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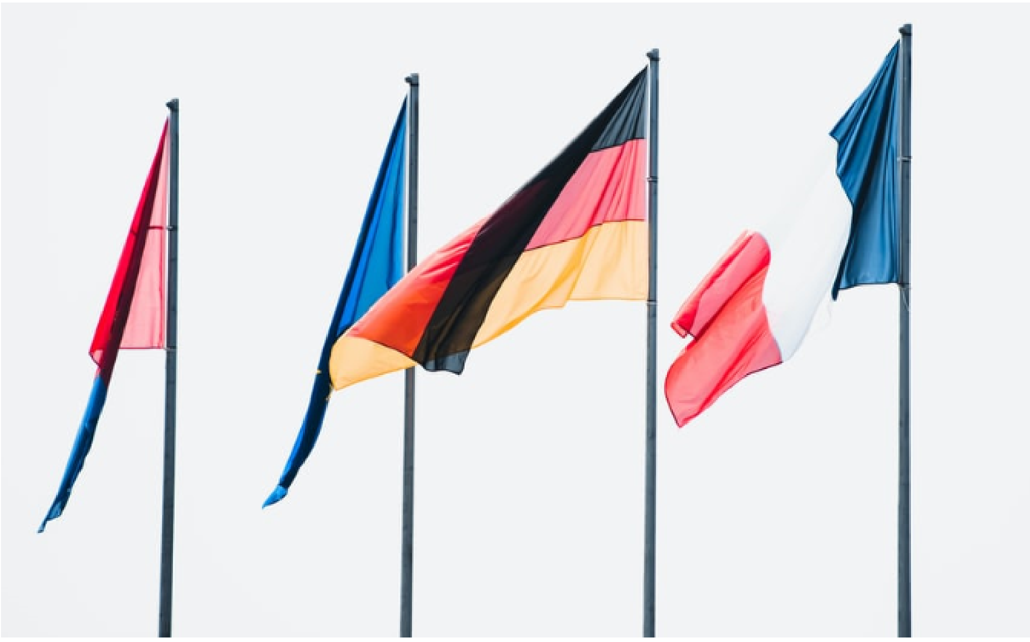
France/Germany: Different flavours of fiscal stimulus



As of now, with no real signs that a second wave of Covid-19 in Europe is threatening a collapse in health systems, the trade-off between public health and the economy is shifting. After emergency fiscal packages aimed at protecting the livelihoods of companies and workers, authorities are now actively stepping up programs to kickstart economic activity.

Paris and Berlin have recently announced national stimulus plans. While both have the same ultimate goal of boosting economic growth, the two packages take a different approach towards achieving this – France concentrates on bolstering national industry (supply), while Germany seeks to catalyse consumer spending (demand). There is, however, a common thread through both, and it is green.

Believing that the current pandemic, while tragic, is also an opportunity to redesign part of our economies, programs around climate adaptation and mitigation have been pushed towards the top of the agenda. Both programs also shared the ambition of kick-starting domestic activity, the current missing-link in achieving inclusive opportunities and a sustained recovery. Southern European countries should soon follow suit and unlike in recent years, their proposals for deficit financing should be better received.

"France Relance"

France's plan (the French relaunch) is worth €100bn (4% of GDP), €40bn of which will come from EU grants under the bloc's €750bn recovery program. The remaining €60bn will come from the national budget, and the Prime Minister, Jean Castex said that this will not result in tax hikes. Rather, it is hoped that tax revenues will flow from increased activity that it is hoped the program will generate. French households have amassed some €100bn in precautionary savings this year, which could potentially be unlocked naturally over time. It therefore makes sense that the overall theme of the plan is more concerned with boosting investment rather than lathering up demand.

From the €100bn, Ministers allocated €30bn to the "ecological transition". Within that figure, €9bn will be spent on the development of a hydrogen industry and other green technologies, €4.7bn on railways and €6.7bn on improving insulation in homes and public buildings. The importance of engineering a green recovery was stressed by President Macron who said: "*The future of hydrogen, recycling, quantum, the future of the green, circular and decarbonated economy must, with this plan, be written in France."*

€35bn will be used to foster industrial competitiveness and innovation, including roughly €20bn in reduced taxes for industry over two years and €1bn to help strategic industries (e.g. healthcare and IT) repatriate operations back onto French soil.

With the gilet jaune movement still in our not-too-distant memory, it is unsurprising that the final €35bn will be used to strengthen "social and regional cohesion". This will be done via employment projects as well as measures targeted towards younger generations such as training, subsidized job contracts and incentives for firms that hire young workers. In July, youth unemployment in France was 19.7% versus

7.1% for the population as a whole.

The French
government expects the economy to shrink up to 11% in 2020 but due to the substantial fiscal package (roughly four times bigger than that rolled out after the financial crisis of 2008) the PM Castex and the Finance Minister, Bruno Le Maire, both said they expected the economy to recover to its pre-crisis level by 2022.

"Ein ambitioniertes Programm"

Germany's
"ambitious program" constitutes a €130bn recovery plan (3% of GDP). For some, the quick reversal of its prudent "black-zero" approach to finances came as quite a surprise, especially considering that in the aftermath of the 2008 crisis, Chancellor Merkel only accepted the need for stimulus (which came in at under 2% of GDP over two years), after the economy had been contracting for three consecutive quarters.

The plan puts emphasis on stimulating demand while sharing France's desire for invigoration. It aims to equip Germany for the future with investment in new technologies, with the guiding theme of climate change mitigation. Berlin will shoulder €120bn of the cost (with a little help from the owners of gas guzzling cars such as SUVs who will begin pay higher taxes from January 2021).

€20bn is
set aside for tax cuts: From July 1st until the end of 2020, the standard rate of VAT will be set at 16% (versus a prior 19%), and the lower band (for essential items such as food) will be 5% as opposed to 7%. At a cost of €4.3bn, parents will receive a
one-off payment of €300 per child.

€50bn is earmarked for climate change, innovation and digital technology such as quantum computing. In relation to the energy transition, €11bn will be used to lower the renewable energy surcharge and with it, the electricity bill of households. The government will also double its share of the existing purchase incentive for electric cars and hybrid cars. To elaborate, Berlin will now pay a grant of €6,000 for a purely electric car. In addition, car manufacturers grant a subsidy of €3,000.

€25bn will be spent on a loan support programme for small firms that
suffered a sales drop of more than 60% in the period from June to August.

This could particularly help bars, restaurants and hotels.

€10bn will be given to municipalities struggling with lower tax receipts, for public spending on infrastructure and housing.

According to government forecasts, the country's GDP should contract by 5.8%. However, from here, German Economy Minister Peter Altmaier, said "we expect to be looking at a V-shaped economic recovery." He expects the economy will return to pre-pandemic levels in 2022.

Germany's
fiscal stimulus comes as good news not only for the domestic economy but for the broader European community. Countries around Germany will benefit from a halo effect - the Finnish Finance Minister acknowledged this saying "This sacrifice by German taxpayers will help us incredibly much". At the same time, if Germany taps the bond markets to finance its spending and issues more Bunds, the ECB will have an easier task in financing the eurozone's most indebted states (because of the capital key rules which dictate proportionality in the ECB's purchasing).

While the
new measures announced by France and Germany vary in style, they should both be instrumental in coaxing back economic activity. With unprecedented fiscal stimulus accompanied by an ultra-easy approach to monetary policy from the ECB, we do believe in a gradual "check-mark" shaped recovery. If investors were not already convinced about the viability of green investing, surely the contents of the fiscal packages outlined above bolster the case. Vast amounts of fiscal funding flowing into the energy transition should present myriad of opportunities. The same can be said for the broad investment theme of digitalisation.

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