Public finances*

General government budget

Surplus again this year despite burdens, …

Germany's public finances are continuing to benefit from the highly favourable underlying economic conditions. As a result, a marked surplus is expected once again this year in spite of various burdens (2016: 0.8% of gross domestic product (GDP)). On the one hand, positive economic developments are easing the strain on public coffers, while the extremely favourable financing conditions at all levels of government are causing interest expenditure to fall further. On the other hand, the nuclear fuel tax repayments to be made in line with a Federal Constitutional Court ruling are having a negative impact.[1] Furthermore, the fiscal policy stance is expansionary on the whole. Additional funding has been earmarked for areas such as infrastructure, the armed forces and long-term care, in particular. Spending on pensions and healthcare is likewise set to rise relatively sharply. On the revenue side, favourable tax developments are on the horizon – despite the slight dampening effect of the income tax cut. In addition, the raising of the contribution rate to the long-term care insurance scheme is generating additional receipts, which are to be used to finance a large part of the benefit increases introduced under the latest long-term care reform. All in all, the tax and social contributions ratio looks set to increase further. The debt ratio fell in the first quarter of 2017 to 66.9% (end-2016: 68.3%). In view of the surpluses recorded by central, state and local government and of nominal GDP growth in the ratio's denominator, it will probably maintain its downward trajectory.[2]

… and debt ratio continues to fall

Current fiscal policy stance to lead to sizeable surpluses even in medium term, yet budget-consuming measures under discussion

As things currently stand, the setting for German public finances will remain favourable in the medium term. Provided there is no change in policy, further sizeable surpluses are to be expected, and the debt ratio could fall back below the 60% threshold in 2019. That said, many of the measures being discussed in the run-up to the German general election would put pressure on the budget.

Moderate structural surpluses helping to address demographic developments and …

In principle, moderate structural surpluses seem entirely appropriate for Germany. The debt ratio is still high, and the financial burdens that are set to arise from demographic developments – particularly in the areas of pensions and long-term care, but also healthcare – will have an impact on public finances in the future and will need to be addressed. These effects will remain limited in the medium term, with the economic situation and highly favourable interest rate level bringing about a temporary period of calm. However, it is precisely in good times that long-term challenges should be kept in mind. Most of these burdens will not materialise until some years down the road when the baby boomer generation retires from the labour force. It is therefore important when assessing public finances or pension issues to take into account significantly longer time horizons.[3]

… improve resilience of public finances

It is also recommended that central and state government draw up budgets that factor in safety margins below the budget ceiling de-

* 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 See p 61 f. Tax refunds owing to court rulings, and the interest that goes with them, are recorded in the national accounts as spending (capital transfers); however, in the government finance statistics, these payments are deducted from tax revenue. Temporary burdens could also arise, in particular, in connection with the remaining state government guarantees issued for HSH Nordbank (roughly €8 billion).
2 Generally speaking, there is uncertainty surrounding the further portfolio reduction and scaling-back of corresponding liabilities at government-owned bad banks. As in the past few quarters, developments could be volatile due, inter alia, to increases or reductions in cash collateral in connection with derivatives transactions.
3 For example, the time horizon in current sustainability reports runs until 2060.

fined by the debt brake. Moderate structural surpluses provide leeway, making it possible to take account of unexpectedly adverse budgetary developments. As a result, there is no need to resort to adopting short-term and, where appropriate, procyclical consolidation measures or to relaxing the debt brake, which would compromise its effectiveness and credibility. The current low-interest-rate environment is taking considerable pressure off those state and local governments with very high levels of debt, in particular. However, the current highly favourable financing conditions and the resulting relatively low interest expenditure should not obscure the fact that high debt levels will place a strain on future budgets. To this end, a more ambitious fiscal policy stance is particularly warranted, not least so as to be equipped to deal with interest rates returning to normal.[4]

Budgetary development of central, state and local government

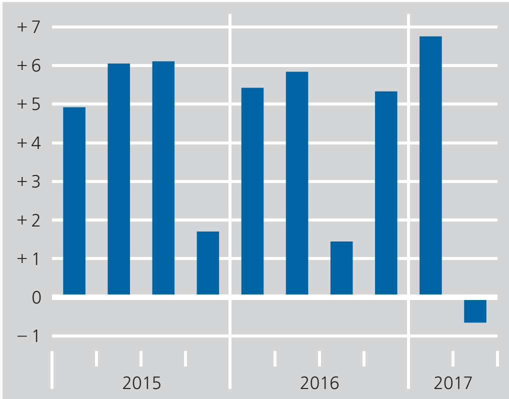
Tax revenue

Slight decline in tax revenue in Q2 due to nuclear fuel tax repayments

The year-on-year decline in tax revenue[5] came to ½% in the second quarter of 2017 (see the chart above and the table on page 62). The decline is due to the fact that, following a ruling by the Federal Constitutional Court,[6] central government was required to repay the €6½ billion collected in nuclear fuel tax payments since 2011 to the operators of nuclear power plants. Without these repayments, revenue would have risen by 3%. At 6½%, growth in wage tax receipts was considerable, though the income tax cut at the start of the year had a slightly dampening effect. On the other hand, the rate of growth was elevated by the fact that child benefit, which is deducted from revenue, rose only moderately. Growth in assessed profit-related taxes remained buoyant. Receipts from withholding tax on interest income and capital gains were up significantly, which is likely to be mainly attributable to capital gains. By contrast, revenue from non-assessed taxes on earnings, the main component of which is investment income tax payments on dividends, decreased considerably. However, this appears to be linked to some extent to dividend payments, which are now made later over the course of the year, meaning that a turnaround can be expected by the end of the year. Turnover tax revenue, which is quite volatile *per se,* increased by a rather modest 3%. While tobacco tax receipts decreased, this was probably largely driven by a (temporary) revenue-boosting one-off effect in the same period a year earlier.[7]

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.

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Growth of 3% expected for 2017 as a whole even in face of nuclear fuel tax repayments

According to the official tax estimate from May, tax revenue (including local government taxes) is expected to rise by 4% in 2017 as a whole. Adjusted for the aforementioned ruling by the Federal Constitutional Court on nuclear fuel

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4 See Deutsche Bundesbank, The development of government interest expenditure in Germany and other euro area countries, Monthly Report, July 2017, pp 33-68.

5 Including EU shares in German tax revenue but excluding receipts from local government taxes, which are not yet known for the quarter under review.

6 See Federal Constitutional Court, Order of the Second Senate of 13 April 2017 (2 BvL 6/13). The order was published on 7 June 2017.

7 The entry into force on 20 May 2016 of the Regulation Governing the Implementation of the EU Tobacco Products Directive (Verordnung zur Umsetzung der Richtlinie über Tabakerzeugnisse) is likely to have increased tax revenue in the first half of 2016 before lowering it in the second half of 2016. Pursuant to the regulation, measures to be taken include putting images of diseases caused by smoking on packaging.

Tax revenue

Type of tax	H1 2016 € billion	H1 2017 € billion	H1 Year-on-year change € billion	H1 Year-on-year change %	Estimate for 2017[1,2] Year-on-year change %	Q2 2016 € billion	Q2 2017 € billion	Q2 Year-on-year change € billion	Q2 Year-on-year change %
Tax revenue, total[2]	317.0	326.4	+ 9.4	+ 3.0	+ 2.9	162.1	161.0	− 1.1	− 0.7
of which									
Wage tax	87.9	93.6	+ 5.7	+ 6.5	+ 5.1	45.3	48.3	+ 2.9	+ 6.5
Profit-related taxes[3]	57.4	61.6	+ 4.2	+ 7.4	+ 3.7	29.2	29.9	+ 0.7	+ 2.6
Assessed income tax	27.5	31.8	+ 4.3	+ 15.7	+ 6.8	12.9	14.8	+ 1.9	+ 14.5
Corporation tax	15.8	16.4	+ 0.6	+ 3.9	− 1.3	7.3	7.9	+ 0.5	+ 7.4
Investment income tax[4]	14.1	13.4	− 0.7	− 5.1	+ 2.4	8.9	7.2	− 1.7	− 18.9
Turnover taxes[5]	107.1	111.7	+ 4.6	+ 4.3	+ 4.8	52.7	54.2	+ 1.5	+ 2.9
Other consumption-related taxes[6]	41.3	42.0	+ 0.7	+ 1.6	+ 0.8	21.9	22.1	+ 0.1	+ 0.7

Sources: Federal Ministry of Finance and Bundesbank calculations. **1** According to official tax estimate of May 2017, adjusted for nuclear fuel tax repayments. **2** Including EU shares in German tax revenue but excluding receipts from local government taxes. Nuclear fuel tax repayments are included here for 2017. **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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tax,[8] which was not published until after the tax estimate had been prepared, this corresponds to an increase of 3%. It is assumed here that profit-related taxes will rise significantly, and at a greater rate than could be expected solely on the basis of macroeconomic assumptions and the financial impact of legislative changes and court rulings. This was also observed for the first half of the year, at least. By contrast, projected growth will be curtailed by further, greater tax refunds owing to court rulings, some of which were made some time ago. Repayments are expected later in the year and primarily concern revenue from profit-related taxes.[9]

Central government budget

Surplus largely depleted in Q2, primarily owing to nuclear fuel tax repayments

Central government recorded a surplus of only €1½ billion in the second quarter of 2017 compared with €14 billion a year earlier. Revenue fell considerably (by 7%, or -€6 billion). This was mainly due to the nuclear fuel tax repayments (see page 61). In addition, the deductions for transfers to the EU budget were up on the year by €1½ billion. At the same time, total expenditure rose sharply (by 8½%, or +€6½ billion). The largest expenditure increase was recorded for higher transfers (+€3 billion), par-

8 Interest payments will also be made to the operators in this connection in future, but the amount of these payments is not yet known. These are not taken into account here. However, including them is not likely to paint a very different picture. Another factor not taken into consideration is that the payments to the enterprises – and, where appropriate, additional dividend payments – are subject to profit-related taxes, which are deducted with a time lag in some cases. The original nuclear fuel tax payments were deductible from their assessment bases. It thus stands to reason that the net burden on government coffers will shrink in future.
9 For the impact of the court rulings on the tax estimate, see Deutsche Bundesbank, Public finances, Monthly Report, May 2017, p 63. Unlike the cash receipt developments described here, the impact of these court rulings is recorded in the national accounts at the time of each ruling as increasing expenditure rather than being deducted from tax revenue. The burden is therefore distributed over several years (2011 and 2013 to 2017) in the national accounts, with tax revenue rising at a significantly sharper rate this year.

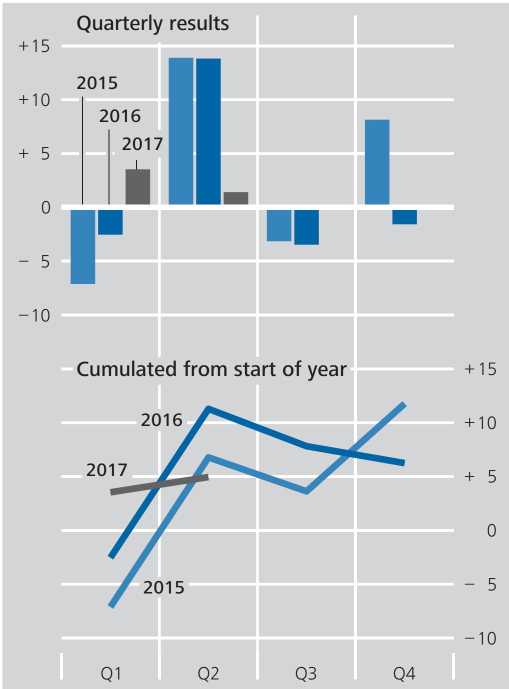
ticularly to the social security funds (most notably the statutory pension insurance scheme) and state governments. Transfers to the latter include central government's increased contribution to accommodation costs for recipients of unemployment benefit II (means-tested benefit), which is to be passed on to local government. However, spending on unemployment benefit II itself was up significantly (by 6%, or +€½ billion). This is largely due to the growing number of refugees who are now eligible for basic allowance benefits, which are financed by central government. Another significant item was the €1½ billion increase in interest expenditure. Of particular note in this regard were rapidly declining premiums,[10] which nevertheless reached an amount of just over €1 billion, and higher payments to the precautionary fund for inflation-linked Federal securities.

General government deficit, and thus recourse to reserve, for year as a whole probably lower than planned

In the first half of the year, the central government budget therefore recorded a surplus of €5 billion, which fell significantly short of the €11½ billion surplus recorded a year earlier. For the year as a whole, however, a deficit of €7 billion is budgeted, amounting to a deterioration of €13 billion on the actual figure for 2016. Compared with the budget estimates, there will be revenue shortfalls as a result of the ruling by the Federal Constitutional Court on nuclear fuel tax (€6½ billion plus interest) and of a €2 billion drop in the Bundesbank's profit. In addition, the budget plan still contains a €3 billion global cut in expenditure. However, more favourable fundamental tax developments are expected (+€7 billion on the basis of the May tax estimate), and several further improvements vis-à-vis the budget estimates are on the horizon. All things considered, the central government budget is expected to develop more favourably than planned, despite the negative effects described here. The deficit and withdrawal from the reserve in order to achieve a "black zero", ie a balanced budget without net borrowing, are thus likely to be lower than the estimated €7 billion (see the table on page 65).[11]

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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Dissolution of reserve to pay down debt advisable

In addition to the result recorded for the central government budget, the deficits of three off-budget entities – the flood relief fund, the fund to promote municipal investment, and the energy and climate fund – are taken into account in the context of the debt brake. The total of their deficits is likely to be somewhat lower than the estimated €3 billion, and, overall, the central government budget looks set to safely comply with the debt brake limit for the structural balance of -0.35% of GDP (-€10½ billion). This remains the case when – in contrast to the Federal Ministry of Finance's approach – looking at the financial balance (deficit) of the core budget rather than borrowing. As it is currently implemented, the option under the national debt brake of central government

10 See Deutsche Bundesbank, Distortive accounting of premiums and discounts in the Federal budget, Monthly Report, July 2017, pp 43-44.
11 Forming and dissolving reserves has no effect on the balance of revenue and expenditure (ie surplus or deficit). However, in the event of an existing deficit, it is possible to avoid borrowing by dissolving reserves.

(and some state governments) of complying with fiscal rules by dissolving reserves is a significant deviation from the European rules. As the national rules should, not least, ensure compliance with European requirements, this inconsistency gives cause for concern. For example, it may give rise to a situation in which compliance with the limits set under national debt brakes is accompanied by non-compliance with European rules. Against this background, but also because it is clear that expenditure relating to refugee immigration can be financed without – as was originally intended – making use of the reserve, it would make sense to dissolve the reserve to pay down debt in the budget.[12] As a general rule, the Stability Council (in which central government and all state governments are represented) reviews compliance with the European rules on the general government deficit. It is important that detailed information on budgetary developments at the level of both central government (and the social security funds) as well as individual state governments (and the sum of their local authorities) are available, together with the corresponding plans. In this way, the Stability Council can also identify risks relating to compliance with the European rules at an early stage – risks that, in spite of compliance with the debt brake requirements, can result, *inter alia,* from differences in the treatment of reserve withdrawals or premiums – and initiate the necessary budgetary adjustments.

2018 draft budget: recourse to refugee reserve masks planned deficit

At the end of June, the Federal Cabinet adopted a draft budget for 2018. This is likely to be revised when the new government takes up office following the general election in September, but is probably the starting point for further planning. Once again, the budget contains no net borrowing. In particular, expenditure for the broadly rule-based payments to the statutory pension insurance scheme, but also for the financing of the energy and climate fund and the military, is set to increase distinctly. Furthermore, interest expenditure is expected to rise (+€2½ billion) – mainly to provide for later final payments for inflation-indexed Federal securities. On the revenue side, growth in tax revenue is to be subdued as transfers to the EU budget are estimated to be much higher, and additional tax revenue is assigned to the state and local governments on a lasting basis as part of the €5 billion municipal relief package. As in the 2017 budget, the Bundesbank's profit is forecast to be €2½ billion, with the Bundesbank announcing burdens resulting from further risk provisioning. The estimated global revenue shortfall of just over €2 billion may represent a certain amount of provisioning, as long as this is not used to cover other imminent burdens, such as the lump-sum refugee payment to the federal states (2017: just over €1 billion). After factoring in a global spending cut of €4 billion, which eases the budgetary burden, €8 billion is to be withdrawn from the refugee reserve. After deduction of coin seigniorage, therefore, the draft budget contains a deficit of €8½ billion (see the table on page 65).

Estimated cyclical budgetary burden unconvincing

The debt brake limits the structural result for 2018 to -€11 billion. The Federal Ministry of Finance is basing its budgetary plans on a net borrowing of €0 for the core budget and a total deficit of €2½ billion for the relevant off-budget entities. A small revenue surplus (€½ billion) is envisaged for financial transactions (which are to be factored out of the calculations). Applying an approach where the cyclical impact is taken to be negative increases (improves) the structural balance, thus leaving leeway of just over €8 billion to the upper limit overall. If instead of net borrowing, the deficit of the core budget were included in the calculations (meaning that withdrawals from the reserve, in particular, were not included), there would no longer be any leeway. Furthermore, the economic situation in the coming year, especially also in light of the low unemployment rate, is generally being classified as good and budget-relieving, rather than as a burden on public finances. It would thus appear more appropriate to figure in cyclical relief for the cen-

12 See Deutsche Bundesbank, Public finances, Monthly Report, May 2017, p 65.

Central government's medium-term fiscal planning for 2017 to 2021 and structural net borrowing under the debt brake

€ billion

Item	Actual 2015	Actual 2016	Target 2017	Draft 2018	Fiscal plan 2019	2020	2021
Expenditure[1]	311.4	317.1	329.1	337.5	348.2	349.4	356.8
of which							
Investment	29.6	33.2	36.1	36.4	37.1	32.6	33.0
Revenue[1, 2]	311.4	317.1	329.1	337.5	348.2	349.4	356.8
of which							
Tax revenue[1]	281.7	289.0	301.0	308.8	321.8	327.1	341.6
Net borrowing (–)/repayment (+)	–	–	–	–	–	–	–
Transfers to (–)/withdrawals from (+) reserves	– 12.1	– 6.5	6.7	8.2	3.8	–	–
Fiscal balance[3]	11.8	6.2	– 7.0	– 8.4	– 4.1	– 0.3	– 0.3
Cyclical component[4]	– 2.5	– 0.0	– 1.6	– 0.4	– 0.2	0.0	0.0
Balance of financial transactions	1.9	0.6	– 0.7	0.6	0.6	0.9	0.9
Balance of relevant off-budget entities							
Energy and climate fund	1.9	0.0	– 1.5	– 0.3	.	.	.
Relief fund (2013 flood)	– 0.9	– 2.3	– 1.0	– 0.8	.	.	.
Fund to promote municipal investment	3.5	3.4	– 0.8	– 1.4	.	.	.
Structural net borrowing (–)/repayment (+)[5]	5.1	0.4	– 0.9	– 2.8	.	.	.
Structural fiscal balance[5]	16.9	6.6	– 8.0	– 11.2	.	.	.
Memo item							
Ceiling	– 18.6	– 10.2	– 10.6	– 11.0	– 11.3	– 11.7	– 12.0

1 After deduction of supplementary central government grants, shares of energy tax revenue, compensation under the 2009 reform of motor vehicle tax and consolidation assistance to Federal states from 2011, including transfers to/withdrawals from reserves. **2** Including coin seigniorage. **3** Corresponds to the difference between the revenue and expenditure of the core budget as defined in the government finance statistics and equals net borrowing/repayment less transfers to/withdrawals from reserves and less coin seigniorage. **4** Notwithstanding legal requirements, data for all years taken from the Federal Government's 2017 spring forecast. **5** Meaning of structural: plus the balance of relevant off-budget entities less the cyclical component and less the balance of financial transactions.

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tral government budget. Based on the budget estimates presented, the structural deficit would therefore exceed the upper limit of €11 billion. However, actual budgetary developments in some areas are likely to be better than estimated in the draft budget, meaning that all in all, from today's perspective, the deficit would still remain under the upper limit, even if this line of thought is followed. Nevertheless, the gap would be significantly lower than indicated in the draft budget.

No net borrowing in fiscal plan up to 2021, but post-election intentions disregarded

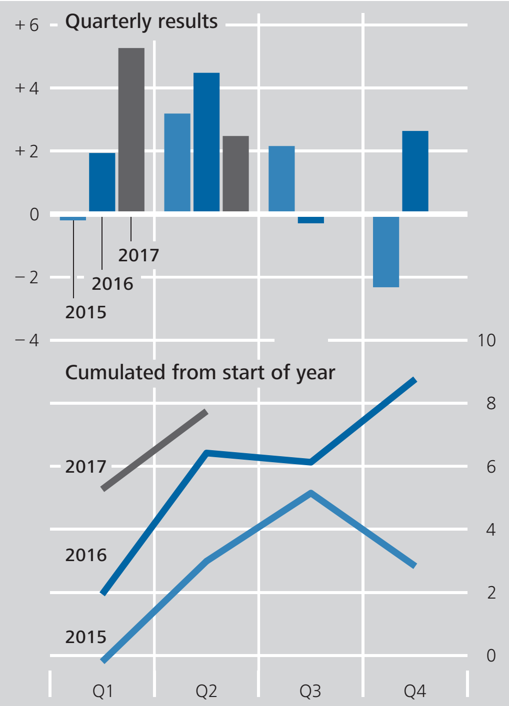
The medium-term fiscal plan for 2019 to 2021 retains a balanced budget. Taking this and the remainder of €4 billion in the refugee reserve into account, the Federal Ministry of Finance indicates that there is room for manoeuvre (global revenue shortfalls) in the amount of €15 billion in cumulative terms. No concrete policy intentions for these funds have yet been established in the plans for the period after the election. Measures such as tax cuts or higher transfers to expand benefits in the statutory pension insurance scheme are being mooted in the election campaign. There have also been hints at NATO agreements regarding increased defence expenditure. However, the favourable economic situation and the very advantageous financing costs underlying the plans continue to ease the pressure on the budget. This puts the aim of no net borrowing into perspective. Furthermore, moderate structural surpluses still seem sensible. In addition to remaining within a safety margin to the debt brake budget limit, fiscal policy would then be making provisions for gradually emerging demographic burdens and a possible increase in capital market rates.

Off-budget entities record unchanged result in Q2 …

In the second quarter of 2017, as in the previous year, a net surplus of €2 billion was reported for 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). Significantly increased central government transfers to the precaution-

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

ary fund for final payments for inflation-indexed Federal securities offset the absence of a repayment to the Financial Market Stabilisation Fund. At the beginning of the second half of the year, the operating companies of nuclear power plants in Germany made a one-off payment of €24 billion to a newly established state fund, which will consequently assume the permanent burdens arising from the disposal of nuclear waste. Against this background, a one-off very high overall surplus is expected for the year as a whole, taking into account all the off-budget entities of central government.[13] However, for the entities covered thus far in the quarterly reports, the surplus might be only slightly up on the year (2016: +€½ billion). In 2016, the retroactive forwarding of revenue from the European bank levy burdened the budget, and the flood relief fund paid back €1½ billion to the central government budget. Additionally, there was an inflation-indexed bond to be repaid last year, and central government transfers to the precautionary fund for final payments for inflation-indexed Federal securities are pushed up by inflation. In contrast to last year, however, no further revenue is likely to be produced by topping up the fund to promote municipal investment or repaying bank aid at the current juncture.

… and only slightly higher surplus for year as whole, excluding nuclear waste disposal payments

State government budgets[14]

Declining surplus in Q2 amidst large increase in expenditure

After a strong start to the year, the surplus in the state government budgets decreased by €2 billion on the year in the second quarter of 2017 to €2½ billion. Revenue rose by only 3% (just over €2½ billion), which was primarily due to the significantly subdued increase in tax receipts (+3½%, or just over €2 billion). However, at 5½% (just over €4½ billion), expenditure rose at a considerably stronger pace than revenue. Personnel costs increased steeply by just over 5%. In addition to the rapid rise in civil servants' pension benefits, the wage agreement in spring and adjustments to civil servants' pay rates, in particular, were responsible for this. Substantial growth was also recorded for investment expenditure (+8½%). By contrast, interest expenditure and other operating expenditure, which was exceptionally high in the previous year as a result of the additional refugee-related expenditure, continued to decline (by around -8% in both cases).

Further surpluses expected this year and in the medium term

As the year progresses, the growth in tax revenue is expected to slow down once more due to the lagged effects of previous court rulings, while the growth in other operating expenditure should return to normal. Viewed as a whole, however, following the very favourable development at the beginning of the year, only a limited decline in the surplus is to be expected for 2017 as whole (2016: €9 billion). As

13 Nevertheless, this inpayment, which is counterbalanced by the assumption of future burdens, retains a neutral balance effect in the national accounts.
14 The development of local government finances in the first quarter of 2017 was analysed in the short article of the July 2017 Monthly Report. These are the most recent data available. The data on state government budgets are based on the monthly cash statistics on the core budgets.

was the case last year, this situation contrasts with the plans of state governments, which currently envisage a deficit of €5½ billion, not least due to earlier less favourable tax estimates. In the absence of any substantial policy changes and on the basis of the tax estimate from May of this year, further surpluses can be expected in the years to come. From 2020, the state governments will then profit from additional central government transfers as part of the reformed financial equalisation scheme. Given the favourable starting position and increased central government transfers, considerably increased investments can be expected.

Stability Council plans to extend budgetary recovery procedures for Bremen and Saarland

Against the backdrop of an overall positive picture, the Stability Council established at its June meeting that all recipient federal states had fulfilled the requirements for the granting of consolidation assistance in 2016. However, Bremen and Saarland only undershot the established respective deficit ceilings by a small margin. The budgetary recovery procedures[15] for Berlin and Schleswig-Holstein were successfully completed. Nevertheless, additional consolidation measures are still deemed necessary for Bremen and Saarland, and an extension of the recovery procedure to the end of 2020 is planned. Under the reform of federal financial relations, Bremen and Saarland are each to receive budgetary recovery assistance from central government to the tune of €400 million on an annual basis from 2020 onwards. However, the repayment obligations for these payments are relatively reasonable in comparative terms.[16]

Social security funds[17]

Statutory pension insurance scheme

Surplus broadly unchanged in Q2

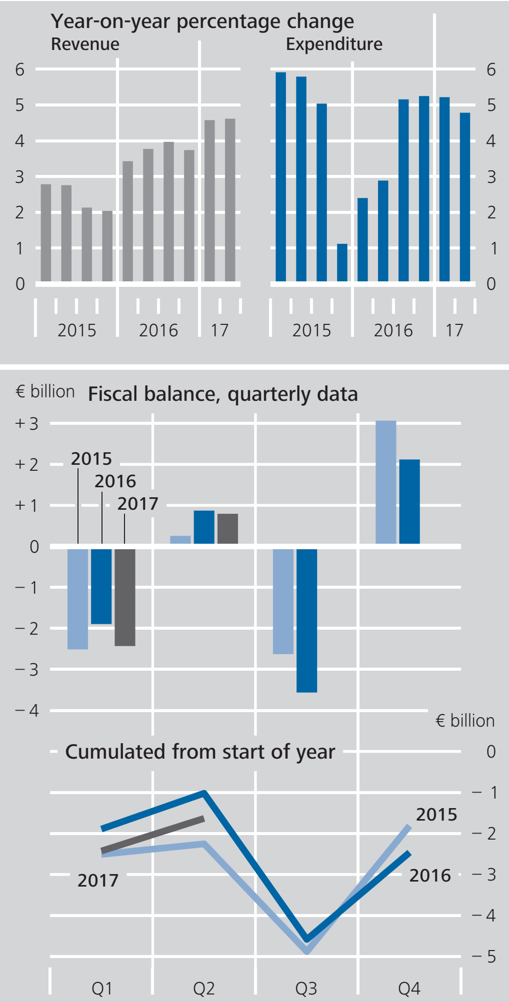
The statutory pension insurance scheme recorded a surplus of just under €1 billion in the second quarter of 2017, which nearly matched the previous year's level. Revenue continued to rise steeply at 4½% on the year. This was largely attributable to the ongoing favourable wage and employment developments, but also to the removal of a reduction factor in the central government grant. Expenditure increased by just under 5%. This was mainly due to the high pension increase in the middle of last year (by 4.25% in western Germany and 5.95% in eastern Germany).

Interim peak in statutory pension insurance scheme, but high demographic burdens in the longer term

In comparison with the first half of the year, considerably smaller increases in expenditure are to be expected in the remainder of the year, with a continued stable rise in revenue. A distinctly lower deficit than in the previous year (2016: just over €2 billion) is therefore on the cards for the year as a whole. This is largely attributable to the removal of the reduction factor (just over €1 billion) in the central government grant mentioned above. Furthermore, growth in contribution receipts could be somewhat higher than that of pension expenditure. As in the previous year, annual average pension growth stands at 3½%.[18] However, since the number of pensions is rising somewhat more

15 In the context of regular fiscal surveillance, budgetary recovery procedures were initiated from 2012 for federal states deemed to be at risk of budgetary hardship. With the exception of Saxony-Anhalt, this affected the federal states in receipt of consolidation assistance. The recovery programmes, which in principle last five years and which do not involve financial assistance, are assessed by the Stability Council on a regular basis.
16 Pursuant to section 2 (2) of the budgetary recovery assistance law, these federal states are committed to reducing their debt levels. To this end, they are, in principle, committed to (1) repaying debts amounting to at least one-eighth (ie €50 million) of the total assistance granted, on a yearly basis, and (2) repaying one-fifth of the total assistance granted (ie €400 million) over a period of five years. Adherence is reviewed at two-yearly or five-yearly intervals by the Federal Ministry of Finance. In the event of an unexcused overall undershooting of (1) in the previous two years, the outstanding amount of repayment is retained from the budgetary recovery assistance until this outstanding amount is repaid, whilst in the case of failure to meet condition (2), the annual repayment obligation of one-eighth of the assistance granted is increased by one-fifth of the outstanding repayment amount for each year of the subsequent five-year period.
17 The financial development of the public long-term care and statutory health insurance schemes in the first quarter of 2017 was analysed in the short articles of the July 2017 Monthly Report. These are the most recent data available.
18 In mid-2017, the pension increase (an average of +2½% for Germany as a whole) was substantially lower than a year earlier, meaning that pension expenditure is set to rise considerably more slowly in the second half of the year. For more information, see Deutsche Bundesbank, Public finances, Monthly Report, May 2017, p 68.

Finances of the German statutory pension insurance scheme



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

slowly from the current perspective, total pension expenditure is also likely to increase slightly less strongly than in the previous year (+4%). At the end of the year, the reserve is expected to be slightly lower than at end-2016, amounting to 1.5 times the scheme's monthly expenditure. This would therefore still place it at the upper end of the envisaged range of variation. This should not, however, be viewed as scope for expanding benefits in the statutory pension insurance scheme. The reserve will gradually be depleted in the medium term. As the "baby boomers" enter retirement and life expectancy continues to rise, funding pressures on the statutory pension insurance scheme will mount considerably in the future, and in the absence of benefit increases, significant rises in the contribution rate are already expected in the longer term.[19]

Federal Employment Agency

Basic financial situation distinctly improved in Q2

In the second quarter of 2017, the Federal Employment Agency posted a surplus of €1½ billion in the core budget,[20] which was somewhat higher than a year ago. An exceptionally high transfer was made to the civil servants' pension fund (as in the first quarter), which reduced the Federal Employment Agency's operating profit by almost €½ billion.[21] This was the main reason for the 2% increase in expenditure, whereas the decrease in unemployment benefit continued in the light of the favourable labour market situation (almost -3½%) and spending on active labour market policies matched the level of the previous year. The latter, however, was attributable to the temporary and non-insurance-related financing of language courses for refugees. Revenue rose by 4%, with an even greater increase in contribution receipts (+5%).

Considerable surplus expected again for year as whole

The Federal Employment Agency's finances are also likely to benefit from the favourable labour market situation as the year progresses, and no further special transfers to the civil servants' pension fund have been planned. Even if active labour market policy expenditure were to increase by a somewhat larger amount, an even higher surplus would therefore be expected for the year as a whole compared to the previous year (2016: €5½ billion). This would then significantly exceed the budgeted amount (€1½ billion) once more, and the reserve for the core

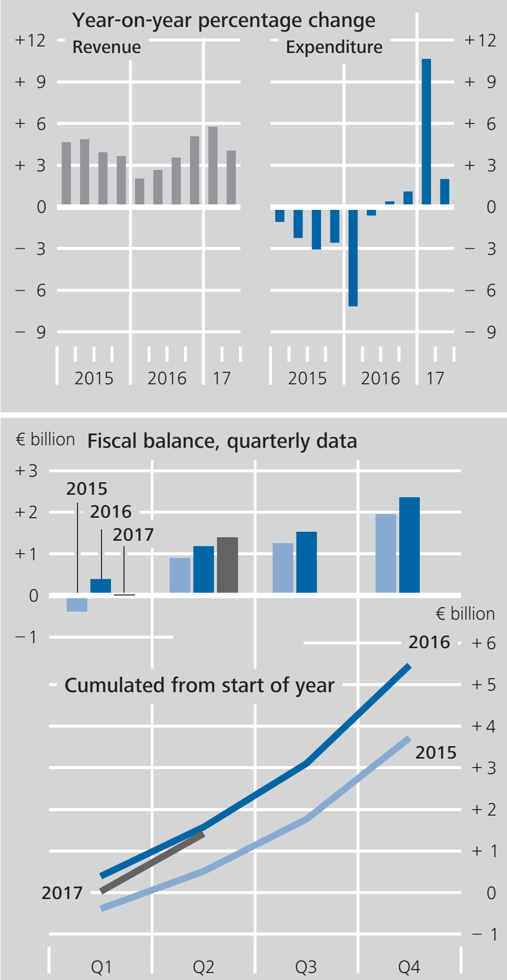
19 For more on the longer-term outlook, see Deutsche Bundesbank, Excursus: longer-term pension developments, Monthly Report, August 2016, pp 68-77.
20 Excluding consolidation with the civil servants' pension fund, thus including surplus-reducing transfers to this fund.
21 These special transfers are connected with low interest rates and resultant additional capital requirements to cover future pension expenditure, particularly for civil servants. These amounted to a total of almost €1 billion in the first half of the year.

budget (end-2016: €11½ billion) would again be topped up by much more than originally planned.[22]

Reduced contribution rate appropriate, given favourable labour market situation

The favourable labour market developments are set to continue in the next few years, according to current forecasts, benefiting the Federal Employment Agency's finances on both the revenue and expenditure sides. Assuming that expenditure on active labour market policy measures reaches a stable level, therefore, surpluses would rise further, and the reserve for the regular operational business as a whole would continue to increase strongly. Such an environment opens up the possibility of reducing the contribution rate. From the current perspective, surpluses could still be achieved if the rate was cut moderately, and the anticipated reserve level could even accommodate a sharper downturn without drawing on central government loans.

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

22 The reserve value reported here refers to the Federal Employment Agency's free reserves and does not include the winter compensation reserve, insolvency benefit or pension reserve.