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GERMAN POLITICS: KEY STATE ELECTIONS AHEAD

Berenberg Macro Flash

Will German Chancellor Angela Merkel still be in office next spring? Two regional elections this Sunday can sharpen the debate within the centre-left SPD whether or not to pull out of the federal government and thus bring down Merkel. We currently see a 25% risk that this may happen.

On Sunday, voters in two of Germany's 16 states will elect new regional parliaments. Saxony on the Czech/Polish border has traditionally been a CDU stronghold while Brandenburg (around Berlin) has usually voted SPD. In both of these east German states, the right-wing AfD has surged in opinion polls since the refugee crisis of 2015 (see Charts 1 and 2).

The key results to watch is whether the SPD stays ahead of the AfD as the top party in Brandenburg and scores well above the 5% hurdle needed to be represented in the state parliament in Saxony. The most recent opinion polls show a slight rebound for the SPD and the CDU on the state level relative to previous polls. This suggests that the SPD may just about pull this off. However, the narrow lead of the SPD over the AfD in Brandenburg is well within the margin of error.

Ruling jointly in a "grand coalition" with Merkel's CDU/CSU in Berlin has been a two-edged sword for the SPD. On the one hand, the SPD has lost significant support in polls and elections. On the other hand, the SPD has managed to impose a major part of its centre-left agenda on the CDU/CSU. In this sense, the SPD's weakness with voters is also its strength: to avoid that the SPD walks out of government, Merkel has shifted significantly towards centre-left policies. As a result, the SPD is torn between the two desires, to get out of an alliance with Merkel that is not helping them with voters and to stay in government to shape policies.

The SPD will elect a new leader or – more likely – a male/female leadership duo shortly. Candidates can put their names forward until this Sunday. After a series of regional debates, SPD members then cast their ballot from 14 to 25 October, with a potential second round of voting from 19 to 29 November before an SPD party congress 6-8 December formally elects the new leader(s). The only high-profile candidate so far is finance minister Scholz (jointly with Klara Geywitz), other candidates are less well known. Unlike almost all other candidates, Scholz wants to continue the coalition with Merkel. If the SPD does less badly than feared in the two state elections this Sunday, his position would look stronger. If the SPD fares badly, the risk that a badly battered and disoriented SPD may go for candidates who want a major change and get out of government may rise significantly.

To a lesser degree, the state election result also matters for the CDU: If the CDU fares badly, the position of CDU party boss Annegret Kramp-Karrenbauer (AKK) as heir apparent to Merkel would be weakened further. If the CDU comes well ahead of the AfD in Saxony, AKK's position would be more secure. If not, the debate whether she should lead the CDU/CSU into the next federal elec-



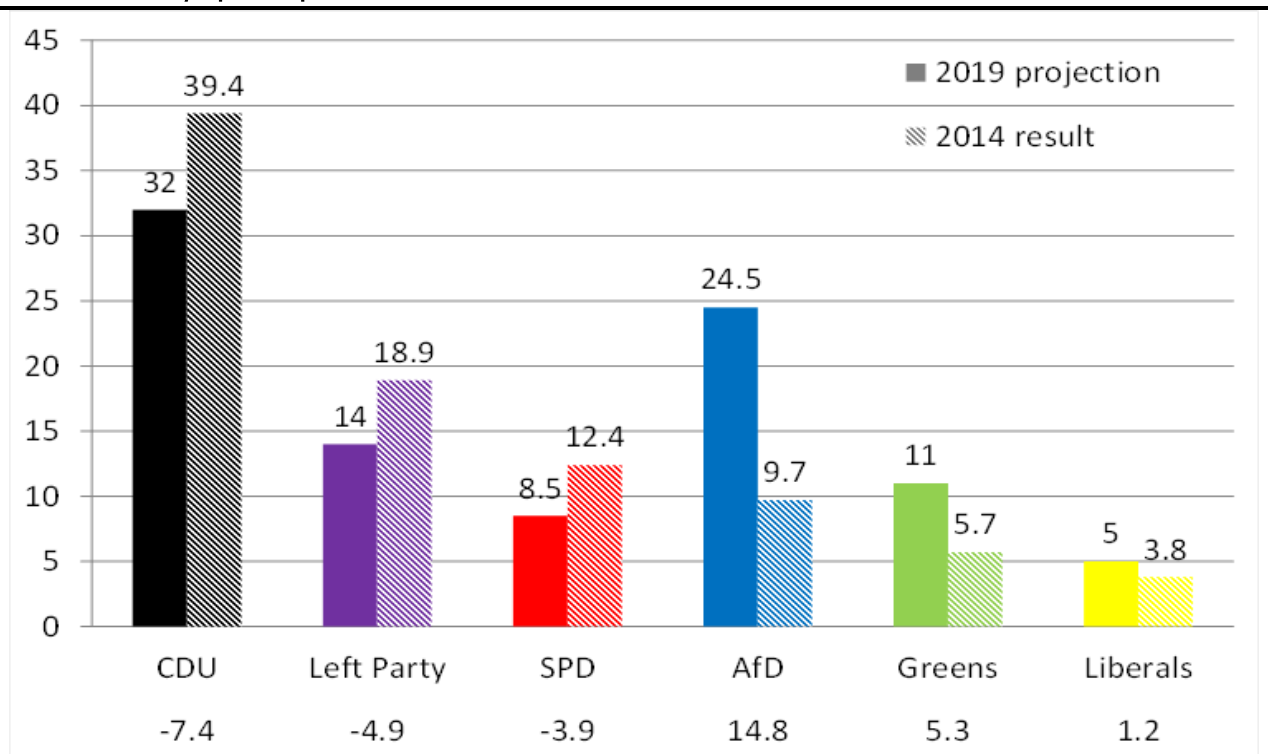
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tion would intensify. A clear alternative to her is not in sight yet, though. While she may no longer be the CDU candidate in regular elections in 2021, she would probably still head the CDU in case of early snap elections.

In the – still unlikely – case of snap elections on the federal level early next year, Germany would probably end up with a CDU/CSU-Green coalition led by AKK. However, as the combined left (Greens, SPD Left Party) is in opinion polls only about 2ppt short of a potential majority of seats at the federal level, an alternative government led probably by the Greens' Robert Habeck would have a significant probability as well. Would such a change in the government in Berlin change the German policy outlook? Yes, but not by much: (1) The CDU/CSU would still have a blocking veto in the upper house of parliament, just like the Greens have today. That affects most tax issues as well as major European decisions. (2) Even a centre-left government could not ramp up public investment spending much faster than is happening already (public investment +10.6% yoy in H1 in nominal terms). Still, a coalition left-of-the-centre would probably mean an increase in government consumption and some regulation in areas where the federal level has the decisive say.

The next state elections are in Thuringia in a few weeks (27 October) and Hamburg on 23 February next year.

Chart 1: Saxony opinion polls (in %)

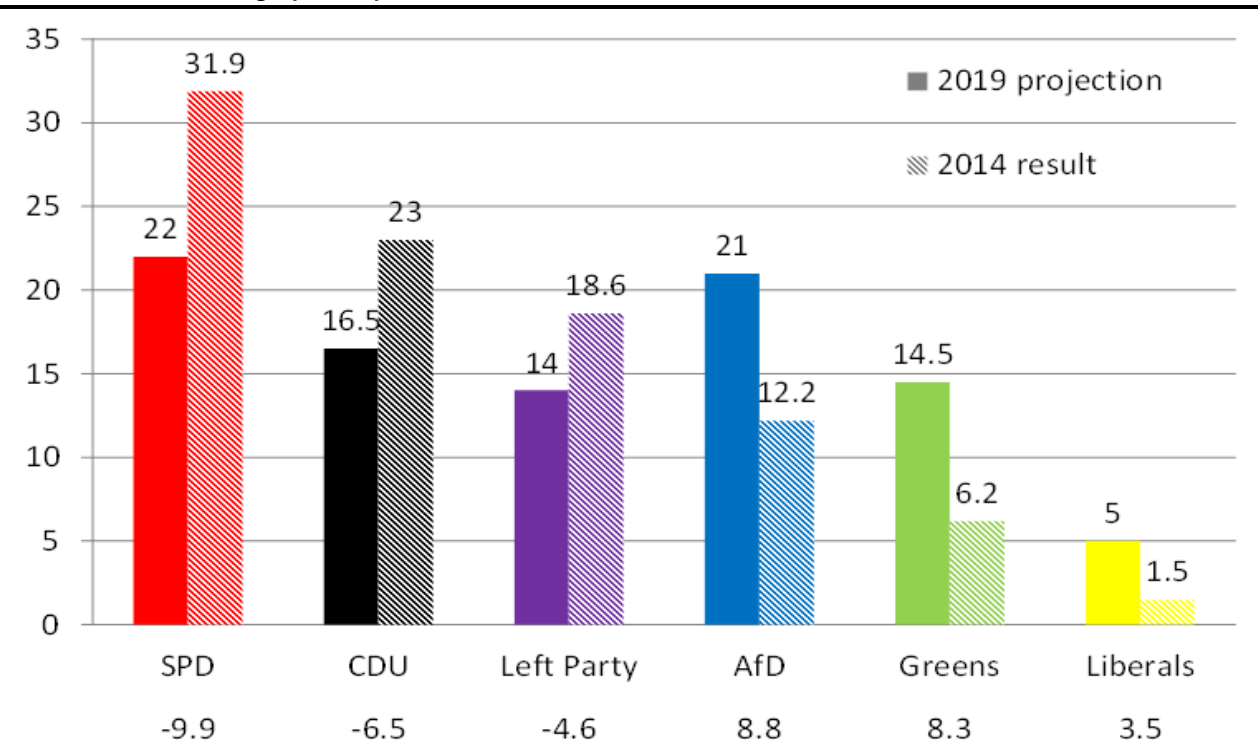


The number below each party's name shows the percentage point change from the party's 2014 election result to the most recent poll for the 2019 election. Source: ZDF, wahlrecht.de



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Chart 2: Brandenburg opinion polls (in %)



The number below each party's name shows the percentage point change from the party's 2014 election result to the most recent poll for the 2019 election. Source: ZDF, wahlrecht.de

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