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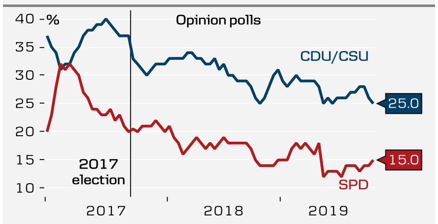
Research Germany

Four reasons why a fiscal boost is not around the corner

With the surprise win of Norbert Walter-Borjans and Saskia Esken, two staunch 'Groko' critics have taken over the leadership of the Social Democrats (SPD). Their outspoken critique of the government's balanced budget policy ('black zero') has rekindled hopes in the market about more expansionary fiscal policies. In this publication we outline four arguments why we think investors (still) should not get too excited about a big German fiscal policy boost in the near-term.

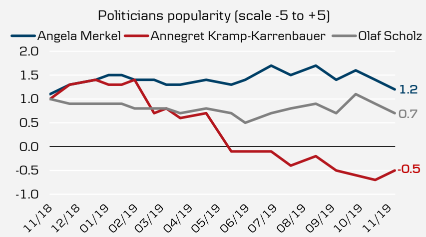
1. **'Groko' collapse not a foregone conclusion:** The new SPD leaders have been staunch critics of the current grand coalition ('Groko') during their campaign. Although we think the risk of a government crisis has risen, new elections in Q1 2020 are still not our base case (see scenarios on next page). Judging from current polling, neither the SPD nor the Conservatives (CDU/CSU) have an interest in an early election that would see their share of the vote diminished compared with 2017. The latest noises from the SPD also suggest such an awareness and the lead motion for this weekend's party convention will apparently not call outright for an end to the grand coalition. Instead, we expect the new SPD leaders to start exploratory talks with CDU/CSU in the coming weeks and months on key demands, such as revisions to the climate package (raise the CO2 price from EUR10 to EUR25/t), additional investments (in the volume of EUR450bn) and an increase in the minimum wage (from EUR9 to EUR12/hr). Minor concessions on these topics are a possibility to uphold the governing coalition for another year, but we doubt a grand scale fiscal policy 'rethink' will be part of it.
2. **The open chancellor question:** Internal divisions continue to haunt the SPD, both when it comes to policy priorities and personnel. The new party leaders are relatively unknown in political Berlin (and to voters for that matter) and it is doubtful whether one of them would receive the backing as a candidate for chancellor from all party wings. The most obvious (and popular) candidate, Finance Minister Olaf Scholz, has just suffered a major political defeat in the leadership battle, making his candidacy to lead the party into new elections highly unlikely. However, it is not only the SPD which is missing a strong chancellor candidate. The same problem can be seen in the CDU, where party leader Annegret Kramp-Karrenbauer (AKK) has so far failed to emerge from Angela Merkel's shadow and convince voters of her leadership qualities. In sum, we think neither the SPD nor CDU/CSU currently have a strong chancellor candidate to lead the parties into an election, again raising the risk that an early election call would backfire.
3. **Debt brake still limits spending:** Even if the CDU/CSU would be willing to compromise on the 'black zero', the constitutional debt brake would still limit fiscal space and hamper any ambitions of a large scale investment package. As we discussed in *Loosening the brake*, the room for extra fiscal spending is limited by the debt brake to some EUR5-6bn (0.2% of GDP) in 2020. While it is relatively easy to abandon the 'black zero' which is just an voluntary rule, the debt brake can only be abrogated in the event of natural catastrophes or 'exceptional emergencies' (neither of which currently applies).

Both SPD and CDU/CSU would lose seats in a new election



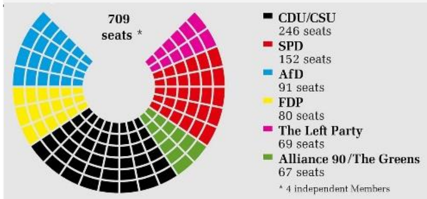
Source: Macrobond Financial, Danske Bank

AKK lacks public backing, while Scholz is probably out of the chancellor race



Source: Forschungsgruppe Wahlen: Politbarometer

Two-thirds majority in Bundestag not possible without CDU/CSU on board



Source: Bundestag

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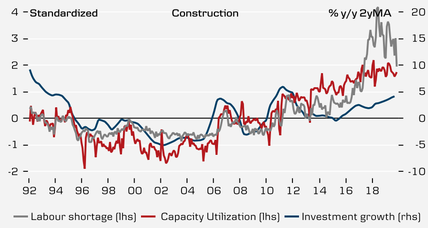
A constitutional change to tweak the debt brake would require a two-thirds majority in parliament (both Bundestag and Bundesrat). Without the CDU/CSU on board that would not be achievable and we doubt there is the political appetite for this at the moment.

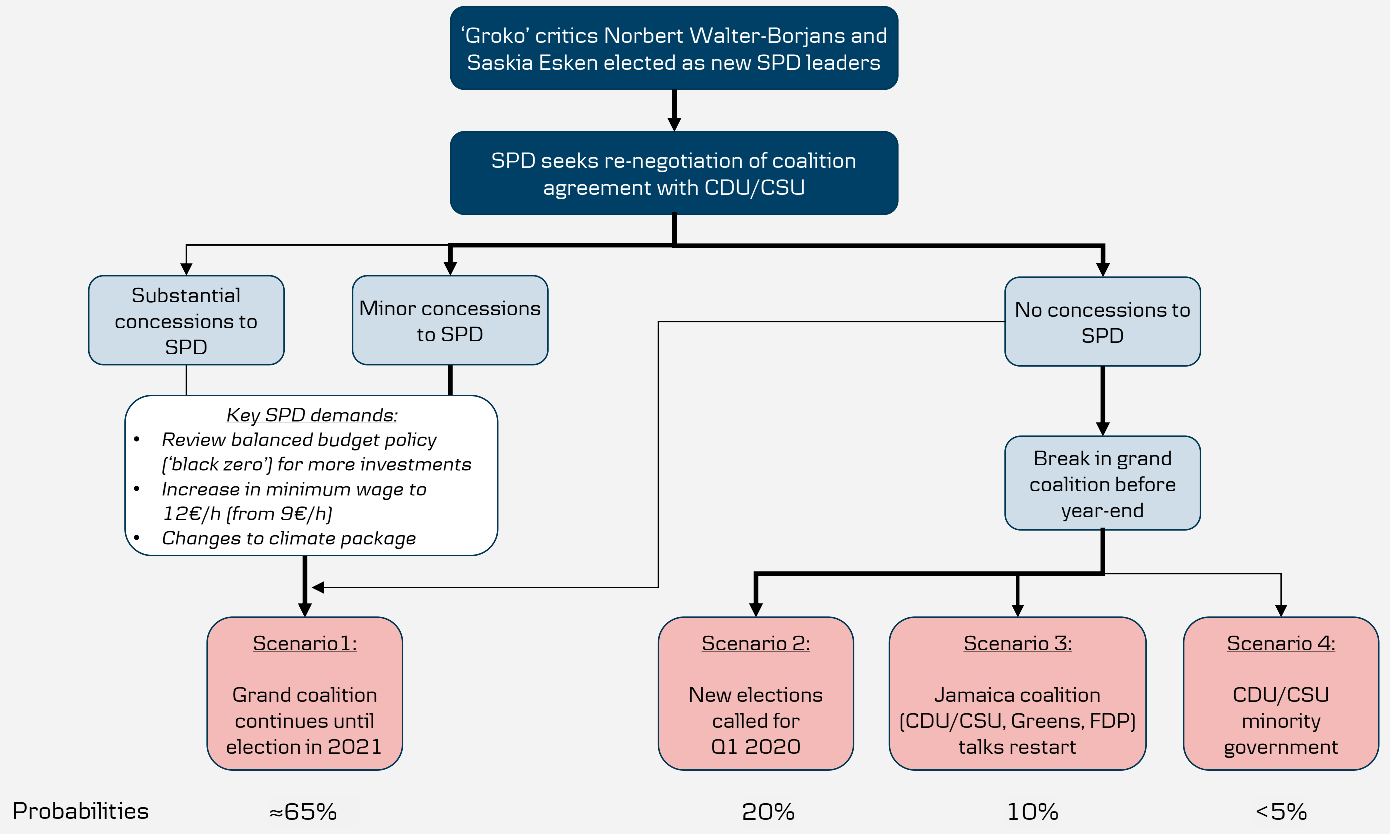
4. **Financing is just one part of the puzzle:** Even if the SPD and CDU/CSU can somehow agree on the financing of a large scale investment package, implementation is far from certain. Apart from the drawn out legislative process to change the debt brake, a more tangible problem stems from capacity constraints in the construction sector to implement such a programme. Labour shortages and planning approval bottlenecks add to the list of impediments, especially at the local government level where most construction investment is realized. In sum, agreeing on the financing is one part of the puzzle. Implementing infrastructure investments on the ground is quite another.

Capacity constraints in construction sector hampers investments



Source: Ifo, Destatis, EU Commission, Macrobond Financial, Danske Bank

German politics is entering some turbulent weeks



Source: Danske Bank

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This research report has been prepared by Danske Bank A/S ('Danske Bank'). The author of this research report is Aila Mihr (Senior Analyst).

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