Global Economy

Approaching fiscal stimulus in Germany

El Confidencial (Spain)

Rafael Doménech

Faced with a 0.1% GDP contraction in the second quarter and the possibility of a third-quarter repeat—as raised recently by the Bundesbank—there is speculation that the German government may approve a stimulus package of up to EUR 50 billion, equivalent to 1.5% of GDP. This was confirmed a few days ago by Finance Minister Olaf Scholz.

The reasons are not new and have much to do with the weakness of the manufacturing sector, the shrinking of Germany's powerful automobile sector since 2018, international trade tensions and uncertainties surrounding Brexit. All of this in an economy that has been growing for a decade, with a GDP 20% higher than in 2009 and unemployment at 3.1%, lows not seen since 1980.

Germany has fiscal margin for stimulus of the proposed magnitude, although everything suggests that any actual stimulus would be significantly smaller, at least under current conditions. Its public accounts ended 2018 with a surplus of 1.7% of GDP. The spring forecasts by the European Commission were for a surplus remaining close to 1% in 2019, allowing public debt to fall to slightly above 58% of GDP. Furthermore, the German 10-year bond yield is in negative territory (-0.65%).

Taking into account the usual fiscal multipliers, the impact on GDP of the potential fiscal stimulus could be significant. This is why the stimulus must be well designed. It must be implemented at the right time, be temporary and contain specific well-targeted and effective measures. This is always important and even more so in an economy that has been running at practically full capacity. An increase in infrastructure spending (probably appropriate for other reasons) may be overdue and increase construction activity, without helping the automobile sector. This could cause a mismatch in the labor market due to increasing demand for some occupations and a decline for others. The workings of the economy are much more complex. There are no perfect communicating vessels between sectors to ensure that Keynesian fiscal stimulus measures have the expected effects on declining sectors.

Remember that, during the international financial crisis, the main route of adjustment for the German economy was its ability to reduce working hours for some time in the sectors most affected by the collapse of international trade, without significantly increasing unemployment. This flexibility enabled workers to hold on to their jobs and most of their incomes (thanks also to government assistance). Companies were able to reduce costs without having to lay off qualified staff that they needed later, while the public sector minimized the cost of unemployment benefits.

Insofar as the current weakness in external demand or in some sectors is temporary, this mechanism will again be useful. However, if this is more of a structural adjustment, a general fiscal stimulus on aggregate demand could be ineffective in the automobile sector or sectors most exposed to declining global production chains. In this case, policies that facilitate sectoral adjustment and increase the long-term potential growth of the German economy are preferable. In the meantime—pending a proper assessment of the extent, length and causes of the recession—it is best not to be rushed. If everything is ultimately a temporary adjustment of an economy that returns to its growth path with a more neutral cyclical position, it will suffice to let fiscal stabilizers act normally. If it is a structural adjustment, fiscal policies must be chosen well to ensure they are effective in the long term.

DISCLAIMER

This document has been prepared by BBVA Research Department. It is provided for information purposes only and expresses data, opinions or estimations regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

Any estimations this document may contain have been undertaken according to generally accepted methodologies and should be considered as forecasts or projections. Results obtained in the past, either positive or negative, are no guarantee of future performance.

This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

With regard to investment in financial assets related to economic variables this document may cover, readers should be aware that under no circumstances should they base their investment decisions on the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

The content of this document is protected by intellectual property laws. Reproduction, transformation, distribution, public communication, making available, extraction, reuse, forwarding or use of any nature by any means or process is prohibited, except in cases where it is legally permitted or expressly authorised by BBVA.

ENQUIRIES TO:
BBVA Research: Azul Street. 4. La Vela Building – 4th and 5th floor. 28050 Madrid (Spain).
Tel. +34 91 374 60 00 y +34 91 537 70 00 / Fax (+34) 91 374 30 25
bbvaresearch@bbva.com www.bbvaresearch.com