Public finances*

General government budget

Reduced surplus this year amid fiscal loosening

Germany's government finances have been shaping up very well in recent years. This has been driven largely by low interest rates and dynamic revenue growth. Last year, general government recorded a surplus of 1.7% of gross domestic product (GDP), while the debt ratio fell to 60.9%. This year, the fiscal balance is set to see a marked deterioration for the first time since 2010. The main reason for this is fiscal loosening. In addition, positive cyclical effects are tailing off. Nevertheless, the government budget is expected to run a significant surplus again. The debt ratio is likely to fall below the 60% threshold.

Macroeconomic development dampening revenue growth; expenditure being stepped up considerably

The economic downturn is primarily evidenced by slower tax revenue growth, and the loosened fiscal policy stance by sharper spending hikes. For example, pension benefits were once again expanded on a considerable scale at the start of the year. Additionally, more funding was made available in areas such as infrastructure, education and defence. Still falling interest payments and what is expected to be lower state government expenditure to stabilise the Landesbanken will provide a slight counterbalance. The tax and social contributions ratio is likely to barely change: income tax cuts will be essentially offset by progressive taxation. Social contribution rates have fallen for employees, but they have risen for enterprises.

Shrinking surplus in coming years, too, due to continued fiscal loosening

As things currently stand, the surplus will be gradually depleted over the next few years. The main reason for this is that fiscal policy is set to be loosened even further. Current projections show no major additional burdens in the baselines stemming from cyclical developments. Thus, the debt ratio is likely to continue to fall.

Compliance with budgetary rules to be achieved by some margin

Under these conditions, compliance with the EU's agreed budgetary rules for general government will be achieved by some margin. According to the latest stability programme, this is also the Federal Government's plan.[1] While budget planning is still based on January's macroeconomic projection, the spring forecast published at the same time is unlikely to fundamentally change this picture: in the short term, GDP growth is even lower, and revenue expectations have been scaled back slightly further based on the latest tax estimate. However, the social security funds should be hardly affected given the labour market's continued strong performance. Therefore, the general government surplus will probably be revised only moderately compared with the scenario outlined in the stability programme.

Many and varied measures putting pressure on government budgets

Fiscal loosening reflects a whole raft of projects and developments. Sharp spending increases are envisaged in the areas of pensions and long-term care. The same is true of investment in transport infrastructure and digitalisation, personnel in sectors such as childcare and education, and internal and external security. There are also plans under the coalition agreement to again significantly increase child benefits from 2021, widen the provision of childcare services for primary school children, channel additional funds into regional policies and partly abolish the solidarity surcharge. Due to international agreements, spending on defence and development aid may be higher in the medium term than so far accounted for by central government in its plans. Furthermore, there is talk of introducing a basic pension without means testing. This would go beyond the scope of the coalition agreement and would entail considerable additional spending.

* The section entitled "General government budget" relates to data from the national accounts and the Maastricht debt ratio. This is followed by more detailed reporting on budgetary developments (government finance statistics). No figures for the first quarter of 2019 are yet available for local government or the statutory health and public long-term care insurance schemes. These will be analysed in the short commentaries featured in the next two issues of the Monthly Report.
1 See Federal Ministry of Finance (2019).

Key figures of the general government fiscal plans drawn up by Federal Government*

Item	2018	2019	2020	2021	2022	2023
Real GDP growth (%)						
Stability programme April 2019	1.4	1.0	1.6	1.1	1.1	1.1
Updated draft budgetary plan June 2018	2.3	2.1	1.4	1.4	1.4	.
Stability programme April 2018	2.4	1.9	1.3	1.3	1.3	.
Fiscal balance (% of GDP)						
Stability programme April 2019	1.7	¾	¾	½	½	½
Updated draft budgetary plan June 2018	1¼	¾	¾	½	¾	.
Stability programme April 2018	1	1¼	1½	1½	.	.
Structural fiscal balance (% of GDP)						
Stability programme April 2019	1.4	¾	½	½	¼	½
Updated draft budgetary plan June 2018	1	¼	½	½	¾	.
Stability programme April 2018	½	¾	1	1½	.	.
Debt level (% of GDP)						
Stability programme April 2019	60.9	58¾	56½	54¾	53	51¼
Updated draft budgetary plan June 2018	61	58¼	56¼	54¼	52	.
Stability programme April 2018	61	58¼	55¾	53	.	.

Source: Federal Ministry of Finance. * The stability programmes are based on Federal Government's macroeconomic projection from January of the same year. The measures stipulated in the coalition agreement were not factored into the 2018 stability programme. These were not taken into account until the updated draft budgetary plan of June 2018, which was based on the macroeconomic projection from April 2018.

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Financial leeway gradually narrowing

All things considered, there will probably still be some financial leeway initially. However, the budgets look set to feel the squeeze eventually. This applies, in particular, to central government as well as to the statutory pension and health insurance schemes, which have still been recording relatively high surpluses as of late. As from the middle of the next decade, demographic change will weigh yet more heavily on the budgets.

Budgetary development of central, state and local government

Tax revenue

Subdued growth in Q1

Year-on-year growth in tax revenue[2] came to 2% in the first quarter of 2019 (see the chart and table on pp. 63 and 64). Wage tax growth remained dynamic (+6%). This was driven chiefly by the continued favourable development of gross wages and salaries. Progressive taxation was offset by tax relief measures. These include the Family Relief Act *(Familienentlastungsgesetz),* which is intended, inter alia, to compensate for last year's bracket creep.[3] However, revenue from profit-related taxes declined markedly (-4½%). Driving the decrease was withholding tax on interest income and capital gains. Revenue from this source halved, which is probably attributable to lower capital gains, in particular. In addition, there was a slight dip in revenue from assessed income and corporation taxes. However, the respective previous year's levels were high, and growth was recorded for both in the important prepayment month of March. By contrast, growth in revenue from non-assessed taxes on earnings was dynamic.

2 Including EU shares in German tax revenue but excluding receipts from local government taxes, which are not yet known for the quarter under review.
3 The basic income tax allowance and child tax allowances were raised and the other income tax brackets shifted to the right. Child benefits, which are deducted from cash revenue, will not be raised until the middle of the year.

Current fiscal developments in the euro area

2018: lower deficit ratio due to economic developments and interest rates

The general government deficit ratio in the euro area stood at 0.5% last year, down by ½ percentage point. According to calculations by the European Commission, this fall was driven by favourable economic developments and lower interest expenditure. By contrast, the fiscal stance (as measured by the change in the cyclically adjusted primary balance)[1] was broadly neutral. The debt ratio sank from 89.1% to 87.1%.[2] Nominal GDP growth in the denominator (denominator effect), which pushes down the ratio, was much stronger than the debt-increasing effect of the deficit.

Deficit ratio to rise again in 2019 due to fiscal loosening

According to the European Commission's forecast from the beginning of May, the deficit ratio is expected to rise again to 0.9% in 2019, where it will stay put for 2020. This is not down to interest expenditure and economic developments, but rather to a marked fiscal loosening in 2019. The debt ratio is set to fall at a somewhat slower pace than in previous years.

Greece: programme completed, sufficient primary surpluses on the horizon but also risks concerning reforms

Greece completed its assistance programme under the European Stability Mechanism (ESM) in August 2018. Since then, Greece has been raising its own funds in the capital markets again,[3] aided by the fact that it continued to comply with (and even outperformed) the fiscal target for the primary surplus (3.5% of GDP)[4] in 2018. The Commission has also forecast that Greece will continue to meet its target in 2019 and 2020, especially because the negative cyclical factors are expected to shrink significantly. At the same time, the fiscal stance is being loosened considerably. The debt ratio is set to fall rapidly on the back of the primary surplus, the relatively low interest burden and ongoing economic growth. However, it will still amount to 168.9% in 2020. Political initiatives that are intent on rolling back reforms beyond the measures that have already been taken to loosen the fiscal stance are a cause for concern. The ESM, too, warns that Greece may miss its budgetary objective by a wide margin. Furthermore, pending court rulings pose a risk to public finances.

Recently, further financial assistance has been granted by other euro area Member States. This assistance was envisaged in May 2016 subject to the condition that Greece implements and abides by the agreed reforms. The responsible European institutions confirmed the release of the first tranche in April 2019, stating that "Greece has taken the necessary actions to achieve all specific reform commitments for end-2018." The Eurogroup resolved to grant Greece further debt relief measures. First, it scrapped the decision to raise the interest rate on some of the assistance loans for a certain period (start of 2018 to mid-2019) as originally planned. Second, it paid transfers corresponding to some of the revenue from Greek government securities gener-

1 The primary balance equals the fiscal balance excluding interest expenditure.
2 These European Commission figures on the debt level in the euro area do not consolidate lending between euro area countries.
3 The available cash reserves would enable Greece to cover its financing needs without recourse to the capital market for a temporary period only.
4 The targets concern the general government primary balance. However, the definition deviates from that used in the national accounts, primarily by not including expenditure related to support for the banking sector or revenue from transfers in connection with the Eurosystem's SMP/ANFA transactions.

Public finances of the euro area countries

European Commission spring forecast, May 2019

Country	Budget balance as a percentage of GDP			Government debt as a percentage of GDP			Structural balance as a percentage of potential GDP		
	2018	2019	2020	2018	2019	2020	2018	2019	2020
Austria	0.1	0.3	0.2	73.8	69.7	66.8	− 0.5	− 0.1	0.0
Belgium	− 0.7	− 1.3	− 1.5	102.0	101.3	100.7	− 1.4	− 1.4	− 1.8
Cyprus	− 4.8	3.0	2.8	102.5	96.4	89.9	2.0	1.1	0.7
Estonia	− 0.6	− 0.3	− 0.5	8.4	8.5	8.5	− 2.2	− 1.7	− 1.5
Finland	− 0.7	− 0.4	− 0.2	58.9	58.3	57.7	− 1.0	− 1.0	− 0.6
France	− 2.5	− 3.1	− 2.2	98.4	99.0	98.9	− 2.6	− 2.6	− 2.5
Germany	1.7	1.0	0.8	60.9	58.4	55.6	1.6	1.1	0.8
Greece	1.1	0.5	− 0.1	181.1	174.9	168.9	5.0	1.9	0.8
Ireland	0.0	0.0	0.3	64.8	61.3	55.9	− 1.4	− 1.2	− 0.5
Italy	− 2.1	− 2.5	− 3.5	132.2	133.7	135.2	− 2.2	− 2.4	− 3.6
Latvia	− 1.0	− 0.6	− 0.6	35.9	34.5	33.5	− 2.1	− 1.6	− 1.1
Lithuania	0.7	0.3	0.0	34.2	37.0	36.4	− 0.8	− 1.0	− 0.9
Luxembourg	2.4	1.4	1.1	21.4	20.7	20.3	2.1	0.9	0.5
Malta	2.0	1.1	0.9	46.0	42.8	40.2	1.4	0.6	0.7
Netherlands	1.5	1.4	0.8	52.4	49.1	46.7	0.8	0.7	0.2
Portugal	− 0.5	− 0.4	− 0.1	121.5	119.5	116.6	− 0.4	− 0.5	− 0.5
Slovakia	− 0.7	− 0.5	− 0.6	48.9	47.3	46.0	− 1.3	− 1.3	− 1.4
Slovenia	0.7	0.7	0.9	70.1	65.9	61.7	− 0.7	− 0.8	− 0.3
Spain	− 2.5	− 2.3	− 2.0	97.1	96.3	95.7	− 2.7	− 2.9	− 3.2
Euro area	− 0.5	− 0.9	− 0.9	87.1	85.8	84.3	− 0.7	− 0.9	− 1.2

Sources: European Commission, ameco.
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ated in the Eurosystem (SMP and ANFA transactions). This resulted in total relief of around €1 billion for Greece (0.5% of Greece's GDP). If Greece continues to honour the agreed reforms and implement them in full, more of such relief measures (scheduled for December and June) can be granted up to June 2022.

Highly indebted countries: fiscal stance generally unsatisfactory

In addition to Greece, according to the Commission's forecast, Italy, Portugal and Belgium will continue to record debt ratios in excess of 100% in 2020, and the levels in France and Spain will be only slightly below this figure. It is specifically those countries that have very high levels of debt that are reducing their debt ratios at a slower pace than agreed in the common fiscal rules.

After Greece, Italy has the highest debt ratio – far above that of the other euro area countries. The European Commission even forecasts a further increase in this level as it expects macroeconomic growth to be weak and the deficit ratio to rise. Interest expenditure and economic developments are not likely to have a notable impact on the balance. Instead the Italian government has been pursuing a looser fiscal stance which is at odds with the key requirements of the European fiscal rules. First, the high debt ratio is not coming down – let alone at a rapid pace as required under the Maastricht Treaty.[5] Second, rising structural deficit ratios in this scenario are likewise incompatible with the rules.[6] By choosing to follow this approach, the required improvement of 0.3 percentage point for 2018 was missed

5 A deficit procedure based on the debt criterion may be launched if the debt ratio does not fall rapidly enough. It is sufficient if the differential with respect to the reference value of 60% decreases over three years at an average rate of one-twentieth per year (even when cyclical effects are taken into account). Transitional provisions are in place for countries that were subject to an excessive deficit procedure (e.g. France) at the time that this rule entered into force.

6 As a rule, the Stability and Growth Pact prescribes structural improvements of 0.5% of GDP per year until the budgetary objectives are achieved. However, country-specific recommendations can deviate from this.

by a wide margin.[7] Third, the European Commission has forecast a deficit ratio of 3.5% for 2020, which is far higher than the reference value of 3%.

France is the only other country in the euro area in which the very high debt ratio is expected to continue rising (slightly). Its deficit ratio is also set to breach the 3% ceiling (by a minimal amount) this year as a one-off event. This is partly due to the decision to change corporate levies that was taken at the end of 2017, resulting in a temporary strain of around 1% of GDP on the 2019 budget. Further pressure will come from the measures implemented by the government at the end of 2018. According to the Commission's forecast, the deficit ratio will fall back to 2.2% in 2020. In structural terms, it has remained broadly unchanged at 2½% since 2015. At the same time, the European Commission has noted a cyclical improvement for the years since 2015 and favourable economic developments are expected over the forecast horizon. France's fiscal developments are also incompatible with the key requirements of the fiscal rules. France is still a long way from achieving the target of a structurally close-to-balance budget (medium-term budgetary objective: MTO); it is not even getting closer to achieving this target; it plans to breach the 3% threshold in 2019, and its high debt ratio is not coming down. Furthermore, it is possible that the development of its public finances will be even more unfavourable as the European Commission did not factor the additional measures announced by the government at the end of April into its forecast.

The European Commission has also forecast unsatisfactory developments in two other highly indebted countries; namely Spain and Belgium. Despite still not achieving their MTO, both countries are easing their fiscal stance. Spain's deficit ratio has not been above 3% since 2018. A further slight reduction is also on the cards because the economy is faring well and the interest expenditure ratio is falling. As a result, it looks likely that the last of the deficit proceedings will come to an end.[8] However, the fact that the debt ratio remains close to 100% and the structural deficit is not approaching the MTO is critical. Indeed, the structural deficit is drifting further and further away from the MTO and is even expected to exceed 3% of GDP in 2020. Belgium's deficit ratio is lower than that of Spain – both in unadjusted and in structural terms. It has also loosened its future fiscal stance to a lesser extent. But its debt ratio also remains virtually unchanged at a very high level.

Portugal and Cyprus[9] also still have very high debt levels. However, the structural budgetary position in these countries is much more favourable. They have both achieved the MTO,[10] meaning that their debt ratios are reducing rapidly.[11] Those other euro area countries with a debt ratio of over 60% are also pursuing the agreed path to bring their ratio below the reference value. Germany should succeed in 2019 and Ireland in 2020.

7 At the end of 2018, the European Commission accepted the Italian government's intention to even allow the structural balance to deteriorate somewhat for 2019, and now also expects this deterioration in its forecast.
8 The structural improvement required to correct the excessive deficit has not been achieved a priori in any year since 2014.
9 In 2018, Cyprus deviated significantly from the reference value for the deficit ratio. This was due to a one-off effect resulting from support measures for Cyprus Cooperative Bank. At the beginning of 2019, Eurostat decided that these measures placed a strain of 8.3% of GDP on the 2018 balance; they push up the 2018 debt level by 16 percentage points.
10 According to the Fiscal Compact, the general ceiling for the MTO is a structural deficit ratio of no more than 0.5%. Only if the debt ratio is significantly below 60% may the MTO be a structural deficit ratio of up to 1%. But other components also need to be taken into consideration when setting the country-specific MTO. Therefore, a number of countries, including Portugal, have more ambitious targets (structurally balanced budget or surplus). For the sake of simplicity, this analysis uses a ceiling of 0.5% or 1% of GDP rather than the country-specific MTOs.
11 According to the Commission's forecast, Portugal is close to complying with the "1/20 requirement".

Often insufficient progress towards MTO

The European Commission expects deficit ratios in most countries to rise (or surpluses to fall) by 2020. Italy is the only country expected to breach the 3% ceiling in 2020. However, almost half of the Member States are likely to infringe the MTO. Of those that missed the target in 2018, 40% are actually easing their fiscal stance up to 2020, which will take them even further away from the target. With the exception of Latvia, none of the Member States that failed to achieve their MTO in 2018 has managed to reduce their structural deficit ratio by 0.5% percentage point per year.[12]

The European institutions should strictly apply those rules that they have agreed upon jointly in order to bring about a change in policy stance. The European Commission has announced that it will analyse and evaluate fiscal developments in the Member States by the start of June. This will be based on the results for 2018 as well as the government plans submitted at the end of April 2019. The Spring Package on budgetary surveillance will therefore be available later than usual – and not until after the European elections.

12 According to the change forecast for 2020, Slovenia and Ireland are now expected to achieve their MTO.

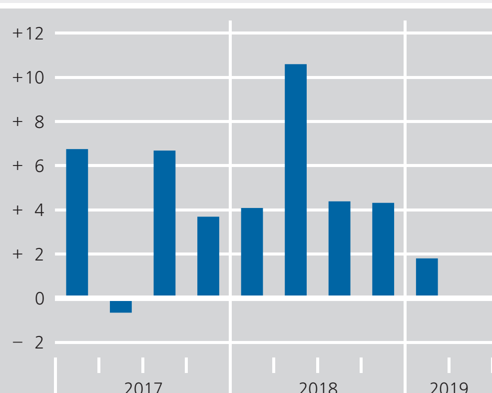
Its main component is investment income tax on dividends. This growth reflects repeated deferrals of dividend payment dates during the year. Turnover tax revenue, which is generally quite volatile over the course of the year, increased moderately by 2%.

Subdued rise in tax revenue expected for 2019

According to the latest official tax estimate, tax revenue (including local government taxes) is expected to increase by 2½% for 2019 as a whole (see the tax estimate table on p. 65). The assumed macroeconomic growth, including progressive taxation, will make for a slightly higher increase. However, this will be dampened to a marked extent, on balance, by legislative changes.[4] These primarily concern the aforementioned Family Relief Act, but also other legislative changes. For example, the raised immediate write-off threshold for low-value assets will result in shortfalls. Repayments are also expected in connection with a VAT ruling made some time ago.[5]

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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4 The official tax estimate is generally based on current legislation.
5 Application of the Federal Fiscal Court ruling on the VAT liability of property developers (Federal Fiscal Court ruling V R 37/10 and Federal Ministry of Finance letter dated 24 January 2019).

Tax revenue

Type of tax	Q1 2018	Q1 2019		Estimate for 2019[1]
	€ billion		Year-on-year change %	Year-on-year change %
Tax revenue, total[2]	172.1	175.2	+ 1.8	+ 2.4
of which:				
Wage tax	48.1	50.9	+ 6.0	+ 5.3
Profit-related taxes	33.7	32.1	− 4.7	− 1.7
Assessed income tax[3]	17.6	17.5	− 1.1	− 0.4
Corporation tax	9.4	9.2	− 2.4	− 2.1
Non-assessed taxes on earnings	3.5	4.0	+ 13.4	+ 4.1
Withholding tax on interest income and capital gains	3.1	1.4	− 53.2	− 31.4
Turnover taxes[4]	59.2	60.4	+ 1.9	+ 3.4
Other consumption-related taxes[5]	20.0	20.1	+ 0.7	− 0.4

Sources: Federal Ministry of Finance and Bundesbank calculations. **1** According to official tax estimate of May 2019. **2** Including EU shares in German tax revenue but excluding receipts from local government taxes. **3** Employee refunds deducted from revenue. **4** Turnover tax and import turnover tax. **5** Taxes on energy, tobacco, insurance, motor vehicles, electricity, alcohol, air traffic, coffee, sparkling wine, intermediate products, alcopops, betting and lottery, beer and fire protection.

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Somewhat higher growth in subsequent years

Tax revenue is expected to grow by 3% next year. Macroeconomic development will be more favourable. Furthermore, legislative changes will make themselves felt to a slightly lesser extent than in the year prior. Although the Family Relief Act will have more of a dampening impact than in 2019, other legislative changes will play a less important role. Tax revenue growth of 3½% is expected for each of the subsequent years up to 2023. This largely reflects the macroeconomic assumptions and progressive taxation. In net terms, revenue shortfalls from legislative changes and court rulings will weigh only marginally on growth. The tax ratio (as defined in the government finance statistics) will dip slightly in 2019 and 2020. Thereafter, it will rise again and is projected to increase to 23.0% by 2023 (2018: 22.9%). Measures which are planned but have not yet been adopted, such as the partial abolition of the solidarity surcharge, have not been taken into account here.

Revenue expectations lowered significantly overall compared with November 2018

Compared with the November 2018 forecast, tax revenue has been revised downwards by €11 billion for 2019. A large part of the downward revision was due to the macroeconomic assumptions being adjusted. However, the revenue shortfalls stemming from legislative changes made in the intervening period are also important. Once again, the most significant factor here is the Family Relief Act. The revenue budgeted for 2020 is €23 billion lower than estimated in the autumn. Roughly half of this is attributable to less favourable economic development, with new legislative changes accounting for the other half. This breakdown also applies to the downward revisions for the years thereafter up to 2023, which amount to around €30 billion per year.

Shortfalls in plans already taken into account for the most part

While the shortfalls compared with the November estimate are considerable, they are rather moderate compared with the most recent plans presented by the Federal Government. The now gloomier macroeconomic environment and the burdens arising from new legislative changes have already been largely factored into the stability programme and the benchmark figures for the central government budget up to 2023.

Central government budget

Significantly worse outturn in Q1

In the first quarter, the central government budget recorded a deficit of €1½ billion, compared with a surplus of €4 billion at the start of the previous year. Revenue fell by 3½%. This was due mainly to a significant decrease in tax revenue (-€4 billion), which was driven by the €4½ billion rise in transfers to the EU budget (deducted from taxes). This is broadly the total

Official tax estimate figures and Federal Government's macroeconomic projection

Item	2018	2019	2020	2021	2022	2023
Tax revenue[1]						
€ billion	776.3	793.7	818.0	847.0	877.8	908.4
As % of GDP	22.9	22.8	22.7	22.8	22.9	23.0
Year-on-year change (%)	5.7	2.3	3.1	3.5	3.6	3.5
Revision of previous tax estimate (€ billion)	1.0	– 10.9	– 23.2	– 28.2	– 29.7	– 32.3
Real GDP growth (%)						
Spring projection (April 2019)	1.4	0.5	1.5	1.2	1.2	1.2
Autumn projection (October 2018)	1.8	1.8	1.8	1.3	1.3	1.3
Nominal GDP growth (%)						
Spring projection (April 2019)	3.3	2.8	3.5	3.0	3.0	3.0
Autumn projection (October 2018)	3.5	3.8	3.7	3.2	3.2	3.2

Sources: Working Party on Tax Revenue Estimates (May 2019) and the Federal Ministry for Economic Affairs and Energy. **1** Including EU shares in German tax revenue and receipts from local government taxes.
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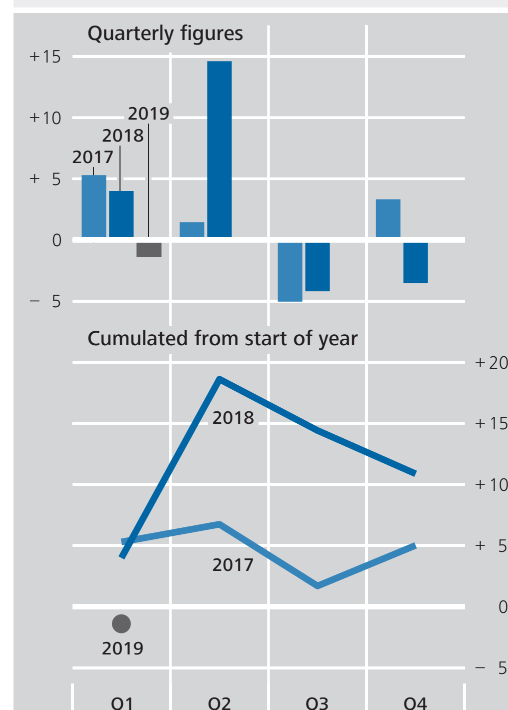
increase expected for the year as a whole. In addition, a larger turnover tax revenue amount was transferred to state government. Non-tax receipts rose by €½ billion on balance. This was due primarily to additional revenue from the Bundesbank's profit distribution and the heavy goods vehicle toll. Revenue from the latter went up on account of higher toll rates and, since mid-2018, all federal trunk roads being subject to tolls. Expenditure grew by 2½%. The reason for the only moderate increase was declining interest expenditure (-€1½ billion), chiefly as a result of higher income from premiums. By contrast, there was significant additional spending on grants (particularly to the pension insurance scheme), staff and other operating expenditure (notably military procurement).

Performance still looks set to be better than envisaged for year as a whole

According to the budgetary plan approved last November, the 2019 outturn will be far worse than the one for 2018 (a deterioration of €16½ billion). The planned deficit of €6 billion is to be covered by the refugee reserve in the amount of €5½ billion and by coin seigniorage to the tune of €½ billion. Since then, the macroeconomic outlook has taken a turn for the worse. According to the latest tax estimate, revenue shortfalls of €1½ billion on balance are now anticipated – despite a downward revision of transfers to the EU budget. More favourable developments elsewhere are likely to be far more significant, however. In particular, planned expenditure appears to be overstated again. In the absence of any further unpleasant surprises, it may therefore be possible to bal-

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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Benchmark figures for Federal Government's fiscal planning up to 2023

Item	2018 actual	2019 target	2020	2021	2022	2023
	€ billion					
Expenditure affecting the fiscal balance	336.7	356.4	362.6	364.1	369.8	373.1
Revenue affecting the fiscal balance[1]	347.6	350.6	352.5	353.4	364.0	374.8
Tax revenue	322.4	325.5	328.6	337.5	348.8	360.2
Other revenue affecting the fiscal balance[1]	25.2	25.1	23.9	15.9	15.2	14.6
of which: global revenue shortfalls[1] (rounded)	–	0	– 2.5	– 13	– 14	– 14.5
Net borrowing	–	–	–	–	–	–
Coin seigniorage[1]	0.3	0.3	0.3	0.3	0.3	0.3
Withdrawals from reserves	– 11.2	5.5	9.8	12.4	7.5	0.0
Topping up reserve for demographic challenges	–	–	–	2.0	2.0	2.0
Core budget balance[1]	10.9	– 5.8	– 10.1	– 10.7	– 5.8	1.7
Cyclical component[2]	6.7	0.7	1.3	– 0.1	– 0.4	–
Balance of financial transactions[1]	0.7	0.7	–	–	–	–
Balance of off-budget entities[1,3]	4.0	– 3.6	– 3	– 3	– 3	– 3
Structural net borrowing (+ = repayment)[1]	– 3.4	– 5.0	– 4.3	– 2.9	– 2.6	– 3.0
Structural balance[1]	7.5	– 10.8	– 14.4	– 13.6	– 8.4	– 1.3
	% of GDP[4]					
Structural balance[1]	0.23	– 0.33	– 0.43	– 0.39	– 0.23	– 0.04
Structural net borrowing (+ = repayment)[1]	– 0.11	– 0.15	– 0.13	– 0.08	– 0.07	– 0.08
	€ billion					
Stock of refugee reserve	35.2	29.7	19.9	7.5	–	–

Sources: Federal Ministry of Finance and Bundesbank estimates. **1** Estimates as of 2020. **2** Data from Federal Government's 2019 spring forecast. **3** Digitalisation fund, energy and climate fund, flood relief fund as well as fund to promote municipal investment. **4** As with the limit for structural net new borrowing (-0.35% of GDP) which is anchored in Article 115 of Germany's Basic Law, the relevant figure is stated as a percentage of GDP in the year before the budget was drawn up.
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ance the central government budget again without withdrawing funds from the reserves.

Benchmark figures up to 2023 feature burdens arising not only from economic slowdown

In mid-March, the Federal Government adopted the benchmark figures for the 2020 central government budget and for the fiscal plan up to 2023. It is remaining true to its goal of aiming for a budget without net borrowing. As previously, the plan is to empty out the refugee reserve to achieve this. Compared with the fiscal plan drawn up in the summer of 2018, the available funds in this reserve have increased by almost €13 billion. Furthermore, total estimated interest expenditure is €5 billion lower. However, lower tax projections (over and above the measures already included via global revenue shortfalls in the last fiscal plan) will broadly balance out these two relief-providing factors. In addition, further additional expenditure from the budget discussions for 2019 as well as a somewhat higher defence budget are taken into account. In order to nevertheless refrain from net borrowing, marked global cuts in expenditure of what appears to be around €4 billion per year from 2020 onwards were factored in.

Buffers exhausted to a large degree

Given the estimated low expenditure growth, spending buffers are likely to be nigh on exhausted in the medium term. On the revenue side, however, it would appear that extensive global revenue shortfalls are still included. They seem to be sufficient for the partial abolition of the solidarity surcharge and the increase in child benefits in 2021. Furthermore, as stipulated in the coalition agreement, the continuation of tax transfers to state government (albeit to a lesser degree) to cover a portion of refugee-related costs appears to have been safeguarded.

Funding absent for many planned projects

Compared with the benchmark figures, the latest tax estimate forecasts tax shortfalls totalling around €3 billion per year from 2021 to 2023. Moreover, the coalition agreement signals, inter alia, that compensation measures for bracket creep in the income tax regime will be

taken beyond 2020. The agreement also contains plans to provide tax incentives for enterprises engaging in research. Additional pressure may arise in various areas on the expenditure side – for instance, in connection with international agreements. For one, the defence budget is set to surge next year, but only for a year. After that it will come back down again in relation to GDP. Spending earmarked for international development aid also appears to be rather low over the medium term. Moreover, an annual amount of only €½ billion has been set aside for phasing out the use of coal. However, the report submitted by the responsible commission, which was welcomed by the Federal Government, puts the figure much higher, estimating that it will already be at around €4 billion in 2023 (excluding costs for decommissioning power stations). Finally, the Ministry of Social Affairs is planning to introduce a basic pension without means testing; the annual costs of which are likely to be in the mid-single-digit billions. There are risks for the (remaining) revenue from the solidarity surcharge: concerns have been voiced that this may be in conflict with constitutional law – not least as special assistance for eastern Germany will be paid for the last time at the end of this year.

Essential to set priorities

Even if the budget outturns are initially likely to be better than planned, pressure on the central government budget will mount considerably. Going forward, there will be no scope to counterbalance the numerous potential strains. It will be possible to use reserves to a greater extent than originally planned, at best, for a limited time only. And it is by no means just the costs of new measures that need to be considered. Demographic trends alone will necessitate a sharp rise in the grant to the pension insurance scheme – even before pension benefits are expanded additionally. It is therefore recommended to set stricter priorities now and to secure funding in the longer term against additional costly measures.

Central government's off-budget entities: slight improvement in Q1 results …

The Federal Ministry of Finance reported a surplus of €1 billion for central government's off-budget entities in the first quarter of 2019.[6] This constitutes a year-on-year improvement of €1½ billion. The absence of repayments of inflation-indexed Federal securities, above all, provided notable relief. Last year, an inflation compensation payment of €1 billion was required when such a repayment became due. In addition, the fund to extend childcare posted a surplus of just under €½ billion due to a central government transfer. The small deficit for the energy and climate fund (ECF), the fund to promote municipal investment, the flood relief fund and the digitalisation fund together rose slightly. The fiscal balances of these four off-budget entities are included in the debt brake.

… and surplus for 2019 as a whole may rise due to 5G auction

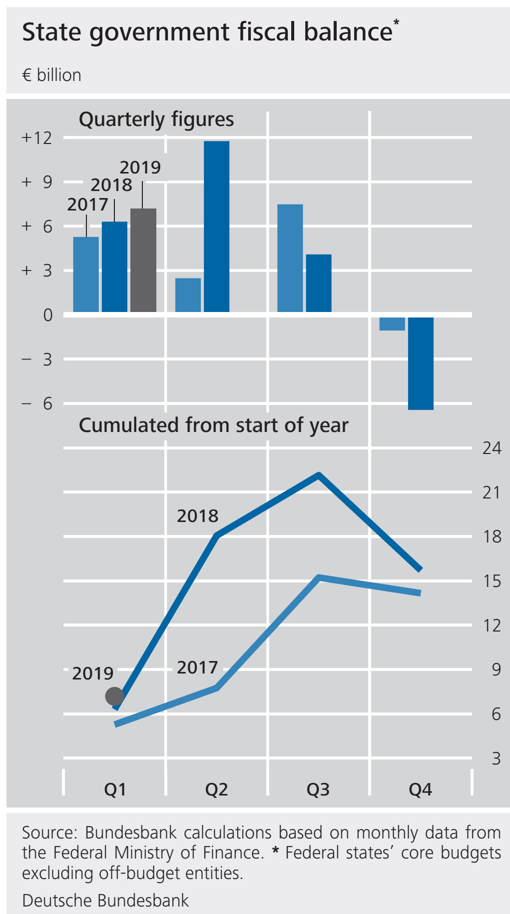
For the 2019 annual outturn, it is essential that central government does not pay any more into the digitalisation fund (-€2½ billion) and that it cuts its payments to the ECF (-€1½ billion). These cuts will be offset by the digitalisation fund's proceeds from the auction of rights to use 5G radio frequencies. From the bids received so far (€6 billion), revenue of just over €5 billion is due this year. This will help central government comply with the debt brake.[7] Overall, the off-budget entities' 2019 cash balance may slightly outperform the high level (€6 billion) recorded last year.

State government budgets[8]

Surplus higher in Q1 2019

State government core budgets posted a surplus of €7 billion in the first quarter of 2019. This constitutes a year-on-year rise of €1 bil-

6 This does not include a deficit of €7½ billion for SoFFin on account of a new (re)financing scheme for the government-owned bad bank FMS Wertmanagement.
7 By contrast, under the national accounts definition, which is key for the European budgetary rules, income is spread over the period of use (after a change in rules). In this year's auction of use rights up to 2040, the frequency packages from the auction in 2000, which generated high levels of revenue, were offered again. The rights auctioned at that time come to an end in 2020. After that, average annual income will be much lower, which will strain the national accounts balance that is relevant for the European rules somewhat.
8 The data on state government budgets as a whole are based on the monthly cash statistics for the core budgets.



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

lion. Overall, revenue went up significantly by 5½%, but growth in tax revenue was distinctly lower (+3%). Revenue was driven, not least, by a sharp rise in transfers from public administrations (+6½%). Expenditure continued to record dynamic growth (+4½%). A major contribution came from transfers to public administrations (+7%), which were also boosted by passing on higher central government transfers to municipalities. Staff costs, one of the major expenditure items, increased only moderately (+2½%). The impact of the March 2019 pay agreement, which put up rates by over 3% and is likely to also be applied to civil servants' pay and pension, has not yet made its mark on the cash balance.

Surpluses to be somewhat lower again for year as a whole and in medium term

After the extremely favourable outturn in 2018, the surpluses are likely to start easing as of this year, but to still be comparatively high. Expenditure is set to remain on its dynamic growth track. Considerable additional spending is planned for education and the police force, in particular. Furthermore, spending on civil servants' pensions is likely to continue rising sharply for a few more years. The rise in tax revenue is initially expected to be reined in by weaker macroeconomic growth. However, the latest tax estimate forecasts a return to more significant growth (average of 3½%) for the period from 2020 to 2023.

Constitutional amendment extends mixed financing, but central government's influence remains limited

Germany's Basic Law has recently been amended to extend mixed financing by central and state government again. Such financing tends to be problematic.[9] This enables central government to co-finance investment (and closely related expenditure) in the local education infrastructure. Yet, in return, central government receives only a limited influence in educational matters. The first central government funds from the digital pact for schools are expected this year. The programme is scheduled to run for five years and has a volume of €5½ billion, including a 10% contribution from state government.

Consolidation reports on compliance with deficit ceilings in 2018: …

At the end of April, Berlin, Bremen, Saarland, Saxony-Anhalt and Schleswig-Holstein submitted their consolidation reports for 2018 to the Stability Council showing whether the structural deficit (i.e. adjusted for cyclical influences and financial transactions) complied with the agreed ceiling. In case of compliance, those states have a claim on the full amount of consolidation assistance for 2018.

… classification of expenditure not convincing in Bremen …

Bremen's report, which has been published already, puts its structural deficit at €170 million, i.e. €80 million below the ceiling. However, this does not include a high net burden of €110 million from financial transactions. In the budget, a capital injection of €90 million was earmarked for hospitals. However, as no yield is to be expected from this amount, in economic terms, this payment cannot be classified as a financial transaction. Instead it should be included in the relevant deficit. The same

9 For a critical evaluation, see Deutsche Bundesbank (2019a), p. 66.

applies to the assumption of a private university's debt, which was approved in a supplementary budget. Had these two transactions been included in the results – as intended under the national accounts – the agreed deficit ceiling would have been breached, assuming that no other adjustments (i.e. to reserves) had been made.

… or in Saarland

According to a press release issued by the state of Saarland, its deficit came in €15 million below the ceiling. The cash statistics record a €60 million acquisition which, according to the budget plan, mainly comprises a further capital injection into the state theatre. In economic terms, this is not a financial transaction, either. Had it been classified otherwise, Saarland would have missed the required budgetary consolidation targets in 2018, had no other adjustments been made elsewhere.

Schleswig-Holstein's budget strained by extensive bank support measures

Schleswig-Holstein has yet to publish its report. However, measures to support HSH Nordbank inflated the deficit substantially in 2018. To date, comparable payments from guarantees have been recorded as a financial transaction and thus not included in the deficit. However, last year, the Stability Council ruled that, for the purpose of monitoring the debt brake, such transactions are to be recognised in the balance – in line with the national accounts. The Federal Statistical Office has announced that it will amend its reports accordingly. Against this background, it would be consistent for Schleswig-Holstein to include these payments in its deficit when filing its new consolidation report.

Stability Council should use data consistent with national accounts and publish reports swiftly

When monitoring those states that receive consolidation assistance, it is essential that expenditure is only classified as a financial transaction if it is actually used to purchase assets. This is consistent with the approach used in the national accounts. Not following this approach risks jeopardising the desired debt containment. States that receive consolidation assistance against the background of high debt levels should be expected to use any budgetary relief to repay debt and not to stockpile funds as reserves for future budgetary strains. Overall, valid and transparent information is of elementary importance for the Stability Council to monitor state budgets. Ideally the respective data should adhere to the accounting rules in the national accounts as closely as possible.[10] In addition, the Stability Council should publish all consolidation reports swiftly. This would enable the general public to be informed at an early stage, thus strengthening control.

Social security funds

Pension insurance scheme

Lower deficit in Q1 as impact of "mothers' pensions" only beginning to filter through to balance

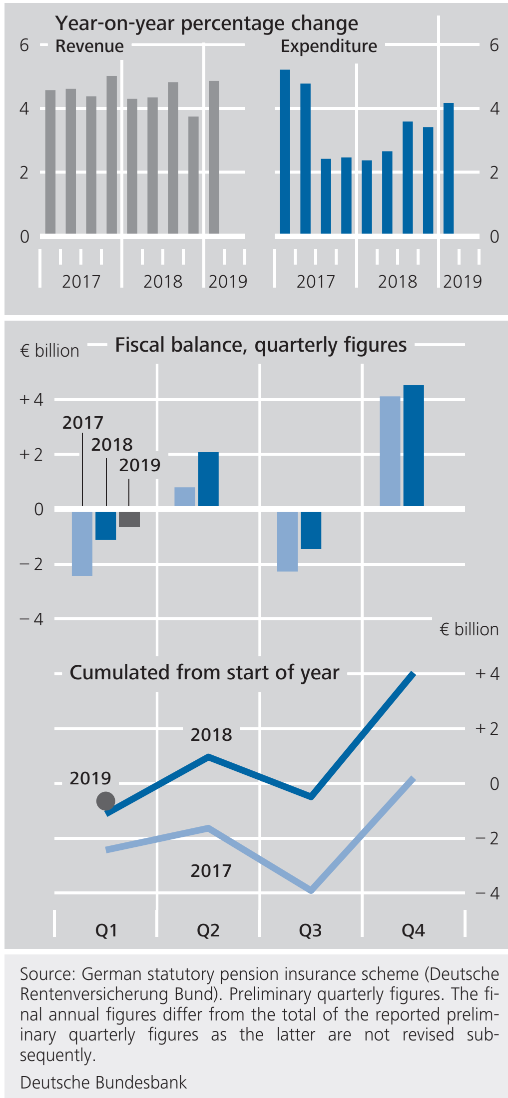
The statutory pension insurance scheme recorded a deficit of €½ billion in the first quarter of 2019. This constitutes a year-on-year improvement of €½ billion. The expansion of "mothers' pensions" at the beginning of the year is yet to make a notable impact. The full effect is likely to be felt towards the middle of the year. In the first quarter, the additional pensions – which are far from having been fully paid out – amounted to €1 billion. Expenditure growth of 4% was driven primarily by the July 2018 pension adjustment (just under 3½%) and a slight increase in the number of pensions. Revenue grew by 5% thanks to continued positive employment and per capita wage developments.

Significant pension adjustment in 2019

In mid-2019, pensions will be raised by 3.2% in the west German states and 3.9% in the east German states due to the favourable per capita wage developments last year. This will be reinforced by the very positive situation on the labour market. The number of persons subject to compulsory contributions rose faster than the number of pension recipients, thus increasing the pension adjustment via the sustainability factor. Furthermore, in line with the pension adjustment formula, pensions will rise by a little

10 For information on budgetary surveillance requirements for state governments, see Deutsche Bundesbank (2018), pp. 32-37. For a critical examination of the controls planned as of 2020, see Deutsche Bundesbank (2019b), pp. 91-98.

Finances of the German statutory pension insurance scheme



Source: German statutory pension insurance scheme (Deutsche Rentenversicherung Bund). Preliminary quarterly figures. The final annual figures differ from the total of the reported preliminary quarterly figures as the latter are not revised subsequently.
Deutsche Bundesbank

more because the contribution rate was cut by 0.1 percentage point in 2018.

Accelerated spending growth to dampen result for year as a whole

The payments and back payments of higher "mothers' pensions" will push up spending growth distinctly as the year progresses. By contrast, the development of revenue is likely to be relatively stable. The result is thus expected to be significantly lower in 2019: following a high surplus last year, the budget is set to be roughly balanced this year.

New limits for the contribution rate (upper limit) and the pension level (lower limit) have been agreed for the statutory pension insurance scheme. Up to 2025, the contribution rate may not exceed 20% and the pension level may not fall below 48%. The pension level stands at 48.2% for the current year. In line with the regular adjustment formula, as demographic pressure rises, pensions are going to increase at a slower pace than wages, with the pension level falling as a result. Once the lower limit has been reached, the regular formula will be abandoned and the level will have to be stabilised. This will give rise to additional expenditure. At the same time – given that deficits are on the cards – the reserves will fall to the lower limit of 20% of one month's expenditure. To ensure that this lower limit is not undershot going forward, the contribution rate will have to be raised. At present, the contribution rate looks likely to reach its new upper limit of 20% in 2025 and a special transfer will then be required from central government.

Increasing financial pressure on scheme's finances in medium term

Ongoing reform debate

In the long term, demographic trends will place an ever greater strain on the pension scheme's finances. This will be especially true when, as of the mid-2020s, the baby boomer generation enters retirement. As things currently stand, the limits for the contribution rate and pension level apply up to and including 2025 only. The reforms implemented in the 2000s put in place key measures to ensure that the statutory pension insurance scheme's finances remain sustainable. They envisaged a certain decline in the pension level and a rise in the contribution rate. This principle still seems to make sense. In addition, it would be advisable to tether the statutory retirement age to (rising) life expectancy for the post-2030 period, as some countries are doing at present. Otherwise, the cohort-specific number of years in retirement will be longer and longer in relation to the corresponding years of contributions.[11] Caution is advised when considering stretching the central government budget further: it is already under pressure from sharp increases in grants to the pension insurance scheme.

11 For more information, see Deutsche Bundesbank (2016), p. 71.

Federal Employment Agency

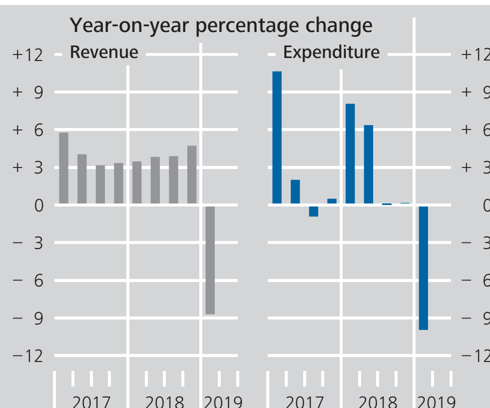
Deficit small in Q1

In the first quarter of 2019, the Federal Employment Agency recorded a small deficit in the core budget,[12] similar to that from the previous year. The strain on the balance was eased by the fact that the special transfer of €1½ billion to the civil servants' pension fund from the first quarter of 2018 was not repeated. However, the significant decline in the contribution rate at the beginning of the year (by 0.5 percentage point to 2.5%) accounted for a similar amount. On the expenditure side, spending on unemployment benefits was up by just over 3½%. This was the first notable increase since the beginning of 2014. The number of benefit recipients also rose again slightly. Spending on active labour market policy increased by 4½%, probably due to vocational training measures being extended. After adjustment for the absence of the special transfer to the civil servants' pension fund, the Federal Employment Agency's spending grew by 3%.

Surplus for year as a whole much lower due to contribution rate cut, but result probably better than planned

Despite the more muted macroeconomic outlook, employment and wages are both expected to fare well over the year as a whole. Nevertheless, the Federal Employment Agency's revenue will fall due to the contribution rate cut. On the expenditure side, the current unemployment benefit and active labour market policy trends are likely to continue. This means, however, that expenditure will remain far below budgeted levels. The surplus for the year as a whole could thus again be much higher than anticipated (€½ billion).

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

12 Excluding the civil servants' pension fund. Transfers to the fund are recorded as expenditure and thus reduce the core budget balance.

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