On a secure foundation: innovatively out of the crisis

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The coronavirus outbreak has hit the German economy, and society at large, hard. The Chief Economists of the Sparkassen-Finanzgruppe wish to emphasise that solid public finances, social cohesion and responsible federalism are - and will remain - decisive factors in limiting the social and economic damage of the pandemic and in enabling us to emerge from it as a stronger community.

The special economic feature of the Covid-19 crisis is the simultaneous occurrence of a supply-side and demand-side shock. The sharp drop in demand is largely an unavoidable side effect of the shutdown necessary from a health-care-policy point of view. Following the decisive supply-supporting measures, the demand side is now moving more into focus.

Support for the demand side should also start at the source, as has already been the case regarding support for the supply side. Under no circumstances should economic stimuli be allowed to fizzle out as one-off "flashes in the pan," generate windfall effects and lead to distortions in economic activity. On the contrary, they must have a cross-sectoral impact and further strengthen public and private investment capability. The sustainability of public budgets must not be put at risk. Only with sound finances can the public sector create important framework conditions for innovative, sustainable economic activity.

Stabilise public budgets

- Sustainable growth can only be achieved on the basis of sound public finances and appropriate framework conditions. Overstretching public budgets must be avoided as a matter of urgency.
- The automatic stabilisers which have come into effect - such as short-time work and unemployment benefits - together with direct government support measures are already putting a heavy strain on public finances. Any further measures must therefore be well-considered. Even a cornucopia will start growing empty at some point.
- The current tax estimate for May 2020 already predicts a sharp drop in tax revenues. Trade tax will be particularly affected. The slump in trade tax is likely to further aggravate financial problems, especially for financially weak municipalities. But local authorities as a whole will also be severely affected. Since much municipal expenditure results from mandatory tasks, many municipalities would have no choice but to reduce their investments in the face of falling revenues. A vicious circle would develop.
- Safeguarding the financial strength of municipalities is therefore of particular importance when it comes to re-strengthening the economy. Only in this way can municipal investments be maintained and, on a best.-case scenario, further expanded.
- Public infrastructure investments, especially channelled into strengthening the digital infrastructure, are necessary prerequisites for a healthy private sector. The efforts being made by the various government levels to further digitalise administrative services are very welcome.
- Planning and approval capacities should be built out further. In many areas, the problem is not a lack of available funds but rather a lack of administrative capacity enabling them to be applied for.
- For many key industries of the future, public (start-up) investments or strategies are necessary. This applies to areas such as digitalisation (example: artificial intelligence) as well as to the development and implementation of new energy sources (example: hydrogen-based recycling management). Here the state can impart key stimuli to innovative developments at companies.

Strengthen private investment capability

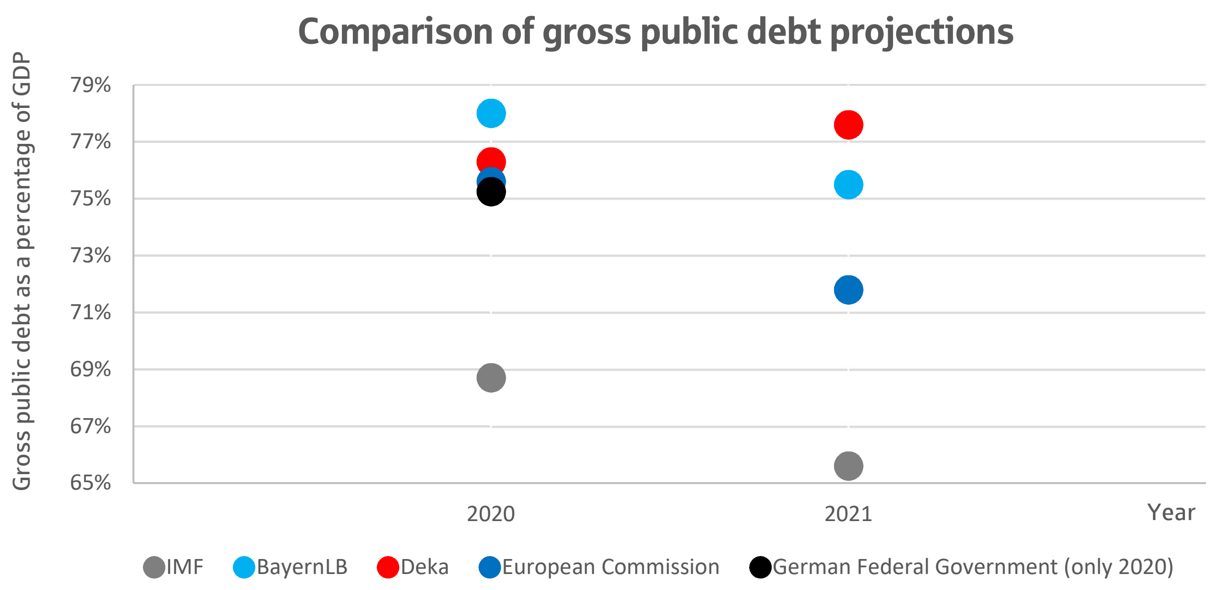
- However, due to the high level of uncertainty resulting from the coronavirus crisis, companies are currently very reluctant to invest.
- The low level of capacity utilisation, which is likely to persist with GDP projected to be depressed in the medium term, provides little reason for capacity-expansion investments. In their spring report, Germany's economic research institutes forecast a decline in plant-and-equipment investment of 8.9 percent in real terms for 2020.

- A lack of preliminary products sourced abroad and problems with global logistics are further dampening factors. The current low prices of raw materials can, it is true, confer advantages on the domestic economy. A greater shift in production chains to the domestic market and thus a reduction of dependence on globalised supply chains can also strengthen the domestic economy in the medium and long term.
- Private investment is an important prerequisite for secure, sustainable jobs, the achievement of climate targets and digital innovation. These factors, in turn, are a decisive basis for the revival of the economy and the necessary further modernization of the capital stock.
- Private investment should therefore be buttressed even more strongly. Improved depreciation conditions are a particularly good way of doing this. Now as before, special attention needs to be devoted, in particular, to optimising digital and knowledge-based investment. That will enable companies to create the jobs of tomorrow.

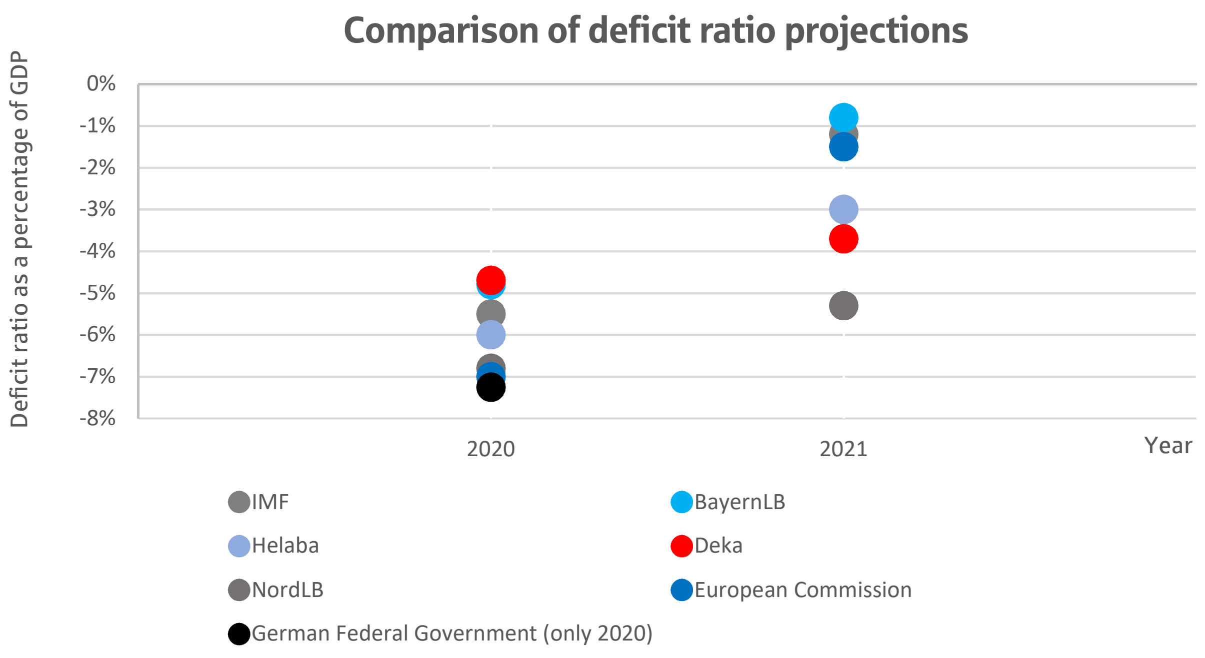
Promoting confidence in the future

- The shutdown was very successful from a health-care-policy point of view. It slowed down the dynamic rise in infection rates. However, as a concomitant effect, it has also led to a sharp slowdown in private consumption.
- With the easing of restrictions on economic and public life since the end of April 2020, numerous consumption opportunities have now become available again. The social-distancing and hygiene rules which are now the “new normal” are leading consumption into a new world.
- The still slightly depressed state of consumer sentiment is not threatening at the present time, particularly for overriding health-care-policy reasons. On the contrary, it helps to consolidate the successes that have been scored in the fight against the virus and, inseparably linked to this, the long-term recovery of the economy.
- Many employees are becoming increasingly worried about their jobs, as some companies will not survive the crisis or will only survive it in significantly downsized shape. Most people’s incomes, however, are currently flowing on in full or are, at least, being partially replaced by short-time work benefits or bridging payments for the self-employed.
- The spring report by Germany’s economic research institutes accordingly forecasts that the savings rate will skyrocket to 15 percent in 2020. Going forward, a demand-side problem is therefore likely to remain.
- An effective means of strengthening private demand would, in principle, be an increase in net private incomes. Adjustments to income tax rates, such as an increase in the basic allowances or compensation for “bracket creep”, would bring people more disposable income. It would also reduce distortions in income tax rates and could thus have positive incentive effects spurring more employment.

- ➔ Admittedly, a large proportion of the demand-side problem is not likely to be due to a lack of financial resources, but rather to the current uncertainty. There is therefore a danger that financial relief will not have the desired effects on consumption, but will instead further boost the savings ratio. Public budgets would continue to be burdened without the desired effect coming into play. Numerous forecasts already indicate a significant increase in gross public debt for the years 2020 and 2021.
- ➔ The tasks of the hour must be to secure public financial strength and strengthen private innovative capability. Important preconditions are now in place for a self-regulating economy to heal itself. Adjustments can be made at one point or another. But the focus must now be on reducing public debt through innovation and sustainable growth.



Comparison of gross public debt projections
Gross public debt as a percentage of GDP
79%
77%
75%
73%
71%
69%
67%
65%
2020
2021
Year
IMF
BayernLB
Deka
European Commission
German Federal Government (only 2020)



Comparison of deficit ratio projections
Deficit ratio as a percentage of GDP
0%
-1%
-2%
-3%
-4%
-5%
-6%
-7%
-8%
2020
2021
Year
IMF
BayernLB
Helaba
Deka
NordLB
European Commission
German Federal Government (only 2020)

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