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GERMAN POLITICS: BAD NEWS FOR MERKEL – AND EUROPE

Berenberg Macro Flash

Heading for trouble. Germany's centre-left SPD will be led in the future by a little-known left-wing duo who are highly critical of the SPD's role in Angela Merkel's government. The vote by SPD members in favour of Saskia Esken/Norbert Walter-Borjans can be seen as a de facto vote against political stability and against the current "grand coalition" between Merkel's CDU/CSU and the SPD. The result need not spell the end of the government and thus of Angela Merkel's reign as chancellor. But as explained in our report "[closer to the danger zone](#)", the outcome of the SPD membership ballot raises the probability that the SPD will walk out and bring down Merkel within the next six months from 30% to 45%. Although the risk that the left may take over the SPD had loomed large in recent weeks, the result probably comes as a negative surprise for markets.

Small majority, big impact - the next steps: In the second round of a membership ballot, the SPD rank-and-file voted by 53.1% for Esken/Walter-Borjans. The centrist and pragmatic finance minister Olaf Scholz, who had run jointly with Klara Geywitz, received merely 45.3%. Roughly 54% of SPD members had cast a ballot from 19 to 29 November. Esken/Walter-Borjans will be formally enthroned at the start of the upcoming SPD convention on 6 December. While it is possible that the SPD may decide at this convention to leave the government, it seems much more likely that the SPD will instead ask to re-negotiate the current coalition agreement with the CDU/CSU and set tough conditions for staying on as Merkel's junior partner. If the two parties cannot agree on the further tilt of German policies to the left which the SPD activists desire, the coalition would end. In that case, Merkel may stay on for a month or two at the head of a minority government before paving the way for new elections, possibly in March. That she could head a minority government until Germany's rotating presidency of the European Council (July to December 2020) is over seems unlikely. Merkel would almost certainly not run again in new elections.

Three reasons why Merkel may still remain in power

For three reasons, the SPD may still decide to stay in the coalition with the CDU/CSU and thus let Merkel remain chancellor until the regular end of her fourth term in September 2021:

- 1) Unlike SPD members, most SPD voters and the majority of the SPD parliamentary party were in favour of Scholz. According to a "ZDF Politbarometer" opinion poll, SPD voters had preferred Scholz/Geywitz over Esken/Walter-Borjans by 38% to 22% with 40% undecided. At the party convention, major parts of the SPD establishment will likely make the case for staying in power.
- 2) The SPD has more to fear from new elections than any other party. Polling at around 15% instead of the already dismal 20.5% it had garnered in 2017, the party could lose more than a quarter of its seats in the Bundestag. The membership vote against finance minister Scholz and in favour of a little-known left-wing duo deepens the party's crisis even further. As a result, the SPD could fare even worse in an election than current polls project whereas the CDU may attract more swing voters in response to the SPD's tilt towards the less responsible left. For the time being, the SPD's parliamentary faction would very much like to avoid such an outcome.



- 3) Getting the blame for bringing a government and triggering new elections is seen as a vote-loser rather than a vote-winner in stability-conscious Germany.

Will the CDU dig in its heels now?

However, re-negotiating the coalition agreement with the CDU/CSU in order to appease the SPD's new left-wing leaders will not be easy. While Merkel may be inclined to give further ground to grant her government a new lease of life, many in her CDU are fed-up with a coalition partner that is turning ever more left-wing and ever less reliable. Having yielded the post as CDU chairwoman to her would-be successor Annegret Kramp-Karrenbauer (AKK) a year ago, Merkel's influence over the CDU is now quite limited. For AKK, who has lost support within her own party throughout this year, the best option to ever become chancellor may be to go for new elections soon, that is before her rivals within the CDU may have mustered the strength to deny her the pole position as the party's candidate for the top office. All in all, we put the risk that potential negotiations to renew Merkel's current coalition will fail and that Germany may be heading for new elections in early 2020 at 45%, up from 30.

The pivotal party – the Greens

In theory, it might still be possible to avoid new elections even if the SPD left the coalition. The CDU/CSU could strike a deal with the Greens and the liberal FDP instead. However, the Greens are riding high in opinion polls with support around 22%, well above their 2017 election result of just 8.9%. They would thus probably insist on new elections before they might join a government thereafter.

If the SPD leaves the coalition with the CDU/CSU, any new government would almost certainly have to include the Greens. After new elections, all parties would still shun the right-wing AfD (around 14% in polls) and neither the small liberal FDP (c8%) nor the CDU/CSU (c27%) would work with the Left Party (c9%). Short of a dramatic upset, new elections in, say, March 2020, could thus result in one of two outcomes: 1) the Greens join the CDU/CSU as junior partner; or 2) they team up with the SPD and the Left Party instead. Including the Left Party no longer seems to be taboo for them. Such a potential coalition of the combined left is only 1-2 points short of a majority in current polls. The option could be attractive for the Greens. As the senior partner, one of their two leaders, the more charismatic Robert Habeck or the more policy-focused Annalena Baerbock, could then be the next German chancellor.

What if? A green-red-red government would be hemmed in by the upper house of parliament. The CDU/CSU could still wield a veto against major shifts in tax and European policies in this chamber of state governments for the foreseeable future. But even without control of the Bundesrat, such a coalition of the left may still re-regulate parts of the German economy such as the labour and housing market significantly and impair trend growth as a result.

An opportunity for Europe? Not at all

Some observers may see the SPD's tilt to the left and the possibility of political change in Germany as raising the probability for both a major fiscal stimulus and for a more accommodative Ger-



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man position in Europe. This view is largely mistaken. To some extent, the opposite may happen. Without Merkel as chancellor and in reaction to the SPD's tilt to the left, the conservative CDU/CSU may harden its own position on these issues. Finding compromises that both houses of the German parliament, the Bundestag and the Bundesrat, could agree to may become more rather than less difficult after Merkel.

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