ECOWEEK

No. 19-35, 27 September 2019

Germany: fiscal stimulus, hope versus reality

■ Germany is probably in a technical recession and recent data do not point to any improvement in the near term, quite to the contrary ■ Given the country's considerable budget surplus, German business leaders are calling for fiscal stimulus. This echoes Mario Draghi's plea in favour of budgetary expansion in countries with fiscal space ■ Simulations show that spillover effects to other eurozone countries would be small ■ Moreover, the implementation of a fiscal package requires long preparation and may be hampered by labour shortages.

The German economy is in a difficult situation: early data indicate that it could have contracted in Q3 for the second consecutive quarter, implying that the economy is in technical recession. The ifo business climate index however improved slightly in September, reflecting a better assessment of the current situation in the non-manufacturing sector. By contrast, expectations continue to go down. The downturn is mainly concentrated in manufacturing where business surveys have reached very low levels. Indicators for services and construction, although weaker from a year earlier, remain at relatively high levels. Labour market conditions remain extremely tight. The unemployment rate was 3% in July, the lowest in the eurozone. In August, a slight rise in unemployment and an increase in short-time work have been noted. In summary, it seems that Germany is in a technical recession at full employment. The Bundesbank considers the current turbulence as a normalisation of the economic situation.

Yet, calls for fiscal stimulus are increasing. Finance Minister Olaf Scholz recently signalled to be ready for a considerable fiscal boost in the case of an economic crisis. The head of the Bundesverband der Deutschen Industrie (BDI), an industry association, called for stepping up investments in digital infrastructure and energy efficiency, seizing the opportunity of negative borrowing costs for the government. Public money could be levered with private funding so as to have a bigger effect. ECB President Mario Draghi has been insisting strongly that countries which have fiscal policy leeway (e.g. Germany, The Netherlands) use this to boost growth, thereby enhancing the effectiveness of the very accommodative monetary policy.

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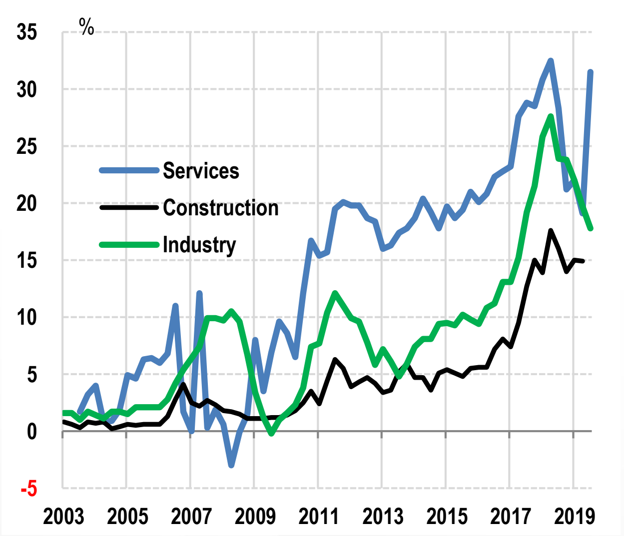
GERMANY: LABOUR MARKET BOTTLENECKS

% of firms reporting labour shortages



Source: European Commission, BNP Paribas

Eco WEEK

ECONOMIC RESEARCH DEPARTMENT

BNP PARIBAS

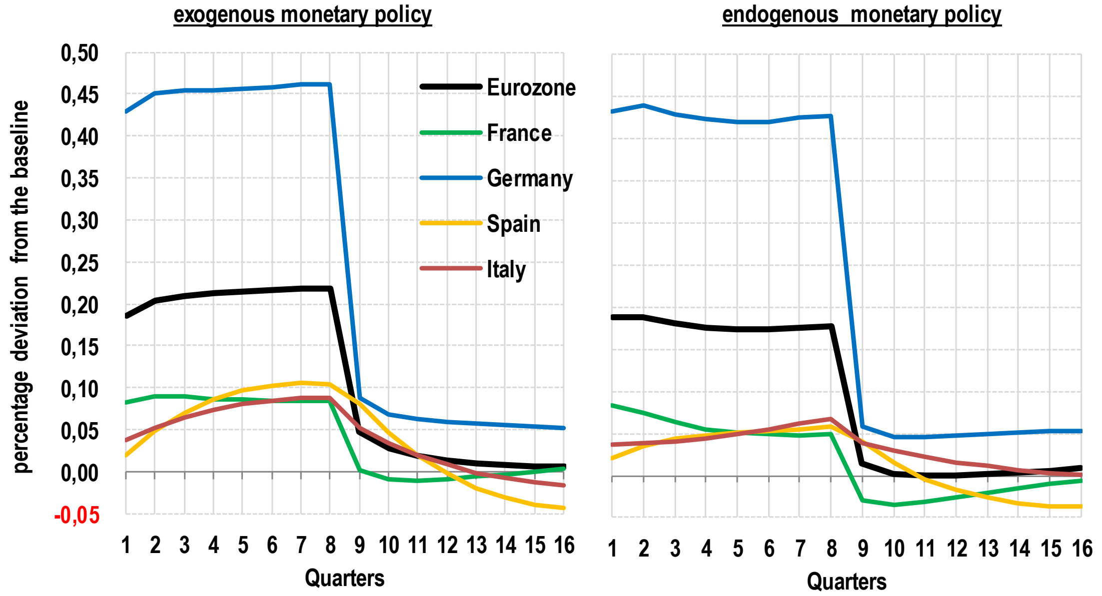
The bank for a changing world

Other eurozone countries are following this debate with great interest, hoping that a German fiscal boost would generate positive spillover effects in terms of growth. The charts show the simulation results using the NiGEM model of an increase of German public investment equivalent to 1% of GDP during two years. All in all, the effects are small. Starting with the chart on the right, German GDP is between 0.40 and 0.45 percentage points higher than the baseline. For the eurozone as a whole, the impact is between 0.15 and 0.20 p.p. For France, Italy and Spain, the impact is negligible in the short run and, in France and Spain it even ends up as a tiny drag on growth because faster German growth creates an environment that warrants a monetary tightening. Given the ECB's recent messages in terms of state-dependent forward guidance, it is more appropriate to run a simulation whereby the policy rate is locked at its level in the baseline scenario. As shown in the chart on the right, the effects are slightly more positive but remain very small.

The simulations suggest that the rest of the eurozone should not expect too much from a possible German reflation. Another reason to cool down the enthusiasm is that the likelihood of anything happening is looking very slim. Policy is already scheduled to be mildly expansionary in accordance with the coalition agreement, although the budget will remain in surplus. Stepping up government investment further, might not be effective because of long planning periods and bottlenecks in the labour market. Recently, the government unveiled a EUR 54 billion climate change package for 2020-2023 to reach the 2030 objectives. Measures to stimulate investment in low carbon infrastructure are largely paid out of the expansion of the national emission trading system to cover the transport sector and heating of buildings. It should hardly weigh on the budget. The "Schwarze Null" which is in the Constitution might not go away soon, unless the economy would go in a full-fledged downturn.

William De Vijlder & Raymond Van Der Putten

THE IMPACT OF AN EXPANSION OF GOVERNMENT INVESTMENT IN GERMANY ON REAL GDP*



* expansion of government investment by 1% of GDP for two years

Source: BNP Paribas simulations using NIGEM

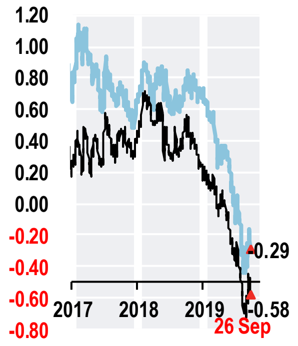
Markets overview

The essentials

Week 20-9 19 > 26-9-19

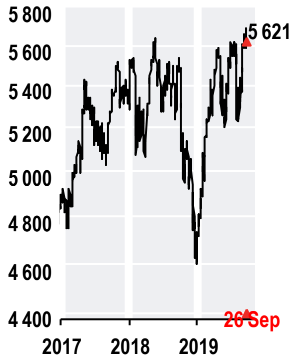
↘ **CAC 40**	5 691	▶	**5 621**	**-1.2**	%
↘ **S&P 500**	2 992	▶	**2 978**	**-0.5**	%
↗ Volatility (VIX)	15.3	▶	16.1	+0.8	pb
↘ **Euribor 3M (%)**	-0.39	▶	**-0.41**	**-2.0**	bp
↘ Libor $ 3M (%)	2.13	▶	2.10	-3.5	bp
↘ OAT 10y (%)	-0.23	▶	-0.29	-6.4	bp
↘ Bund 10y (%)	-0.52	▶	-0.58	-6.0	bp
↘ US Tr. 10y (%)	1.75	▶	1.69	-6.7	bp
↘ **Euro vs dollar**	1.10	▶	**1.09**	**-0.6**	%
↗ Gold (ounce, $)	1 504	▶	1 510	+0.4	%
↘ **Oil (Brent, $)**	65.0	▶	**61.8**	**-4.8**	%

10 y **bond yield, OAT vs Bund**



Euro-dollar

CAC 40



Money & Bond Markets

Interest Rates		highest' 19		lowest' 19	
€ ECB	**0.00**	0.00	at 01/01	0.00	at 01/01
Eonia	**-0.46**	-0.25	at 07/06	-0.46	at 20/09
Euribor 3M	**-0.41**	-0.31	at 24/01	-0.45	at 03/09
Euribor 12M	**-0.32**	-0.11	at 06/02	-0.40	at 21/08
$ FED	**2.00**	2.50	at 01/01	2.00	at 19/09
Libor 3M	**2.10**	2.81	at 01/01	2.10	at 25/09
Libor 12M	**1.99**	3.04	at 21/01	1.89	at 05/09
£ BoE	**0.75**	0.75	at 01/01	0.75	at 01/01
Libor 3M	**0.76**	0.93	at 29/01	0.75	at 29/08
Libor 12M	**0.93**	1.19	at 11/01	0.81	at 03/09

At 26-9-19

Yield (%)		highest' 19		lowest' 19	
€ AVG 5-7y	**-0.27**	0.68	at 09/01	-0.36	at 03/09
Bund 2y	**-0.74**	-0.53	at 05/03	-0.92	at 02/09
Bund 10y	**-0.58**	0.25	at 01/01	-0.72	at 28/08
OAT 10y	**-0.29**	0.73	at 08/01	-0.44	at 28/08
Corp. BBB	**0.80**	2.15	at 08/01	0.64	at 30/08
$ Treas. 2y	**1.69**	2.62	at 18/01	1.44	at 04/09
Treas. 10y	**1.69**	2.78	at 18/01	1.46	at 04/09
Corp. BBB	**3.29**	4.65	at 01/01	3.15	at 04/09
£ Treas. 2y	**0.42**	0.83	at 27/02	0.32	at 03/09
Treas. 10y	**0.45**	1.35	at 18/01	0.33	at 03/09

At 26-9-19

10y bond yield & spreads

1.63%	Greece	220 pb
0.83%	Italy	140 pb
0.18%	Portugal	75 pb
0.16%	Spain	73 pb
-0.27%	Belgium	30 pb
-0.27%	Ireland	30 pb
-0.29%	France	29 pb
-0.32%	Finland	25 pb
-0.32%	Austria	25 pb
-0.44%	Netherland	14 pb
-0.58%	Germany	

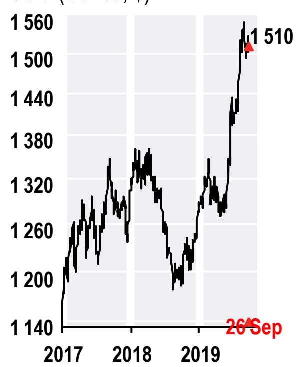
Commodities

Spot price in dollars		lowest' 19			2019(€)
Oil, Brent	**61.8**	53.1	at	01/01	**+21.6%**
Gold (ounce)	**1 510**	1 268	at	02/05	**+23.1%**
Metals, LMEX	**2 772**	2 718	at	07/08	**+3.4%**
Copper (ton)	**5 693**	5 585	at	03/09	**-0.0%**
CRB Foods	**324**	312	at	11/09	**+4.3%**
wheat (ton)	**174**	166	at	30/08	**-7.6%**
Corn (ton)	**142**	128	at	24/04	**+8.7%**

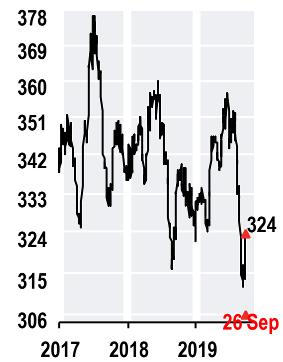
At 26-9-19 *Variations*

Oil (Brent, $)

Gold (Ounce, $)



CRB Foods



Exchange Rates

1€ =		highest' 19			lowest' 19			2019
USD	**1.09**	1.15	at	10/01	1.09	at	26/09	**-4.3%**
GBP	**0.89**	0.93	at	12/08	0.85	at	14/03	-1.2%
CHF	**1.09**	1.14	at	23/04	1.08	at	04/09	-3.6%
JPY	**117.81**	127.43	at	01/03	116.08	at	03/09	-6.1%
AUD	**1.62**	1.66	at	07/08	1.57	at	18/04	-0.3%
CNY	**7.80**	7.96	at	27/08	7.51	at	25/04	-0.6%
BRL	**4.54**	4.63	at	27/08	4.18	at	31/01	+2.5%
RUB	**70.43**	79.30	at	01/01	70.22	at	24/09	-11.2%
INR	**77.56**	82.00	at	04/02	76.37	at	01/08	-2.8%

At 26-9-19 *Variations*

Equity indices

	Index	highest' 19			lowest' 19			2019	2019(€)
CAC 40	**5 621**	5 691	at	20/09	4 611	at	03/01	+18.8%	**+18.8%**
S&P500	**2 978**	3 026	at	26/07	2 448	at	03/01	+18.8%	**+24.1%**
DAX	**12 289**	12 630	at	04/07	10 417	at	03/01	+16.4%	**+16.4%**
Nikkei	**22 048**	22 308	at	25/04	19 562	at	04/01	+10.2%	**+17.3%**
China*	**75**	86	at	09/04	68	at	03/01	+7.0%	**+11.5%**
India*	**567**	612	at	03/06	526	at	22/08	+3.3%	**+6.3%**
Brazil*	**2 123**	2 354	at	10/07	1 862	at	17/05	+17.0%	**+14.1%**
Russia*	**716**	747	at	04/07	572	at	01/01	+17.4%	**+30.8%**

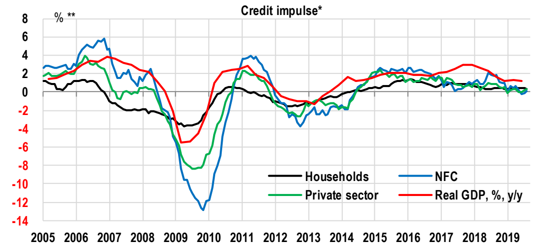
At 26-9-19 *Variations*

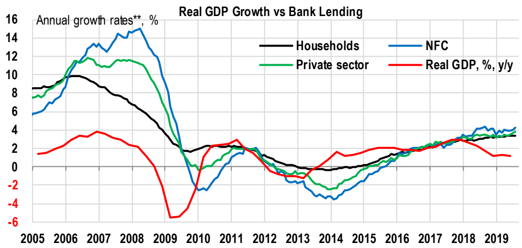
* MSCI index

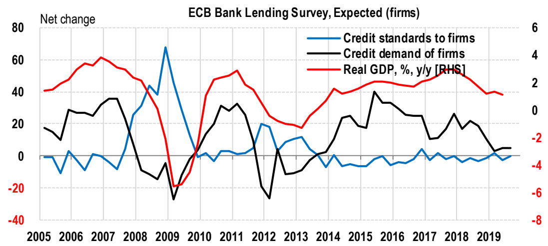
Pulse

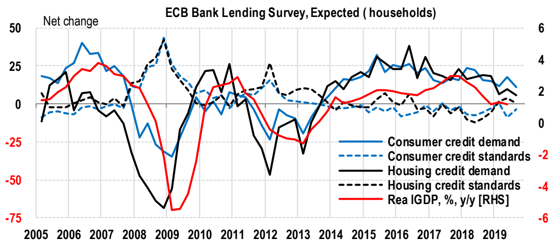
Eurozone : Bank loans to corporations grow at a slightly faster pace than loans to households

Credit impulse slightly picked up in August 2019 for non-financial corporations (NFCs), while it was nearly unchanged for households. In spite of the slowdown in the euro area GDP in Q2 2019 (+1.1% yoy in 2019 Q2 vs +1,3% in Q1), exceptionally low lending rates have continued to support loans outstanding, which reached +3.4% year-on-year for households, and +4,3% for non-financial corporations. Banks expect demand from NFCs to stay close to its current levels in Q4 2019, which should experience a modest tightening in lending conditions. Credit institutions also expect a moderation in loans for house purchase and consumer loans' demand from households. They intend to ease lending conditions for the former and to tighten them for the latter.









*Credit impulse is measured as the annual change of the annual growth rate of MFI loans ** Adjusted for securitizations

Source: ECB, ECB survey on the distribution of credit, BLS, BNP Paribas calculations

Indicators preview

It's the start of a new month and this means a heavy data schedule ahead of us. Purchasing managers indices for manufacturing and services as well as the composite number will be published in several countries. In this respect, the attention will go in particular to the Chinese PMIs and to Germany, where recent data continue to point to an increasingly challenging outlook. In the US, the ISM indices for the manufacturing and non-manufacturing sector and the crucially important labour market data will allow to gauge how the economy is doing. This will influence market expectations in terms of Federal Reserve policy for the remainder of the year.

Date	Country/Region	Event	Period	Survey	Prior
09/30/2019	China	Composite PMI	Sep.	--	53.0
09/30/2019	China	Manufacturing PMI (Caixin)	Sep.	50.2	50.4
09/30/2019	Eurozone	Unemployment rate	Aug.	--	7.5%
09/30/2019	Germany	CPI EU Harmonized	Sep.	--	1.0%
10/01/2019	Japan	Large manuf. (Tankan)	3Q	--	89.3617
10/01/2019	France	Manufacturing PMI (Markit)	Sep.	--	50.3
10/01/2019	Germany	Manufacturing PMI (Markit/BME)	Sep.	--	41.4
10/01/2019	Eurozone	Manufacturing PMI (Markit)	Sep.	--	45.6
10/01/2019	Eurozone	CPI y/y	Sep.	--	0.9%
10/01/2019	United States	Manufacturing ISM	Sep.	50.5	49.1
10/02/2019	Japan	Consumer confidence	Sep.	--	37.1
10/03/2019	France	Composite PMI (Markit)	Sep.	--	51.3
10/03/2019	Germany	Composite PMI (Markit/BME)	Sep.	--	49.1
10/03/2019	Eurozone	Composite PMI (Markit)	Sep.	--	50.4
10/03/2019	Eurozone	Retail Sales y/y	Aug.	--	2.2%
10/03/2019	United States	Durable Goods Orders	Aug.	--	--
10/03/2019	United States	Non-manufacturing ISM	Sep.	55.2	56.4
10/04/2019	United States	Change in non-farm payroll	Sep.	140000	130000
10/04/2019	United States	Unemployment rate	Sep.	3.6%	3.7%

Source: Bloomberg, BNP Paribas

Economic scenario

UNITED STATES

- Growth is slowing and this trend is expected to continue under the influence of corporate investment (slower profits growth, uncertainty) and housing (declining trend of affordability). Consumer spending should be more resilient. The trade dispute with China acts as an additional drag. Inflation is expected to decline, due to softer growth and weaker oil prices.
- We expect one more Fed Funds target rate cut of 25bp this year and two additional cuts in 2020.

CHINA

- Economic growth continues to slow and our GDP forecasts have been revised down since June. Industrial activity and exports have been hard hit by US tariff hikes. Domestic demand has also decelerated.
- The central bank is easing liquidity and credit conditions, though the reduction in financial-instability risks should remain a priority and banks seem to remain prudent. Fiscal policy is expansionary through increased infrastructure spending and a rising number of household/corporate tax cuts.
- In the short term, exports and private domestic investment should continue to decelerate. Tax measures should have some success in supporting consumer spending.

EUROZONE

- The economic slowdown is continuing in the eurozone, especially in Germany, due to notably international environment uncertainties and a slowdown of the Chinese economy. Activity in the manufacturing sector continues to decline but services still show resilience.
- Inflation is now expected to decrease while core CPI is hardly moving. The activity slowdown also implies that the pick-up in core inflation should be slower than expected until recently.
- Faced with an outlook of subdued inflation, the Governing Council has eased policy at its meeting on 12 September. This very accommodative environment will be maintained as long as inflation hasn't converged sufficiently, in a convincing and lasting way, towards the ECB's objective.

FRANCE

- Growth is slowing although the economy shows resilience. Households' consumption should get a boost from the tax cuts and the jobs recovery but inflation reduces purchasing power gains. Business investment dynamics remain favourable. The global backdrop is less supportive. A slight rise in core inflation is appearing but remains to be confirmed.

INTEREST RATES AND FX RATES

- In the US, we expect the Fed to cut its official rate in December in reaction to a slowing economy, moderate inflation and heightened uncertainty. 2020 should see two more cuts. Treasury yields are to decline further in the coming months. Eventually, in the course of 2020 they should move up again in anticipation of a pick-up in growth.
- In the eurozone, the ECB's state-dependent forward guidance and the sluggishness of the inflation process imply that the very accommodative environment will remain in place for a long time. This will exert downward pressure on bond yields.
- No policy rate change expected in Japan.
- With the Fed in easing mode and given the very accommodative ECB policy, we expect little change in EUR/USD even though euro's fair value is quite higher than current pricing. The yen should strengthen on the back of stable BoJ policy and high market volatility.

	GDP Growth			Inflation		
%	2018	2019 e	2020 e	2018	2019 e	2020 e
Advanced	**2.2**	**1.6**	**1.0**	**2.1**	**1.4**	**1.3**
United-States	2.9	2.2	1.5	2.4	1.8	1.8
Japan	0.8	1.2	0.2	1.0	0.6	0.3
United-Kingdom	1.4	1.1	0.6	2.5	1.9	1.8
Euro Area	**1.9**	**1.1**	**0.7**	**1.8**	**1.1**	**0.8**
Germany	1.4	0.4	0.2	1.9	1.4	1.0
France	1.7	1.2	1.0	2.1	1.2	1.0
Italy	0.7	0.1	0.0	1.2	0.6	0.5
Spain	2.6	2.2	1.6	1.7	0.8	0.7
Emerging	**4.4**	**3.8**	**4.2**	**4.7**	**4.8**	**4.5**
China	6.6	5.9	5.6	2.1	2.4	2.8
India*	6.8	6.5	6.3	2.9	3.0	3.3
Brazil	1.1	0.5	2.0	3.7	3.7	3.5
Russia	2.3	1.2	2.0	2.9	4.8	3.8

Source : BNP Paribas Group Economic Research (e: Estimates & forecasts)
* Fiscal year from April 1st of year n to March 31st of year n+1

Interest rates, %		2019						
End of period		Q1	Q2	Q3e	Q4e	2018	2019e	2020e
US	Fed Funds	2.50	2.50	2.00	1.75	2.50	1.75	1.25
	Libor 3m $	2.60	2.32	1.90	1.70	2.81	1.70	1.25
	T-Notes 10y	2.42	2.00	1.35	1.00	2.69	1.00	1.50
Ezone	Deposit rate (%)	-0.40	-0.40	-0.50	-0.60	-0.40	-0.60	-0.60
	Bund 10y	-0.07	-0.32	-0.50	-0.80	0.25	-0.80	-0.50
	OAT 10y	0.26	-0.01	-0.20	-0.55	0.71	-0.55	-0.30
UK	Base rate	0.75	0.75	0.75	0.75	0.75	0.75	0.75
	Gilts 10y	1.00	0.84	0.75	0.55	1.27	0.55	0.75
Japan	BoJ Rate	-0.06	-0.08	-0.10	-0.10	-0.07	-0.10	-0.10
	JGB 10y	-0.09	-0.16	-0.30	-0.40	0.00	-0.40	-0.25

Source : BNP Paribas GlobalMarkets (e: Forecasts)

Exchange Rates		2019						
End of period		Q1	Q2	Q3e	Q4e	2018	2019e	2020e
USD	EUR / USD	1.12	1.14	1.10	1.11	1.14	1.11	1.14
	USD / JPY	111	108	105	102	110	102	96
	GBP / USD	1.30	1.27	1.20	1.23	1.27	1.23	1.36
	USD / CHF	1.00	0.98	0.99	0.99	0.99	0.99	1.00
EUR	EUR / GBP	0.85	0.89	0.92	0.90	0.90	0.90	0.84
	EUR / CHF	1.12	1.11	1.09	1.10	1.13	1.10	1.14
	EUR / JPY	124	123	116	113	125	113	109

Source : BNP Paribas GlobalMarkets (e: Forecasts)

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