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Macroeconomic Comment

Change of Government in Germany – Impact on Europe

November 30, 2021, Peter von Elten

The change of government occurs during a challenging transitional period in which the worrying development of the pandemic demands swift and responsible action due to the overburdoning of the healthcare systems. However, the new government coalition of Social Democrats, the Green Party and Free Democrats – the so-called "traffic light coalition" – will not be able to officially take up office until it has been confirmed by parliament on December 6.

The title of the coalition agreement «Alliance for Freedom, Justice and Sustainability» reflects the coalition partners' respective core concerns. The FDP is committed to a liberal market economy and a debt brake, the SPD to social justice and the Green Party to the ecological transformation of the economy. The absolute will to govern has led the three parties to make major programmatic concessions that were considered unthinkable just a few months ago. For example, the SPD and the Green Party had demanded higher taxes on companies and on high incomes and wealth as indispensable to finance the enormous costs of the necessary modernization of the economy and ecological transformation; the FDP, on the other hand, prevailed with its categorical rejection of tax increases and the retention of the debt brake.

«The Great Transformation», «Reconciliation of Ecology and Economy», «Commitment to Progress» are the key words that describe the coalition partners' strong will to shape the future and have raised great expectations. At the center is the climate policy, which is a high-level task that affects all economic, industrial, social as well as societal policies. Germany sees itself as a pioneer on the road to climate neutrality, which is to be achieved by 2045, and hopes to play a leading role worldwide in the development of new decarbonization technologies. Following the hasty phase-out of nuclear power, the end of coal-fired power generation is now to be brought forward a further time, if possible to 2030. The areas hit particularly hard by the coal phase-out, especially in eastern Germany, have been promised many billions in state aid to encourage new businesses to set up there. Since the expansion of renewable energies cannot replace coal-fired power generation that quickly, the new government is planning to rapidly add gas-fired power plants as a temporary technology to ensure a stable supply.

The coalition agreement also includes many plans to further develop Germany into a progressive welfare state, such as a more stable pension and healthcare system, a new unconditional basic income, relief for tenants and accelerated construction of social housing. A 25% increase in the minimum wage planned for 2022 could shift the entire standard wage level upward. Regarding

pension policy, the pay-as-you-go system, which has been overstretched for years, will have to be supported by further substantial subsidies from the state budget.

The implementation of the ambitious targets is likely to stimulate growth for years to come and trigger high levels of government and private-sector investment, especially in the construction sector, which is already working to capacity. Risks for Germany's competitiveness lie in the growing influence of the state on the economy and in additional costs for companies, which are already struggling under government regulations, high taxes and energy costs. The ideological exaggeration of the ecological transformation, to which everything is to be subordinated, also raises fundamental questions. Financing all the projects will present the coalition with major challenges.

Impact on Europe

From a European perspective, the change of government is likely to contribute to a further stabilization of the European Union.

The coalition members envision the further development of the EU into a federal and decentralized European state.

The new government wants to push ahead with the completion of the EU banking union and support the introduction of European deposit reinsurance, which has been called for for years.

Although the coalition intends to adhere to the debt brake introduced by many European countries, it has outlined a number of ways by which the enormous investments for climate protection, digital transformation and creating competitiveness in the semiconductor sector can be financed outside the debt brake. These include start-up financing for state-owned companies as a basis for private-sector investment. This is likely to be an approach that will be supported by both the Brussels authorities and many member states. The austerity policy, which has been strongly criticized by many countries, will not be revived in the light of the major European tasks.

With the departure of Chancellor Merkel after a 16-year reign, Germany's dominant influence will weaken. France and Italy recently formed an alliance calling for a stronger say in reshaping European affairs. With the departure of Great Britain, the balance of power is shifting more toward southern Europe.

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Mr. von Elten has decades of experience in the banking industry. Since 2008 he has been a member of the advisory board of BSZ AG, which took over IFP AG in 2014 and thus became Belvoir Capital AG. He enjoyed an international career at JP Morgan for close to 30 years. He returned to Switzerland as General Manager of Schroder & Co Bank AG from 1995 to 2003. Furthermore, Mr. von Elten's passion is art; he is a co-founder of the gallery Elten & Elten.

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