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GERMAN POLITICS: KEY STATE ELECTIONS AHEAD

Berenberg Macro Flash

German politics will make headlines in the next three weeks. Likely heavy losses for Angela Merkel's CDU/CSU at state elections in Bavaria (14 October) and Hesse (28 October) may fan the talk that she may not serve out her full term as Chancellor until 2021. However, her position is probably still secure for now, partly because potential successors need more time to build up support before they may challenge her eventually. Apart from possibly strengthening the influence of the centre-left Greens on some policy decisions such as Germany's future energy mix, the state elections will not result in a significant policy shift. European policies should not be affected even if the right-wing AfD makes further noteworthy gains.

A MAJOR SETBACK FOR MERKEL’S COALITION

Opinion polls point to heavy losses for the CSU in Bavaria, the CDU in Hesse and for the SPD in both states (see charts 1 and 2 below). The CDU/CSU alliance along with the SPD form Merkel's national government in Berlin. The projected losses are likely to go well beyond a usual mid-term drubbing for a ruling coalition. The SPD may not lose as much as the CDU/CSU, but this simply reflects their lower starting level.

The sharp drop in support for CDU/CSU and SPD over the last three months is largely the result of recent turmoil in Merkel's coalition in Berlin. In early July, the Bavarian branch of the conservatives, the CSU, nearly blew up the government over a minor detail of migration policy (see German politics: the impact of the political crisis). In mid-September, the centre-left SPD rebelled clumsily over the coalition's mishandling of a second-order personnel issue. The noise has put off many voters. But this effect may fade over time if and when the government in Berlin learns to better handle the inevitable internal disagreements.

WATCH THE GREENS MORE THAN THE AfD

Further gains for the right-wing AfD may dominate the headlines. Following the two votes, the AfD will likely be represented in the parliaments of all 16 German states. However, their influence on actual policies will remain negligible. For the time being, all other parties will lock them out of power. While still rising on trend, support for the AfD remains well below that for similar right-wing parties in many other European countries.

Judging by opinion polls, the real winners could be the centre-left Greens with up to 18% in both states, well ahead of the AfD. The Greens have managed to turn themselves into the alternative of choice for mainstream voters that are dismayed by the recent noise in Berlin but are unwilling to back the radicals. Unlike the small liberal FDP, the Greens also exude the confidence that they actually want to govern and accept the compromises needed for that.

The Greens will likely remain part of the state government in Hesse. With a chance of up to 40%, they may also enter the state government in Bavaria in a coalition with a deflated CSU. If so, the
Greens would be part of 10 state governments. Although they are not part of the federal government in Berlin, their strong position in the Bundesrat, the upper house of parliament representing Germany’s 16 state governments, gives them a significant say in many policy decisions. For example, the Greens fully support Emmanuel Macron’s reform agenda for Europe. If they do as well as opinion polls project, the state election results may even make it a little easier, rather than harder, for Germany to find common ground with France on some modest EU/Eurozone reforms well ahead of the EU parliamentary elections next May.

Of course, gains for the AfD may spark a debate whether mainstream parties should tilt more towards the AfD’s right-wing agenda. But if opinion polls are not completely wrong, the real lesson from the state elections could be different. The CSU’s attempt in June and July to dent support for the AfD by adopting a controversial hardline approach on some aspects of immigration seems to have backfired badly. The polarised debate focusing on the AfD agenda seems to have hurt the CSU while helping both the AfD and the Greens. The latter attract voters most repelled by the AfD agenda.

**MERKEL AT RISK?**

All of the three parties that form Merkel's CDU/CSU-SPD coalition in Berlin may go into a period of soul-searching after the two state elections. But from a weakened starting position, none of them would have anything to gain from bringing down Merkel and potentially triggering early elections (see our earlier discussion [German politics: the waning of Merkel’s power](#)).

Heavy losses for the CSU in Bavaria will likely cost Horst Seehofer his position as CSU party leader and, possibly, also his job as interior minister in Merkel's government in Berlin. As he was the key player in the July turmoil in Berlin, he may get the blame for the outcome.

If Merkel’s CDU does even worse than expected in Hesse two weeks after the Bavarian elections, we should expect a discussion about her position at the helm of the CDU. Nonetheless, she probably will not have to face a serious challenger when she is up for re-election as party leader at the CDU convention in Hamburg on 7-8 December. Potential successors (such as Jens Spahn, Armin Laschet, Ralph Brinkhaus) need more time to build support within the party; Merkel's apparent choice to succeed her in 2021, Annegret Kramp-Karrenbauer, seems unlikely to challenge her mentor now. All of these potential candidates are young enough to still bide their time for a while.

Amid serious challenges (Trump, Putin, Brexit, EU reforms, Italy to name the most obvious ones), Merkel is unlikely to throw in the towel soon. Our base case remains that she will serve out the last three years of her final term and that the current CDU/CSU-SPD coalition will stick together. However, the strained coalition of parties joined together in a loveless marriage is unlikely to drive any dramatic change of policies on the national, European or international level. EU reforms will remain piecemeal and modest. But that is not really new anyway.
MerkelDaemmerung in 2019?
The likely losses for Merkel’s coalition raise two issues for 2019 rather than 2018:

First, as Merkel is facing more headwinds at home, may she change her mind next year and go for the job of European Commission president after the European parliamentary elections next May? Still unlikely but not impossible.

Second, will the badly battered SPD stay in government in late 2019 when, according to their coalition agreement, the CDU/CSU and the SPD want to re-evaluate their hapless partnership? Probably yes, but as voters seem to punish rather than reward the SPD for their part in the current coalition, this has become a pretty close call.

Would It Matter? Not Much
More than in almost all other major countries, German policies are shaped by a widespread consensus between all mainstream parties. Germany’s federal structure and its two-chamber parliament see to that. As the second chamber representing the governments of the 16 federal states needs to approve most laws, the ruling parties in Berlin are forced to co-operate with the mainstream opposition which is usually strong on the state level. Together, the mainstream parties including the Greens and the liberal FDP still represent 70-75% of German voters.

As a result, a change at the top, a new coalition (CDU/CSU-Greens-FDP?) or new elections leading to a new coalition would cause some irritation followed by some modest tweaking of policies. For better or worse, do not expect market-relevant dramatic policy shifts under any realistic scenario.
Chart 1: Opinion polls for Bavarian state elections vs. 2013 result

Centre-right CSU, centre-left SPD, centre-left Greens, liberal FDP, ultra-left Left Party, radical right AfD and centrist to centre-right Independents (“Freie Wähler”). Election result in 2013 versus average of 3 latest available polls for 2018 election. Change in pts above the columns. Sources: INSA, FW, Infratest dimap, wahlrecht.de.

Chart 2: Opinion polls for Hesse state elections vs. 2013 result

Centre-right CDU, centre-left SPD, centre-left Greens, liberal FDP, ultra-left Left Party and radical right AfD. Election result in 2013 versus average of 3 latest available polls for 2018 election. Change in pts above the columns. Sources: INSA, FW, Infratest dimap, wahlrecht.de.