Public finances*

General government budget

Surplus of around 1% again this year …

German public finances remain in very good shape. In view of this, the surplus is likely to hit the 1% mark once again this year (2016: 0.8% of gross domestic product (GDP)). Repayments of the nuclear fuel tax, which was declared unconstitutional in June, are placing a strain on public coffers.[1] However, economic activity is significantly boosting public finances, and continued favourable financing conditions are also providing relief. In addition, the tax and social contributions ratio is rising distinctly, chiefly as a result of exceptionally high growth in profit-related taxes, making it possible to offset the equally considerable increase in structural primary expenditure[2] on, most notably, long-term care, healthcare and pensions. The debt ratio fell to 66.0% in mid-2017 (end-2016: 68.1%). Given the surpluses in the central, state and local government budgets also expected in the second half of 2017 and the sharp nominal GDP growth, the ratio is set to fall further by the end of the year.[3]

… and debt ratio in continued decline

In principle, positive outlook with highly favourable underlying conditions

As things currently stand, the setting for Germany's public finances will remain highly favourable in the medium term, too. The strain being placed on public coffers by nuclear fuel tax payments, which have now been refunded in full, will cease after this year, and the expected continuing upswing will have a positive impact. The surplus could thus – disregarding the detrimental impact of any new measures – increase further and markedly above 1% of GDP in the years to come. In structural terms (ie excluding cyclical and temporary effects), a relatively stable surplus amounting to around 1% of GDP would be achieved. However, as time progresses, it is to be assumed that at least some of the financial leeway at the disposal of central, state and local government under the budgetary rules will be utilised, and that social contribution rates could be lowered markedly. It is therefore to be expected that the structural surpluses will shrink and public finances will follow an expansionary path. Regardless of this, the debt ratio is likely to fall below the 60% mark in 2019.

Moderate structural surpluses and debt ratio of well below 60% appropriate

Generally, moderate structural surpluses for Germany seem appropriate. It is advisable to continue to rapidly reduce the debt ratio, not least given the challenges posed by demographic change. In this manner, the ratio could be reduced to well below the 60% threshold before the baby boomer generation leaves the labour force. Overall, this would markedly enhance the resilience of public finances as well as make it easier for younger people and future generations to shoulder foreseeable increases in spending on pensions, long-term care and healthcare. Moreover, moderate structural surpluses in central and state governments' fiscal plans create a budgetary buffer to cushion the impact of any unexpected negative budgetary developments within the debt brake rules. This avoids the need for procyclical consolidation in an economic downturn.

Also with the aim of achieving moderate structural surpluses, a certain amount of fiscal lee-

* The section entitled "General government budget" relates to data from the national accounts and the Maastricht debt ratio. The subsequent more detailed reporting on the budgets of central, state and local government and of the social security funds pursuant to available data is based on the figures as defined in the government finance statistics (which are generally in line with the budget accounts).
1 By comparison, the temporary burdens associated with fresh calls on state government guarantees issued for HSH Nordbank have thus far been significantly lower. Risks still exist in connection with the guarantees that have not yet been called upon (€6½ billion of an original amount of €10 billion remaining as at mid-2017).
2 Total expenditure less interest expenditure, cyclical impact and relevant temporary factors.
3 Developments in the portfolio reduction and scaling-back of corresponding liabilities at government-owned bad banks are rather volatile due, inter alia, to increases and reductions in cash collateral in connection with derivatives transactions. In particular, the reduction of gross debt at FMS Wertmanagement (recorded in the government sector) could be delayed by its repurchase of liabilities belonging to the DEPFA Group (not classified as part of the government sector) under the DEPFA resolution process.

Possibility of lowering social contributions

way opens up given the very favourable medium-term conditions. Even now, the Federal Employment Agency is already clearly benefiting from the continued healthy labour market situation. With an unchanged contribution rate, high surpluses and a major expansion of the already relatively large reserves can be expected. Against this background, a markedly lower contribution rate would be plausible, which could take pressure off employees and enterprises directly. The reserves of the statutory pension insurance scheme and the health insurance institutions are likewise fairly high and, in the pension insurance scheme's case, the statutory upper limit for the reserves would be exceeded by quite a margin, even in the budget plan, in the absence of a contribution rate decrease. This means that cuts in social contributions are also on the agenda, even though contribution rate increases are to be expected once again in the longer term.

Define non-insurance-related benefits and fund them using tax revenue

Should a new Federal Government envisage extra spending by the social security funds, it should be established whether it is on insurance-related benefits, for which social contributions are a justifiable source of financing. As a general rule, to keep fiscal policy transparent and open to scrutiny, defining spending categories that are deemed non-insurance-related and pegging the level of tax-funded central government grants to associated funding requirements would be welcome moves.

Keep an eye on long-term burdens

Furthermore, the healthy state of the social security funds' finances at present should not obscure the fact that additional spending which may appear manageable today could, in the face of demographic change, result in a considerable mortgage on the future.

Central, state and local government finances performing well owing to lower interest expenditure and higher tax ratio

In the absence of new measures, further improvement in the structural budgetary situation is to be expected at the central, state and local government level. To this extent, certain budgetary burdens would be compatible with the objective of a moderate structural surplus. However, the favourable medium-term outlook is based on the scenario of continued stable economic development. Furthermore, the revenue from profit-related taxes has been decoupled from the macroeconomic reference variables for some time, with the former accelerating away from the latter. In view of strong fluctuations in the past, there is a risk of this situation reversing. It should also be noted that the overall positive budgetary situation is related to a large extent to lower interest expenditure. Looking at the longer term, it should be kept in mind that budgetary policy will have to readjust to less favourable financing conditions and additional burdens arising from demographic change.

New spending priorities and comprehensive tax reform possible

Regardless of the current positive situation, policymakers must not forget to consistently exploit efficiency reserves and to consider the possibility of budget shifts in order to fund the political priorities currently being debated in areas such as education, investment, and national and international security. Investment needs have to be addressed consistently. However, the focus should not, as a general rule, be on a certain financing volume but rather on a needs-based infrastructure in which funds are used effectively. As regards the envisaged income tax cut, it would be worth considering an extensive approach to reform that limits exemptions in the tax system as a whole. It would then be possible, in principle, to finance more extensive tax rate cuts. The discussed phasing-out of the solidarity surcharge could be incorporated into an income tax rate reform of this kind. In any event, it does not appear straightforward to keep the current solidarity surcharge in place in its present form as of 2020. This add-on to income taxes imposed by central government requires the existence of particular financing needs, while not least the special-purpose grants to the east German federal states will be phased out when the reform of federal financial relations then enters into force.[4]

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4 As a general rule, differences in budgetary tightness between central government and state government are to be accommodated by adjusting the distribution of turnover tax receipts. Under the reform of the state government financial equalisation system, central government transferred turnover tax revenue to state government. In light of this, too, there appears to be no reason to assume that central government still has special financing needs.

Budgetary development of central, state and local government

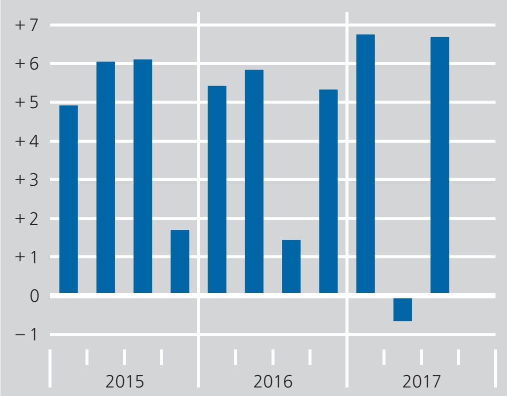
Tax revenue

Dynamic growth in Q3

Tax revenue[5] was up by 6½% on the year in the third quarter of 2017 (see the chart opposite and the table on page 56). This increase was broad-based and also boosted by one-off factors: intra-year shifts in non-assessed taxes on earnings and the tobacco tax have resulted in weaker developments in the first half of the year being followed by strong growth.[6] By contrast, revenue growth was slowed by further – smaller – payments to nuclear power plant operators.[7] The increase in wage tax receipts was 6%. The tax cut[8] at the start of the year had a dampening effect on the year-on-year figure here. It was not least owing to the aforementioned rise in tax payments on dividends that revenue from profit-related taxes climbed by 19%, though growth in revenue from the high-yielding assessed income and corporation taxes was also dynamic. At 5%, the pick-up in turnover tax – fluctuations in which are volatile during the course of the year – was significant. Revenue from other consumption-related taxes went up by an even greater amount, primarily due to the aforementioned growth in tobacco tax revenue.

Tax revenue*

Year-on-year percentage change, quarterly data



Source: Federal Ministry of Finance. * Including EU shares in German tax revenue but excluding receipts from local government taxes.
Deutsche Bundesbank

Significant revenue rise in year as a whole despite nuclear fuel tax repayment and tax cuts

The latest official tax estimate projects tax revenue growth (including local government taxes) of 4% for 2017 as a whole. This is slightly stronger than would be expected based on favourable developments in the macroeconomic reference variables for tax revenue[9] alone. Although the nuclear fuel tax repayment is curbing growth considerably[10] and revenue shortfalls resulting from tax cuts are outweighing the arithmetical revenue increase stemming from fiscal drag,[11] growth in profit-related taxes remains strong.

5 Including transfers to the EU budget – which are deducted from German tax revenue – but excluding receipts from local government taxes, which are not yet known for the quarter under review.
6 In the case of non-assessed taxes on earnings, the main component of which is investment income tax payments on dividends, fluctuations are probably attributable to dividend payments being made later this year. Tobacco tax revenue rose, comparatively speaking, to a far less significant extent and from a low level last year. This low level was related to the entry into force of an EU regulation that prescribes, inter alia, images of diseases caused by smoking on packaging.
7 Following a ruling by the Federal Constitutional Court published on 7 June 2017 (2 BvL 6/13 of 13 April 2017), central government was required to repay all nuclear fuel tax payments to the operators of nuclear power plants. Some €6½ billion was paid out in June. This was followed in August by a further €1 billion of interest, which was also recorded in the government finance statistics as part of the nuclear fuel tax repayment.
8 The basic income tax allowance and child tax allowance were raised and the tax brackets "shifted to the right" (specified tax rates only apply to higher taxable income). The simultaneous raising of child benefit, which is deducted from revenue, likewise reduces wage tax receipts in the government finance statistics.
9 This estimate is based on the Federal Government's current macroeconomic projection. In 2017, real GDP growth is expected to be 2.0% and nominal growth 3.5% (May: 1.5% and 3.0% respectively). GDP growth for 2018 is forecast to be 1.9% in real terms and 3.6% in nominal terms (May: 1.6% and 3.1% respectively). For 2019, GDP growth is estimated to be 1.7% in real terms and 3.4% in nominal terms (May: 1.4% and 3.2% respectively). In the medium term, nominal growth of around 3% per annum is still forecast.
10 In addition, revenue shortfalls are also expected in connection with several other court rulings (relating to profit-related taxes, in particular), some of which have made themselves felt in previous years or are expected to do so in the years to come. In the government finance statistics, such refunds reduce revenue at the point in time the refund is paid. By contrast, they are recorded in the national accounts as government spending (capital transfers) at the point in time an absolute ruling is made.
11 This refers to the net positive revenue effect arising from income tax bracket creep (real and price-related) and the dampening impact of specific excise duties being largely independent of prices.

Tax revenue

Type of tax	Q1 to Q3				Estimate for 2017[1,2]	Q3			
	2016	2017				2016	2017		
	€ billion		Year-on-year change € billion	%	Year-on-year change %	€ billion		Year-on-year change € billion	%
Tax revenue, total[2]	472.5	492.3	+ 19.8	+ 4.2	+ 4.0	155.5	165.9	+ 10.4	+ 6.7
of which									
Wage tax	132.6	140.8	+ 8.3	+ 6.2	+ 5.9	44.7	47.3	+ 2.6	+ 5.8
Profit-related taxes[3]	80.9	89.6	+ 8.7	+ 10.8	+ 8.6	23.5	28.0	+ 4.5	+ 19.1
Assessed income tax	39.4	44.6	+ 5.1	+ 13.1	+ 10.2	11.9	12.7	+ 0.8	+ 6.9
Corporation tax	21.3	22.4	+ 1.1	+ 5.2	+ 3.9	5.5	6.0	+ 0.5	+ 8.8
Investment income tax[4]	20.1	22.6	+ 2.5	+ 12.2	+ 10.5	6.0	9.2	+ 3.2	+ 52.6
Turnover taxes[5]	161.0	168.2	+ 7.2	+ 4.5	+ 4.4	53.9	56.5	+ 2.6	+ 4.8
Other consumption-related taxes[6]	62.7	64.6	+ 1.9	+ 3.1	+ 2.5	21.4	22.6	+ 1.3	+ 5.9

Sources: Federal Ministry of Finance and Bundesbank calculations. **1** According to official tax estimate of November 2017. **2** Including EU shares in German tax revenue but excluding receipts from local government taxes. **3** Employee refunds deducted from revenue. **4** Withholding tax on interest income and capital gains, non-assessed taxes on earnings. **5** Turnover tax and import turnover tax. **6** Taxes on energy, tobacco, insurance, motor vehicles, electricity, spirits, air traffic, coffee, sparkling wine, intermediate products, alcopops, betting and lottery, beer, fire protection.

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Similar increases in years to come – under current tax legislation

Revenue is also expected to rise by 4% in both 2018 and 2019. The revenue shortfalls stemming from legislative changes[12] will more or less offset fiscal drag on balance. The fact that the bulk of the tax refunds to be paid out as a result of various court rulings will come to an end during this period will have an accelerating effect on this. Annual average growth of just under 4% is then projected for the medium term up until 2022, arising primarily from the macroeconomic assumptions and fiscal drag. The tax ratio (as defined in the government finance statistics) is therefore projected to increase significantly to 23.3% by the end of the forecast period in 2022 (2016: 22.4%). In particular, the sharp increase in profit-related taxes in the current year, as well as fiscal drag, which will not be offset in the medium term, will make themselves felt here.

Revenue expectation raised slightly for 2017 and significantly for years thereafter

The May 2017 tax revenue forecast has been revised upwards for the current year (+€2 billion). Of somewhat greater significance here than the nuclear fuel tax repayment (the ruling on which had not yet been made known at that time) and opposing adjustments owing to the effects of previous court rulings, are the more favourable macroeconomic assumptions and the additional intra-year growth in profit-related taxes. In the years to come, the net negative corrections arising from adjustments to tax repayments and legislative changes will play a significantly less important role than the more favourable macroeconomic developments and the higher 2017 starting level for profit-related taxes. All in all, the upward revisions stand at €7 billion for 2018 and at €6 billion for each of the following years up to 2021. In the case of profit-related taxes, there is a risk of a setback given the very high level of revenue. However, this growth rate, which has been fairly high for some time now, could also reflect, for instance, greater efforts to limit tax

12 The Working Party on Tax Revenue Forecasting issues projections on the basis of current tax legislation.

evasion and avoidance. As regards the macroeconomic assumptions, there are risks arising from international uncertainty, on the one hand, but also, in particular, domestic upside risks, on the other.

Central government budget

Increased deficit in Q3 despite marked revenue growth

Central government recorded a deficit of €5 billion in the third quarter of 2017 compared with €3½ billion a year earlier. Revenue rose markedly by 4% (€3½ billion). Going up by 7½% (€5½ billion), tax revenue grew even more steeply. The repayment of nuclear fuel tax collected in the period from 2011 to 2016 ordered by the Federal Constitutional Court in early June and immediately enforced was followed by a compensation payment for interest accrued (€1 billion), placing a strain on tax revenue. By contrast, relief was provided in the form of a €1½ billion reduction in deductions for transfers to the EU budget. The sharp decline in other revenue was caused, in particular, by last year's one-off repayment of €1½ billion from the flood relief fund. Overall expenditure rose fairly sharply once again (+5½%, or €5 billion). The main driving forces were higher transfers (+€2½ billion), primarily to the statutory pension insurance scheme but also to state government (as a result of central government's higher effective share of spending on accommodation costs at the local government level for recipients of unemployment benefit II). Owing to the large number of asylum seekers who have now been granted refugee status, unemployment benefit II transfers were also up (+5½%, or €½ billion). Interest expenditure remained virtually unchanged, as a burden of almost €1 billion from declining premiums[13] was offset, not least, by persistent refinancing advantages. Increasing by €2 billion, investment expenditure went up significantly. The most important single factor here was a one-off capital injection for Deutsche Bahn (€1 billion).

In spite of nuclear fuel tax repayments, surplus now likely for 2017, too; dissolving of reserves appropriate

After three quarters, the central government budget is now balanced following a surplus of €7½ billion a year earlier. If no unpleasant surprises occur, a distinct surplus can be expected again for the year as a whole.[14] This expectation is supported by the results of the latest tax estimate, which was raised again despite burdens of €7½ billion stemming from the repayment of nuclear fuel tax (+€½ billion compared with the situation in May, or +€7½ billion compared with the budget estimate). The refugee reserve, which had already increased to just over €18½ billion at budget outturn for 2016, is thus likely to rise significantly once more rather than being tapped. As the reserve has not yet been needed to finance refugee expenses and the influx of refugees has stabilised since 2016, it seems appropriate to release the reserve at the end of 2017 to pay down debt.[15]

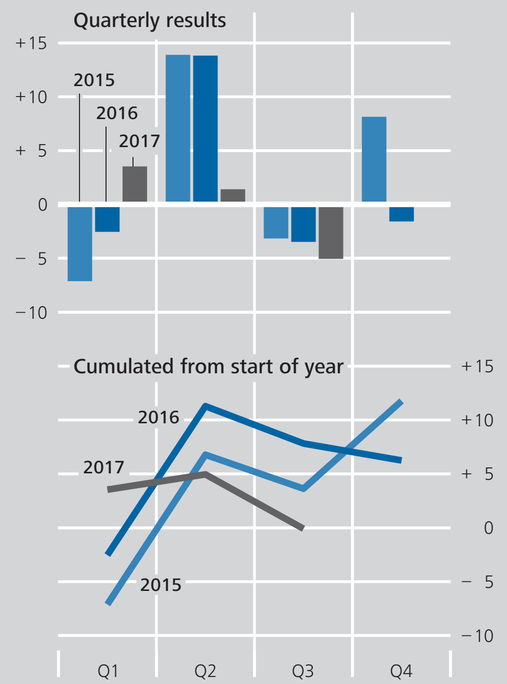
Fiscal plans to be revised by future government; leeway available, especially in the medium term

The draft budget for 2018, adopted by the Federal Cabinet at the end of June, will be revised by the as yet unformed new government. As no Budget Act is set to have been adopted by the start of 2018 – as has also been the case at the beginning of previous legislative periods – the relatively stringent cost-curbing regulations for provisional budgets will be applicable. The previously planned withdrawal of €8 billion from the reserve appears to be superfluous as the tax revenue expectations of the Working Party on Tax Revenue Forecasting have since been raised by €7 billion and the other very positive developments overall in the current year are set to continue, at least in part. This means that there should be no trouble achieving the planned global spending cut of €4 billion as well when the budget is implemented. However, if the future government stands by the decision to forego new net borrowing (ensuring a "black zero" or balanced budget) and does not liquidate the extensive refugee re-

13 See Deutsche Bundesbank, Distortive accounting of premiums and discounts in the Federal budget, Monthly Report, July 2017, pp 43-44.
14 The slightly negative result in the final quarter of 2016 was the result of one-off burdens amounting to a total of around €7 billion from the transfer of turnover tax revenue to the state governments and the one-off expansion of the fund to promote municipal investment.
15 For more details, see Deutsche Bundesbank, Public finances, Monthly Report, May 2017, p 65.

Central government fiscal balance*

€ billion



Source: Bundesbank calculations based on data from the Federal Ministry of Finance. * Core budget excluding off-budget entities. Not adjusted for financial transactions or cyclical effects.

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serve to finance new projects, the current fiscal room for manoeuvre will remain relatively limited. Only in the medium term is this leeway likely to expand notably. Therefore, not least in view of the considerable surpluses to be expected for state and local governments overall, additional transfers to their budgets are not an urgent necessity.[16]

Off-budget entities: improved result in Q3 and higher surplus for year as a whole

Central government's off-budget entities covered by the Federal Ministry of Finance's quarterly overviews (excluding, in particular, bad banks and other entities keeping commercial accounts) achieved a balanced result in the third quarter following a deficit of €1½ billion a year earlier on account of the flood relief fund making repayments to the central government budget. In the reporting quarter, the off-budget entities to be included in the debt brake (the energy and climate fund, the flood relief fund and the fund to promote municipal investment)[17] together also recorded only a moderate deficit of just under €½ billion. This balances the result of the first three quarters and, for 2017 as a whole, the deficit forecast by central government (just over €3 billion) may be significantly undershot. For the off-budget entities included here taken as a whole, an improvement is on the cards in relation to 2016 (surplus of €½ billion). While last year's central government expansion of the fund to promote municipal investment will not be repeated, the precautionary fund for final payments for inflation-indexed Federal securities is expected to record a much better result as no repayments are to be made from this fund this year and inflation-linked transfers from central government are higher. Essentially, the perceptible relief afforded by the absence of repayments from the flood relief fund and the similarly extensive forwarding of the previous year's bank levies to the European Single Resolution Fund, which was then new, are thus set to make an impact.[18]

16 During the previous legislative period, permanent transfers were approved (in particular, continuous additional funds for local governments from 2018 and for the new federal financial equalisation scheme from 2020), as was the decision to pass on funds for several years primarily to offset refugee-related additional expenditure and to promote investment by financially weak local governments.
17 At the end of the third quarter, ie more than two years after the fund was established, only €½ billion of the originally available total of €3½ billion (which has since been increased by a further €3½ billion) had been paid out. This may be attributable to insufficient planning capacity in the financially weak beneficiary local governments. Moreover, it may be the case that the scope of action for central government investment subsidies, restricted by Germany's Basic Law (Grundgesetz), did not reflect the actual acute needs of the local governments.
18 The payment of €24 billion from nuclear power plant operators received by a central government off-budget entity this year for the assumption of the long-term storage costs of nuclear waste is not included in the Federal Ministry of Finance's reporting group. In the national accounts, this compensation payment does not affect the general government fiscal balance as it is considered to be an advance payment for future expenditure.

State government budgets[19]

Marked surplus in Q3 from substantial revenue growth and stagnating expenditure

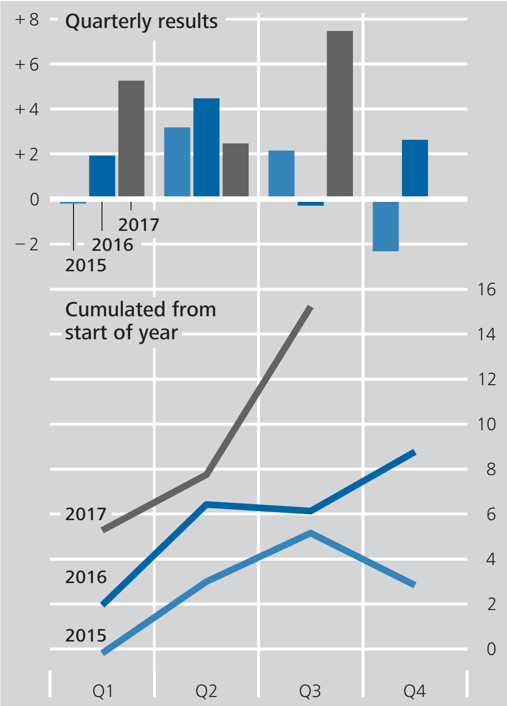
The state governments ran a cash surplus of €7½ billion in the third quarter of 2017, which was a very clear improvement on the year (deficit of just under €½ billion). Following more subdued developments in the previous quarter, revenue rose substantially by just over 9% (just under €8 billion) compared with the previous year. Alongside the dynamic growth in tax revenue (+9%, or €5½ billion), this was also due to the ongoing rise in revenue received from public administrations (+5%, or €1 billion), which included central government funds to be forwarded to local government. In addition, a repayment from BayernLB to the tune of €1 billion made itself felt as a special factor. By contrast, overall expenditure stagnated. Personnel expenditure increased (by 4½%, or €1½ billion) and current payments to local government saw a distinct rise (+4%, or €1 billion). However, following an exceptionally strong increase in the previous year related to support for refugees, other operating expenditure declined once again (-1½%). Finally, other expenditure, which is not broken down further in the monthly statistics, fell particularly sharply.[20]

Surplus in the current year higher than forecast and very favourable outlook

After three quarters, the surplus of the state government core budgets already amounts to just under €15½ billion. A certain deficit might again be recorded in the final quarter (whereas in the fourth quarter of 2016, a positive one-off effect still occurred due to transfers of central government tax revenue). For the year as a whole, however, an even better result is now expected in comparison to 2016 (€6 billion).[21] The Federal Ministry of Finance's July forecast for general government envisaged a surplus of €6 billion for the state government core budgets. Ongoing substantial surpluses were expected here for the medium term, fostered not least by the new financial equalisation scheme which will enter into force from 2020 onwards. According to the latest tax estimate, state government tax revenue is set to rise somewhat more sharply again during this period (by 4% on an annual average before deduction of related additional payments as part of the local government financial equalisation schemes). The more positive development in the non-tax areas is also likely to continue, thus improving the underlying outlook for state government further still overall.

State government fiscal balance*

€ billion

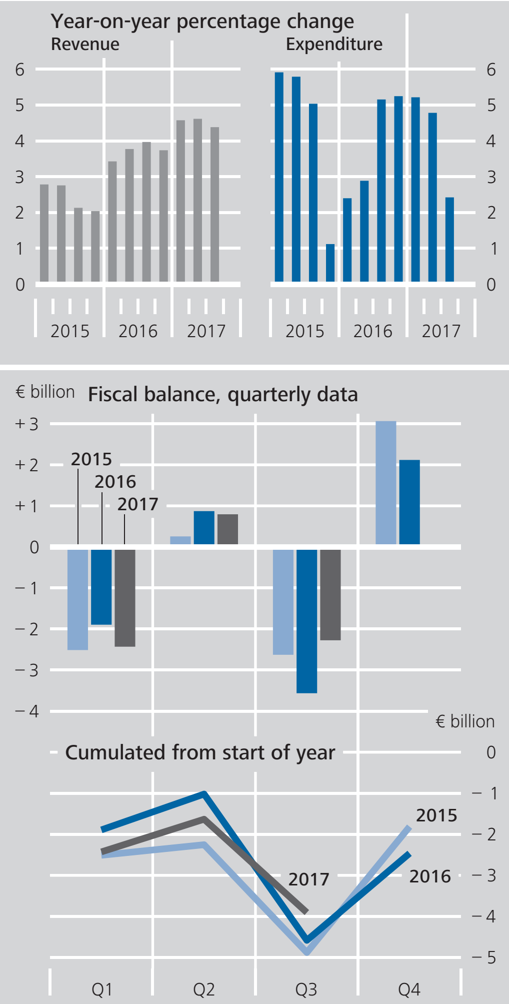


Source: Bundesbank calculations based on monthly data from the Federal Ministry of Finance. * Federal states' core budgets excluding off-budget entities.
Deutsche Bundesbank

Against this background, it should be possible to mitigate the continued problems encountered by the local governments in some federal states. In Hesse, for example, local government

19 The short articles in the Bundesbank's October 2017 Monthly Report contain a more detailed analysis of the development of local government finances in the second quarter of 2017. These are the most recent data available. The data on state government budgets are based on the monthly cash statistics on the core budgets.
20 A significant factor here was the change in the payment of transfers made by North Rhine-Westphalia to its higher education establishments, which took place in the second quarter. Following additional costs of around €2 billion in the preceding quarter, relief amounting to €1 billion was consequently supplied in the reporting quarter.
21 Closing entries such as special transfers to off-budget entities placed an additional strain of around €3 billion on the balance compared with the monthly data used here.

Finances of the German statutory pension insurance scheme



Source: German statutory pension insurance scheme (Deutsche Rentenversicherung Bund). Preliminary quarterly results.
Deutsche Bundesbank

Important for state governments to offset local governments' budgetary imbalances

cash advances are to be virtually fully paid off from mid-2018 with the assistance of the state government. In return, a distinct tightening of budgetary surveillance is envisaged. This approach could resolve the problems overall. In any event, it would be essential for the budget supervisory authorities of the individual federal states to tackle the racking up of cash advances in a decisive manner in future.[22]

Funds available for future-oriented tasks such as education, plus potential for tax cuts

Additionally, funds are available for future-oriented tasks. A needs-based expansion of support services and learning opportunities in day care facilities for small children and schools is under discussion which aims at improving parents' employment, promoting general education and facilitating the integration of refugees, for example. If the state governments were to grant further legal claims, the local governments that were mandated with the provision of additional services would be entitled to receive a cost reimbursement. It would also be necessary to establish how improvements to the education system could be made elsewhere. Furthermore, the state governments should also be in a position to withstand a certain amount of tax cuts.

Social security funds[23]

Statutory pension insurance scheme

Deficit in Q3 much lower than a year earlier

In the third quarter of 2017, the statutory pension insurance scheme recorded a deficit of just under €2½ billion. The deficit – which is usual for this time of year – was down by almost €1½ billion in year-on-year terms. Revenue continued to rise steeply (by 4½%). Alongside pay rises, ongoing favourable employment developments, in particular, made an impact on contribution receipts. Furthermore, a temporary reduction in the central government grant came to an end. Expenditure growth was much more subdued at 2½%. The main reason for the weakened growth over the course of the year was the fact that the mid-2017 pension increase (+1.9% in western Germany and +3.6% in eastern Germany) was lower than last year.[24]

On an annual average for 2017, pensions have increased at a similar pace to last year, at 3½%.

22 See Deutsche Bundesbank, Local government finances: Development and selected aspects, Monthly Report, October 2016, pp 13-36.
23 The financial development of the public long-term care and statutory health insurance schemes in the second quarter of 2017 was analysed in the short articles of the September 2017 Monthly Report. These are the most recent data available.
24 See also Deutsche Bundesbank, Public finances, Monthly Report, May 2017, p 68.

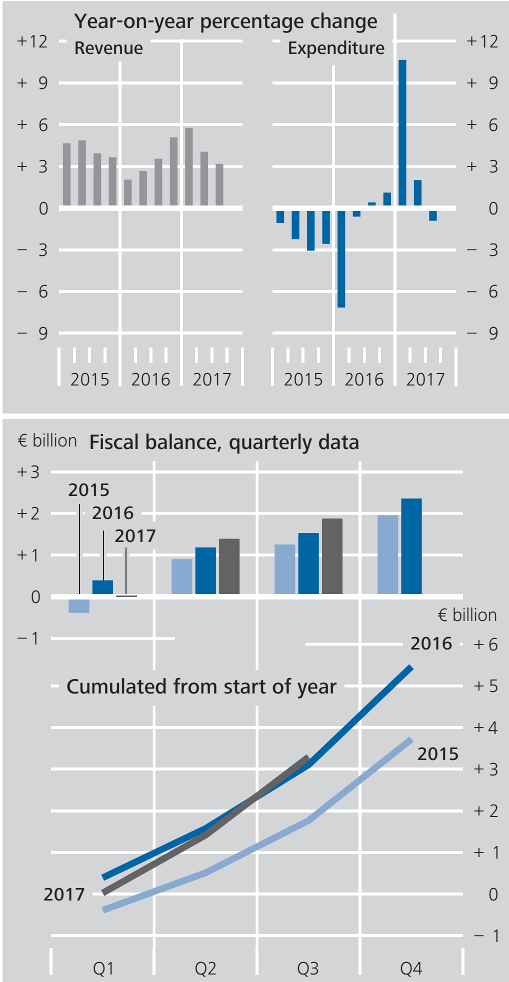
Much better result expected for year as a whole, too

On account of the somewhat weaker growth in the number of pensions, however, overall, pension expenditure is expected to rise slightly more slowly than in 2016 (+4%). On the revenue side, the increase is likely to be somewhat higher. This is largely attributable to the removal of the reduction factor (just over €1 billion) in the central government grant, but contribution receipts could also increase a little more strongly. For 2017 as a whole, the result of the statutory pension insurance scheme is likely to improve considerably compared with 2016 (deficit of just over €2 billion). The reserve is expected to change only slightly and should remain distinctly above the upper bound of the fluctuation band, or 1.5 times monthly expenditure.

Interim peak in statutory pension insurance scheme makes rule-based contribution rate reduction possible

The finances of the statutory pension insurance scheme are currently at an interim peak. Considering the very positive developments expected on the labour market and an environment of comparatively moderate growth in the number of pensions, the financial situation could even continue to improve somewhat in the coming year. As things stand, therefore, and assuming the contribution rate remains unchanged, the reserve is set to distinctly exceed the upper limit at the end of 2018, too. In this case, the statutory framework stipulates a contribution rate reduction for 2018. First, this could take pressure off employees and enterprises and, second, pension recipients could profit from this further down the line when the pension adjustment formula is applied, yielding a somewhat higher pension increase. However, as time passes and more people enter retirement with an increased life expectancy, funding pressures on the statutory pension insurance scheme are set to mount again. If a new series of substantial benefit expansions were to be implemented in the current positive environment, the revenue-side pressure on the statutory pension insurance scheme would rise additionally, thereby increasing demographic-related adjustment needs further still.

Finances of the Federal Employment Agency*



Source: Federal Employment Agency. * Federal Employment Agency core budget including transfers to the civil servants' pension fund.

Deutsche Bundesbank

Federal Employment Agency

Continued improvement of financial situation in Q3

In the third quarter of 2017, the Federal Employment Agency posted a surplus of €2 billion in the core budget,[25] which constituted a year-on-year improvement of almost €½ billion. Contribution receipts continued to increase considerably (by almost 4%). By contrast, revenue shortfalls were recorded for insolvency benefit contributions (the level of which was

25 Excluding the civil servants' pension fund, but including surplus-reducing transfers to this fund.

cut at the beginning of the year).[26] Total revenue increased by 3%. By contrast, expenditure decreased by 1%. In view of what was still a very favourable labour market situation with an even lower number of benefit recipients, the decline in unemployment benefit continued (-2%). Expenditure on active labour market policy measures, on the other hand, rose – from an already significantly elevated level – yet further (+2½%) compared to the previous year.

Increased surplus expected again for year as a whole

Favourable developments are expected to continue for the year as a whole. The Federal Employment Agency's finances are benefiting from the positive labour market situation on both the revenue and expenditure sides. Against this backdrop, a major acceleration of expenditure growth on active labour market policy measures does not seem appropriate. In spite of special transfers to the civil servants' pension fund during the first half of the year[27] (just over €½ billion), the surplus appears to be higher on the year (2016: €5½ billion) for 2017 as a whole. This is, once again, significantly above the budgeted amount (€1½ billion). Thus the free reserves for operational activities will see a further substantial increase (end-2016: €11½ billion).[28]

Continued favourable labour market conditions in the medium term advocate marked contribution rate reduction

According to current forecasts, the positive labour market trend is set to continue for the next few years. Further-rising surpluses and a steep increase in free reserves are therefore on the horizon, in line with current spending policy, providing scope for a significant reduction in the contribution rate. A lower rate would still enable surpluses to be generated, which is appropriate during an upswing, and free reserves could be built up further. This would even make it possible to accommodate a sharper downturn without drawing on central government loans.

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26 Following a further reduction, revenue from insolvency benefit contributions cumulated for the first nine months of 2017 (2016: €1 billion) still exceeded insolvency benefit payments by almost €0.2 billion (2016: €½ billion). The reserves available for insolvency benefit payments totalled just over €1½ billion at end-2016.
27 These reserves were linked to low interest rates and resultant additional capital requirements to cover future pension entitlements, particularly for civil servants of the Federal Employment Agency.
28 The winter compensation reserve, insolvency benefit and pension reserve are not included in this figure.