unilateral German action to reject at the border those asylum seekers already registered in Italy or other EU member states, has reportedly offered to resign from his top job at the CSU and as Germany's interior minister.**
- **At the time of writing (23:30h German time), it remains unclear whether Seehofer will indeed resign and whether that could ease the conflict between the CSU and the CDU. As the Seehofer-Merkel clash seems to have turned personal to some extent, Seehofer's resignation – if it stands – may initially help to contain the conflict between CDU and CSU. Still, whether that would make the CSU more or less likely to compromise on substance is another matter. Also, the resignation of her adversary may after a while raise questions within the CDU whether Merkel should serve out her entire four-year term.**
- **As it stands, the risk remains serious that the CSU may leave Merkel's government. It is thus worth pondering the potential "what if" consequences.**
- **As long as Merkel does not herself choose to resign, she could stay on as chancellor of a minority government.**
- **The crisis weakens Merkel's standing at home and her influence in Europe and beyond.**
- **Whichever way the crisis ends, a major shift in German policies remains unlikely except for potential modest changes in German attitudes to European reforms.**
- **Even a deep political crisis in Germany would have little direct impact on the German economy. But it could further complicate the discussion about European reforms. A potential conflict between Germany and Italy over migration would pose a bigger risk to Italy's fragile bond market and its economy than to Germany.**

WHAT IF? GERMAN SCENARIOS

Although parts of the CDU have some sympathy for the CSU's hardline view on migration, Merkel has managed to largely rally the CDU behind her. While the CDU hopes for a compromise, even the conservative wing of the CDU does not want to be blackmailed by an intransigent CSU. If the CSU really walks out of the government, the CDU would likely continue to support Merkel, allowing her to stay on as chancellor for the time being.

New elections? Unlikely

Against the will of the reigning chancellor, it is almost impossible to call early federal elections in Germany. Unless Merkel were to resign herself, she could stay on as chancellor until parliament elects a successor supported by a majority in parliament. That the other parties ranging from the ultra-right AfD to the Left Party would agree on a successor to Merkel and outvote a CDU-SPD coalition seems virtually impossible. If



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Merkel wanted to trigger new elections, she would have to call a vote of confidence and deliberately lose that vote. Only in that case could the federal president dissolve parliament within 21 days and call early new elections within 60 days thereafter. In the wake of the current turmoil, the CDU would have no interest in new elections. Neither would the SPD, which is doing badly in opinion polls anyway.

Minority government? Possible

If the CSU really walks out, Merkel could stay on as head of a minority government backed by CDU and SPD. Together, the two parties have 353 of the 709 seats in the Bundestag, two seats short of a majority. She could seek issue-by-issue support from the centre-left Greens (67 seats) or the liberal FDP (80 seats).

New coalition including the Greens?

After a brief interlude, such a minority government could turn into a formal coalition between CDU-SPD and either the Greens or the FDP. As the FDP had abandoned the talks about a "Jamaica" coalition between CDU/CSU, FDP and Greens last autumn, the Greens might be Merkel's preferred replacement for the CSU. The SPD would also find it easier to co-opt the Greens than the FDP as an additional partner into a CDU-SPD alliance.

New chancellor? Only if Merkel decides to throw in the towel

On the domestic political scene, Merkel's star waned somewhat after the election last September. It took her six months to hobble together a coalition. She is widely expected to not run for a fifth term in 2021. Despite the current turmoil, she does not face a serious challenge from within her CDU at the moment, though. Three potential successors, **Annegret Kramp-Karrenbauer**, **Daniel Günther** and **Jens Spahn** would all need a few more years to prove their mettle in high-profile politics before they could be well placed to take over. Kramp-Karrenbauer (currently general secretary of the CDU party) and, to a slightly lesser extent, Günther, (the relatively new CDU prime minister of Schleswig Holstein) seem to be very close to Merkel in terms of their overall policy stance whereas Spahn (Germany's minister of health) has honed a more conservative image.

In the unlikely case that Merkel were to step down, Wolfgang Schäuble - currently president of the Bundestag - might be the stopgap chancellor for a while, possibly serving out most of Merkel's term before handing over to a successor.

POTENTIAL ECONOMIC IMPACT

Uncertainty is bad for markets and for the economy. Still, the direct economic impact of protracted political uncertainty or even a change in government on the German economy would likely be very small. The dispute between CDU and CSU is about (i) a detail of immigration policy and (ii) the extent to which Germany should seek solutions on the European level instead of adopting unilateral measures to restrict migration against the interests of transit countries such as Italy and Austria. None of these two issues has a major direct economic significance for Germany.

Germany could easily function even with a government that has no majority in parliament. Blessed with full employment and a fiscal surplus, no major national decisions need to be taken urgently. However, protracted political uncertainty in Germany could – once again – delay and complicate reform discussions in Europe. Also, if a harder German line on migration were to pose a problem for Italy, any conflict between Germany and Italy would spook Italian rather than German bond markets.



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Whichever way the crisis ends, Germany's euro-sceptic political far right would not make it into a position of power. With or without a hypothetical change in government, the overall orientation of German politics would not change dramatically. Despite disagreements on some significant details, Germany's mainstream political parties including the CSU share a rough consensus on key issues such as NATO and the overall direction of German policies in Europe. For example, the federal parliament has just endorsed the latest support package for Greece with a broad majority.

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