



EU Politics: Germany's political impasse spoils EMU reform timeline

- The fluid political situation in Germany threatens to stall EU policymaking in a number of fields, above all the build-out of the euro area. The EU summit on Dec 14/15 is unlikely to yield an agreement on a potential roadmap for reforming the monetary union making it even more difficult to take final decisions in June 2018 as envisaged by the EU Commission. This will in return dampen optimism that a French-German tandem will provide a fresh impetus to the EU as a whole before the European Parliament elections in 2019.
- Mapping out a way forward for the EU27 remains a major issue. A new plan for larger military and security cooperation has been signed recently. In migration policy, however, there is no real progress in finding a joint response to the challenge. Bold EMU reforms are likely to prove difficult, even with a German government in place at some point in 2018.
- Brexit negotiations are unlikely to be impacted immediately. The broad consensus among German parties on this topic allows the German caretaker government to decide with its EU27 partners on whether enough progress has been made to move to the second stage of talks. We regard a positive decision in this respect as likely, clearing the way to negotiate a transition period and guidelines for post-Brexit relations.

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German elections – the "non-event" of the year

The German elections were supposed to be a non-event in a year with critical national elections across Europe, such as in the Netherlands and France against strong euro-sceptical and populist headwinds. This still holds true in terms of the role and relative importance of populist forces in Germany - even though the right-wing anti-migrant AfD entered the Bundestag. But government formation proved to be way more difficult than expected, resulting in a collapse of coalition talks between the leading CDU/CSU, the Greens and the Liberals – an unprecedented event in Germany's post-war history. At the time of writing momentum was building for a renewed grand coalition between CDU/CSU and SPD to avoid snap elections. Still, this implies a prolonged period of political uncertainty that will last well into spring 2018. From a European perspective, this is a highly unwelcome development at a time when a proactive contribution and guidance from the biggest EU member state is high on demand.

Berlin crucial for ambitious EMU reform timeline

On the top of the EU reform agenda is the build-out of the euro area including a review of institutions and new initiatives for risk-sharing. The EU Commission is expected to put forward more detailed proposals early in December. The agenda should then be discussed in the Eurogroup, allowing EU leaders to endorse a potential roadmap for reforming the euro area at the December 14-15 EU summit (see timeline) and lead to concrete decisions next June. This was



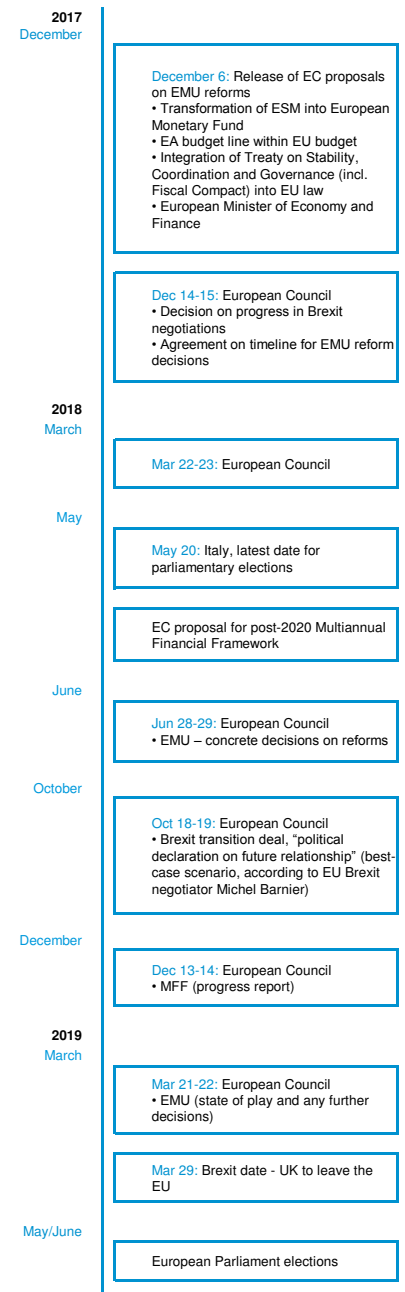
an ambitious timeline in the first place given that proposed reform elements such as a fiscal capacity and a finance minister for the euro area or progress with the common deposit insurance system are highly debated among EMU members. Holding to the planned timeline now seems (even more) unrealistic. The caretaker government under Chancellor Merkel lacks the political legitimacy to take bold decisions and commit Germany to ambitious projects despite a broad pro-European consensus among the mainstream parties and MPs.¹

The political impasse in Germany has raised concern that the euro area might risk missing a narrow window of (reform) opportunity, undisturbed by the states'/EU election calendar² and supported by the current benign economic environment. With lengthy government formation expected in Germany, this window now seems to be shrinking rapidly. The concern is particularly strong in France where President Macron hoped for a strong Franco-German leadership to push through ambitious reforms to European institutions. While Merkel has not subscribed to all of Macron's ideas, she as well as representatives from the CDU already voiced support of the ESM's transformation into a European Monetary Fund, speed up solving legacy issues in the financial sector to fully implement banking union and a review of the overly complex fiscal framework.³ The general preparedness to strengthen the Franco-German relationship will not be put into question by the current political uncertainty, though. On closer military and security cooperation, another policy field emphasized by Macron in his [Sorbonne speech](#), Germany signed up to a new European defence plan even without a proper government in place.⁴ But to find common ground on EMU reforms will be much more difficult, even with a new German government eventually in place early next year. A minimum compromise (extended mandate for ESM/EMF, completing banking/capital markets union) therefore seems to be the most realistic scenario, whereas plans for an EU finance minister and euro area budget including a macroeconomic stabilisation function are at risk of being watered down or discarded.⁵

Brexit talks – low impact of German political stalemate

For another key topic on the EU agenda – the ongoing Brexit drama - the impact of the political stalemate in Germany should be low. Brexit talks are conducted by the EU Commission under clear "negotiating directives" and guidelines from the EU27. Given that there are no diverging views on content and process of the talks between the major German parties, the acting Chancellor will decide in line with EU27 partners on whether "sufficient progress" has been made on the topics of citizens' rights, fiscal obligations and the border issue in Northern Ireland to move to the second stage of negotiations. Thus, we consider it likely that at the December summit the EU27 will provide the EU Commission with the mandate to start talks on principal orientations for a post-Brexit relationship between the UK and the EU and a possible transition period to get there. Expectations by some observers that Chancellor Merkel by her own would be willing or able to push her partners in the Council towards a more favourable deal for the UK were set to be disappointed in any case.

Figure 1: EU timeline (selected)



Source: Deutsche Bank, European Commission, European Council

1 This consensus would still allow Germany to react to a euro crisis even without a government in place.
2 No major EU elections between Italian parliamentary elections in early 2018 and European Parliament elections in April/May 2019.
3 See Focus Europe Special (3 November 2017): "[European integration and the role of the ESM](#)".
4 See Focus Europe (30 June 2017): "[Defence spending, fiscal stimulus and European integration](#)".
5 See Focus Europe (9 June 2017): "[EMU reflection paper - mere "wish list" or plausible way forward?](#)".



Appendix 1

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