Germany

Historic stimulus for fighting corona crisis

The German economy has come to a standstill because of the almost complete lockdown. To fight the economic consequences, the government launched a massive stimulus plan to increase spending in the health sector, protect jobs and support businesses. Nevertheless, production losses may reach dimensions that are well beyond growth falls in previous recessions. In the worst scenario of a three-month lockdown, GDP growth could lose around 20 percentage points and 6 million people may have to join the short-time work scheme.

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Coronavirus derails economy

In March, the German economy came virtually to a halt because of an almost complete lockdown. The measures are meant in the first place to stem the rapid expansion of the coronavirus and avoid overloading the health system. However, they will have a massive economic impact.

Some sectors have completely shut down such as education, non-essential retail outlets, hotels, restaurants and the tourism industry. In some services sector, activity could be maintained, albeit at a much slower pace, thanks to teleworking. In the manufacturing sector, production had often to be halted because the breaking down of supply chains. Production in the car industry was halted not only because of supply disruptions or staff shortages, but also because of collapsing demand.

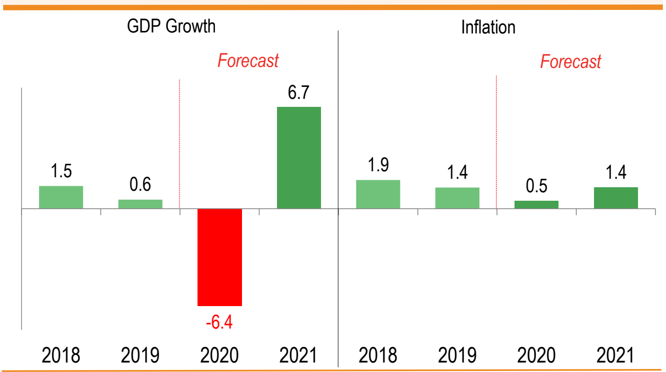
The March surveys indicate a sharp deterioration of the business climate. The Ifo climate index, a reliable business sentiment indicator, collapsed by 10 points the steepest fall ever recorded since German reunification. Other indicators available within a particular short time delay also show a sharp decline in demand. At Frankfurt Airport, in the week of 16-22 March, passenger numbers slumped by almost 75% from a year earlier, whereas cargo volume dropped by about one fifth. The German economy is in shock.

Quick and strong action to protect the economy

In March, the German government launched an aid package of historic proportions. The main aim is to protect jobs and income. The package has three pillars. The first pillar is dedicated to protect the health care sector. EUR 3.5 billion are made available for emergency measures, such as buying protective suits and masks, working on a vaccine. Additionally, EUR 55 bn are made available to fight the pandemic.

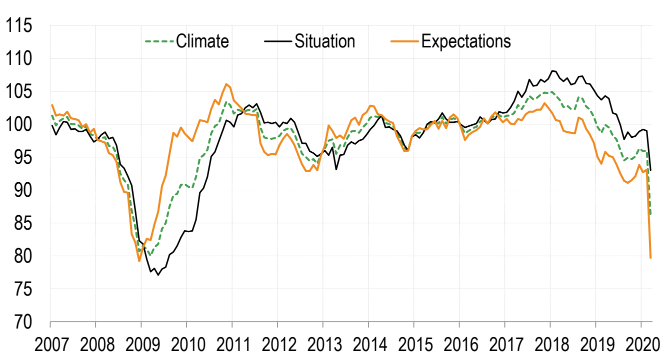
The second pillar consists of measures to protect jobs by facilitating access to short-time working scheme (Kurzarbeit), under which the Federal Employment Agency (FEA) pays 60-67% of the forgone wages of workers whose hours are being cut. The scheme was very successful in protecting jobs during the great recession in 2008-09. During that period, the FEA disbursed about EUR 10 billion, mainly to workers in the manufacturing sector. This time the scheme will be much widely used in other sectors, such as retail, hotels and restaurants. In addition, eligibility requirements to the scheme have been loosened. The costs of the measure are hard to predict as they depend on the depth and duration of the crisis (see below).

1- GDP Growth and inflation
(Y/Y, %)



Source: BNP Paribas Global Markets

2- Deterioration in the business climate in March
2015=100



Source: IFO

The third and by far the largest pillar of the package is an extensive assistance programme to support businesses, partly through the expansion of existent schemes – liquidity assistance programmes and loan guarantees mainly through the German state development bank KfW – or a new programme to support small businesses, freelancers and the self-employed. Tax authorities will grant tax payments deferrals. Moreover, funds are available at the federal and the state (Land) level to buy equity stakes in struggling companies.

The budgetary costs are considerable. The Federation will take out new loans totaling roughly EUR 156 bn (4.5% of GDP). This does not include possible calls on the loan guarantees or participations in equity.

Germany supports the efforts on the European level. It welcomes the plan to establish a EUR 25 bn Coronavirus Response Investment Initiative. It also has opened its hospitals for corona victims from other EU countries. However, the government remains opposed to the pooling of European debt, which would have helped lending to the southern European countries that are most hit by the coronavirus.

Outlook depends on length and depth of the crisis

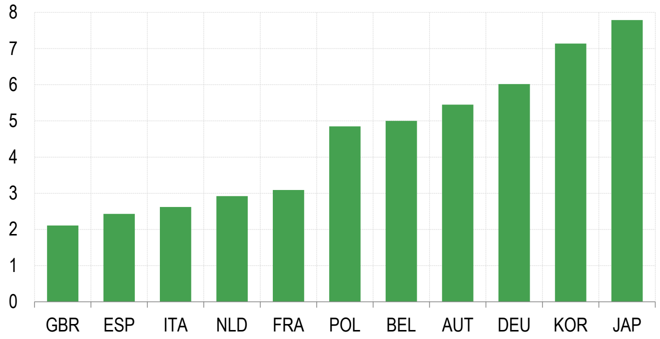
The effect of the corona crisis is much more severe than anything that the Federal Republic has experienced in its history. The output losses will depend on the duration of the lockdown period, the fall in activity during that time, and the subsequent recovery period. To gain some insight in the possible magnitude, the Ifo institute has developed three scenarios – low, high, and a medium scenario based on business expectations in the March Ifo survey – combined with different lockdown durations and recovery periods.[1] These calculations assume that the lockdown period will last between one month in the mildest scenario to three months in the most severe one. In all scenarios, activity could return in 2021 to the same as level as before the crisis.

In the mildest scenario - 40% GDP loss in the lockdown month and one month post-lockdown recovery period – the annual GDP growth rate could decline by around 5%. In the most severe scenario, the GDP loss in the lockdown month amounts to 48.7% and the loss in the annual growth rate could be 6.1%. If the lockdown period lasts for 2 months and the recovery period 3 months, the decline in the annual GDP growth rate amount to 12% and 14% in the low and high scenario, respectively. In the worst case scenario, a three-month lockdown followed by a four-month recovery period, the losses could amount to around 20% of GDP.

In all scenarios, the total number of short-time workers rises to levels that exceed the 1.5 million part-time workers during the 2008-09 financial crisis significantly. In the case of a one-month lockdown, 2.1 million to 3.9 million can be expected according to the Ifo calculations. If the lockdown continues for two or three months, the number should increase to 3.4 to 5.5 million and 4.2 million to 6.6 million, respectively.

The state budget is likely to be heavily impacted. From a stabilisation point of view, this is a desirable effect. A study on the impact of the tax and transfer systems in the European Union and the US in the 2008-09 economic crisis found that the automatic stabilisers absorb 48% of an income shock in Germany, compared with 38% in the EU and 32% in the US.[2] The Ifo scenarios show that, depending on the length of the lockdown period and the severity of the activity fall, the burden on the state budget could be between EUR 50 bn or 1.4% of GDP (low scenario, 1 month lockdown) to EUR 200 bn or 5.7% of GDP (high scenario, 3 month lockdown).

3- High hospital bed capacity in Gemany
Acute care hospital beds per 1000 people



Source: OECD

These budgetary costs do not include losses on state-guaranteed loans and the contribution to the European emergency package. It is likely that the German government accounts remain in deficit for a considerable period.

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[1] Ifo (2020), *Shutdown für Deutschland: Eine Szenarienrechnung*, ifo Schnelldienst, 2020, 73, Nr. 04.
[2] Dolls, M., Fuest, C., & Peichl, A. (2012). *Automatic stabilizers and economic crisis: US vs. Europe*. Journal of Public Economics, 96(3-4), 279-294.