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MACRO UPDATE: GERMAN POLITICS, UK ELECTION

Berenberg Macro Flash

GERMAN SPD: NO RED LINES, NO DEADLINES

Is Angela Merkel now safe? Not quite. Although the new left-wing leaders of her coalition partner SPD are shying away bringing down the government soon, the faction-riven SPD remains an unpredictable ally for Merkel. After a tame SPD convention 6-8 December, we now put the probability that the SPD will stay in the German government throughout 2020 at 60% instead of 55% a week ago. Including the small chance that Merkel may want to lead a minority government, even if the SPD is out, we thus see a 65% probability that Merkel will still be in power at Christmas time 2020 – see [Forecasts at a Glance](#) for precise probabilities of various scenarios.

Three decisions which the SPD took at its party convention suggest that the centre-left party would rather stay in government than run the risk of losing one third of its seats in parliament at potential new elections:

- 1) Although the SPD drew up a list of leftist demands (more investment, higher minimum wage etc), it set no red lines or deadlines for the “talks” rather than “negotiations” it wants to hold with its senior coalition partner, the CDU/CSU, about the government agenda for the remainder of the parliamentary term that runs until autumn 2021.
- 2) Beyond the SPD’s new left-wing leaders, the party’s parliamentary faction and its government ministers will be heavily involved in the talks with the CDU/CSU. The SPD members of parliament and its ministers have a strong interest in preserving the status quo.
- 3) The final decision as to whether or not to remain in government after talks with the CDU/CSU about potential policy changes will rest with the SPD presidium in which those who want to stay in are strongly represented.

For two reasons, the risk that the desperate SPD may walk out on Merkel in 2020 remains elevated nonetheless.

- 1) The new little-known and uncharismatic SPD leaders Saskia Esken/Norbert Walter Borjans face an uphill struggle to revive the fortunes of their badly battered party, to put it very mildly. More likely, they will continue on a path towards electoral irrelevance as most of their themes do not resonate well with their party’s traditional working-class base. Two opinion polls taken after the SPD membership ballot in favour of Esken/Walter-Borjans show a further slump in support for the SPD from 14% to an all-time low of 11% (Forsa) and from 15% to 13% (infratest dimap). Such low numbers could strengthen the desire among party activists for a fundamental change – i.e. to get out of government.
- 2) CDU/CSU leaders show little inclination to grant the SPD major policy changes. The CDU/CSU sees a balanced budget as one of its major achievements in government. CDU leader Annegret-Kramp-Karrenbauer has flatly rejected SPD demands to abolish the “black zero” (balanced federal budget) and to soften the constitutional debt brake, which restricts federal fiscal deficits to 0.35% of GDP in normal times.

Room for compromises exists. The government may use some off-budget funds to de facto get around the “black zero”. It may ask an independent commission to evaluate the scope for a higher minimum wage (the SPD demands €12 per hour instead of the current €9.19). In negotiations with



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the upper house of parliament, the Bundesrat, in which the Greens have a de facto veto, the starting level for the proposed carbon tax on sectors not covered yet by an emission trading scheme may be raised beyond the envisaged €10 per ton of CO₂ emissions. We thus see a better than even chance that CDU/CSU and SPD will find an agreement, stay together and allow Merkel to remain chancellor throughout 2020. Still, the risk that the SPD may give in to the impulse to turn its back on government and lick its wounds in opposition instead continues to loom large.

UK ELECTION: BORIS LOOKS SET TO NICK IT

The usual flurry of polls over the weekend suggests that, on balance, prime minister Boris Johnson and the Conservative Party continue to sustain a c11 point poll lead (five poll average) against opposition Labour led by far-left leader Jeremy Corbyn. This puts Johnson on track for a majority of seats in the House of Commons at the general election on Thursday (12 December). Yesterday, the Sunday Times published analysis by Datapraxis which predicted a 38 seat majority for the Conservatives.

While polling has consistently showed Johnson ahead by double digits since the campaigns started on 6 November, the range across the last five major polls is 8 to 15. [We calculate](#) that the Conservatives need to be 8 points ahead of Labour on the eve of the election to be on course for a majority (our base case). While this remains on track, the wide range of estimates suggests some caution. A late-surge in support for Labour could still prevent Johnson from winning a majority. For now, this seems unlikely.

A Conservative majority would put the UK on track for an orderly Brexit on 31 January and a rebound in economic momentum over the next couple of years. Markets would likely take the news positively and extend their recent gains. UK-focused equities and sterling would likely jump along with gilt yields. If our economic base case prevails - [we look for real GDP growth to pick up from 1.3% in 2019 to 1.8% in 2020 and to 2.1% in 2022](#) - we would expect further gains in UK risk assets over the medium-term.

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