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Germany: EUR 130 bn stimulus to support growth after COVID-19 shock

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Yesterday evening, the coalition committee agreed on a so-called "Fiscal Stimulus and Crisis Management Programme" (Konjunktur- und Krisenbewältungsprogramm). The overarching goal of the programme is to boost the economy, secure employment, unleash Germany's economic potential, mitigate the adverse economic and social consequences due to the crisis, strengthen the federal states and municipalities and, finally, give financial support to families.

The two programmes have a total volume of EUR 130 bn (around 3.8% of GDP in 2019) and are therefore (at a first glance) clearly above the expected range of EUR 80-100 bn. At a second glance, however, the fiscal package is somewhat lower than it seems as the part of the EUR 25 bn of "interim aid" paid to firms should be financed through unused resources from already existing programmes. As a result, we understand that the effective size of the fiscal package is "only" around EUR 105 bn (3.1% of GDP in 2019) and thus very close to the stimulus volume of EUR 100 bn which we had already assumed in our baseline scenario for 2021. However the overall effect from the recent government stimulus package will probably be more front-loaded than we have thought so far as large parts of the package (like the VAT reduction) will become already effective in 2020 (recall: we assumed a fiscal stimulus not starting before 2021).

Given the deepness of the COVID-19 crisis, there was probably no way around for the government to come up with another large stimulus programme. The volume confirms the government's paradigm in this crisis to do things big to maximize the psychological impact.

We expect the temporary reduction in value-added tax will have a strong short-term economic effect on private consumption and thus also on the economy as a whole in H2 2020. However, this is based on a targeted strong pull-forward effect of private consumer spending, which is likely to be bought at the price of a weak development in H1 2021.

The promised rise in "future investment" is per se a good thing to boost the economy (given a large multiplier effect of public investment). Still, timely implementation could be an issue (implementation lags, pent-up investment). Hence, these additional investments will help raising Germany's growth potential but are unlikely to have any meaningful effects on economic growth in the short-run.

EUR 130 bn fiscal stimulus package for 2020/21

Yesterday evening, the coalition committee agreed on a so-called "Fiscal Stimulus and Crisis Management Programme" (Konjunktur- und Krisenbewältungsprogramm). The overarching goal of the programme is to boost the economy, secure employment, unleash Germany's economic potential, mitigate the adverse economic and social consequences due to the crisis, strengthen the federal states and municipalities and, finally, give financial support to families. To strengthen Germany's position as a global exporter of high-technology as well as to improve the domestic health system and the protective power of the country against pandemics, the above programme will be also supplemented with a dedicated "Future Programme" (Zukunftspaket).

The two programmes have a total volume of EUR 130 bn (around 3.8% of GDP in 2019) and are therefore (at a first glance) clearly above the expected range of EUR 80-100 bn. The federal government contributes EUR 120 bn to the programme (3.5% of GDP), the remaining EUR 10 bn (0.3% of GDP) will be provided by the 16 federal states. At a second glance, however, the fiscal package is somewhat lower than it seems as the part of the EUR 25 bn of "interim aid" paid to firms should be financed through unused resources from already existing programmes. As a result, we understand that the effective size of the fiscal package is "only" around EUR 105 bn (3.1% of GDP in 2019) and thus very close the stimulus volume of EUR 100 bn which we had already assumed in our baseline scenario for 2021. However the overall effect from the recent government stimulus package will probably be more front-loaded then thought as large parts of the package (like the VAT reduction) will become already effective in 2020 (recall: we assumed a fiscal stimulus not starting before 2021).

The programme(s) at a glance

The stimulus package includes a large list of single measures (a total of 57 points) and aims to a) stimulate private consumption (value added tax reduction, family bonus), b) give further financial (liquidity) support to economic sectors strongly affected by the crisis ("interim aid") and c) promote the modernization of the economy (e.g. digitalisation, climate protection, etc.).

As expected, the coalition partners could not agree on a highly controversial debt relief programme for some highly indebted local communities (proposed by FinMin Scholz, strongly rejected by the CDU/CSU). Instead, the federal government and the federal states (generally, responsible for communal public finance) will support local governments by compensating for the decline in the municipal business tax (Gewerbesteuer) in 2020. The costs will be shared equally between the federal government and the states (estimated at a total of EUR 11.8 bn or 0.3% of GDP in 2019). On top of that, the federal government will finance a larger part of local authorities' expenses for people receiving basic security benefits for job seekers (estimated at EUR 4 bn per year).

Moreover, the highly contentious buyer's premium for combustion-engine powered cars demanded by some federal MPs will not be implemented. Neither will the planned partial abolishment of the solidarity surcharge tax (starting in 2021) be brought forward.

The biggest surprise is the temporary reduction in the value added tax in H2 of this year (starting on 1 July and ending on 31 December 2020). The VAT rate should fall to 16% from a current 19% (the reduced rate to 5% from 7%). The associated tax relief to consumers and/or firms is estimated at around EUR 20 bn (0.6% of GDP in 2019). Certainly, the effect on the consumer price inflation rate will be temporarily negative (and later positive once the reduction terminates). How large the effect on inflation will be is difficult to predict as some firms (e.g. restaurants) could try to pass the (temporary) VAT reduction only partly on to consumers in order to compensate for the higher costs due to hygiene and additional administrative measures. In areas hard hit by the current demand slump (such as automobiles, furniture, etc.) the VAT reduction will almost certainly passed on in order to lure clients back into the shops.

Further relief to private households and firms will be coming from a lowering of electricity tariffs, through a reduction of the "renewable energy law share"; financed by federal extra payments. That said, the planned reduction in the "renewable energy law share" over the 2021-22 period is estimated to amount to a total volume of EUR 11 bn. Moreover, families will receive for every child a one-time payment of EUR 300 (estimated at EUR 4.3 bn).

As regards financial support to firms strongly affected by the Corona pandemic ("interim aid"; Programm für Überbrückungshilfen), the coalition agreed to provide further liquidity/financial support in the amount of up to EUR 25 bn (0.7% of GDP in 2019) during the three months period June to August 2020. Although this financial assistance (i.e. subsidy) is meant to be inter-sectoral, it aims to specifically consider the certain conditions in the most affected economic sectors like for instance the hotel, restaurant, touristic, logistic and exhibition businesses. Firms can apply for the "interim aid" if a) the corona-driven drop in their April/May 2020 sales volume amounts to at least 60% compared to April/May 2019 and b) if the decline in sales will still amount to at least 50% in the period June to August 2020. In case of a drop of at least 50% compared to the level a year ago firms will receive a subsidy of up to 50% of their fixed business expenses. In case of a sales drop of more than 70% firms will receive up to 80% of their fixed business expenses. The maximum amount is capped to EUR 150k for three months. While companies with staff of up to five persons should receive a maximum amount of EUR 9k, companies with up to ten persons should generally receive no more than EUR 15k. The application deadline is 31 August 2020 and payments are made only until the end of November 2020. The financing of the programme expenses should be secured by using unutilised resources from existing programmes. Hence, the above mentioned EUR 25 bn of "interim aid" included in the total fiscal package volume of EUR 130 bn are apparently no extra-spending but rather stemming from a tapping of unused money already provided in the March supplementary budget for 2020. Hence, at a second glance, the fiscal package is effectively amounting to "only" EUR 105 bn (3.1% of GDP in 2019) and hence closer to expected range of EUR 80-100 bn ahead of the coalition meeting.

Moreover, companies' liquidity situation should be supported by stepping up the tax loss carry-back (steuerlicher Verlustrücktrag) in the years 2020 and 2021 (EUR 2 bn). Furthermore, an extension of the depreciation allowance for 2020/21 should incentivise firms to increase business investments (EUR 6 bn).

Given all the above measures, with around EUR 50 bn (1.5% of GDP in 2019) a substantial share of the total stimulus should be allocated into "future investments". This includes for instance the promotion of e-cars (doubling of buyer's premiums) (EUR 2.2 bn), the roll-out of e-charging points (EUR 2.5 bn), the modernisation of bus/truck fleets (EUR 1.2 bn) and airplanes (EUR 1.0 bn). Part of these investments will be further the modernisation of the infrastructure for inland water transportation (EUR 1.0 bn), the implementation of a "national hydrogen strategy" (Nationale Wasserstoffstrategie) (EUR 7 bn), various measures to boost research and development in the business sector as well as the promotion of CO2-friendly building restoration (EUR 2 bn) and artificial intelligence (EUR 2 bn).

As a response to the current pandemic, the coalition also agreed to strengthen the health sector (by e.g. increasing staffing at health offices) (Pakt für den öffentlichen Gesundheitsdienst) (EUR 4 bn), to improve the infrastructure at hospitals (Zukunftsprogramm Krankenhäuser) (EUR 3 bn), to promote the flexible activation of a national production for important pharmaceutical/medical products (EUR 1 bn) and to build-up stockpiling of protective clothing (EUR 1 bn).

VAT reduction to boost private consumption in H2 2020, but no significant near-term growth effects from the rise in public investments

Given the deepness of the COVID-19 crisis, there was probably no way around for the government to come up with another large stimulus programme. The volume confirms the government's paradigm in this crisis to do things big to maximize the psychological impact. The temporary (1 July to 31 December) reduction in the standard (to 16% from 19%) and reduced (to 5% from 7%) VAT rates is the most timely and effective element of the current stimulus package. This is particularly true if companies pass on the adjustments via lower prices. Consumers are likely to be relieved by around EUR 20 bn (0.6% of GDP in 2019) (assuming firms do not raise prices), which should noticeably boost their spending in H2 2020. Nevertheless, private households will very likely remain cautious in the coming months, as the health threat posed by COVID-19 has not disappeared at all. This is also shown, for example, by experiences with consumer behaviour in China and South Korea.

A reduction in VAT is a comparatively more targeted instrument to ease the burden on low-income earners, but middle-income earners will also benefit. Even if the direct economic impact might be limited due to various leakage effects, the positive psychological effect of the economic stimulus package should not be underestimated as it will support consumer confidence. However, at the same time private consumption and overall growth might be pulled back by precautionary savings given the deteriorating labour market situation. We reckon that private consumption growth might be around 3 pp higher in H2 2020, adding a good 1.5 pp to GDP growth in the second half of this year. However, growth in Q1 2021 will be in turn negatively affected by the pay-back in private consumption. Given the high uncertainty regarding the further development of the pandemic and the economy as well as the specific economic effects from the stimulus package, we refrain from fine-tuning our annual GDP growth rate (keeping it unchanged for now at -9% in 2020 and +4% in 2021).

The promised rise in "future investment" is per se a good thing to boost the economy (given a large multiplier effect of public investment). Still, timely implementation could be an issue (implementation lags, pent-up investment). Hence, these additional investments will help raising Germany's growth potential but are unlikely to have any meaningful effects on economic growth in the short-run.

Overall, the effective size of the fiscal package is relatively close to the assumption we had made for our baseline scenario. However the overall effect from the recent government stimulus package will probably be more front-loaded than we have assumed so far as large parts of the package (like the VAT reduction) will become effective in 2020 (recall: we assumed a fiscal stimulus not starting before 2021).

Appendix 1

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