After the slump in consumption: Will reduced savings pull us out of the swamp?

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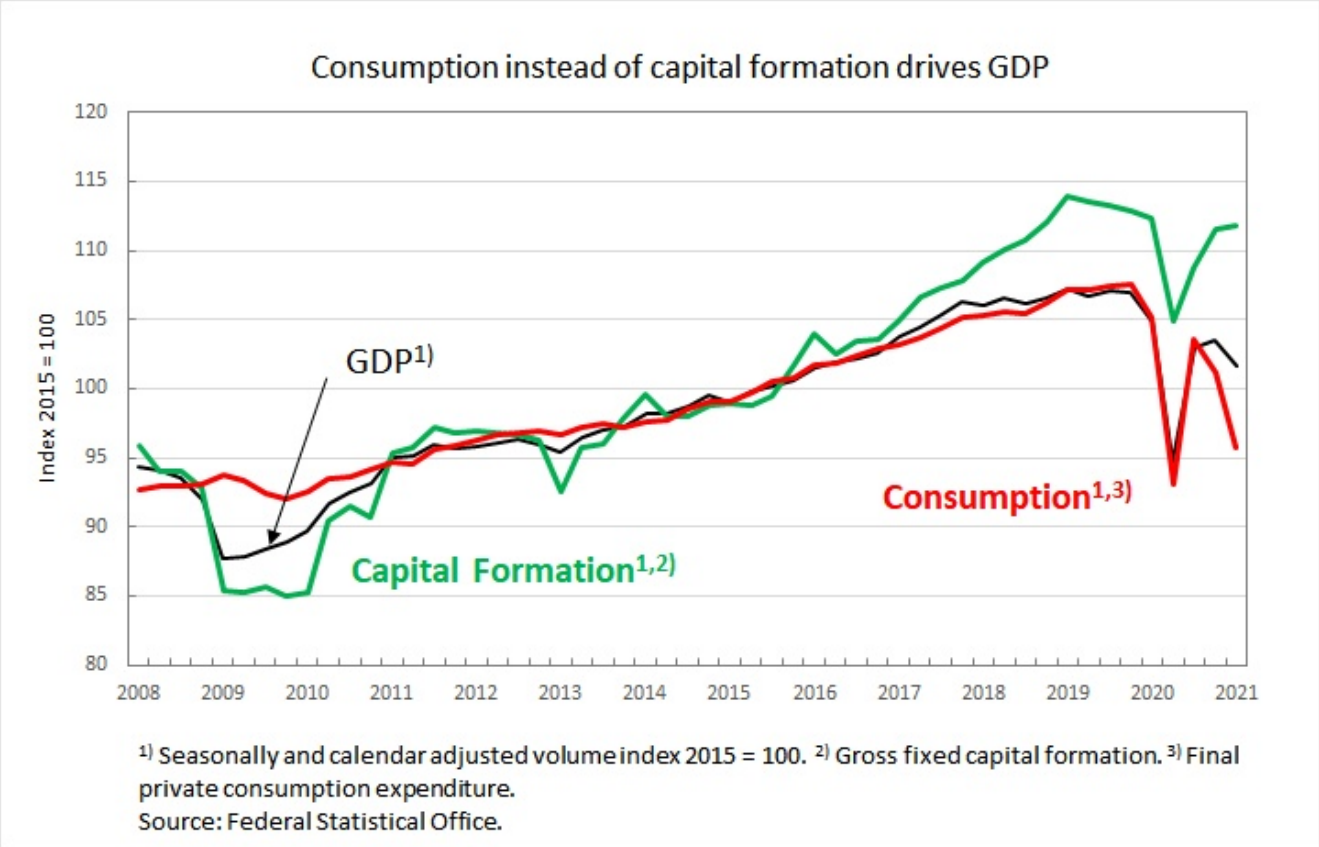
The Corona crisis is shaking the economy very differently than all previous crises in the economic history of the western industrialized countries in the last 75 years: Its extent is extreme in terms of geographical scope, impact, duration and, above all, the structure-shifting effects. This also applies to Germany, as can be seen from the more detailed data on macroeconomic development in the first quarter of 2021, which the Federal Statistical Office has recently published.

Another slump in consumption in the first quarter of 2021

The 1.8 percent decline in German GDP (price, calendar and seasonally adjusted) in the first three months of this year, which was quite steep compared to other European countries, was primarily due to the decline in private consumption (see Figure 1). Since private consumer spending makes up a little more than half of the total economic output, a minus of almost 5½ percent is enormously important. That was already the case at the beginning of the pandemic in the second quarter of 2020: At that time consumption collapsed at 11½ percent due to the lockdown measures, much more than gross fixed capital formation (-6.7 percent). During the positive backlash in the third quarter of 2020 it was the other way around: Consumption caught up more than investment. Gross fixed capital formation is normally the most responsive aggregate, as can be seen in Figure 1: The fluctuations of this aggregate were regularly greater throughout the years than the comparatively „sluggish“ private consumption. That was also the case in the 2008/2009 financial crisis. At the moment, however, it is very different. Consumption determines the pattern, does not cushion it, but is the driver of development.

Figure 1



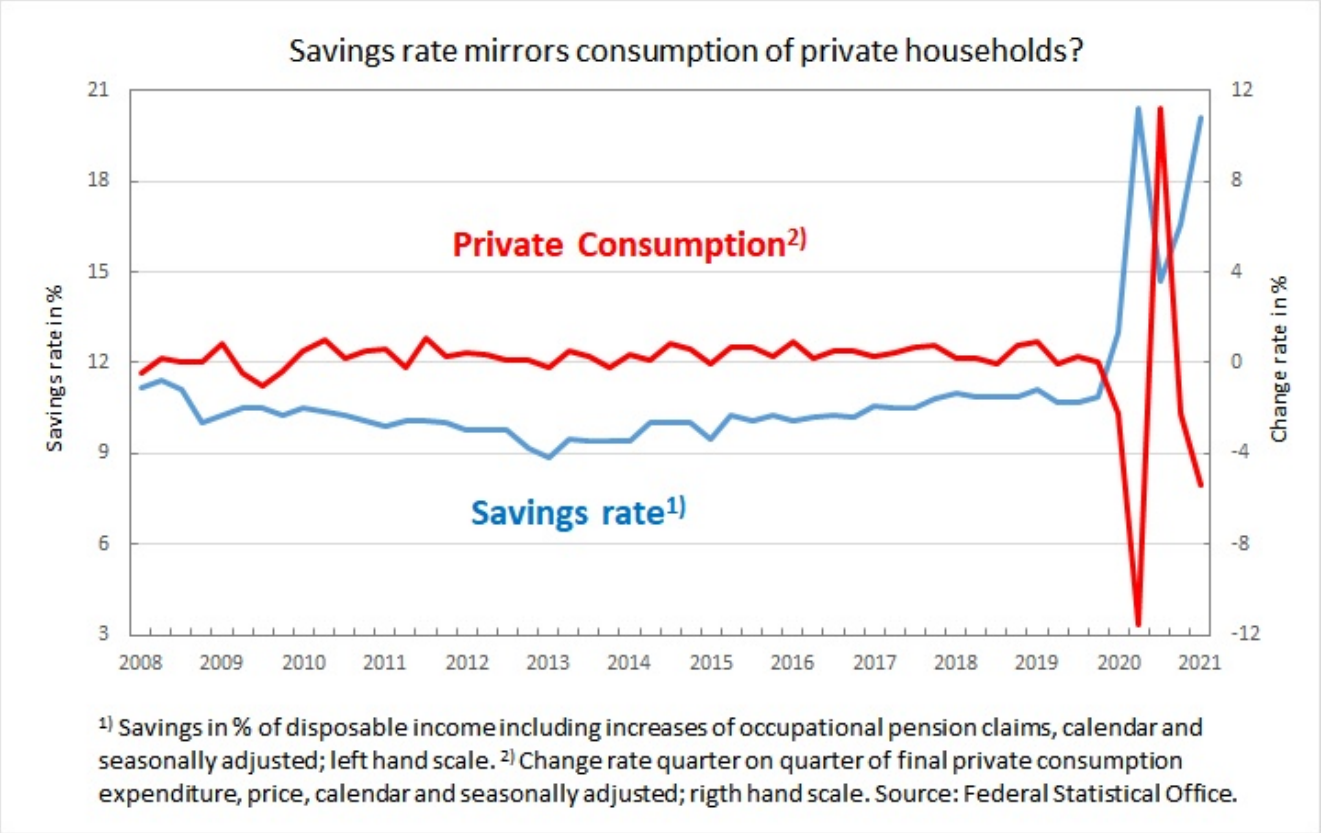
The enormous fluctuations in private consumption – above all, of course, the slumps – are causing great problems for everyone in the sectors concerned – employees as well as self-employed. Because, unlike the manufacturing industry or the construction industry, they are less prepared for such rapid ups and downs: self-employed people, many of whom work in the particularly strongly and long-lasting restricted cultural sector, are not entitled to short-time work benefits. The same applies to mini-jobbers in the hotel and catering sector, for example. Even under normal conditions, retail workers earn comparatively little. The short-time work benefits are correspondingly low for them and far below what an industrial skilled worker receives, especially since in the manufacturing industry, short time work benefits are often boosted by collective agreements.

Hope for a recovery in consumption

Many people hope that as soon as the pandemic will be more controllable through an increasing proportion of vaccinated people and therefore the restrictions that limit the possibilities of consumption will correspondingly be relaxed or even lifted, the related sectors will get back into a more even channel. In particular, it is expected that a decline in household savings will lead to a massive recovery in consumption and that this will result in a sustainable upswing. One example is Sebastian Dullien, director of the union-related Institute for Macroeconomics and

Business Cycle Research (IMK), said so according to German newspaper *taz*.

Figure 2



In fact, the savings rate, i.e. the share of the disposable income of private households that is not spent, has skyrocketed again, almost a mirror-image of the collapse in private consumption. In the first quarter of 2021 it is at 20 percent, the same level as at the beginning of the pandemic (see Figure 2). The German Central Bank (Deutsche Bundesbank) states in its current monthly report: „As seen before in the summer quarter of 2020, private consumption should recover quickly as soon as the restrictions will be withdrawn widespread and lasting. In the medium term, private consumption is likely to be additionally fueled by the fact that savings accumulated involuntarily during the Corona period will partially be reduced.“ (p. 62; all translations of texts from Deutsche Bundesbank are mine)

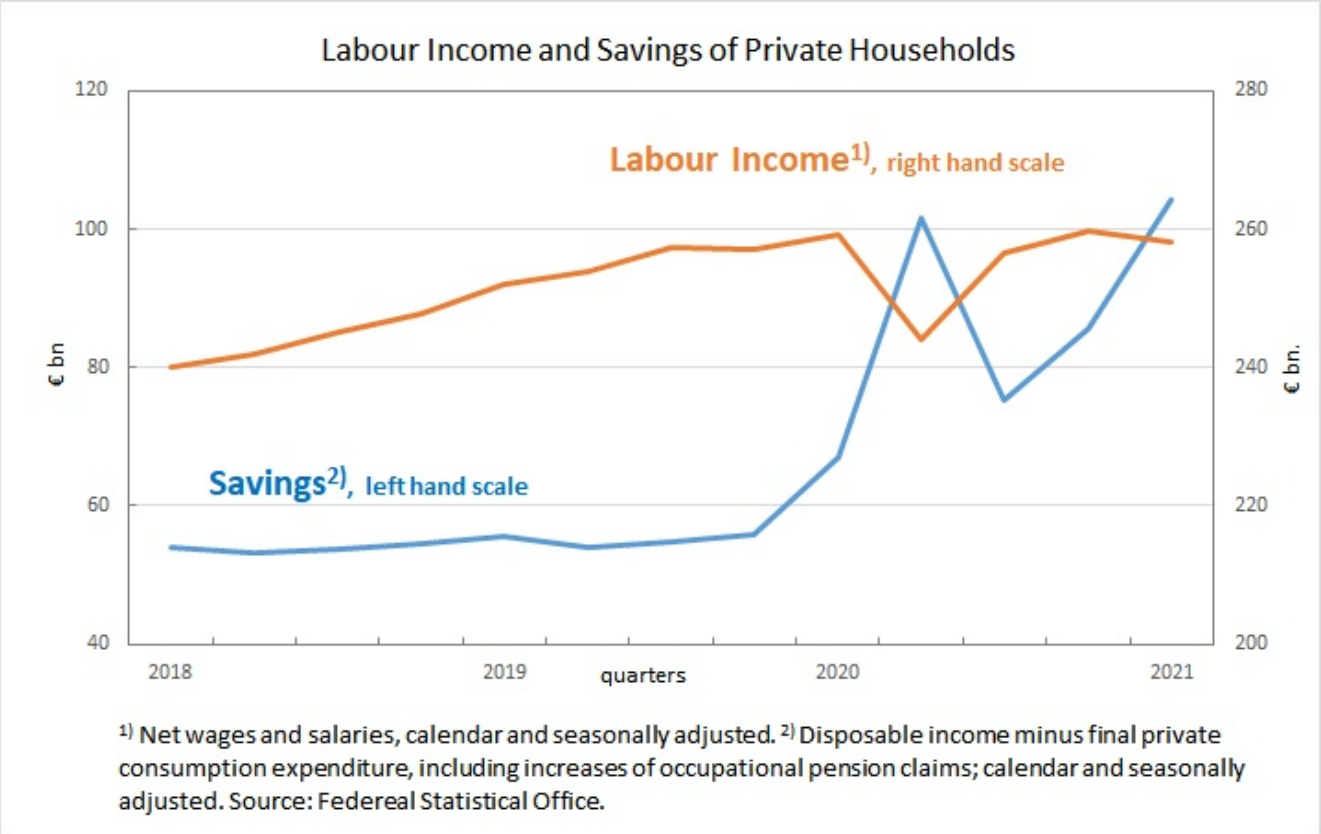
But will things work out that simple – everyone is returning to their usual consumption patterns, dissolving the savings they have accumulated in the meantime, thereby increasing capacity utilization and thus helping the economy as a whole, including the labour market, to get back on its feet? It would be nice, but there is more to it than one would believe at first glance. Savings are not just income put aside by some, but lost income for others. These others do not necessarily have to be located in Germany. For example, foreign tourism industry

has lost demand from German tourists. But there are also workers in Germany whose wages have fallen due to the – often involuntary – savings of others.

One person's savings reduce other persons' income

This relationship is illustrated in Figure 3. There, the savings activity of private households and their labour income, more precisely the net wages and salaries, are shown in absolute billion euros.

Figure 3



Between 2019 and 2020, household savings increased from 220 billion euros to 330 billion euros. The peak in the second quarter of 2020 stands vis-à-vis a slump in labour income – albeit to a lesser extent in absolute terms – while the sharp decline in savings activity in the third quarter is accompanied by a significant increase in labour income. The renewed increase in savings in the following two quarters goes along with a weak recovery and a slight decline in net wages and salaries.

Of course, mass income is decisive for private consumption. In addition to net labour income it consists of monetary social benefits such as pensions, short-time working and unemployment benefits, basic security benefits, etc. and is cushioned

by them. Therefore there was no such strong counterreaction to the formation of savings as with the net wages and salaries. But mass income also reacted in the opposite direction. For the economy as a whole the following is always true: Expenditures of one person are the income of the other, and thus expenditures not made are lost income of someone else.

These figures from official statistics, with their strong fluctuations, may appear rather technical, but can be interpreted instructively on closer inspection. They show the distribution problem triggered by the Corona crisis: Those who earn little, who have been sent to short-time work or lost their job entirely, are presumably not in a position to increase their savings. It is their jobs that suffer from the savings of others. Those who, on the other hand, receive an above-average income that is somewhat protected from the consequences of the pandemic – for example in the public service, in the sought-after IT sector, in the again profitable export sectors or even in the lucrative sector of speculative financial transactions – can calmly watch the growth of their savings and wait until the opportunity arises to spend this money again for consumption purposes.

Dissaving does not provide a sustainable economic stimulus

In addition to the inequality gap, this is primarily a problem because the dissolving of accumulated savings is not an extra economic stimulus. Existing structures are not better utilized than before and therefore there is no additional stimulating effect. To put it bluntly: It is nice when the pain subsides after a hammer blow on your thumb, but that does not mean that the thumb is healed again in that very instant. Reduced savings cannot be expected to result in the same capacity utilization as in pre-pandemic times. The shift in the distribution of income can lead to a significant change in the demand structure that no longer fits existing production structures and qualification structures.

For example, imagine someone who ran a fast-food restaurant before the pandemic and whose previous regular customers can no longer afford to go there. Or „fear saving“ takes place, i.e. the previous customers cut down on expenses. Then it is not very likely that you simply leave your fast-food restaurant behind, change jobs and become a gourmet chef. In addition, employment relationships terminated during the crisis cannot easily be resumed if your former employees have found a new job. This poses a problem for their former employers. Clothing stores in city centres that have not survived the long lockdown are firing

salespeople who cannot be used seamlessly in the IT area, even if there may be an urgent need for workers there. If truck drivers are currently in high demand in the logistics industry, this does not mean there is a job opening for an unemployed actress.

Conversely, the dissolution of savings may encounter overutilized capacities in certain industries. This may result in price increases there, with little expansion of production and jobs. Incidentally, this also applies to government investment demand. The German construction industry is currently experiencing a sharp rise in prices for building materials thanks to increased (inter-) national demand. Apparently, there is a threat of delivery bottlenecks, which lead experts to fear that short-time work could occur in this branch of the economy in the summer.

There is no denying that we can't just start again at the same point where we stood before the crisis. All these frictions have stimulated a downward sloped process that stands in the way of a rapid, sustainable and beneficial upswing – unless there is an independent impact to counterbalance it.

No impact to be expected from wage policy

It is already becoming apparent that wages in the troubled sectors will come under pressure and, due to the uncertain labour market prospects, the development of the wage level will be weak overall. This is rational and understandable from a microeconomic point of view, but unfortunately wrong for the economy as a whole, because it makes it difficult to return to somewhat stable domestic demand. To boost low wages, for example, the state would have to raise the minimum wage noticeably because the unions in the current crisis situation do not have the strength to prevent the current wave of wage moderation.

Without policies protecting the wage level, there will be a structural break instead of structural change that will leave long-lasting deep marks in the economy, politics and society. There is a threat of further division in society along the dividing line between highly qualified, well-paid workers in emerging industries and people whose qualifications are less and less in demand due to a self-reinforcing downward spiral in their industries and/or who were in precarious jobs anyway.

The Deutsche Bundesbank predicts a weak wage development (p. 58) alongside an inflation rate of up to 4 percent (p. 60). Surprisingly it does not consider this

an obstacle to a rapid and lasting recovery in private consumption. Instead, it apparently relies on the reduction of savings to fuel private consumption sufficiently.

Who will step into the breach?

A normalization of the savings rate results in a one-off boost that cannot compensate for what the rise in the savings rate has previously caused. But where should the independent impact required for sustainable dynamics come from? From the corporate sector, which has not adequately fulfilled this task for ten years, as evidenced by its savings? In addition, the crisis-damaged part of the companies will lick their Corona wounds and beware of greater debt (keyword „balance sheet recession“).

Can the impact come from abroad? Nothing is to be expected from Europe, because Germany, due to its high level of competitiveness, sets the depressed pace in European wage policy and thus for weak internal European demand. Outside of Europe, the desire to increase an import surplus with Europe is certainly limited, which is manifested in the smoldering trade conflicts. There is also the exchange rate valve, which can be used against overstretching trade imbalances in favour of Europe.

Finally, there is the public sector. The EU Commission is relying on its aid package worth billions, which essentially targets the same sectors as national public demand, namely construction, IT and health sectors. The same bottlenecks described above will come into play here. In addition, planning and tender procedures are likely to drag on, which also stands in the way of rapid economic stimulation.

What is happening at the national level? Will the European national budgets continue to act as a driving force, as in the USA for example? Unfortunately, that is doubtful. In any case, most German economists and economic politicians, whose influence on the EU Commission is huge, do not see the public sector at all in the role of the driving force that will continue to be necessary in the medium term. On the contrary, they want the state to withdraw from the task of indebtedness required by the economy as a whole. The debate on the question of when the debt brake should be adhered to again shows this just as clearly as the criticism of the European Central Bank’s policy.

German currency watchdogs on well-known tracks

In its current monthly report, by way of precaution the Deutsche Bundesbank points out the direction in which they believe the journey should go: „In order to increase funds when the budget limits are exhausted, various options for action are available. If the tax burden is not to be increased because of negative growth effects, political priorities or adopted spending programs would have to be readjusted." (p. 64) In other words: Compliance with the debt brake, no tax increases, but reallocations in the state budget if additional funds are needed somewhere. It is not difficult to predict that these reallocations would be at the expense of social spending and thus at the expense of those who were economically most negatively affected by the Corona crisis. Meaningful promises made during the Corona crisis, such as strengthening the public health service and promoting climate protection, will remain lip service.

For the European level, the Deutsche Bundesbank has this advice: „Effective and credible fiscal rules are important – also with a view to the entire EU. They create trust in solid state finances and protect monetary policy. This is one of the reasons why they are anchored in treaties and constitutions." (p. 71) And a few pages further the Deutsche Bundesbank says quite bluntly: „All in all, from today's perspective – on the basis of the Commission forecast – the end of the exception clause would not require a change in fiscal policy in 2022, which could endanger economic development. In high deficit countries, the necessary gradual consolidation would be accompanied by an excessive deficit procedure. This would involve greater surveillance. Given the very high deficits and debts, this is definitely desirable." (p. 80)

Based on the EU Commission's optimistic growth forecast, the Deutsche Bundesbank does not consider further support for the European economy to be necessary in the coming year. Instead, „stronger monitoring" of the debt behaviour of European partner countries is described as „desirable". Viewed realistically, this means that Germany will not provide any noticeable impact from either the private or the public sector in order to work its way out of the crisis quickly, sustainably and noticeably for everyone. German monetary authorities want the hands of the EU partners tied so they cannot provide an impact, too. That is by no means desirable.