

UNCERTAINTY IN GERMANY – WHAT ARE THE OPTIONS?

Last Sunday the coalition negotiation in Germany for the so called "Jamaika-Koalition" failed, as one of the junior partners, FDP (Free Democratic Party), pulled out of the discussions after four weeks of talks. The FDP cited the limited willingness of the environmental party, Die Grünen (The Greens), to compromise on critical issues, like immigration. Christian Lindner, the party leader, said on Sunday evening, that for his party it would be better to not govern, than govern badly. This statement was later spread by the party across the social media channels, which led to accusations that the exit was long planned by the FDP.

After the failed coalition negotiations, four options exist.

The first option would be a minority government led by Chancellor Merkel. Although the FDP mentioned that they would support such a government, Merkel said on Tuesday night that she would prefer a snap election over a minority government. The latter has been never tried in Germany and is unpopular because minority governments are seen as one of the culprits of the failure of the Weimarer Republik, which led to the rise of Adolf Hitler.

The second option would be a snap election, but it is hard to see how the results could be materially different from last the election results. However some parties, like Merkel's CDU (Christian Democratic Union) might toughen their position on the key topic of the September election: immigration, which might help to take away votes from the AfD (Alternative for Germany) the far right populist party. At the moment, polls are suggesting that except for the environmental party, which might gain 2-3%, results will be more less the same as in September. Moreover for a snap election the parliament needs to be dissolved, which in Germany can be only called by the President, Frank Steinmeier, who is the head of the state. He is reluctant to do so and is rather pursuing the third and fourth option.

Third option would be a continuation of the "Jamaika-Koalition" negotiations and the fourth option would be to convince Merkel's current junior partner, SPD (Social Democrats) to govern for another term. This week he is meeting the leaders of all involved parties to remind them about their responsibilities for the country and importance of a stable government as well as working out if option three or four is still feasible. Nevertheless at the moment both options seem unlikely. The aggressive social media campaign that the FDP started after leaving the negotiations table makes a continuation of the discussions difficult; furthermore, the SPD's

party leader and chancellor candidate, Martin Schulz, rejected again the idea of joining the next government.

However, even as the situation in Germany to form a new government is difficult, the constitution rules that the chancellor and his/her ministers should remain until a new government is appointed. The Bundestag, the German parliament, activated on Tuesday morning the necessary steps to run the country for an extended time period with a caretaker government, by establishing a "Hauptausschuß". The latter is a working group of 47 MPs responsible for the preparation of bills. The group is chaired by Wolfgang Schäuble, the former Finance Minister. The "Hauptausschuß" was once used in 2013, when three months were required to conclude coalition negotiations. The first real test for a caretaker government would only come in mid-2018 when the budget needs to be approved.

Market Outlook

Financial markets have reacted very mildly to the uncertainties. The German stock market as well as the Euro opened weaker on Monday morning, but both recovered their losses later during the session. It is unlikely that the political turmoil will have a lasting impact on the market, as Germany's current economic strength is probably not impacted by the absence of a government. In our initial election paper in September ([Germany's Election Should Be Supportive](#), 5 September 2017), we discussed all possible coalition options and concluded that some would be more and some would be less market friendly but none would lead to major changes. This assumption should also hold for the results of a possible snap election, which explains the market's relaxed reaction.

Over the course of the coming weeks we will likely discover which of the four options Germany's political leadership will pursue. Nevertheless for financial markets this will be only a side show and therefore we would like to reiterate our preference for bonds from German "Mittelstand" companies.

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