14 January 2021
Investment Solutions & Products
Europe

CREDIT SUISSE

Credit Suisse Economics

European Economics Notes: German politics in 2021

CONTRIBUTORS

Neville Hill
44 20 7888 1334
neville.hill@credit-suisse.com

Sonali Punhani
44 20 7883 4297
sonali.punhani@credit-suisse.com

Anais Boussie
44 20 7883 9639
anais.boussie@credit-suisse.com

Rick Kieffer
44 20 7883 0688
rick.kieffer@credit-suisse.com

The German federal election is one of the political highlights in 2021: After four consecutive Merkel-led governments since 2005, the 2021 federal elections will potentially bring meaningful change into the political leadership and policy-focus of the country.

The next government will likely involve the Greens: The strength of the Greens and continued weakness of the SPD in the polls, combined with the aversion among CSU/CSU and SPD to a third grand coalition government, make a coalition involving the Greens a highly probable scenario. This would mean that the coming elections and change of government will likely go hand in hand with an intensification of Germany's focus on greening its economy.

We are not expecting major changes to the long-term fiscal approach: The current crisis will have likely shown policy makers how important active fiscal policy is and investors might assume that this would soften the attitudes toward Germany's previous *schwarze Null* no-deficit fiscal stance. However, the government has been consistent in its message that the magnitude of the fiscal response in the current crisis was only possible because of the fiscal prudence in the preceding years.

In any case, the legal constraints on Germany's fiscal policy in the years ahead are pretty inflexible. The future government's room for maneuver will be heavily restricted by the constitutional debt brake, which limits the structural deficit to 0.35% of GDP (see the appendix here).

Unless the next government changes the constitution, which we do not think is likely, there simply is not that much flexibility to change course, even if the new administration wanted to do so. In fact, the debt brake will force the coming coalition to run down the debt accrued during the crisis. When it triggered the emergency clause, the current government had to submit a binding plan laying out how the new debt will be reduced in the future. The latest budget projections assume that the deficits are back below the structural deficit threshold by 2023.

Potentially meaningful implications for EU policy: We think that a more green-focused German government would likely increase the support for a broader European push on climate and green issues. For example, the Greens are calling for more ambitious climate targets as well as increased European investment and spending in those areas.

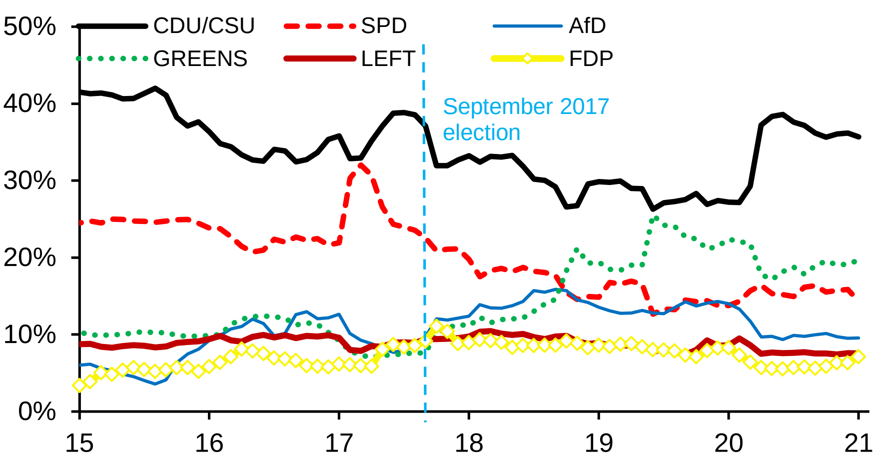
Rick Kieffer
44 20 7883 0688
rick.kieffer@credit-suisse.com

The political landscape has shifted since the 2017 elections

The latest polls show that the Greens continue to benefit from the population's increasing focus on green and climate issues (Figure 1) and now stand at 20% of the votes in the polls compared to 9% in the 2017 elections. The CDU still has a leadership election to hold, which could lead to different outcomes, but is benefiting from a high approval of the government's handling of the current crisis. Unlike the CDU/CSU, the SPD has not been able to benefit from a crisis bonus, despite being the only other coalition partner in government and is now polling below the Greens at around 15%.

Figure 1: The political landscape has shifted since the 2017 elections

Average of various polls



Source: Credit Suisse, various polls

The far-right, anti-establishment AfD has struggled to be heard in the current circumstances, and is polling at around 10% after having been stable at around 15% over the last two years. Additionally, the AfD is facing increasing tension within the party as a split between the more moderate forces and the very far-right wing keeps intensifying.

The FDP, who is currently polling at around 6%, was a crucial player after the 2017 election when a potential Jamaica coalition (CDU/CSU + Greens + FDP) initially appeared to be the most likely outcome. However, given that reports indicate that there seems to be a willingness between CDU/CSU and Greens to form a coalition, the FDP's role will likely be less relevant in the coming elections.

The strength of the Greens, as well as the continued weakness of the SPD in the polls, combined with the aversion among CDU/CSU and SPD to a third grand coalition government, make a coalition involving the Greens a highly likely scenario, in our view. This means that the coming elections and change of government will likely go hand in hand with an important intensification of Germany's focus on greening the economy.

According to the latest polls, a CDU/CSU + Greens coalition would reach around 55% of the votes. Given the SPD's weakness in the recent years, even a Greens + SPD + FDP coalition or a left-leaning Greens + SPD + Left alliance would only reach around 40% of votes. Furthermore, taking into account the FDP's and the Left's current polling at 6% and 8% respectively, it is not necessarily a given that the parties will pass the 5% threshold needed to be allocated seats in parliament.

While the Greens will obviously have to find compromises in a potential coalition with the traditionally more pro-industry CDU/CSU, the CDU/CSU is also trying to reposition themselves somewhat in light of the latest voter preferences. As such, while the actual policy changes might be less radical than proposed by the Greens, we think that either way there will likely be a shift toward greener policy.

Nevertheless, the degree of commitment toward climate issues and other green topics also depends on 1) who will lead the CDU and 2) who the CDU/CSU alliance choses as their chancellor candidate going into this election.

The CDU leadership election will take place the coming weekend on the 16 and 17 January during an online party convention. There are three candidates:

- Friedrich Merz, who narrowly lost out to Annegret Kramp-Karrenbauer in the previous leadership election in 2018, and stands on the more conservative and pro-business side of the political spectrum. Under Merz the CDU would likely strengthen its focus on fiscal prudency and would be more skeptical of further EU integration based on grants.
- Armin Laschet, the current Minister-president of the state of North Rhine-Westphalia the most populous state in Germany. He is generally seen as a close ally to chancellor Merkel and his leadership would likely be more or less of a continuation in the broad directions for the CDU. This would probably also mean a continuation of the status quo in terms of fiscal attitudes and an overall pro-EU stance.
- Norbert Röttgen, who currently chairs the Foreign Affairs Committee in the German parliament and was Federal Minister for Environment, Nature Conservation and Nuclear Safety in the government of Chancellor Angela Merkel from 2009 until he was dismissed in May 2012. Röttgen is the outside candidate and there is a higher degree of uncertainty around his larger policy views beyond foreign policy. He is generally viewed as being in favour of further European cooperation and integration.

Recent polls among CDU voters still put Merz in the lead at 29% but Laschet and Röttgen are close at 25% each and Laschet has been catching up at a significant pace recently. A caveat with the polling data however is that the next leader will actually be decided by the party delegates rather than the general public. As such, these polls do not necessarily reflect the delegates' voting preference.

The vote will take place on Saturday 16 January and the preliminary outcome will be announced the same day. A legally binding mail-in vote to confirm the online result will be announced on 22 January.

The results will likely be tight. Hence, whichever candidate will end up winning, will have to make compromises across the party's various factions and will have to adopt his strategy for the wider non-CDU/CSU public in view of a potential chancellor candidacy.

Some in the party leadership have not completely excluded the option of having a chancellor candidate that is not at the same time party leader. This could theoretically also open the path for Health Minister Jens Spahn, who was a contestant in the 2018 leadership election. However, while he is currently enjoying high approval ratings in the polls, he has said that he will not put forward his candidacy and that he supports Laschet's leadership bid.

Either way, we do not think that the CDU wants to split the party leadership and chancellorship, especially after the negative experience from doing so under Kramp-Karrenbauer.

Finally, it is also not a given that the CDU leader will be the CDU/CSU alliance's chancellor candidate. An alternative candidate could be CSU leader Markus Söder, who currently serves as Minister President of Bavaria. Although he has previously said that he is not interested in running for the chancellorship, he has enjoyed strong support in polls.

Söder previously was one of the driving forces behind the CSU's shift to the right of the political spectrum in order to recapture votes from the AfD in Bavaria. However, over the last year, he has moderated his stance and has shown himself fairly pragmatic on a variety of issues.

An early test for the various parties' candidates will come in various local elections this year before the federal elections:

- Baden-Württemberg and Rhineland-Palatinate, 14 March
- Thuringia, 25 April (date to be confirmed)
- Saxony-Anhalt, 6 June
- Mecklenburg-Vorpommern as well as Berlin are scheduled to vote on the local parliament alongside the federal elections on 26 September.

Mixed fiscal implications of a CDU/CSU + Greens coalition

Overall, a potential CDU/CSU + Greens coalition will likely put greater emphasis on public investments in the various green sectors and focus on creating the necessary infrastructure, either directly or through subsidies and tax incentives.

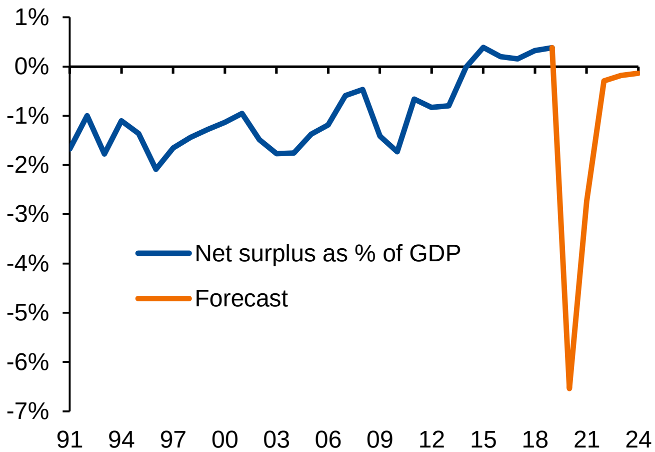
Nevertheless, we do not expect a major shift in Germany's long-term fiscal policy approach. The current crisis will have likely shown policy makers how important active fiscal policy is and investors could assume that this would soften the attitudes toward Germany's previous *schwarze Null* no-deficit fiscal stance. However, the government has been consistent in its message that the magnitude of the fiscal response in the current crisis was only possible because of the fiscal prudence in the preceding years.

As such, we are not convinced that there necessarily is appetite for further deficits among the more political as well as fiscally conservative CDU/CSU after the recent substantial run up of debt (Figure 2). Furthermore, the restrictions of the constitutional debt brake, which limits the structural deficit to 0.35% of GDP (more information on the debt brake in the appendix here), also prevent a major change.

In fact, the future government will be obligated by law to reduce the debt accumulated during the current crisis (Figure 3). When it triggered the emergency clause, the current government had to submit a binding plan laying out how the new debt will be reduced in the future. The latest budget projections assume that the deficits are back below the structural deficit threshold by 2023.

Figure 2: The deficit has soared

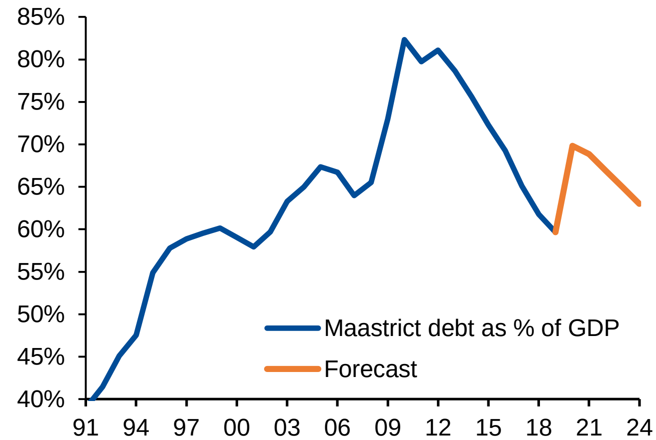
Federal net surplus, % of GDP



Source: Credit Suisse, Bundesbank

Figure 3: Federal debt levels have risen significantly

Federal debt, % of GDP



Source: Credit Suisse, Bundesbank

Alternatively, the government could propose amending the constitution, which would require a two-thirds majority and as such would most likely need the cooperation of other political parties. However, we do not think that there is much willingness to do so across the political spectrum.

We are therefore not expecting major changes on the fiscal front, and expect the debt brake to remain a) in place and b) respected. Nevertheless, we think that the composition of Germany's fiscal expenditures will likely shift toward having a greater focus on climate-related issues and the greening of the economy.

Implications for EU policy and for European integration

The Greens' programme calls for more ambitious climate targets at the European level as well as increased EU investment and spending on climate-related issues. Among other things, the party wants to focus on modernising and greening the European economy through a dedicated instrument in the EU budget.

Compared to other European stakeholders that see a potential two-speed Europe as a way forward, the Greens are against a divide between a core and a periphery. As such, it remains to be seen how enthusiastic a German government involving the party would be to support these kind of efforts.

While polls indicate that a CDU/CSU + Greens coalition currently looks like the most likely outcome, the appetite for further integration will also to a significant degree depend on who will be leading the CDU going the elections as well as on the eventual CDU/CSU chancellor candidate. A pro-integration coalition could potentially raise support for mechanisms like the Recovery Fund and toward greater EU tax autonomy.

Additional Important Information

This material has been prepared by the Investment Strategy Department personnel of Credit Suisse identified in this material as "Contributors" and not by Credit Suisse's Research Department. The information contained in this document has been provided as general market commentary only and does not constitute any form of personal advice, legal, tax or other regulated financial advice or service. It is intended only to provide observations and views of the Investment Strategy Department, which may be different from, or inconsistent with, the observations and views of Credit Suisse Research Department analysts, other Credit Suisse departments, or the proprietary positions of Credit Suisse. Observations and views expressed herein may be changed by the Investment Strategy Department at any time without notice. Credit Suisse accepts no liability for losses arising from the use or reliance on of this material. This material is not for distribution to retail clients and is directed exclusively at Credit Suisse's institutional clients.

FOR IMPORTANT DISCLOSURES on companies covered in Credit Suisse Global Markets Division research reports, please see http://www.credit-suisse.com/researchdisclosures. To obtain a copy of the most recent Credit Suisse research on any company mentioned please contact your sales representative or go to http://www.credit-suisse.com/researchandanalytics.

This material does not purport to contain all of the information that an interested party may desire and, in fact, provides only a limited view of a particular market. It is not investment research, or a research recommendation for regulatory purposes, as it does not constitute substantive research or analysis. This material is provided for informational purposes only and does not constitute an invitation or offer to subscribe for or purchase any of the products or services mentioned.

The information provided is not intended to provide a sufficient basis on which to make an investment decision and is not a personal recommendation or investment advice. While it has been obtained from or based upon sources believed by the trader or sales personnel to be reliable, each of the trader or sales personnel and Credit Suisse does not represent or warrant its accuracy or completeness and is not responsible for losses or damages arising from the use or reliance on of this material.

Where distribution of this material is subject to the rules of the U.S. Commodity Futures Trading Commission ("CFTC"), it is a "solicitation" of derivatives business only as that term is used within CFTC Rule 1.71 and 23.605 promulgated under the U.S. Commodity Exchange Act (the "CFTC Rules") where applicable, but is not a binding offer to buy/sell any financial instrument. The views of the author may differ from others at Credit Suisse Group (including Credit Suisse Research).

Credit Suisse is acting solely as an arm's length contractual counterparty and not as a financial adviser (or in any other advisory capacity including tax, legal, accounting or otherwise) or in a fiduciary capacity. Any information provided does not constitute advice or a recommendation to enter into or conclude any transaction. Before entering into any transaction, you should ensure that you fully understand the potential risks and rewards and independently determine that it is appropriate for you given your objectives, experience, financial and operational resources, and other relevant circumstances. You should consult with such advisers (including, without limitation, tax advisers, legal advisers and accountants) as you deem necessary.

Credit Suisse Securities (Europe) Limited ("CSSEL") and Credit Suisse International ("CSI") are authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority ("FCA") and the Prudential Regulation Authority under UK laws, which differ from Australian Laws. CSSEL and CSI do not hold an Australian Financial Services Licence ("AFSL") and are exempt from the requirement to hold an AFSL under the Corporations Act (Cth) 2001 ("Corporations Act") in respect of the financial services provided to Australian wholesale clients (within the meaning of section 761G of the Corporations Act) (hereinafter referred to as "Financial Services"). This material is not for distribution to retail clients and is directed exclusively at Credit Suisse's professional clients and eligible counterparties as defined by the FCA, and wholesale clients as defined under section 761G of the Corporations Act. Credit Suisse (Hong Kong) Limited ("CSHK") is licensed and regulated by the Securities and Futures Commission of Hong Kong under the laws of Hong Kong, which differ from Australian laws. CSHKL does not hold an AFSL and is exempt from the requirement to hold an AFSL under the Corporations Act in respect of providing Financial Services. Credit Suisse Equities (Australia) Limited (ABN 35 068 232 708) ("CSEAL") is an AFSL holder in Australia (AFSL 237237). In Australia, this material may only be distributed to Wholesale investors as defined in the Corporations Act. CSEAL is not an authorised deposit taking institution and products described herein do not represent deposits or other liabilities of Credit Suisse AG, Sydney Branch. Credit Suisse AG, Sydney Branch does not guarantee any particular rate of return on, or the performance of any products described.

If this material is issued and distributed in the U.S., it is by Credit Suisse Securities (USA) LLC ("CSSU"), a member of NYSE, FINRA, SIPC and the NFA, and CSSU accepts responsibility for its contents. Clients should contact sales coverage and execute transactions through a Credit Suisse subsidiary or affiliate in their home jurisdiction unless governing law permits otherwise. Investment banking services in the United States are provided by Credit Suisse Securities (USA) LLC, an affiliate of Credit Suisse Group. CSSU is regulated by the United States Securities and Exchange Commission under United States laws, which differ from Australian laws. CSSU does not hold an AFSL and is exempt from the requirement to hold an AFSL under the Corporations Act in respect of providing Financial Services. Credit Suisse Asset Management LLC (CSAM) is authorised by the Securities and Exchange Commission under US laws, which differ from Australian laws. CSAM does not hold an AFSL and is exempt from the requirement to hold an AFSL under the Corporations Act in respect of providing Financial Services.