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GERMAN POLITICS: THE RACE IS ON

Berenberg Macro View

Who will succeed Angela Merkel as German chancellor after the 26 September national election? The two top parties vying to lead the next German government have both vowed to nominate their candidate between Easter and Pentecost (23 May). Whereas Merkel's centre-right **CDU/CSU** is under pressure to settle the issue soon amid a major drop in public support, the **Greens** can take it easier. The choices which the two parties make in coming weeks could possibly make a decisive difference for what promises to be a closely contested election in September. Both the CDU/CSU and the Greens have two potential candidates. If the CDU/CSU opts for Armin Laschet (CDU) instead of Markus Söder (CSU) and if the Greens pick Annalena Baerbock rather than Robert Habeck, the probability that the Greens may win and lead the next German government may rise from 25% to at least 30% and possibly to 35%, in our view.

Laschet or Söder for the CDU/CSU?

As the leader of the CDU since late January, the centrist "continuity" candidate Laschet (60) would be the natural joint CDU/CSU choice to succeed Merkel as German chancellor in late 2021. But after a plunge in support for the CDU and a series of mishaps, he is no longer the clear favourite. His apparent rival Söder (54) from the CDU's Bavarian "sister party" CSU is much more popular with voters. In a poll in late March, 56% of respondents rated Söder as a suitable chancellor versus a mere 23% for Laschet, whom 65% saw as not suitable (see chart 1). Whereas a recent kickback scandal involved Söder's CSU at least as much as Laschet's CDU, Laschet has come across as dithering on the need for stricter measures to contain the pandemic. Söder has presented himself more consistently as backing Merkel's tougher line. Söder's ratings have improved slightly over the last two months while Laschet's ratings are even weaker than they were in January.

As head of the much smaller CSU, Söder cannot force Laschet out. An open attempt to do so might rally the CDU behind Laschet. Instead, Söder needs the CDU establishment to ask Laschet to cede to Söder. Although some CDU backbenchers have come out in favour of Söder, senior CDU leaders have not (yet) done so. They may be afraid that open strife within the CDU could hurt the party's electoral prospects by almost as much as choosing the less popular of the two candidates. Over the last few days, some pro-Söder CDU backbenchers have proposed to let the joint CDU/CSU faction in the federal parliament (Bundestag) vote on the candidates if Laschet and Söder cannot settle the issue between the two of them. The leaders of the parliamentary faction are scheduled to meet on Sunday before the parliamentary faction gets together next week again after the current Easter break. The issue may thus come to a head shortly.

Laschet and Söder have both made it to the top of the CDU and CSU, respectively, against strong resistance. Both have won state elections, Laschet for the CDU in North Rhine-Westphalia, Söder for the CSU in Bavaria. Nonetheless, they differ significantly in terms of their background and past policy pronouncements. Apart from Laschet's occasional disputes with Merkel over the need for a stricter lockdown, he has usually supported Merkel on other policies



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including her handling of the 2015 refugee crisis. He is thus seen as the continuity candidate. His somewhat unassuming style and penchant to moderate and bridge differences resembles Merkel's approach. Hailing from Aachen on the Belgian and Dutch border, he is instinctively pro-European. He would be willing to go along with some additional fiscal burden sharing in Europe. But we would not emphasise this point too much. With strong ties to traditional industries in North Rhine-Westphalia, he also supports the Nord Stream 2 pipeline which is opposed by France and most other European countries as well as the US.

Söder comes from a more conservative background with stronger reservations against any mutualisation of risks in the Eurozone and the EU. He has also been more critical of unconventional ECB policies than Merkel. But the somewhat divisive Söder has proven to be a fast learner if need be. If he makes it into the chancellor's office, he may not remain beholden to positions on Europe that had served him well in the past in conservative Bavaria.

Habeck or Baerbock for the Greens?

Like no other party, the Greens embody the Germany's current urban "Zeitgeist". Policies with a green tilt are popular as long as they do not cost too much. Climate change is a major concern to many Germans. As a result, the Greens have overtaken the traditional centre-left SPD which is torn between the remnants of its erstwhile blue collar base and its urbanite supporters. The Greens have also benefitted from the fact that Habeck (51) and Baerbock (40) have worked together very harmoniously ever since the duo became co-leaders of the Greens in January 2018. Both represent the moderate wing of their party. While Habeck is slightly more popular, Baerbock has narrowed the gap significantly in the last few months. Among voters at large, 30% view Habeck and 25% Baerbock as a suitable chancellor (ARD Deutschlandtrend 1 April 2021). Among supporters of the Greens, however, Baerbock's rating (60% see her as a suitable chancellor) is now almost identical to that of Habeck's (61%). Many observers would expect the more policy-savvy Baerbock to perform well on the campaign trail against an all-male cast of leaders from the other mainstream parties (CDU/CSU, SPD and FDP). We see a better than even chance that Baerbock will be the Green candidate. If she really wants to, Habeck would probably cede to her.

Our probabilities for the election outcome

The surge in support which the CDU/CSU enjoyed last spring due to Germany's deft handling of the first wave of the pandemic is over. Although the CDU/CSU has fallen back in opinion polls from 35% in January to an average of 27.3% in the last six polls, the party remains the favourite to win the election. It remains ahead of the Greens at 22.3%. Parties with less than 5% of the popular vote do not make it into the Bundestag. As the minnows may get around 6-7% together, an alternative coalition to oust the CDU/CSU from government would need c47% of the popular vote for a majority of seats in parliament. Based on the average of the last six opinion polls, a "traffic light" alliance between the Greens, the centre-left SPD (16.2%) and the liberal "yellow" FDP (9.3%) could make it with 47.7% support whereas a "Green-red-red" coalition of Greens, SPD and hard-left Left Party (7.6%) would fall narrowly short with 46.0% - see p.3 in the slidedeck attached.



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A lot can happen before Germany goes to the polls on 26 September. If the CDU/CSU-led federal government manages to speed up the vaccinations in line with the current outlook for vaccine deliveries so that most Germans can enjoy a summer holiday, the mood may still brighten. Our current probabilities for the election outcome:

- **70%** for a government **led by the CDU/CSU** with Laschet or Söder as chancellor. Such a government may be a coalition with the Greens (60%) or the SPD (10%).
- **30%** for a government **led by either the Greens or the SPD**. This could be either a coalition between Greens, SPD and hard-left Left Party (15%) or between Greens, SPD and liberal FDP (15%).

Within the 30% for a government without the CDU/CSU, we see a

- **25% probability** for a coalition **led by the Greens** with either Habeck or Baerbock as chancellor and a
- **5% probability** that such a coalition would be **led by the SPD**, with current finance minister Olaf Scholz (62) as chancellor.

If the CDU/CSU opts for Laschet and the Greens anoint Baerbock as their candidate, the probability that the Greens may lead the next government would probably go up from 25% to at least 30%, in our view, with a corresponding drop in the probability of a CDU/CSU chancellor from 70% to 65% or less. On way or the other, the Greens are likely to be part of the next government (90% probability)

Policy impact

Germany's political system works largely by consensus. Because the major opposition party (or parties) can usually wield a veto in the upper house of parliament, key decisions on fiscal policy and European affairs can rarely be taken on a partisan basis. As a result, a change at the top of the federal government from Merkel to Laschet or Söder or even a major change in government to a coalition without the CDU/CSU would have less of an impact on the overall fiscal stance and on Germany's position on key European issues than many outside observers seem to believe. As in the US, however, the federal government can impose serious regulations even without parliament - or without the upper house of parliament in which the CDU/CSU would most likely still have a veto even if it is no longer part of the federal government.

In a leftist alliance at the federal level, the left-wing base of the SPD and Greens would likely tilt regulatory policies to the left. Whereas tighter regulations of labour, service and housing markets would not have a major impact on the short-term business cycle, they could turn into a serious drag on German trend growth over time. This is the tail risk to watch. The policy differences between other potential coalitions could be quite relevant for individual sectors of the economy but

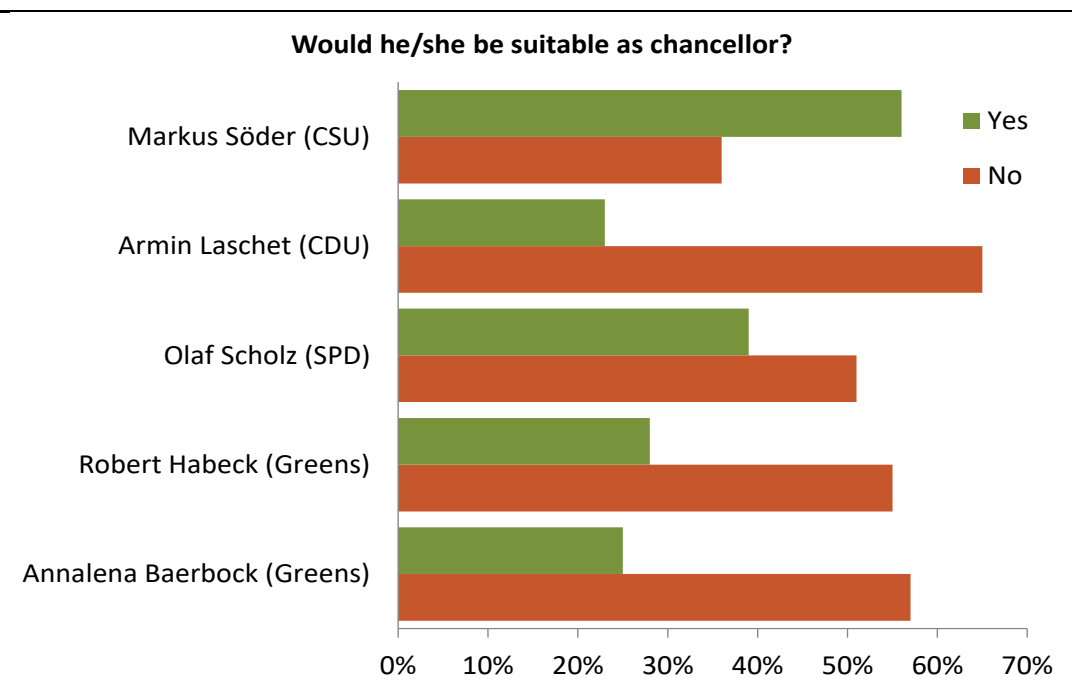


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less so for the overall macroeconomic outlook. In a Green-SPD-FDP coalition, for example, the liberals would likely see to it that the regulatory burden does not increase too much.

We will take a closer look at policy positions of the major parties in a separate note shortly. For more on opinion polls and some key Green policy positions, see the slidedeck attached. See also [German conservatives: falling from grace](#) (25 March 2021).

Chart 1: How popular are the candidates to succeed Merkel?



Source: ZDF Politbarometer opinion poll 26 March 2021



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