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.

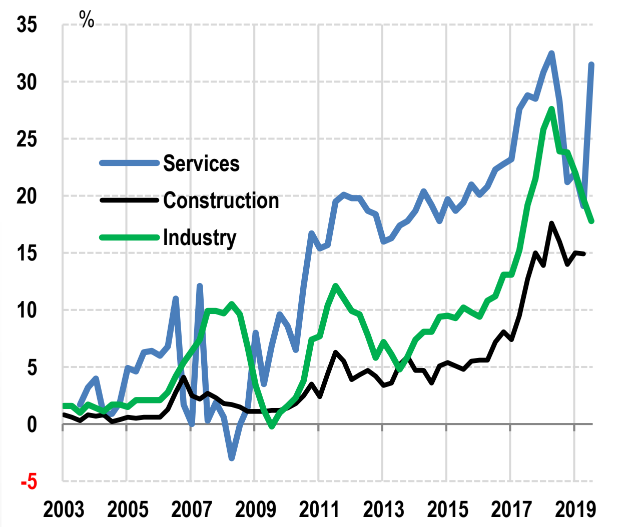
The German economy is in a difficult situation: early data indicate that it could have contracted in Q3 for the second consecutive quarter, implying that the economy is in technical recession. The ifo business climate index however improved slightly in September, reflecting a better assessment of the 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.

…/…

GERMANY: LABOUR MARKET BOTTLENECKS

% of firms reporting labour shortages



Source: European Commission, BNP Paribas

Eco WEEK

ECONOMIC RESEARCH DEPARTMENT

BNP PARIBAS

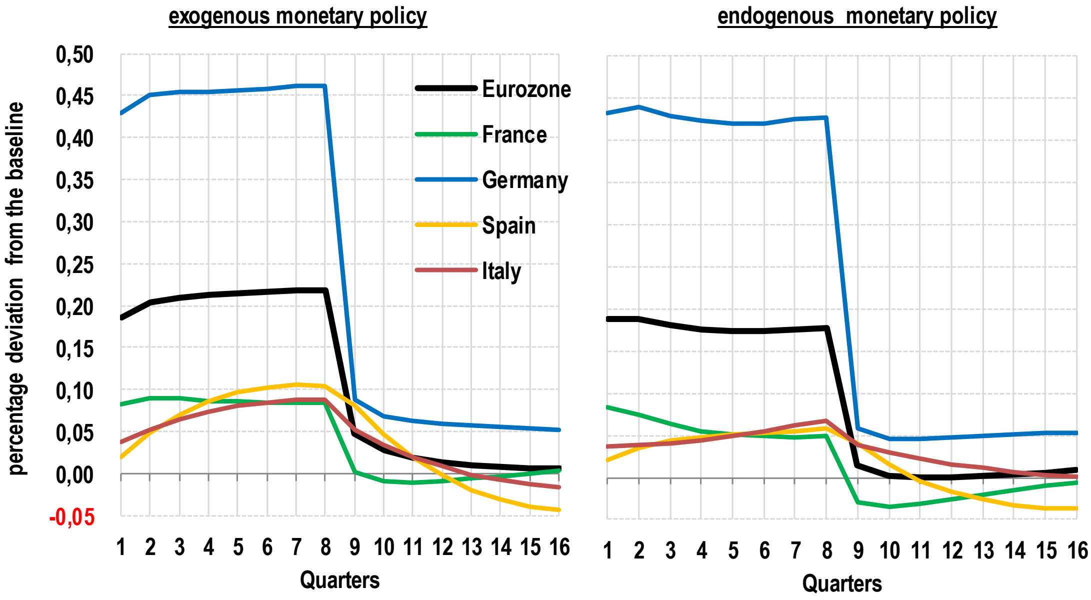
The bank for a changing world

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