

# **The Race for the Bundestag 2017:** What is, who is and what ifs?

OCBC Global Treasury Research  
12<sup>th</sup> Sept 2017

# Executive Summary

- **Germany will elect its new leaders into the Bundestag on 24<sup>th</sup> September as it heads to the polls.** Chancellor Angela Merkel will be looking to continue her fourth term in power, defending her position against Social Democratic Party's (SPD) Martin Schulz. According to the polls, Merkel's party, the Christian Democratic Union (CDU) with its sister party the Christian Social Union (CSU) is commanding 36.5%\*. This will then be accompanied by runner ups, the SPD at 23.5%\*. Should the polls turn to reality, the most likely scenario will be a coalition government of both parties (incumbent "grand coalition" consisting of the CDU/CSU and SPD). Should both parties revisit a coalition partnership, they may form a majority of around 60%.
- **Nevertheless, there are risks to be explored.** If the "grand coalition" fails to materialise, Merkel's next best option would be to form a "Jamaica" coalition, consisting of the Free Democratic Party (FDP, 8.5%\*) and The Greens (Greens, 6.5%\*). Although the CDU has already reached agreements to form a coalition with these two smaller parties in Schleswig-Holstein, a federal coalition would be similar but at a much larger scale.
- **Given the similarities in policy stance of the CDU/CSU and SPD, we could see a continuation of policies into the next 4 years** if Merkel and Schulz were to win. Notwithstanding this fact, pre-election polls for Frauke Petry's Alternative for Germany (AfD) at 10.5%\* effectively overshadows the rest of the other smaller parties and may reintroduce renewed "Dexit" fears should actual-day votes surprise higher.

# How do Germans elect their parliament?



## The first vote

- As the Germans head to the polls this 24th September, they will receive a ballot with two choices. The voters pick their choice candidate in the first vote and choice party in the second.
- Every candidate that wins one of Germany's 299 constituencies confirms their position in the Bundestag.



## The second vote

- In order to fill the other 299 seats, voters will cast their ballots in the second vote, known as the "Zweitstimme".
- This vote is special as it relates to a political party instead, determining the allocation each political party attains in the Bundestag.



## Proportional distribution and voting

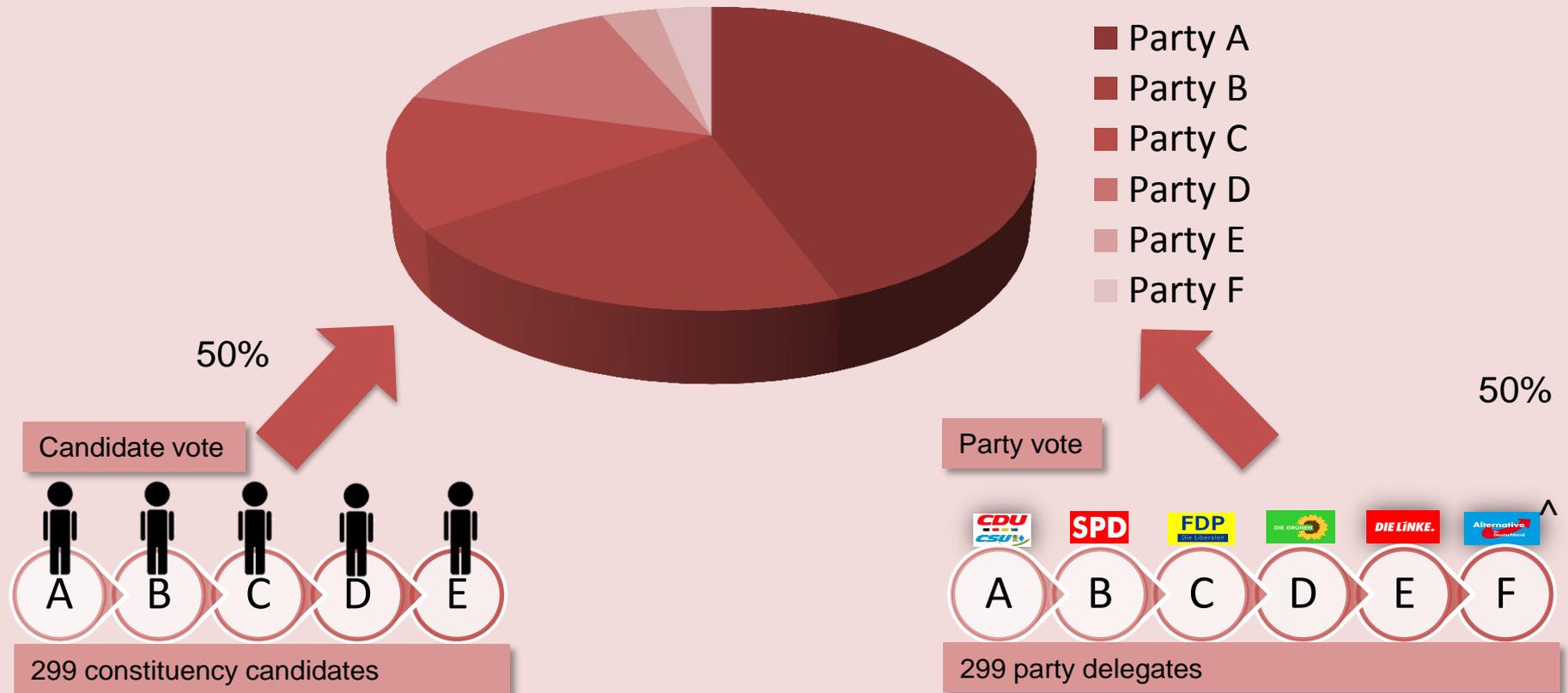
- To illustrate, if a party wins 15% of the 2<sup>nd</sup> vote, it will be allocated 15% of the 598 seats in the Bundestag which translates to around 90 MPs.
- If that same party secures 40 seats in the first vote, the party will then be entitled to allocate another 50 MPs to the Bundestag.
- More often than not, a party may secure more seats at the constituency level, in this scenario, the party will hold on to these extra seats. Thus, resulting in an "overhang" parliament, causing the Bundestag to have more than 598 MPs.

# How do Germans elect their parliament?

Bundestag: 598 seats\*

Step 1. First-past-the-post

Step 2. Proportional representation



\* Base number – Parliament is usually larger due to “overhang seats”

^ Note: For illustration purposes, only parties above 5% in polls are represented here

# The Candidates

Angela Merkel



Martin Schulz



Christian Linder



Katrin Goering-Eckardt and Cem Ozdemir



Christian Democratic Union/ Christian Social Union (CDU/CSU)

- Germany's main centre-right party, heads the outgoing coalition government.
- Well received mostly among older, rural, conservative and Christian voters
- Currently polling at 36.5%.



Social Democratic Party (SPD)

- The country's main centre-left party
- Strong in industrial western Germany
- Led by former European Parliament President, the SPD is 23.5% in the polls.



Free Democratic party (FDP)

- Pro-business Free Democratic Party (FDP) has spent more time in government than any other party.
- Failed to enter parliament in 2013 for the first time.
- Under new leader Christian Lindner, the FDP is polling at 8.5%



The Greens (GREENS)

- The Greens finds support in west Germany's university cities
- Currently, with 6.5% vote in the polls, they are not the force they were in the early 2000s, when they formed a coalition government with the SPD.

# The Candidates (cont.)

Dietmar Bartsch and Sahra Wagenknecht



Alice Weidel and Alexander Gauland



**DIE LINKE.**

## The Left Party (Die Linke)

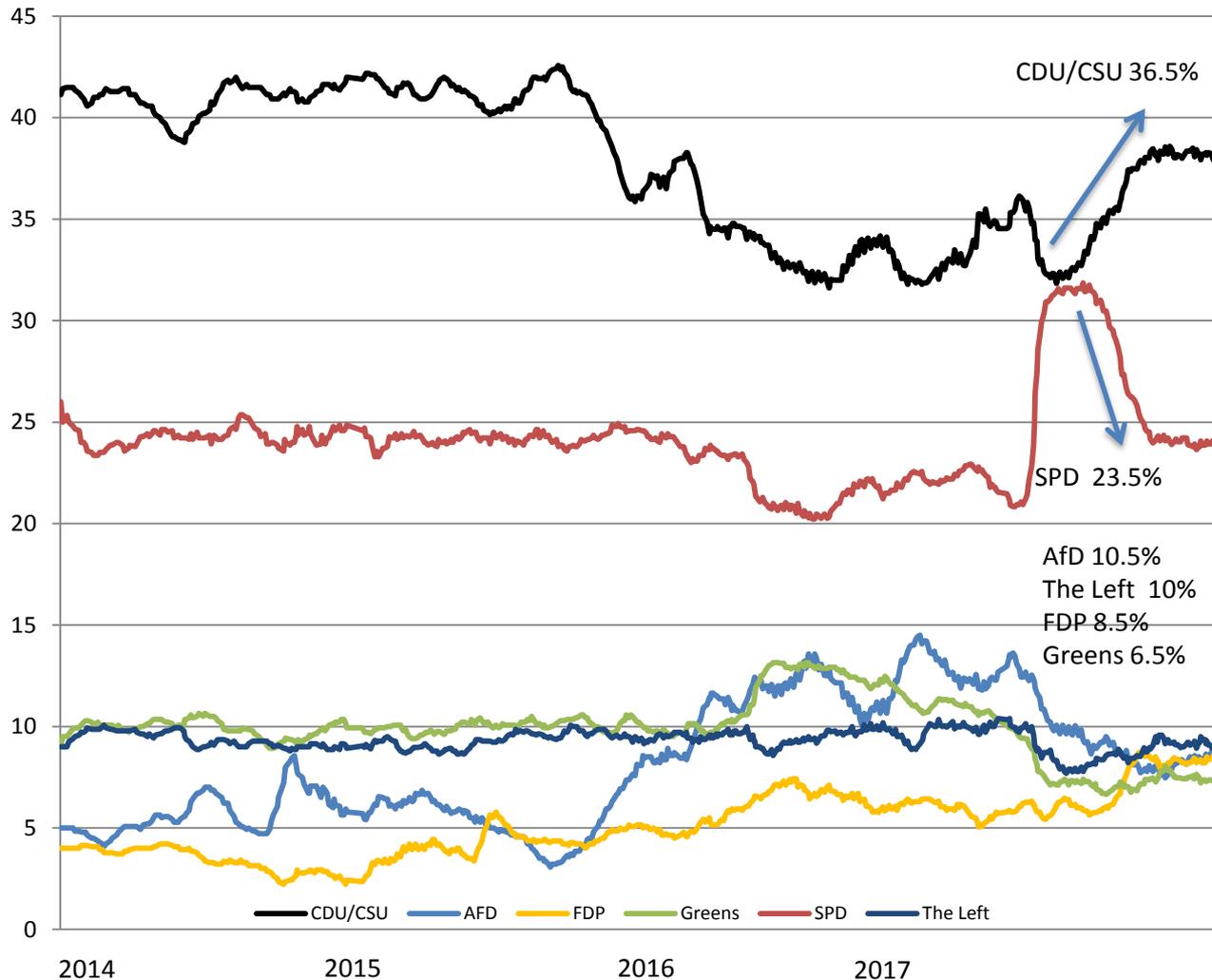
- Die Linke is a more radical leftwing party formed in 2007.
- Strongest in the former East Germany, it is currently the largest opposition party.
- Polls show that it looks to win at 10%.

**Alternative  
für  
Deutschland**

## Alternative for Germany (AFD)

- AFD was formed by euroskeptics who welcomed both Brexit and Trump.
- The party looks poised to enter the Bundestag for the first time in its four-year history.
- Its support fell from 15% at the height of the refugee crisis, to 10.5% currently.

# Historical poll standings



- Polls are suggesting that Merkel's party (CDU/CSU) is slated to garner the most votes in the upcoming election. The support for CDU/CSU is likely underpinned by the voters' want for stability and policy-continuity, while scrutiny over her refugee policies dissipated.
- SPD polls on the other hand fell starkly below 30% for the first time since Martin Schulz became the party's candidate. Schulz took over office from Sigmar Gabriel in January. In the recent election debate, the polls still saw Merkel doing better than Schulz.

# Party breakdown and policy focus

Views			
Euro	<ul style="list-style-type: none"> <li>No debt sharing stand, focusing on keeping the euro together</li> <li>Welcomes euro-area budget and the European monetary fund</li> </ul>	<ul style="list-style-type: none"> <li>Open to euro-area budget and European monetary fund</li> <li>To maintain the euro and keen on ending fiscal spending</li> </ul>	<ul style="list-style-type: none"> <li>Against debt-sharing, permitting countries to leave EU</li> <li>To end ECB's low interest rate policy</li> </ul>
Taxes and economy	<ul style="list-style-type: none"> <li>15 billion-euro tax cut, no taxes on the wealthy</li> <li>Balanced budget, to boost government R&amp;D and development funding</li> </ul>	<ul style="list-style-type: none"> <li>To implement a 10 billion-euro middle-class tax cut and raising taxes on those with income above 250,000 euros</li> <li>To boost spending on infrastructure and public housing</li> </ul>	<ul style="list-style-type: none"> <li>For a 30 billion-euro tax cut</li> <li>To pay down national debt</li> </ul>
Russia	<ul style="list-style-type: none"> <li>Called for sanctions to stay until Eastern Ukraine ceases fire</li> </ul>	<ul style="list-style-type: none"> <li>To remove sanctions progressively, hand-in-hand with progress made in Ukraine</li> </ul>	<ul style="list-style-type: none"> <li>Call to keep sanctions in place till Russia ends its Crimea occupation</li> </ul>
U.S./Trump	<ul style="list-style-type: none"> <li>Considers US the "most important partner outside Europe"</li> <li>To combat against unfair trade</li> </ul>	<ul style="list-style-type: none"> <li>Considers US the key partner outside EU</li> <li>Feels EU should resolve unfair trade</li> </ul>	<ul style="list-style-type: none"> <li>To defend free trade</li> <li>Protect the trans-Atlantic partnership while firming up the EU</li> </ul>
Defense	<ul style="list-style-type: none"> <li>To boost defense spending to 2% of GDP by 2024, in line with NATO</li> </ul>	<ul style="list-style-type: none"> <li>Does not plan to increase defence budget to 2%</li> <li>To improve development aid and defence spending in tandem</li> </ul>	<ul style="list-style-type: none"> <li>Increase development, defence and foreign spending to 3% of GDP</li> </ul>

# Party breakdown and policy focus

Views			
Euro	<ul style="list-style-type: none"> <li>No fixed stand on EU bonds</li> <li>Calling for “sustainable investment” plan for Europe</li> </ul>	<ul style="list-style-type: none"> <li>Keen on an European investment plan</li> <li>To end German “Hegemony” in the EU</li> </ul>	<ul style="list-style-type: none"> <li>Leave the EU</li> <li>Prepare the option of return to deutsche mark</li> </ul>
Taxes and economy	<ul style="list-style-type: none"> <li>Implement tax on the “super rich”</li> </ul>	<ul style="list-style-type: none"> <li>Dissolve the balanced budget</li> <li>To implement a 75% top income-tax rate</li> <li>Make all banks public</li> </ul>	<ul style="list-style-type: none"> <li>Cut taxes for low and medium income</li> <li>Retirement with full benefits after 45 years of age</li> </ul>
Russia	<ul style="list-style-type: none"> <li>Preserve sanctions to emphasize the protection of Eastern Europe</li> </ul>	<ul style="list-style-type: none"> <li>End sanctions</li> <li>End NATO’s eastward expansion</li> </ul>	<ul style="list-style-type: none"> <li>End sanctions</li> <li>Strengthen relationship with Russia</li> </ul>
U.S./Trump	<ul style="list-style-type: none"> <li>Nurture trans-Atlantic relations with US</li> </ul>	<ul style="list-style-type: none"> <li>To clear out US nuclear weapons</li> <li>Close U.S bases in Germany</li> </ul>	<ul style="list-style-type: none"> <li>Regards US highly as a key ally out of EU</li> </ul>
Defense	<ul style="list-style-type: none"> <li>Focuses on crisis prevention</li> <li>No intention of spending 2% of GDP on defense</li> </ul>	<ul style="list-style-type: none"> <li>Defence spending cuts</li> <li>Bring German troops back from overseas exercises</li> </ul>	<ul style="list-style-type: none"> <li>Strengthen NATO EU pillar</li> <li>Restore conscription eradicated by Merkel</li> </ul>

# Differing views between the incumbent and AfD



Angela Merkel  
CDU



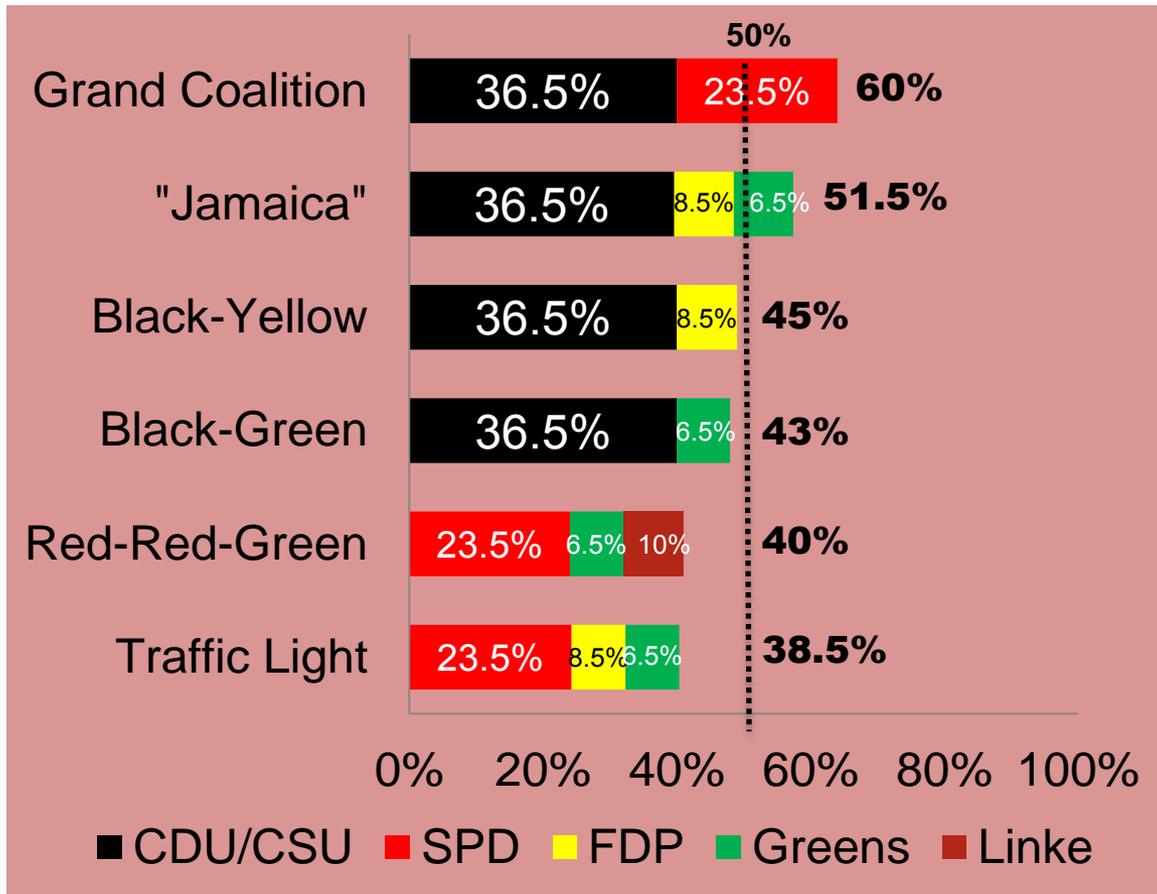
Martin Schulz  
SPD



Alice Weidel and Alexander Gauland  
AFD

<p><b>Profile:</b></p> <ul style="list-style-type: none"> <li>• A former research scientist with a doctorate in physical chemistry</li> <li>• Entered politics in the revolutions of 1989</li> <li>• Appointed into the bundestag as Minister for Women and Youth</li> <li>• Germany's chancellor since 2005</li> </ul>	<p><b>Profile:</b></p> <ul style="list-style-type: none"> <li>• Member of European Parliament from 1987-2017</li> <li>• European Parliament's President from 2012 to 2017</li> <li>• In 2017, Schulz announced he would leave his post to head his party's campaign, the SPD.</li> </ul>	<p><b>Profile:</b></p> <ul style="list-style-type: none"> <li>• Newly launched in 2013</li> <li>• Anti-immigration party</li> <li>• Embraces populist views</li> <li>• Feels Islam is incompatible with the constitution</li> </ul>
<p><b>Recent headlines:</b></p> <ul style="list-style-type: none"> <li>• Denied making mistakes with her open-door policy</li> <li>• Arrival of a million refugees over last two years from Syria and Iraq weakened CDU's support.</li> </ul>	<p><b>Recent headlines:</b></p> <ul style="list-style-type: none"> <li>• Schulz recently repeatedly attacked Merkel for planning to spend additional €30bn on armed forces.</li> <li>• Vows to oppose 2% Nato spending target which he says is being forced on Germany by Trump.</li> </ul>	<p><b>Recent headlines:</b></p> <ul style="list-style-type: none"> <li>• Rose to popularity two years back amid EU refugee crisis</li> <li>• Previously commanded relatively larger portion of votes but polls have slid after their populist movement died off.</li> </ul>
<p><b>Political views:</b></p> <ul style="list-style-type: none"> <li>• Merkel has employment, tax cuts and ongoing public investment in key focus</li> </ul>	<p><b>Political views:</b></p> <ul style="list-style-type: none"> <li>• The SPD is traditionally a working class party, assuring investment in education and infrastructure, financed by increased taxes for the rich.</li> </ul>	<p><b>Political views:</b></p> <ul style="list-style-type: none"> <li>• When formed in 2013, AFD positioned itself as anti EU</li> <li>• Individual members criticised of encouraging neo-Nazi ideas.</li> <li>• Strong for their radical views to "use firearms if necessary" on refugees</li> </ul>

# Potential coalition combinations



- **Similar to the previous\* three German elections, CDU/CSU will find it tough to win majority in the Bundestag.**
- **Thus, it is highly likely that one of these six coalition combinations might occur, with the grand coalition proving to be the most promising.**
- **Note that SPD has voiced its reluctance to form a coalition with CDU/CSU in the upcoming government make-up.**

Source: Bloomberg Composite of German Election Polls 2017, updated 7<sup>th</sup> Sep 2017

\* Previous elections in 2013, 2009 and 2005 saw Merkel's party win 41.5%, 33.8%, 35.2% respectively, with no majority of 50% in the Bundestag

# Key takeaways from the Merkel vs Schulz debate

Topic	Angela Merkel	Martin Schulz
<b>Migration policy</b>	<ul style="list-style-type: none"> <li>Merkel said that Germany must ensure that refugees find spots in educational institutions and secure jobs.</li> <li>Feels that Germany needs to aid in the fight with the cases of such crises, citing the violence in Syria.</li> </ul>	<ul style="list-style-type: none"> <li>Accused Merkel of failing to coordinate plans with EU neighbours.</li> <li>Despite the statement, Schulz supported Merkel's decision of welcoming refugees, agreeing that "integration of Muslim immigrants presents no greater challenge".</li> </ul>
<b>Turkey</b>	<ul style="list-style-type: none"> <li>Agreed with Schulz that Turkey should not become a member of the EU, indicating that a joint position will be formed on this matter with other member nations.</li> <li>Insists that despite the tough relationship, diplomatic relationships should not be hurt.</li> </ul>	<ul style="list-style-type: none"> <li>Believes that Turkey should not become a member of the EU as the President of Turkey was trampling on international law.</li> </ul>
<b>Foreign relations</b>	<ul style="list-style-type: none"> <li>Merkel expressed she would do "everything in her power" to keep the US on diplomatic terms with North Korea.</li> </ul>	<ul style="list-style-type: none"> <li>Expressed doubt on Trump's ability to resolve North Korea's ballistic intimidations, criticising the U.S President's twitter comments.</li> </ul>

# How did viewers react to the debate?



Merkel

Schulz

Opinion polls



Overall debate poll



Credibility poll



Est. 40% undecided in opinion\* poll

- Prior to the election debate, Merkel was about 13 points ahead of Martin Schulz according to a poll by Insa.
- After conclusion of the heated debate, a survey by Infratest Dimap for ARD television showed Merkel's overall performance was viewed more convincing compared to Schulz.
- Merkel's display of experience over her exchange on Trump and South Korea appeared to work with voters as seen from an ARD poll showing that 49% of those surveyed regarded the German chancellor more credible while 29% preferred Schulz.



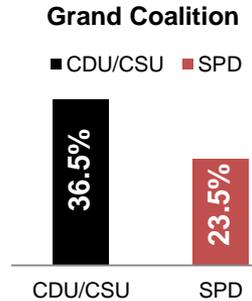
Source: Survey by Infratest Dimap for ARD television, Wahlrecht.de: insa poll, Reuters  
 Image source: Google images  
 \* Opinion poll refers to the Bloomberg Composite of German Election Polls 2017, updated 7<sup>th</sup> Sep 2017

# Possible scenarios and their risks

## Scenario 1: Grand Coalition (CDU/CSU and SPD)



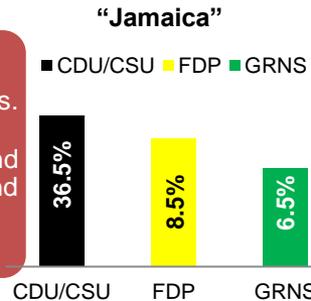
- Although the CDU/CSU and SPD coalition is likely, variables like new leader Martin Schulz and differences in EU issues could introduce uncertainties into the Bundestag.
- Note that SPD leaders had explicitly voiced their reluctance to form a Grand Coalition. Even if this coalition comes to pass, Schulz has mentioned that he is for debate as it results in better ideas. This could lead to prolonged policy scrutiny and perhaps policy paralysis in the future should disagreements arise in the Bundestag.



## Scenario 2: “Jamaica” Coalition (CDU/CSU, FDP and GREENS)



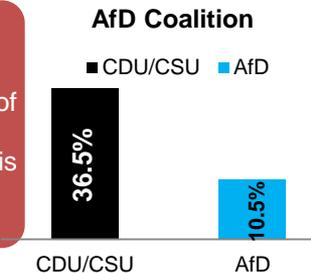
- This tri-party coalition was deemed as tough given differing views on social policy and economics. Although of late, the legalising of gay marriage has demolished a large problem.
- A tri-party coalition may introduce a greater sense of uncertainty in terms of policy implementation and continuity. Note that the three parties have been seen to have differing views on social policy and economics.
- Still, a coalition of three parties or more has not been seen since the 2<sup>nd</sup> Bundestag (1953 – 1957).



## Scenario 3: Alternative for Germany Coalition (CDU/CSU and AfD)



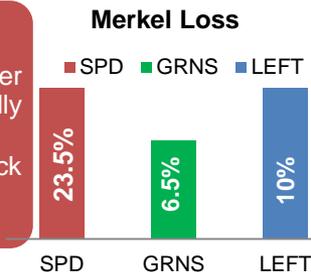
- The AfD is traditionally recognised as a “far right” party, with the CDU/CSU being a center-right.
- Both parties differ in many fundamental issues, including but notwithstanding the refugee policy, role of Islam in Germany and the euro.
- Furthermore, AfD has expressed its interest to enter the Bundestag as an opposition party and thus is unlikely to form coalition with Merkel, largely reducing the amount of possible friction which might occur.



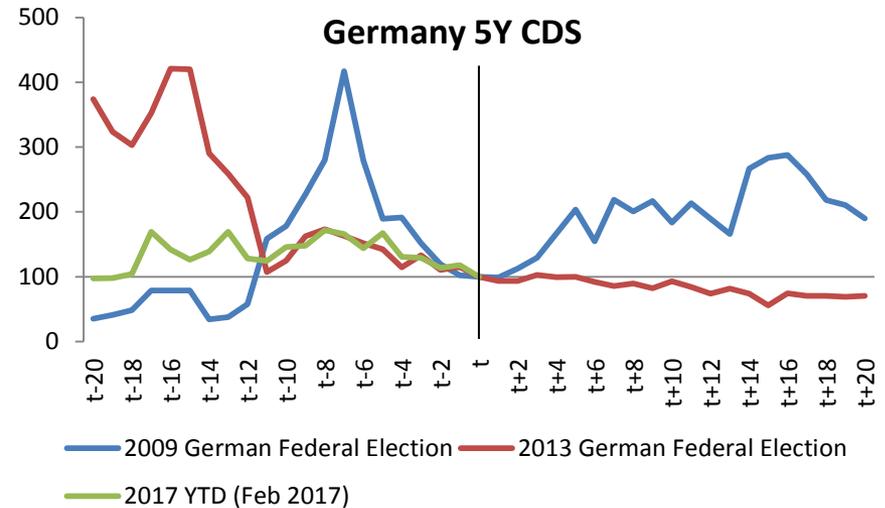
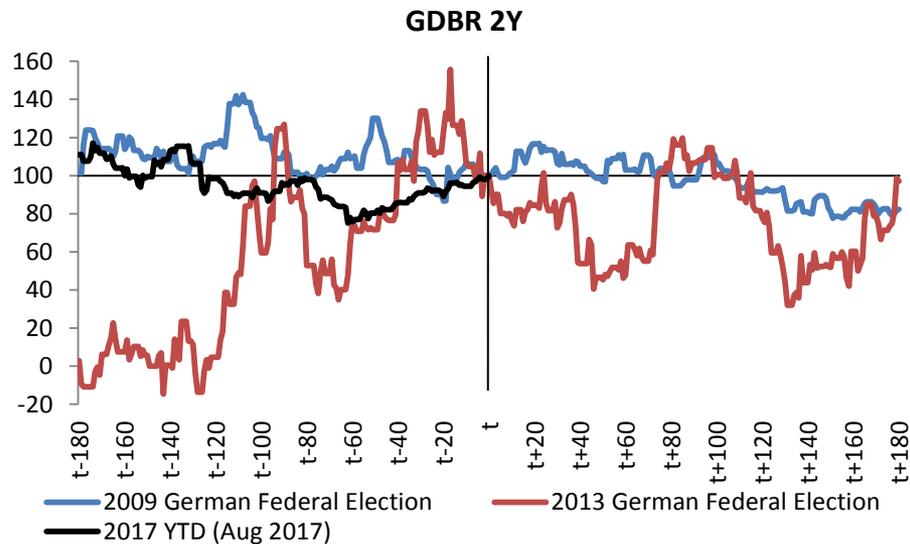
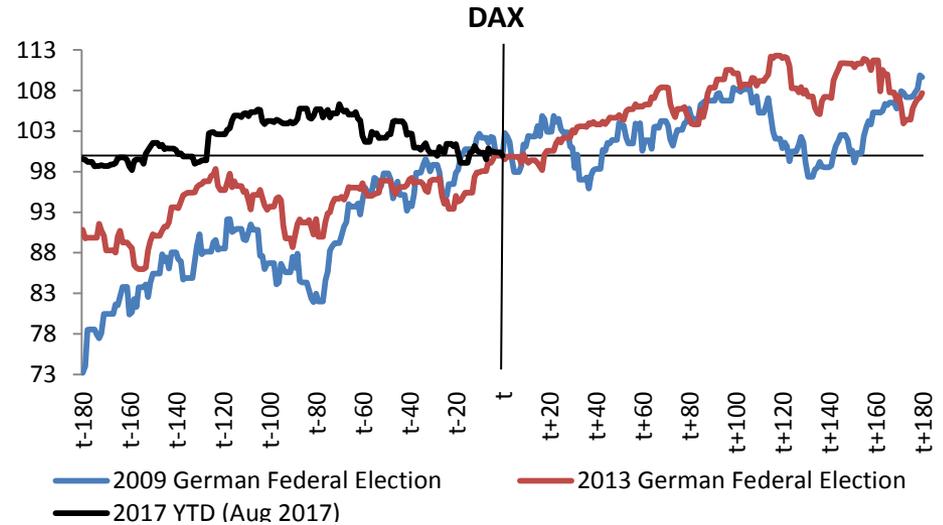
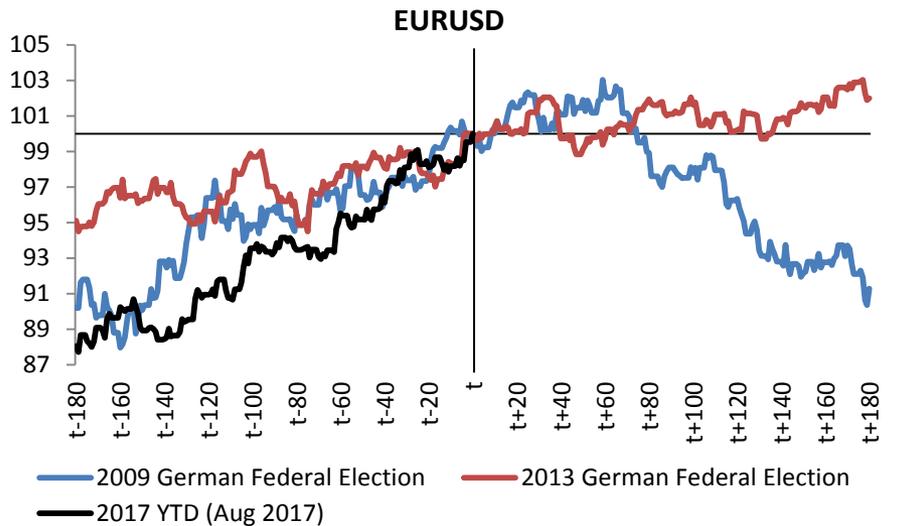
## Scenario 4: Merkel losing power



- Merkel has traditionally been pro-EU, maintaining a strong Eurozone. If Merkel loses grip in her leadership by not securing Chancellor, Germany’s fate could land in the hands of a less EU-friendly leader, possibly destabilizing EU related assets.
- Moreover, French President Macron could assume as a key figure in Europe, pushing strongly for quick integration and a common monetary board, as well as a strict stand over Brexit.
- Despite these risks, this scenario is highly unlikely to occur.



# So far, market indicators tip no election surprises



# Delving into scenario 3: What if an AfD Coalition?

## Core differences

- The incumbent CDU is center-right while AfD is a far-right party
- AfD supports populist trends like Brexit and Trump's victory
- CDU recognises the AfD as a "radical" party and may lose credibility if they formed coalition with them
- Frauke has often mentioned that the AfD wants to stay as an opposition if elected into parliament

## Policy variances

- CDU is for close ties with NATO while AfD plans to cut NATO ties to a sole defensive alliance and to bring German soldiers back from their respective posts.
- AfD repels Merkel's refugee plans while CDU feels the refugees may be key to Germany immigration policy.
- AfD supports US-centric law-and-order stances, while CDU promotes utilising state surveillance to counter terrorism.

## Risk involved

- AfD has many differing opinions with CDU and could possibly cause friction in the Bundestag.
- However, Frauke has expressed that AfD has intentions to only stay as an opposition party.
- Given the many differences between these parties, as well as Merkel's risk of losing credibility should she consider a coalition, we view that this scenario is highly unlikely.

# Delving into scenario 4: Merkel losing power

	Current (Sept 2017)	Dot Com bubble (Mar 10, 2000 – Oct 9, 2002)	2005* German federal election (Sept 18th)	Global financial crisis (Dec 12, 2007 – Mar 3, 2009)	Greece debt crisis (Jan 2010 – Mar 2012)	Merkel loss?
EUR-USD	1.194	+3.3%	-5.0%	-14.5%	-7.24%	-2% to -5%
Deutsche Boerse German Stock Index	12,520	-66.6%	-3.6%	-51.7%	+10.4%	-5% to -10%
10y- Govt Bond Yield	0.34%	-103bps (to 4.30%)	+49bps (to 3.54%)	-129bps (to 3.01%)	-154bps (to 1.80%)	+10 to +25bps
German Consumer Con- fidence	103	-7.1%	-1.4%	-30.9%	+20.8%	-5% to -10%

- The kneejerk market impact of Merkel losing would be highly unpredictable, even though this is not our base-case scenario.
- Positive fund flows into Germany (and Europe) could unwind in the near-term. An unexpected loss in power for Merkel could prompt a sharp pull back in risk appetite and potentially see near-term fund outflows.
- Alternatives to Merkel's leadership include Martin Schulz leading a tri-Red-Red-Green (SPD, De Linke and Greens) coalition, which Germany has not seen for over 50 years. In another plausible scenario, Merkel could give up coalition power to Schulz or a rival within CDU/CSU. In any case, there could be some short-term market trepidation for a new administration and its policy effectiveness.
- These being said, the chances of Merkel losing would be highly unlikely given the current poll standings, with elections being less than 2 weeks away.

\* 2005 German federal election: Confidence in the then incumbent Gerhard Schroder failed. Although Merkel was expected to take over with a 21 point lead over the SPD, her party lost a significant lead and both parties ended up close at 35.2% (CDU/CSU) and 34.2% (SPD). This was contrary to expectations.

## Treasury Market Research & Strategy

Selena Ling ([LingSSSelena@ocbc.com](mailto:LingSSSelena@ocbc.com))

Emmanuel Ng ([NgCYEmmanuel@ocbc.com](mailto:NgCYEmmanuel@ocbc.com))

Tommy Xie Dongming ([XieD@ocbc.com](mailto:XieD@ocbc.com))

Barnabas Gan ([BarnabasGan@ocbc.com](mailto:BarnabasGan@ocbc.com))

Terence Wu ([TerenceWu@ocbc.com](mailto:TerenceWu@ocbc.com))

## OCBC Credit Research

Andrew Wong ([WongVKAM@ocbc.com](mailto:WongVKAM@ocbc.com))

Wong Liang Mian ([NickWong@ocbc.com](mailto:NickWong@ocbc.com))

Ezien Hoo ([EzienHoo@ocbc.com](mailto:EzienHoo@ocbc.com))

Wong Hong Wei ([WongHongWei@ocbc.com](mailto:WongHongWei@ocbc.com))

Tel : (65) 6530 4887

Tel : (65) 6530 4073

Tel : (65) 6530 7256

Tel : (65) 6530 1778

Tel : (65) 6530 4367

Tel : (65) 6530 4736

Tel : (65) 6530 7348

Tel : (65) 6722 2215

Tel : (65) 6722 2533

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