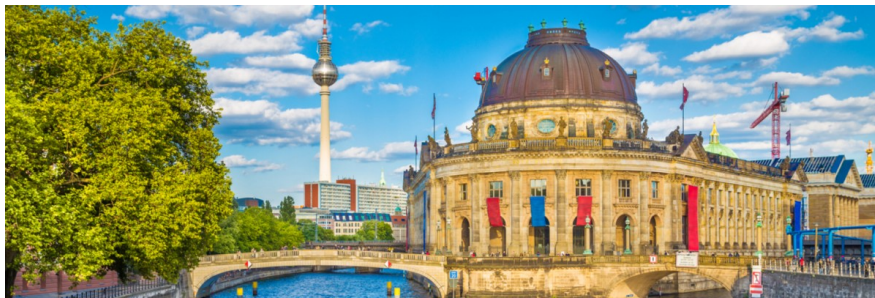


Germany: Finally a first step towards a new government

Germany's CDU/CSU and SPD parties have reached an agreement to restart coalition talks this morning. It might not be a visionary breakthrough but enough to maintain Germany's role as the strong man of Europe in the coming years



Exactly 110 days after the election, the three parties which have actually governed the country for the past four years agreed to start formal coalition talks. Just to be clear: there is no new German government, yet. But there is a clear determination of the current government to govern for another four years. The so-called exploratory talks ended with a 28-page-long paper, forming the basis for the coalition talks.

Some details

In short, what are the most important economic issues the three parties agreed on?

- Europe will be key. The paper starts with Europe and opens with the title “A new dawn for Europe”. A new grand coalition would give Europe and further European cooperation a high priority. However, the pro-European stance falls short of clear and concrete measures.
- Eurozone reforms remain vague. Particularly when it comes to the future of the Eurozone, the paper remains very vague. Phrases like a close partnership with France to reform the Eurozone in order to make it resilient against future global crises, will make Paris happy but keep lots of room for interpretation. The only concrete plan is to transform the ESM into an EMF, put into European law.
- Pensions and health care. A new grand coalition plans to guarantee pensions at their current levels until 2025. The SPD demand of an overhaul of the health care system will not happen. There will only be a minor change in the financing of the public health insurance. At

the same time, the paper commits to the legal entitlement of all-day schooling for children up to 10 years old. An important measure to increase female labour market participation.

- Digitalisation. Not surprisingly, digitalisation will be another spearhead project. More investment, more investments in education, more emphasis on digital education and digitalisation of the public administration.

In sum, the current agreement would broadly continue the economic policies of the last four years. A bit more social spending, some minor tax cuts and the expected investments in infrastructure and digitalisation. All of this would currently add up to a total fiscal stimulus of around 45bn euro over the next four years (some 1.2% of GDP). As regards Europe, a new grand coalition would probably focus more on the EU and some mild reforms, rather than on huge reform steps for the Eurozone.

First assessment

Is it a breakthrough? Well, it is a breakthrough in the way that it opens the door for Germany to finally get a new government. However, it is clearly not a breakthrough for the economy. Judging from the paper, the measures are positive for the economy and there are no real economic blunders or obvious electorate gifts, like for example, the reduction of the retirement age. As regards economic policies, the agreement is a continuation of the well-known policies of the last few years: cautious steps forward, rather than any visionary experiments. Pro-growth structural reforms, however, are still hard to be found.

What's next?

The destiny of a new grand coalition is now in the hands of the SPD. On 21 January, the SPD party congress will have to approve the formal start of coalition talks. Once there is any coalition agreement, all SPD party members will be polled on their agreement.

In our view, the party congress on the 21st is the biggest hurdle. Once this stage has been passed, it is very unlikely that the coalition talks will still fail. The current paper is already too detailed for any huge surprises to happen. However, having said this, the last few months have shown that German politics can be more eventful and with more surprises than most people thought.

In any way, don't expect a government to be sworn in before Easter.

Breakthrough or no breakthrough?

In our view, it's a breakthrough with a bad taste in the mouth. The good thing is that finally the first step towards a new government has been taken. However, the difficulties to reach the current compromise shows that any new grand coalition will not be the result of love at first sight but rather a coalition of convenience. For all main actors in these negotiations (Merkel, Schulz, Seehofer) a collapse of the talks could have marked the beginning of the end of their respective political careers. For the economy, the current compromise might not be a visionary breakthrough but it will clearly maintain Germany's role as strong man of Europe over the next years.

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