

German Election Monitor # 1

Next euro area election unlikely to rock the boat

- SPD candidate Martin Schulz is struggling to differentiate himself from Angela Merkel, while AfD has lost in the polls due to infighting.
- CDU-led grand coalition or centrist coalitions between CDU, FDP and Greens are still the most likely outcomes, given the proximity in policies and current polling.
- As coalition talks usually last for four-six weeks, a renewed push with France for closer EU integration is unlikely to begin before end-October.

Angela Merkel's CDU remains the favourite to win election

With the final vote less than a month away, an aggressive German election campaign continues to be absent. This is due partly to a close similarity in party programmes (page 3), with both the Conservatives (CDU/CSU) and Social Democrats (SPD) calling for a policy mix of more infrastructure spending and tax cuts, while deeper structural challenges that loom ahead, such as possible eurozone reforms or integration of refugees, are visibly absent from the headlines.

According to the polls, Merkel is still on track to secure her fourth term in office, as her conservative CDU party remains ahead with around 40% (see Chart 2). Following a brief poll surge (dubbed the 'Schulz effect') after the SPD selected him as leader in January, Martin Schulz's popularity has abated. The SPD also lost to the CDU in an important federal election in the traditional SPD stronghold of North Rhine-Westphalia (NRW) in May and Schulz has struggled to create renewed momentum for the party, which still polls 14 percentage points below the CDU.

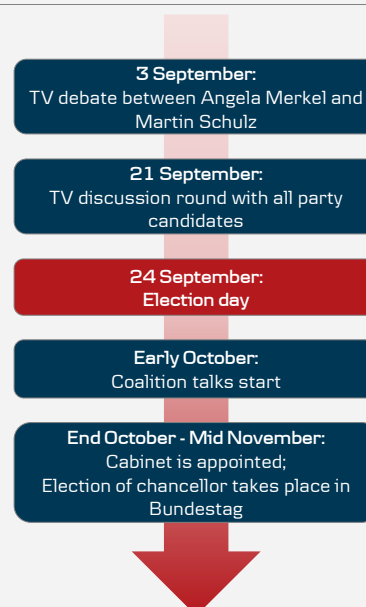
Schulz has tried to attack Merkel on a range of issues, including refugee policy, defence spending and Turkey. However, with her soft-spoken campaign style that avoids any provocations to rivals, Merkel has weathered these attacks without any dent to her popularity, as she benefits from her incumbent position and an image of stability and reliability, which resonates well with the risk-averse German public. **Merkel's campaign capitalises on the strong economic background:** GDP growth is on track for 2% in 2017, unemployment is at a record low of 5.6%, fuelling consumer confidence and private consumption and in H1 17, the government achieved a budget surplus of EUR18.3bn, while public debt remains low at 67% of GDP. External factors have also played in Merkel's favour, such as the election of Trump in the US and an abatement of the 2015-16 refugee crisis. Overall, 52% of respondents in a recent poll by *Infratest Dimap* would prefer Angela Merkel as chancellor (compared to 30% for Martin Schulz) and she outranks her rival in most categories such as leadership skills, trustworthiness and likeability (Charts 3 and 4).

However, it is too early to rule out a comeback from the SPD, should it finally succeed in differentiating itself from Merkel's platform. Schulz has indicated that he plans to focus on his campaign 'leitmotif' social justice in the weeks ahead, pledging already to spend EUR12bn to improve education if he becomes Chancellor. This could turn out to be a promising strategy for the SPD, given that social justice remains the second most important topic for voters after immigration (Chart 5).

Other Research on Germany

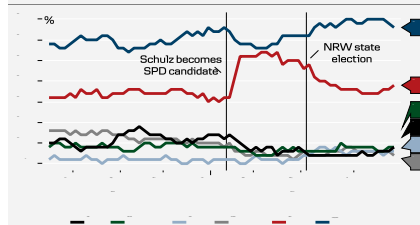
- *Research Germany - Status-quo after the 2017 parliamentary election?*, 6 April 2017

Chart 1: German election timeline



Source: Danske Bank

Chart 2: CDU still leading the field



Source: Macrobond Financial, Danske Bank

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The same applies to the populist AfD (Alternative for Germany) party, whose support has subsided amid internal party feuds in recent months and with the fading of the refugee crisis. However, with 46% of voters still undecided – the highest in 20 years – the election outcome remains too close to call (see Chart 6).

In terms of governing coalitions, a range of possibilities exists (see page 3). **In our view, another CDU-led grand coalition or centrist coalitions of CDU, FDP and Greens are still the most likely outcomes, given the proximity in policies and/or current polling.**

Chart 7: Coalitions tracker – “Grand” or “Jamaica” still the most likely (see more on p. 3)

	"Grand coalition"	"Jamaica" coalition	"Black-Yellow" coalition	"Black-Green" coalition	"Traffic light" coalition	"Red-Red-Green" coalition
Policy match	✓	÷	✓	÷	÷	÷
Polling	✓	✓	÷	÷	÷	÷
Overall	✓	✓	✓	÷	÷	÷

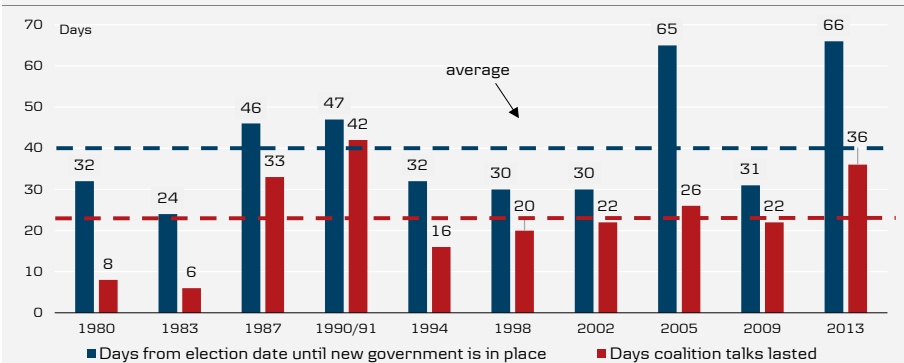
Policy match: How close the parties are in their policy proposals and ideology.
Polling: Whether the coalition would be able to form a government under current polling results.
Match: ✓; Some accordance ÷; No/Few accordance ÷

Source: Danske Bank

Nevertheless, in contrast to the French election, the risk of a populist government in Germany that includes the euro-sceptic AfD is very small, and the hurdles to a euro exit referendum would be considerable, as we also point out in *Research Germany - Status-quo after the 2017 parliamentary election?*, 6 April 2017. Hence, **as the election will most likely result in a broad status quo in terms of domestic policies, with a mixture of moderate tax cuts and slightly higher infrastructure spending, we expect the market impact in the run-up to the vote to very limited.**

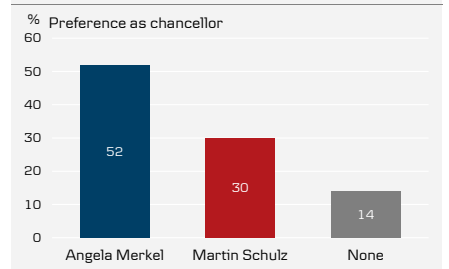
Markets will also focus on whether we will see a renewed push for closer EU integration as advocated by the French President Emmanuel Macron, following the September election. As most parties have either voiced support or not ruled out such a step, we think that discussions about a eurozone budget and finance minister will gather pace after the election. A grand coalition under a SPD finance minister (although unlikely currently) would strengthen the prospect of wide-ranging euro zone reforms under a re-energized Franco-German alliance, whereas a coalition with the free-market FDP, which strictly opposes any kind of debt mutualisation or transfer union, could dampen the probability of grand leaps forward in deeper EU integration. Nevertheless, **given that coalition talks in Germany usually last for four to six weeks on average (Chart 8), the process is unlikely to begin before end-October.**

Chart 8: It takes 40 days on average until a new government is in place



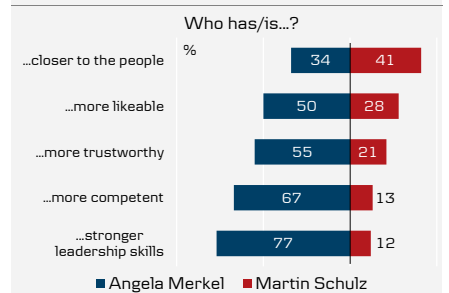
Source: Der Spiegel, Danske Bank

Chart 3: Most people prefer Angela Merkel as chancellor...



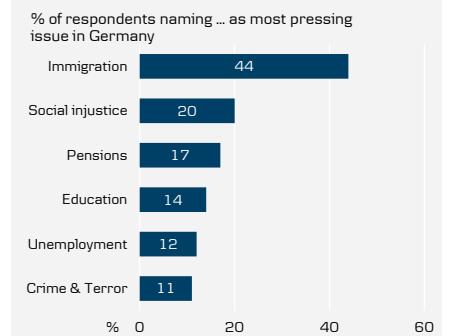
Source: Infratest Dimap, Danske Bank

Chart 4: ...as she capitalises on an image of trust and competency



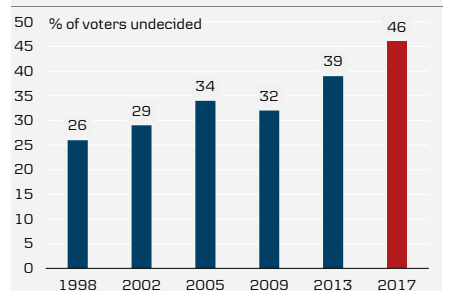
Source: Infratest Dimap, Danske Bank

Chart 5: Social justice and immigration are high on voters' concern list



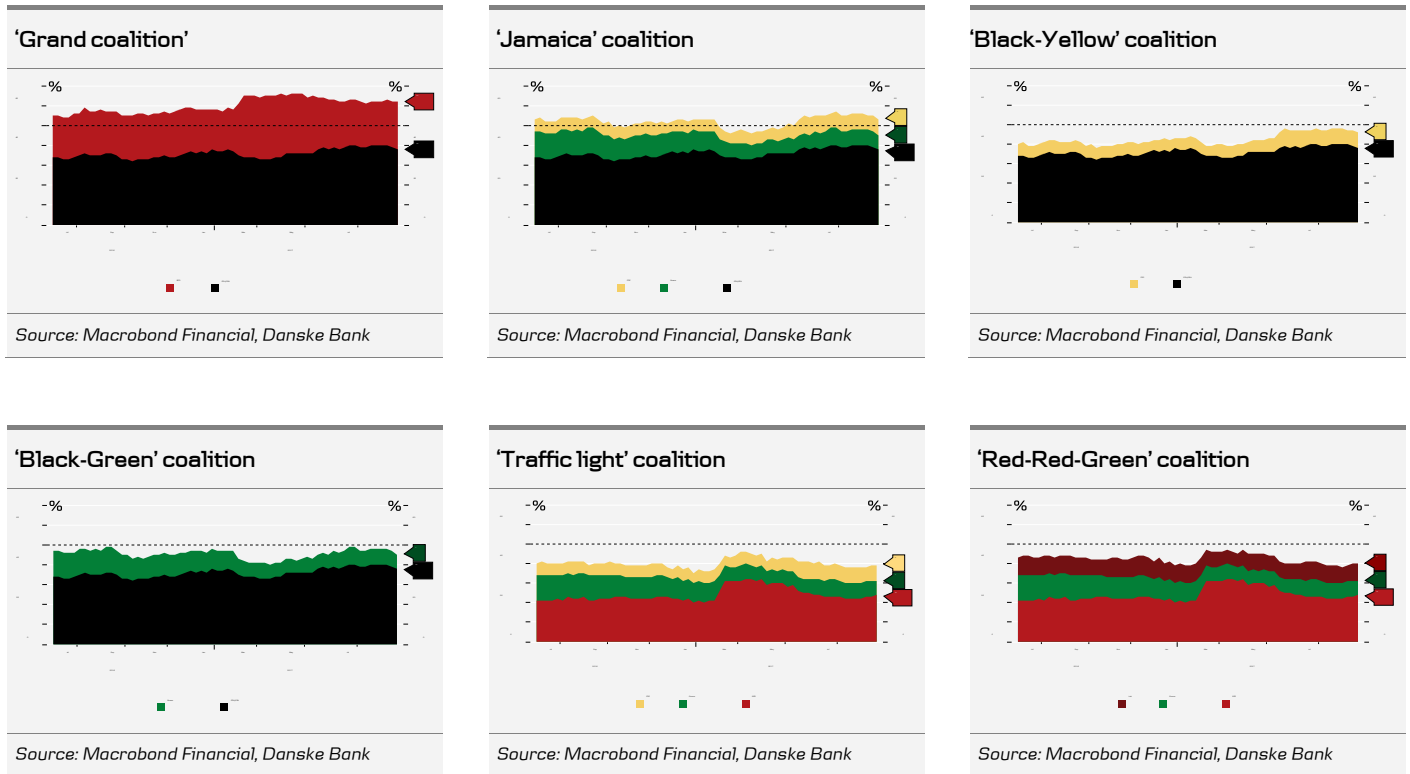
Source: Infratest Dimap, Danske Bank

Chart 6: High share of electorate remains undecided



Source: Allensbach Institute, Danske Bank

Overview of possible governing coalitions



Overview of party programmes

Few radical differences in mainstream parties' programmes

	CDU/CSU	SPD	FDP	Greens	The Left	AfD
Economic policy	<ul style="list-style-type: none"> Full employment (jobless rate <3%) by 2025 Pro free trade and globalisation Raise investment in education & infrastructure/broadband 	<ul style="list-style-type: none"> Focus on raising investments in education/infrastructure/broadband Invest 3.5% of GDP in R&D by 2025 Boost spending on child care, public housing 	<ul style="list-style-type: none"> Increase education spending Encourage entrepreneurship and venture-capital Invest in infrastructure and digitalisation Pro free trade 	<ul style="list-style-type: none"> Higher R&D and environmental spending Only green energy Debt brake for banks More infrastructure spending, sustainable investments 	<ul style="list-style-type: none"> Re-nationalize banking system to some degree; end investment banking Retirement at 65 Higher social benefits (min EUR1,050/month) Minimum wage of EUR12/h 	<ul style="list-style-type: none"> More direct democracy similar to Swiss model More protectionism (agriculture) Minimum wage Against FTAs and Paris climate agreement
Fiscal policy	<ul style="list-style-type: none"> Balanced budget No increase in public debt Income tax cuts of EUR15bn Boost government R&D funding 	<ul style="list-style-type: none"> Introduce additional type of unemployment benefits (ALG Q) EUR10bn tax cuts for small and medium incomes, raise taxes for the wealthy 	<ul style="list-style-type: none"> Cut bureaucracy and state subsidies Cut EUR 30bn in taxes and social contributions Reduce public debt 	<ul style="list-style-type: none"> Introduce tax on the "super-rich" 	<ul style="list-style-type: none"> Higher income taxes for the wealthy (75%) and corporate taxes More infrastructure spending (EUR120bn a year) Eliminate balanced budget 	<ul style="list-style-type: none"> Tax brake and reduce VAT to 12% from 19% Abolish wealth and inheritance tax. Balanced budget, reduce public debt
Europe	<ul style="list-style-type: none"> Ready to work with the new French government to develop the euro zone step by step, but no debt mutualisation Pro EU defence union 	<ul style="list-style-type: none"> Create euro zone budget, finance minister and parliament Transform ESM into European monetary fund Pro EU defence union 	<ul style="list-style-type: none"> 'Multi-speed' Europe; allow countries to leave euro Common EU foreign and defence policy End ECB's low-rate policy No debt mutualisation or transfer union 	<ul style="list-style-type: none"> Pro-EU stance Less austerity More power to EU parliament In favour of further EU enlargement 	<ul style="list-style-type: none"> More power to European parliament parliaments (ECB accountable to EP) Against EU defence union European investment plan, end to German "hegemony" over EU 	<ul style="list-style-type: none"> Referendum and exit from the Euro More competencies for national states
Foreign policy	<ul style="list-style-type: none"> Reject full EU membership for Turkey Boost defense spending to 2% of GDP by 2024 US important partner 	<ul style="list-style-type: none"> Closer cooperation with France US remains important partner More engagement on global security issues Don't raise defense spending to 2% of GDP 	<ul style="list-style-type: none"> Stronger role for EU in NATO US important partner Tough stance on Russia Reject full Turkey EU membership 	<ul style="list-style-type: none"> Against CETA, TTIP (new, fair FTAs instead) More common EU defence and foreign policy Reject spending 2% of GDP on defense 	<ul style="list-style-type: none"> Anti-military stance Pro-Russian stance Against FTAs and against closer ties to Turkey Abolition of NATO 	<ul style="list-style-type: none"> Reform UN No EU army More influence in NATO Reject full EU membership for Turkey Stronger ties with Russia

Source: Danske Bank

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