After Germany's 'Boring' Vote, Austria and Italy Loom

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Germany's election is shaping up to be a non-event in Europe's "super cycle", with all likely outcomes resulting in solidly pro-EU governments. This bodes well for Germany's economy and Europe's continued resurgence. But Austria, Italy and even Spain will soon hold votes with greater potential consequences.

Key takeaways

- Chancellor Merkel is likely to win again and the status quo should continue
- Even if Mr Schulz wins, he's a seasoned politician with pro-EU credentials
- A victory by Mrs Merkel should lead to a constructive "Merkron" alliance with French President Emmanuel Macron
- Austria and Italy's votes are more important: Either could initiate leaving the euro and/or the EU
- The independence movement for Catalonia in Spain could show signs of resurgence

Geopolitical developments have made more than their fair share of headlines in recent months – from continued US protectionism to growing tensions on the Korean peninsula – but Germany's upcoming national parliamentary elections have barely registered.

Quite the contrary, in fact: The 24 September election in Germany is shaping up to be something of a non-event in Europe's elections "super cycle", which started in the Netherlands last March. Most polls indicate that Germany's centre-right Christian Democratic Union (CDU) and Christian Social Union (CSU) parties will emerge victorious, and that Chancellor Angela Merkel will continue her leadership for the next four years.

Barring any major upsets, investors should focus on the fact that Germany will most likely have pro-European Union leadership in place come 25 September, and that Germany's economy will continue to be the engine that is powering a resurgent Europe. The continuity of Mrs Merkel

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as Chancellor, assuming her party emerges victorious, would only stand to underscore this position. Mrs Merkel promises to provide her country with a proven, steady hand on the tiller during a time of geopolitical turmoil. This should be reassuring not only to the majority of German citizens, but to the markets as a whole.

Three possible coalitions

The only open question of any significance is which governing coalition will be formed in the Bundestag, Germany's main legislative body, in the election's aftermath. Given that there are six political parties coming into the Bundestag, and with the right-wing Alternative for Germany (AfD) party such a pariah that it is effectively excluded from joining a coalition, a governing majority without the CDU/CSU is all but impossible. As a result, we expect to see one of three outcomes:

1 CDU/CSU and free-market-friendly FDP

If Mrs Merkel's conservative party joins forces with the liberal Free Democratic Party (FDP), investors should expect some tax relief. They should also expect to see a rather strict adherence to existing European rules and processes – and a stricter view on refugees. We may see some structural reforms in goods markets, but we do not expect labour-market reforms to be rolled back. In terms of new ideas, this coalition would likely focus its efforts on education and digitalization.

2 CDU/CSU and SPD, together again

If the status quo continues, and the Social Democratic Party (SPD) forms another grand coalition with the CDU/CSU, it won't matter much that the SPD's candidate Martin Schulz found himself on the losing end of a contest with Mrs Merkel. In terms of Germany's relationship with Europe, there is not much difference between the parties' programmes. Overall, if this coalition is formed, investors should expect to see tax relief, pro-EU policies and a higher chance for euro-zone policy harmonization than in our first scenario. We could also see some rollback of labour-market reforms – for example, the implementation of new regulations on temporary workers.

3 The "Jamaica" option: CDU, FDP and Greens

A reference to the black, yellow and green colours of the Jamaican flag, this coalition is mathematically possible, but not overly likely. There are too many differences between the FDP and the Green party on issues related to the economy, the labour market, the EU and the euro.

Germany's elections should have little impact on its economy

Germany's economy is doing well, with growth supported by external demand and by domestic factors – domestic consumption is benefiting from a strong labour market, and capital expenditures are ticking up.

Structurally, we see moderate to declining levels of leverage in Germany's economy, and home prices on average are picking up while not overvalued on a national level. Prices are, however, overshooting a bit in big and booming cities.

Moreover, as the details of Brexit get hashed out, Germany is not exposed to any more Brexit-related growth risks than the average EU nation. The exceptions are Ireland, Belgium, the Netherlands and Luxemburg, which have the most to lose of any EU member except for the UK itself.

To be fair, any future slowdown in the global economy would leave its marks on Germany's growth, but the resilience of Germany's domestic demand should provide a cushion. As a result, we don't expect the outcome of Germany's elections to pose any real risk to financial stability in Germany or beyond.

On a related note, it seems that Germany's strong economy and high current-account surplus have helped keep populist and anti-globalization parties from gaining as much traction there as they have in other countries, such as Italy.

Holding our breath for Austria and Italy

Regardless of whether Germany's elections will be the non-event we think they will be, there are two more events in Europe's super cycle that bear watching. Austria is holding national legislative elections on 15 October, and Italy will head to the polls in the spring of 2018. Spain's 1 October referendum on Catalan independence may also cause some jitters, although it is unclear how the political procedure would unfold and how much economic impact it might have.

Given rising anti-EU feelings in Austria, and given Italy's challenging economic straits, there is a legitimate risk of a strong anti-Europe result in their upcoming votes. It is entirely possible – if still not probable – that these nations could initiate the process of leaving the euro and/or the EU. Considering the wounds that could be inflicted upon the "United States of Europe" by either of these two elephants in the room, it would be quite understandable if the world finds itself looking back fondly on a "boring" result in Germany.

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