



## The collapse of German coalition talks

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Last night, Germany's Liberals (FDP) surprisingly pulled the plug on talks to form a new government. In recent weeks, key stumbling blocks included Germany's energy and immigration policies (notably whether to reinstate the right of recognized refugees for their family members to join them in Germany). These areas brought the policy differences between Chancellor Angela Merkel's centrist Christian Democratic Union (CDU), its more right-wing Bavarian sister party, the Christian Social Union (CSU), the market-friendly Liberals, and the environmentalist Green Party into sharp focus. But even in other areas, notably fiscal and broader environmentalist policy, coming to a coalition agreement was always expected to be difficult.

So far, the market impact has been limited, and rightly so, we would argue. The euro weakened slightly against the dollar, benefitting German exporters. Partly as a result, the German equity market was broadly flat overall. At the sector level, German carmakers and utility stocks rose on relief that the Greens are now less likely join the government and push for more strident measures on climate change.

These modest movements are in line with our view that not all that much changed overnight. After all, Germany's post-war constitution was explicitly drafted to ensure the country remains governable no matter what. In particular, it provides powerful incentives for parliamentary parties to try to find a consensus, while creating formidable obstacles to snap elections to the Bundestag, the lower house of the German parliament. Through the strong role of the Bundesrat, the upper house of the German government, it also frequently forces the government to look for support beyond its coalition ranks.

As acting Chancellor, Angela Merkel will remain in power, for now. In coming days, she will probably try to convince the center-left Social Democratic Party (SPD), still its partner in the current, acting government, to start talks on a new coalition agreement. Leading Social Democrats figures have repeatedly and energetically ruled this out. However, the Social Democrats may come under enormous pressure in coming days to change their mind. Depending on the public reaction, the Liberals might also decide to come back to the negotiation table.

Failing that, Article 63 of the German constitution leaves two potential outcomes. The arguably more likely one is a minority government. Under this scenario, Christian Democrats and Christian Socials would nominate a candidate for Chancellor, probably Ms. Merkel. If Ms. Merkel cannot secure majority backing in the Bundestag, the Bundestag has 14 days to vote for another candidate. After that, Ms. Merkel could be elected by a simple

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plurality. In that case, it is up to Germany's President to either accept the formation of the new – minority – government or to dissolve parliament.

We think it is unlikely that in such a scenario, President Frank-Walter Steinmeier would actually dissolve parliament, which would trigger new elections to the Bundestag within 60 days. And, once elected, a new minority administration might actually prove rather more stable than a multi-party coalition. The reason is that under Germany's constitution, the opposition can only oust a Chancellor with a "constructive vote of no confidence". This means Germany's fragmented opposition would need to align on an alternative candidate first.

In Germany, forming such a minority administration following an indecisive election would be unprecedented. In the short term, it might also raise some eyebrows among its European allies in Brussels and potentially cause some market ripples. In principle, however, we think it could well prove sustainable and result in a continuation of the status quo. Big, and necessary, reforms, notably to Germany's pension and educational systems, would be unlikely in coming years. But with Germany's economy firing out of all cylinders, it might take a while for markets to fret about that.

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## Glossary

### Alliance 90/The Greens

The **Alliance 90/The Greens**, also referred to as the "**Greens**", is an environmentalist political party in Germany that is considered center-left in the German political landscape.

### Christian Democratic Union of Germany (CDU)

The **Christian Democratic Union of Germany (CDU)** is a Christian democratic and liberal-conservative political party in Germany that is considered center/center-right in the German political landscape. The CDU is the sister party of the Christian Social Union in Bavaria (CSU), which operates only in the state of Bavaria.

### Christian Social Union in Bavaria (CSU)

The **Christian Social Union in Bavaria (CSU)** is a Christian democratic and conservative political party in Germany that only operates in Bavaria and that is considered center-right in the German political landscape. The CSU is the sister party of the Christian Democratic Union of Germany (CDU), which operates in the rest of Germany.

### Free Democratic Party (FDP)

The **Free Democratic Party (FDP)**, also referred to as the "**Liberals**", is a market-friendly and social-liberal political party in Germany that advocates human rights, civil and economic liberalism and that is considered centre-right in the German political landscape.

### German Bundestag

The **German Bundestag** is the national parliament of the Federal Republic of Germany. It is the lower house of the two legislative chambers, the German Bundesrat being the upper house.

### Social Democratic Party of Germany (SPD)

The **Social Democratic Party of Germany (SPD)**, also referred to as the "**Social Democrats**", is a social-democratic political party in Germany that is considered center-left in the German political landscape.

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