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GERMAN POLITICS: UPEHAVAL DOES NOT HERALD MUCH BIGGER STIMULUS

Berenberg Macro Flash

More stimulus to come? Many observers seem to believe that the tilt of the SPD to the left and the risk that the new SPD leaders may bring down Merkel could herald a significantly bigger fiscal stimulus and a more accommodative position on Eurozone reform issues. While possibly containing a tiny kernel of truth, these suggestions are overdone. For the time being, German fiscal policy will not become much more expansionary than it already is. We see four reasons for that:

- 1) Germany is already granting itself a stimulus of roughly 0.5% of GDP in 2020 after an expansion of 0.3% in 2019.
- 2) Ramping up public investment even faster than planned already is almost impossible due to lengthy planning procedures, time-consuming court challenges and a lack of skilled labour. [Construction has hit capacity constraints](#) which can be eased only gradually by an ongoing expansion of that sector.
- 3) As long as the SPD remains in government, Olaf Scholz will probably remain finance minister. If the SPD walks out of the government, to which we attach a 45% probability, the SPD would have less rather than more influence on fiscal policy.
- 4) The CDU/CSU will most likely talk to the new SPD leaders once the latter have clarified their ideas at the 6-8 December party convention. But the CDU/CSU is very reluctant to yield a lot. Many conservatives are inclined to dig in their heels instead. Even more so than Scholz, they do not believe that a country with full employment and a serious shortage of skilled labour needs a bigger fiscal stimulus. For many in the CDU, the „black zero“ (balanced federal budget) is a key policy which appeals to their base among voters. Of course, if tax receipts fall short of estimates due to an unexpectedly deep economic downturn, they would not tighten fiscal policy to prevent a fiscal deficit. But short of a serious recession, they will not pass a budget that envisages a significant deficit.

What precisely the SPD will demand to stay in government remains to be seen. In the past, the new party leaders have argued for a higher minimum wage, more social spending, a higher tax on carbon emissions and a big investment push of up to €500bn over 10 years.

Small concessions are possible for the CDU/CSU. In my view, that may include an independent review of the minimum wage, a slightly higher starting level for the new tax on carbon emissions and some general proposal to raise public investment gradually further in coming years in some select areas. But the CDU/CSU would only renegotiate the existing coalition agreement substantially if the SPD also yields ground, for instance by agreeing to a significant corporate tax reform. The new left-wing SPD leaders are unlikely to accept that.



POTENTIAL OUTCOMES

We still see a 55% probability that the current coalition will stick together.

With the change at the top of the SPD, the probability that [the SPD will leave the government within the next six months has risen to 45%](#). If so, Chancellor Angela Merkel would initially stay on as head of a minority government backed by her CDU/CSU. Such a conservative-only government would probably not get much done. However, it would not spearhead a significant fiscal stimulus.

A **minority government** could potentially stay on for quite a while (a German chancellor who does not call and lose a confidence vote herself can only be brought down if a replacement candidate musters a - currently elusive - majority in parliament). More likely, however, a short interim period of a minority government would be followed by early elections. While the CDU/CSU does not seem to have a clear view on the issue yet, it could make sense for the party's boss Annegret Kramp-Karrenbauer to go for new elections before her position as heir-apparent to Merkel could be challenged by her rivals within the CDU. Party strategists may also consider the blame game. After just a short period of an interim government, it would be easier for the CDU/CSU to pin the blame for unpopular snap elections on the SPD for leaving the coalition and on the Greens for refusing to join a potential coalition with the CDU/CSU (and the small liberal FDP) without holding elections first.

New elections would likely lead to a **CDU/CSU coalition with the Greens** (2/3 probability in case of new elections). Policy details would shift modestly (faster exit from coal, some corporate tax reform and possibly a slightly more ambitious increase in military spending). However, the overall fiscal stance and the approach to European issues would not change significantly.

Alternatively, new elections could bring a **leftist alliance** (Greens, SPD, Left Party) to power (1/3 probability). Such a federal government would indeed favour a looser fiscal stance. But even in that case, the CDU/CSU could use its solid veto power in the upper house of parliament, the Bundesrat, to prevent most changes in tax and European policies. 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, though.



MACRO NEWS

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