11 October 2022

# Euro macro notes

## Germany's energy package: stoking or quenching the fire?

Finding itself in the eye of the storm of Europe's energy crisis, Germany's sizable support packages (amounting of up to EUR 295bn - 7.7% of GDP) have drawn the ire of other EU countries lacking the same fiscal firepower and fearing distortions within the EU's internal market. **Most of the measures under the *third help package* (EUR 65bn for one-off payments to students and pensioners, increased welfare payments and an electricity price brake among others) and the *'Comprehensive Protection Shield'* (up to EUR 200bn) will only begin to support the economy in 2023 in our view.** Funds from the protection shield are earmarked primarily for a gas price brake (likely to take effect from March 2023, see details next page), while measures from the third help package remain in limbo amid financing disagreements between the central government and the states.

The government plans to raise the funds for the protection shield through a 'shadow budget' (Economic Stabilisation Fund - WSF), which circumvents the debt brake. The government's 'creative accounting' allows it to comply with the debt brake in the 2023 budget, with the aim of ensuring that "that German federal bonds will continue to meet with the highest level of confidence on financial markets". **We think the German government will be in no rush and raise the funds on an ongoing basis, as the cost becomes more apparent**. Overall, the German 'off-balance' borrowing scheme is also in line with a general EU trend towards increased issuance via national agencies and/or supras, to protect national government bond markets.

**We see a high likelihood that not all of the EUR 200bn earmarked funds will be used/raised.** This was also the case with the earlier pandemic EUR 600bn support package financed through the WSF, of which only some EUR 50bn were used. A first proposal puts the cost of a gas price brake at ca. EUR 91bn until 2024. The electricity price brake might cost another EUR 25bn/year if the government aims to return prices to 2021 levels, although plans foresee this largely financed though 'windfall profit taxes'. Overall, we think the earmarked funds should suffice to finance the energy price caps at least until 2024, but the cost will also depend on how market prices develop.

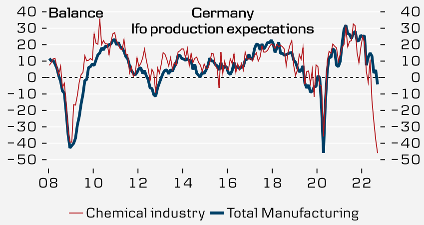
**We doubt that the energy price caps can prevent the economy falling into recession.** Higher energy costs will still take their toll on industrial activity and aggregate demand. The downturn is likely to be shallower than without the support measures, decreasing especially the risk of bankruptcy waves and an ensuing labour market crisis. However, with diminished incentives for energy savings, the risk of gas rationing still looms large later this winter, affecting especially energy intensive sectors like the chemical industry.

**The inflationary effects are somewhat ambiguous in our view.** Although the price caps limit the increase in energy inflation (see also *Euro inflation notes - Energy variations*, 10 October), we also see a risk that high core inflation pressures will continue to remain a feature for some time due to second round effects and firms protecting their margins. Heterogeneous country measures to deal with the energy crisis risk increasing the outcome span for inflation next year and diverging inflation trends between euro area countries will further complicate the ECB's job in calibrating the right monetary policy stance, increasing the risk of policy mistakes.

### Key points

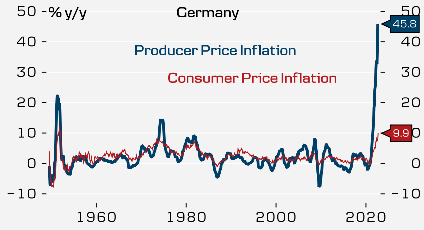
- Fiscal measures will mainly support the economy in 2023
- High likelihood that not all of the EUR 200bn earmarked funds will be used/raised
- Energy price caps will not prevent economy falling into recession
- Ambiguous inflation effects

**Energy intensive industries fear gas rationing and shut-downs this winter**




*Source: Ifo, Macrobond Financial, Danske Bank*

**Second round effects could keep core inflation elevated for some time yet**




*Source: Destatis, Macrobond Financial, Danske Bank*

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### Germany's gas price brake

On 10 October, the gas advisory group tasked by the German government presented a first proposal how a gas price brake could be constructed. It foresees a dual solution, featuring both one-off payments as well as a price cap.

In a first step, all gas and district heating customers would receive a government-backed discount on their energy bills in December this year. In a second step, the government will cap gas prices for consumers and SMEs at 12ct/kWh from March 2023 to March 2024, with the state subsidy applying to about 80% of gas consumption. For district heating customers, the price level would be set at 9.5ct/kWh and for large industry at 7ct/ kWh and apply for ca. 70% of gas consumption.

The dual approach was chosen with the aim to produce quick and unbureaucratic relief to households and firms, as energy providers need several months preparation time to implement a price cap. For industry, the cap will already take effect in January 2023, as it affects only some 25,000 firms and therefore can be implemented more quickly.

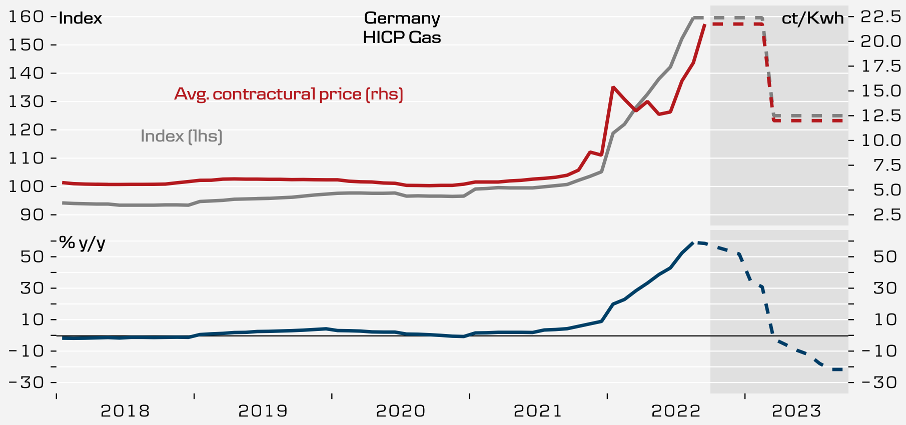
A gas price cap at 12ct/kWh would constitute a significant reduction from the current average market price (22ct/kWh in September), but maintains prices at a higher level than in 2021 (ca. 6ct/kWh). For a yearly consumption of 20,000 kWh, an average household would save ca. 2400€.

The panel put the total cost of the measures at some EUR 91bn until 2024 (EUR 66bn for households and SMEs and EUR 25bn for industry until 2024).

While the price caps leave some incentives for energy savings in place, the same cannot not be said of the December 2022 one-off payments. This is especially concerning, given that households have lagged industry in energy savings, and so far the *20% gas consumption reduction goal remains elusive*, increasing the risk of gas rationing being required later this winter.

The government will now review the group's recommendations and is expected to issue a decision in the coming weeks.

**Our back on the envelop calculations suggest that German HICP gas inflation could approach -20% y/y in H2 23 with the cap. Assuming an unchanged 3% gas weight in HICP, this creates downside risks of some 0.6pp for German HICP and 0.2pp for euro area HICP.**




*Source: Eurostat, Verivox, Macrobond Financial, Danske Bank*

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