

FRANCE, GERMANY, ITALY: GOOD FISCAL STIMULUS, BAD TRADE DEFICITS?

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The unprecedented fiscal stimulus plans launched by European governments this summer (phase II to relaunch growth engines after phase I emergency relief programs) should help to boost economic growth by +2.4pp in France, +2pp in Germany and +0.7pp in Italy (see Figure 1) over 2021-22.

In France, the EUR100bn (4.3% of GDP) stimulus package is geared towards achieving the green transition (EUR30bn), fostering industrial competitiveness (EUR35bn) and preserving social cohesion (EUR35bn) via transfers and labor market measures. Compared to the German stimulus package (3.8% of GDP), which is essentially demand-oriented, the French stimulus aims at reviving the supply side of the economy. The French government clearly aspires to relaunch the domestic production engine – even to reshore traditional industries such as automobiles – by addressing the long-lasting structural rigidities of the economy. However, France is strongly reliant on imports (see Appendix), both for consumption and investment. Therefore, the flipside of this fiscal stimulus will be the widening of the already high trade deficit.

In fact, by stimulating domestic demand, government stimulus packages naturally increase demand for imports, hence benefiting trading partners: out of Europe's major economies, we find that France could experience the largest leakage from its fiscal stimulus, causing its structural merchandise trade deficit to deteriorate by a net –EUR12bn over 2021-22. The picture is radically different in Germany where we estimate a slight decline of –EUR3bn in the trade surplus, whereas in Italy the surplus would increase by +EUR1bn. France's fiscal deficit already stood at –2.1% of GDP (EUR43.1bn) in Q2 2020 (see Figure 2) and as half of the fiscal package is allocated to boost investment, our calculations show that in 2021-22, this would increase French imports by 1.8% of GDP (EUR42bn). Exports would only increase by 1.3% of GDP (EUR30bn). Thus, overall, this would widen France's trade deficit by an additional –EUR12bn.

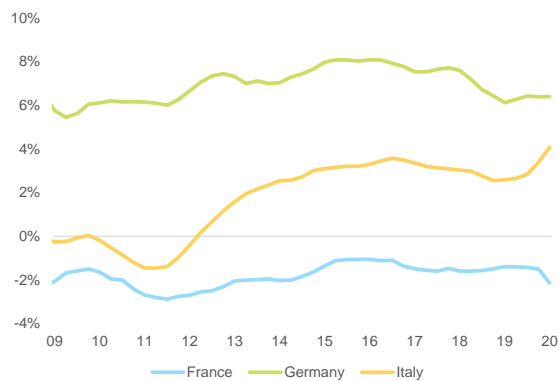
Figure 1: Covid-19-adjusted fiscal multipliers for 1% GDP increase

		Announced Phase II stimulus (EURbn)		
Type of measure	Covid-19-adjusted fiscal multiplier	France	Germany	Italy*
Consumption taxes / subsidies	0.10	0	31	1
Transfers	0.10	10	14	3
Corporate taxes & competitiveness	0.50	30	13	1
Labor support (incl. partial unemployment)	0.50	20	10	12
Public consumption	0.50	15	25	3
Public investment	0.85	25	50	2
TOTAL		100	143	31
Share of GDP		4.3%	3.8%	1.5%
Country-wide fiscal multiplier		0.55	0.50	0.48
Impact of stimulus on growth		2.4pp	2pp	0.7pp

*not all measures have been detailed, only partial categories. Totals might not add up

Sources: IMF, National Sources, Euler Hermes, Allianz Research

Figure 2: Merchandise trade balance (% of GDP)



Sources: National Sources, Euler Hermes, Allianz Research

Figure 3 – Import and export - growth impact of fiscal spending

		Trade Balance, Goods 2020 Q2 (4Q, EUR bn)	Announced phase 2 fiscal spending (% of GDP)	Trade Balance impact of the stimulus 2021-22 (EUR bn)		
France		-43.1	4.3%	-12		
Germany		199.5	3.8%	-3		
Italy		60.9	1.5%	1		
	Import elasticity to GDP growth	Government Stimulus impact in 2021-22		Export elasticity to GDP growth	Government Stimulus impact in 2021-22	
		Import of goods (% of GDP)	Import of goods (EUR bn)		Export of goods (% of GDP)	Export of goods (EUR bn)
France	3.1%	1.8%	42	2.4%	1.3%	30
Germany	2.1%	1.3%	43	1.6%	1.2%	40
Italy	4.3%	0.7%	12	3.9%	0.8%	13

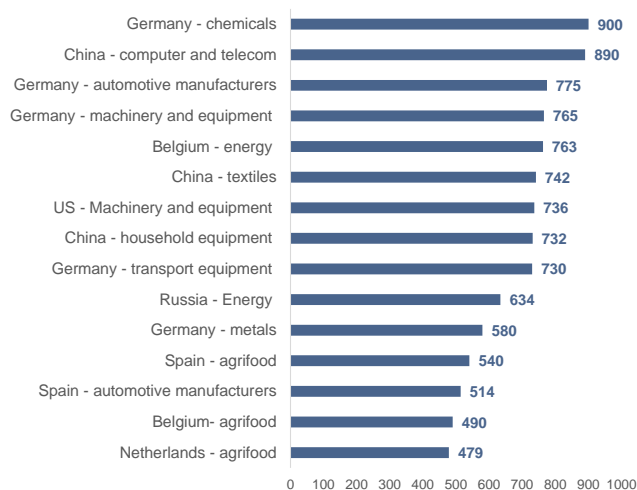
Source: Euler Hermes, Allianz Research, Eurostat

Notes: The import elasticities above are taken from a reduced form import regressions by country from 1994Q1 to 2020Q1 (OLS estimator). Quarterly change in imports is modelled in function of the change in government spending, past GDP and real effective exchange rate. The methodology is detailed at the end of the paper.

How does this compare to the 2009 Global Financial Crisis? The 2020 stimulus is larger as a share of GDP than that of 2009 (EUR26bn or 1.3% of GDP) due to the unprecedented fall in GDP expected (-10.8%). Thus we estimate that this new stimulus should boost imports four times as much as that of 2009. Our model shows the 2009 stimulus only boosted imports by EUR8.9bn or 0.5% of GDP. Moreover, beyond the stimulus, the Covid-19 crisis has created long-lasting supply chain disruptions, which makes it hardly comparable to 2009. In the current crisis, we expect global trade to only return to pre-crisis levels in 2022, meaning that the recovery of French exports would not be as vigorous as in 2010-11. In addition, service-oriented economies, such as France, tend to suffer more from the Covid-19 crisis, making it hard to compensate for the deteriorating balance of goods.

Which countries and sectors could ride France’s stimulus wave? German chemicals (+EUR900mn), Chinese computers and telecom (+890mn) and German automotive manufacturers (+EUR775mn) could reap the most benefits from France’s soaring imports. Taking all sectors together, Germany, France’s main trade partner (EUR6.1bn), would emerge as the winner, followed by China (EUR3.9bn), Italy (EUR3.1bn) and the U.S. and Belgium (both EUR2.8bn). The top three sectors worldwide to benefit from France’s stimulus-boosted imports would be energy (EUR5bn), chemicals (EUR4.3bn) and agrifood (EUR4.1bn).

Figure 4 – Top 15 country/sector exporters to benefit from France’s higher stimulus-induced imports



Sources: UNCTAD, Euler Hermes, Allianz Research

What about the German stimulus? In Germany, the deterioration in the trade balance will be smaller as a share of GDP. Import-elasticity to GDP growth is smaller (2.1%) than in France (3.1%). The 3.8% of GDP stimulus would boost imports by 1.3% of GDP (EUR43bn). As for exports, they will increase by 1.3% of GDP (EUR40bn).

The overall trade balance deterioration will be smaller in Germany (-EUR3bn): these imports will also benefit the domestic economy to a greater extent in Germany, reflecting the large share of the manufacturing sector (19% vs. 10% in France) that uses a high share of imported inputs in its production process.

In Italy, despite large trade elasticities to stimulus, the overall trade balance impact will be moderate, given the relatively small size of the announced package (1.5% of GDP). Italian imports are expected to increase by 0.7% of GDP (EUR12bn) and exports by 0.8% of GDP (EUR13bn) over 2021-2022.

Due to relatively lower import-intensity in India, Brazil and China, domestic stimuli should neither trigger sizable international leakages as a share of GDP nor a significant widening of trade imbalances (see Appendix). Yet as the stimulus has so far focused on infrastructure and construction in China, in addition to domestic suppliers, it is likely to induce positive spillovers for commodity exporters worldwide.

APPENDIX

Covid-19 fiscal stimulus import intensity heat map

Import intensity rank		Structural import intensity				Cyclical import intensity		
		Imports (% GDP)	Share of manufacturing sector (% GDP)	Foreign input content of consumption (%)	Foreign input content of investment (%)	Import growth / Public spending growth (2017-2019)	REER Variation (ytd in 2020)	Announced Phase II fiscal spending (% of GDP)
1	France	27%	10%	12%	11%	3.5	-0.5%	4.3%
2	Germany	35%	19%	14%	22%	1.0	0.8%	3.8%
3	United Kingdom	28%	9%	12%	17%	1.4	1.6%	1.0%
4	Italy	25%	15%	9%	10%	2.0	-1.3%	3.2%
5	Spain	27%	11%	9%	14%	1.1	-0.8%	1.5%
6	United States	11%	11%	4%	10%	0.7	6.9%	5.0%
7	Russia	19%	13%	15%	11%	1.0	-4.8%	0.0%
8	Japan	14%	21%	5%	8%	1.2	3.9%	4.6%
9	China	16%	27%	3%	5%	0.6	4.1%	4.7%
10	India	16%	14%	1%	6%	0.3	1.6%	1.5%
11	Brazil	13%	9%	2%	7%	-1.0	-24.2%	0.0%

Source: National Statistics, World Input Output tables, World Bank, Euler Hermes, Allianz Research

Methodology:

We use an econometric model to investigate the main drivers of import increases. The results show that historically **government spending has no significant direct impact on import increases in a given quarter**. However, **the indirect effect of stimulus on imports appear to work through the GDP in the past quarter**. In other words, GDP growth in a quarter creates a virtuous circle of demand for both domestic and imported goods. Hence, higher growth in a given quarter marks the start of a new investment cycle and boosts consumer confidence down the road.

Knowing that imports will react to an additional GDP increase, we build **country-specific fiscal multipliers, based on IMF research¹**, to gauge the

¹ <https://www.imf.org/en/Publications/TNM/Issues/2016/12/31/Fiscal-Multipliers-Size-Determinants-and-Use-in-Macroeconomic-Projections-41784>

growth impact of the announced public spending measures. But what if things are different this time because of the peculiarities of this crisis? How does Covid-19 play out with the stimulus? We believe that, in the context of Covid-19, **government stimulus is likely to work differently as sanitary restrictions continue to weigh on activity**. Eventually, we identify the **Covid-19-specific factors, which can either support or undermine the growth impact of the stimulus**.

- **Tailwind factors to emphasize the growth impact of the stimulus:** First, having **synchronized and EU-level coordinated stimulus packages** is likely to boost demand coming from the main trade partners, hence support export growth (hence the GDP growth). In addition, after dramatic losses of output in the first half of 2020, being in a **historically down economic cycle** is expected to boost the level of the fiscal multiplier. Finally, disruption to **foreign trade may also attenuate the import-enhancing impact of the stimulus**: Consumers may need to replace some imported goods temporarily with local ones because of supply-chain disruptions and availability issues from overseas exporters.
- **Headwind factors that could hold back the efficiency of the stimulus:** **Economic and sanitary uncertainty** is the main factor that could partially offset the growth-boosting impact of the stimulus. Due to the dim employment outlook, households may prefer using cash transfers from the government to build **precautionary savings** instead of spending them. Firms, in turn, may **delay investment decisions** amid high uncertainty and use the stimulus money for hoarding cash or reimbursing debt. Moreover, the financial sector could also reduce the efficiency of the stimulus by **tightening credit conditions** amid rising business insolvencies. Difficult access to bank funding could push credit-constrained firms to hold stimulus cash, instead of investing it into the economy.

Having in mind these Covid-19 specific factors, we adjust the IMF fiscal multipliers by type of expense in Germany and France to obtain the country level fiscal multipliers (see Figure 1). Accordingly, **a 1% increase in government spending in France and Germany would boost GDP by 0.53 and 0.54 points, respectively**. Combining these fiscal multipliers with import elasticities obtained from the econometric model (see Figure 3), we find that France will experience the largest leakage (1.3% of GDP) from the stimulus.

These assessments are, as always, subject to the disclaimer provided below.

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