

Smart^{im}: Market Note

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Smart Investment Management

German Election result

At the start of the year, much was made of the level of political risk in Europe, with elections in a number of countries and populist parties on the rise. To date, the election outcomes have been relatively benign for investors, with the one populist leader to gain power, Emmanuel Macron, being a centrist and perceived as business-friendly. Yesterday's election of Angela Merkel to serve a fourth term as Chancellor of Germany continues this pattern, and such continuity is generally taken positively by markets. However, the details of the result reveal a more complex situation.

Whilst it is no mean feat for any politician to be elected for 4 consecutive terms, this was Merkel's worst result of her election successes. It was speculated that some voters would decide to punish her for the policy that allowed nearly 1 million refugees of the Syrian conflict to come to Germany, a decision that has caused a degree of social problems within the country, and the unexpectedly strong performance of the openly anti-immigration, anti-Islam AfD would suggest that this was a factor in voting. The rise of a right wing party on the back of concerns about immigration levels is not unique recently within Western politics, and the 13% of the vote gained by the AfD is not in itself an overwhelming problem. However, it is significant in 2 very important ways.

Firstly, the ability of a far right party like the AfD to gain seats is arguably more noteworthy in Germany than almost any other country. Germany has worked hard to come to terms with its history, and has embraced a 'collective quilt' over the atrocities of the Third Reich in order to prevent anything similar happening again. Therefore, for a party described by Sigmar Gabriel, the German Foreign Minister, as "real Nazis" to gain such support may mark the breakdown of taboos within Germany that have existed for decades. If so, this may be the beginning of a radical change in German politics, although only time will tell.

Secondly, and a more immediate issue for Merkel, the success of the AfD was part of a greater fragmentation of the vote. As well as Merkel's CDU-CSU alliance losing nearly 10% of the votes cast, her coalition partners, the social democratic SPD, fell to a post war low of 20%. The losses of the 2 main parties mean that, as well as the AfD being in parliament for the first time, the Free Democrats (FDP) will be represented again after a 4 year break, having broken through the 5% vote share threshold required to achieve representation in the Bundestag, the German Parliament. With the Left and Greens making gains as well, there will be 6 parties represented in the Bundestag for the first time since 1953 (source: Bloomberg).

The increased number of parties would often mean a higher number of potential collations but, with the SPD having declared its intent immediately after the vote to return to opposition, and no parties prepared to work with the AfD, the 'Jamaica' coalition is the only realistic option. The name comes from the respective colours of the CDU-CSU alliance (black), the FDP (yellow) and the Greens. However, being the only viable option does not make it easy to form, or manage. Knowing that Merkel has no real alternative may embolden the FDP and Greens in coalition negotiations, exaggerating their demands, and the fact that the 2 parties are on opposite sides of a range of issues, from energy to immigration, will make finding an agreement challenging. Therefore, whilst German politicians are experienced at forming coalitions, as the electoral system tends to produce no majority party, it will take all of Angela Merkel's experience to achieve a successful outcome.

This leads us to the short term risk, namely that, with the process expected to take weeks or even months, Merkel will be distracted by domestic political issues when her role as de facto leader of Europe requires that she deals with more global issues. As an example, some had voiced hope that, having secured her own re-election, she would be able to use her influence to move along the struggling negotiations over Brexit. However, any such possibility must now be much reduced. The longer term risk is that the fragmentation seen continues to grow, and the stability that has been German politics in recent years may be under threat. This latter issue will only be known with time. However, whilst the pattern of relatively market-friendly outcomes in European politics cannot be said to have reversed, the German result may not turn out to be as benign as it appears at first glance.

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