

GERMANY: POLITICS AND FISCAL POLICY

WHY SUNDAY'S STATE ELECTIONS MATTER

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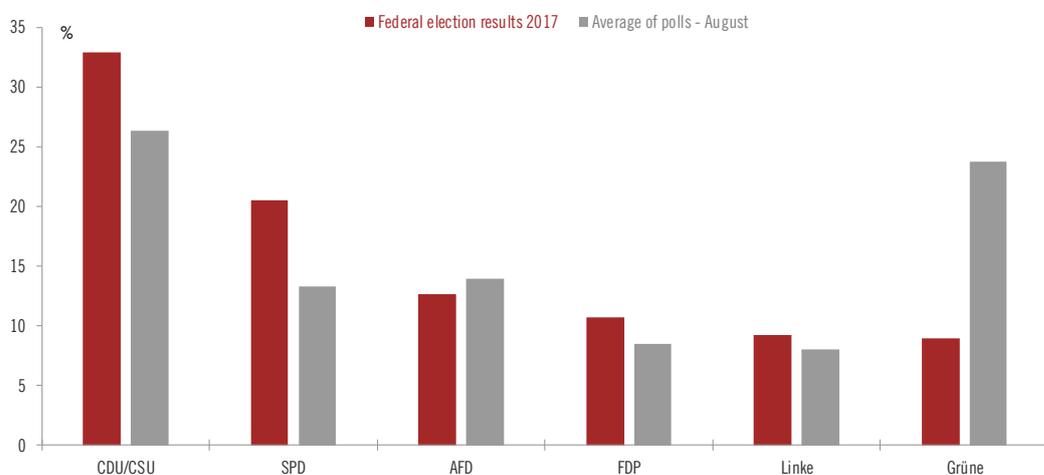
SUMMARY

- › The results of Sunday's state elections in Saxony and Brandenburg will be scrutinised closely. A heavy CDU or SPD defeat would send shock waves through Berlin.
- › Germany's slowdown has raised expectations for further fiscal stimulus. The fragile situation of the two mainstream parties makes decision-making more complicated.
- › Nevertheless, at least the debate among officials has started and a gradual approach might emerge in autumn. Notably, there seems to be growing support to agree on measures to tackle climate change. The 2020 budget debate in September may also offer further clues as to whether pressure is really growing or not.
- › Beyond the political situation, there is also the official assessment of the health of the economy. The fact that the industrial slump has started to leave some marks on domestic demand should at least start to ring some alarm bells in the government.
- › An external shock such as a no-deal Brexit or US tariffs on EU cars could also prompt a policy response. A political crisis leading to snap elections and a change of government could also be a catalyst for further fiscal stimulus.

A changing political landscape

Since the 2017 Federal elections, Germany's political landscape has changed. Voter intentions in support of the two mainstream parties - the CDU/CSU and SPD - declined, while support for the Green party rose (see *Chart 1*). **Federal elections are scheduled for autumn 2021, but early elections remain a possibility** (see *Appendix 1* for further details). If elections were held today, the current grand coalition, composed of the CDU/CSU and the SPD would no longer have the majority and the participation of the Greens in a new government seems an increasing possibility.

CHART 1: GERMANY - OPINION POLLS NEXT FEDERAL ELECTION VERSUS 2017 RESULTS



Source: PWM - AA&MR, various polls

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Against this backdrop, on Sunday 1 September, **important state elections are taking place in Saxony and Brandenburg**, followed by Thuringia on 27 October. Meanwhile, the SPD will elect a new leader where the final vote will be held at the party conference on 6-8 December. At this stage, finance minister Olaf Scholz is the most prominent candidate. **The party will also carry out a mid-term review of its participation in the grand coalition with Merkel's CDU/CSU.**

Regional election results will be closely scrutinised. **A heavy CDU and SPD defeat would send shock waves through Berlin.** Notably, the authority of Chancellor Merkel would be challenged if the AfD were to come in ahead of the CDU in Saxony. A defeat of the SPD in Brandenburg (the party is currently governing the state) would provide further tailwinds to numerous critics within the party regarding the grand coalition. The Greens' performance will also be important to look at.

CHART 2: SAXONY 2019 STATE ELECTION POLLS

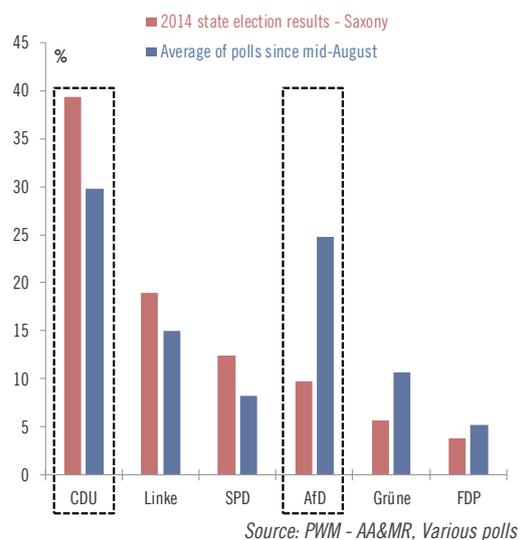


CHART 3 : BRANDENBURG 2019 STATE ELECTION POLLS

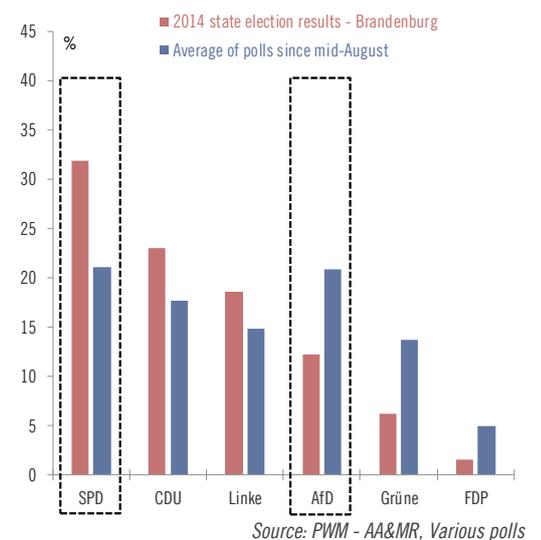


TABLE: MAJOR POLITICAL SIGNPOSTS

2019	
01 Sep	Brandenburg state election
01 Sep	Saxony state election
20 Sep	Coalition to agree on a policy package for climate change
Sep/Oct	2020 draft budget debate
26 Oct	SPD to declare the result of the membership ballot on its new leader(s) - first round*
27 Oct	Thuringia state election
Oct/Nov	SPD to evaluate the midterm review
Dec 6-8	SPD convention (discussion of the party delegates on continuation of the coalition)

*If no single-person-candidate receives an absolute majority of the votes cast, the two candidates with the highest number of votes cast will qualify for the second round of the vote. The party's executive board will propose the winner between 6-8 December at party convention.

Source: PWM - AA&MR

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Politics, fiscal stimulus and the economy

Germany's slowdown (see our Flash Note [here](#)) has raised expectations for further fiscal stimulus. The fragile situation of the two mainstream parties renders decision-making more complicated. According to public comments by Chancellor Merkel (see [here](#)) and Finance Minister Scholz, there are no indications (yet) that Berlin is ready to quickly abandon the *Schwarze Null* ("Black Zero"), or even ignore the constitutional debt brake (see *Appendix 2* for further details regarding fiscal rules) and start to spend.

Nevertheless, **at least the debate among officials has started and a gradual approach might emerge in autumn**. There seems to be growing support to agree on measures to tackle climate change. In this regard, on September 20, Merkel's cabinet will decide on a comprehensive package to enhance climate protection. **The 2020 budget debate in September may also offer further clues as to whether pressure is really growing or not.**

Beyond the political situation, **there is also the official assessment of the health of the economy**. Fiscal discipline is a virtue in Germany and the situation in the country has not deteriorated to a point where further fiscal stimulus is required. To some extent the fact that the industrial slump has started to leave some marks on domestic demand should at least start to ring some alarm bells in the government. Employment will be the key variable to watch. **An external shock such as a no-deal Brexit or US tariffs on EU cars could prompt a policy response**. A political crisis leading to snap elections and a change of government could also be a catalyst for further fiscal stimulus.

Of note, even within the constraints of fiscal rules (at the German and at the European level (see *Appendix 2*)), there is some space, more than 1% of GDP if the government adheres to all fiscal rules. Therefore, the government has enough spending leeway to (at least) stabilise the economy. Of course, if need be, both European and German fiscal rules allow for an overshoot in exceptional circumstances (such as a major shock outside the government's control).

A look at the last fiscal package

The best precedent for a German fiscal stimulus package was the package implemented in response to the global financial crisis in 2008/09. **German authorities launched an extensive stimulus package amounting to EUR 50bn (or 1.6% of GDP) in February 2009**. The German package included investment in infrastructure (EUR18bn of new investment in the construction and repair of roads, rail network and of schools and universities). Some of the money was also used for faster internet communication networks, tax relief, reductions in health care contributions and money for families with children (one-off bonus of EUR 100 per child and child benefit payments increased for the long-term unemployed). A boost to the car industry in the form of an "old banger bounty" offered people the chance to trade in cars more than nine years old in exchange for a EUR 2,500 credit towards a new car.

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Appendix 1: Snap elections

The coalition's fragility raises the prospect of early elections in Germany. The SPD could exit the governing coalition. Alternatively, following a heavy defeat in regional elections Merkel could decide to step down. In the past, **German chancellors have stepped down before the scheduled end of parliament in one of three ways**: by resignation, having lost a vote of confidence, or by dissolution of the Bundestag—but a lost vote of confidence or resignation have not necessarily led to snap elections. The [German Constitution](#) (article 67) stipulates that the chancellor may be removed from office by majority vote in the Bundestag only if a prospective successor also has the support of a majority. Since 1949, only two 'constructive votes' of no confidence (where an alternative to the chancellor in place is proposed) have been attempted, and only one has been successful (in 1982, Helmut Schmidt was successfully voted out of office in favour of Helmut Kohl).

The chancellor can also dissolve the Bundestag, leading to snap elections. **Elections must be held within 60 days of parliament's dissolution.**

Appendix 2: Fiscal rules

Germany has various fiscal rules:

Starting with European fiscal rules, according to the Stability and Growth Pact, Germany's obligation is for the structural deficit to be no greater than 0.5% of GDP (medium-term objective (MTO)). According to the European Commission estimate, the structural surplus is projected at around 1.0% of GDP in 2019 (and 0.8 % in 2020). So, available fiscal space would be above but close to 1.0% of GDP.

The unofficial policy target of die *Schwarze Null* ("Black Zero"), introduced in 2014 by then Finance Minister Schäuble, calls for a balanced nominal budget. With an estimated government surplus of around 1.0% of GDP in 2019 (and 0.8% in 2020), this would allow for 1.0% more spending.

Similarly, the German constitutional debt brake calls for a maximum structural budget deficit of 0.35% of GDP, but only applies to the Federal government, so there is room for flexibility.

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