Public finances*

General government budget

Shrinking surplus this year

Germany's public finances are currently still in a favourable position. Although the general government surplus is likely to fall in the current year, it is expected to remain significant on account of its favourable starting point (2018: 1.7% of gross domestic product (GDP)). The debt ratio stagnated at 61% in the first quarter. Over the course of the year, however, it is expected to decline further, falling below the 60% ceiling enshrined in the Maastricht Treaty for the first time since 2002.

Weaker economic activity weighing on tax revenue growth, but bank support funds and interest expenditure lower

Weaker economic activity is weighing on tax revenue growth, especially compared with the dynamic development seen in previous years. However, wage levels, private consumption and employment, which are of particular importance for the government budget, are likely to show comparatively robust development over the year as a whole. Any negative impact on public finances thus appears limited, as things currently stand. Reduced spending on Landesbanken and lower interest expenditure are likely to more or less compensate for adverse cyclical effects.

Spending stance relaxed

The fiscal stance is thus largely responsible for the declining surplus. Fiscal policy is being loosened and is bolstering macroeconomic development. Factors driving this decision include additional pension benefits and more funding for infrastructure, education and defence. On the revenue side, by contrast, burdens and relief appear to be largely balanced, with additional revenue from progressive taxation offsetting income tax cuts. Social contribution rates have remained broadly unchanged overall. The return to parity funding of the statutory health insurance scheme is relieving pressure on households, but weighing on enterprises and the government.

Further fiscal loosening and shrinking surplus likely in coming years

Over the next few years, fiscal policy is set to be loosened further. Consequently, the general government surplus will experience a continued decline. Nevertheless, barring fundamental policy changes, the budget is likely to remain in positive territory in the medium term if the economy as a whole remains stable, in line with the baselines of the current projections. This will place it comfortably within the structural general government deficit limit of 0.5% of GDP. In addition, the debt ratio is set to remain on a downward path. In the longer term, however, public finances will come under increasing pressure as the demographic lull ends and the baby boomer generation enters retirement. Demographic pressures should be taken into account when decisions are made in the future, especially in strongly affected areas such as the pension and long-term care insurance schemes.

Budgetary development of central, state and local government

Tax revenue[1]

Robust tax revenue growth in Q2

Tax revenue achieved robust growth in the second quarter amid weaker macroeconomic performance, rising by 4% on the year (see the chart and table on pp. 63 and 64). Wage tax revenue growth remained dynamic (+6%) as a result of the positive development in gross wages and salaries. Progressive taxation was

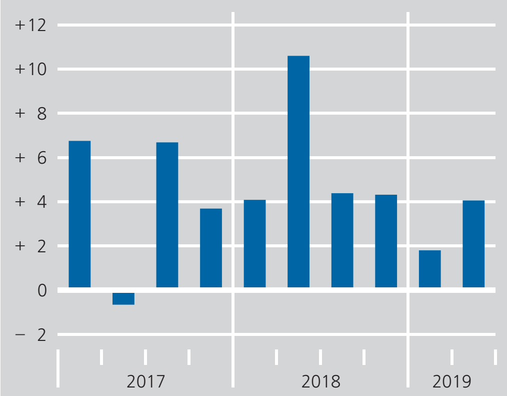
* The section entitled "General government budget" relates to data from the national accounts and the Maastricht debt ratio. This is followed by more detailed reporting on budgetary developments (government finance statistics). No data for the second quarter of 2019 are yet available for local government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

1 Total revenue includes EU shares in German tax revenue. The as yet unknown receipts from local government taxes are not included in the intra-year results.

offset by tax relief measures, among them the Family Relief Act *(Familienentlastungsgesetz),* which is intended, inter alia, to compensate for last year's bracket creep.[2] Profit-related taxes saw a moderate increase of 2%, having fallen in the first quarter, and assessed income tax showed dynamic growth. Although corporation tax declined overall, this was attributable to higher reimbursements and lower supplementary payments for previous years, though prepayments increased. Non-assessed taxes on earnings (primarily investment income tax on dividends) climbed steeply. Here, however, deferred dividend payment dates are masking the underlying trend, and annual growth rates are likely to deteriorate again as the year progresses. Withholding tax on interest income and capital gains continued to decline. Turnover tax made a substantial contribution to the robust pick-up in tax revenue; being generally quite volatile over the course of the year, it recorded an increase of 6%.

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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Weaker growth expected for remainder of 2019, but set to be somewhat higher in subsequent years

According to the official tax estimate from May, tax revenue growth of 2½% can be expected for 2019 as a whole. Following an increase of 3% over the first six months, this represents a weaker second half of the year. The estimate for 2019 as a whole assumes a subdued rate of macroeconomic growth. Progressive taxation is expected to generate additional revenue, while the Family Relief Act and other legislative changes are set to have a marked dampening effect. Moreover, repayments are anticipated, not least in connection with a VAT ruling made some time ago. Growth of between 3% and 3½% per annum is projected for the years 2020 to 2023. As the estimate is based on current legislation, the reduction in the solidarity surcharge (by just over 1% of tax revenue) planned for 2021 has, notably, not yet been factored in.

Property tax to remain a local government tax: a welcome development

In June, the Federal Government presented a draft reform on local government property tax, as the Federal Constitutional Court had deemed it to be unconstitutional in its current form. The reform concerns, in particular, the rejected valuation method used to calculate the tax. In future, the intention is to apply standardised approaches in order to converge towards actual values. In principle, the property tax can be viewed as a general charge for local government services. As its use is likely to impact on land values, it seems wholly reasonable to apply a value component. Applying standardised approaches will make it possible to keep levy costs within limits. The reform would allow the individual federal states to implement their own diverging regulations for property tax. However, federal state specifics are not yet available. On the whole, being reformed in this manner, property tax would remain a significant and stable source of revenue for local government.

Central government budget

Stable result in Q2, disregarding special effect on interest expenditure

In the second quarter of 2019, the central government budget recorded a surplus of €7½ billion. Apparently as a result of a special effect on interest expenditure, this surplus decreased to almost half of its prior-year level. Interest expenditure rose by €6½ billion, although higher

2 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, were raised on 1 July 2019.

Tax revenue

Type of tax	H1 2018 € billion	H1 2019 € billion	H1 2019 Year-on-year change € billion	H1 2019 Year-on-year change %	Estimate for 2019[1] Year-on-year change %	Q2 2018 € billion	Q2 2019 € billion	Q2 2019 Year-on-year change € billion	Q2 2019 Year-on-year change %
Tax revenue, total[2]	350.2	360.5	+ 10.3	+ 3.0	+ 2.4	178.1	185.3	+ 7.2	+ 4.1
of which:									
Wage tax	99.5	105.4	+ 5.9	+ 5.9	+ 5.3	51.4	54.4	+ 3.0	+ 5.9
Profit-related taxes	68.6	67.8	− 0.8	− 1.2	− 1.7	34.9	35.7	+ 0.8	+ 2.2
Assessed income tax[3]	32.5	33.5	+ 1.0	+ 3.1	− 0.4	14.9	16.1	+ 1.2	+ 7.9
Corporation tax	18.7	17.3	− 1.4	− 7.7	− 2.1	9.3	8.1	− 1.2	− 13.1
Non-assessed taxes on earnings	12.8	14.3	+ 1.4	+ 11.2	+ 4.1	9.3	10.3	+ 1.0	+ 10.3
Withholding tax on interest income and capital gains	4.5	2.7	− 1.8	− 40.0	− 31.4	1.4	1.3	− 0.2	− 11.1
Turnover taxes[4]	115.0	119.5	+ 4.5	+ 3.9	+ 3.4	55.8	59.1	+ 3.3	+ 5.9
Other consumption-related taxes[5]	42.1	42.3	+ 0.2	+ 0.5	− 0.4	22.1	22.1	+ 0.0	+ 0.2

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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premiums depressed this figure by €½ billion. It appears that, in an exception to the rule, the interest payments on Bunds due at the beginning of July were recorded in June. After adjusting for this, interest expenditure again declined markedly. Spending on grants (particularly to the pension insurance scheme) and on staff and other operating expenditure (notably military procurement) rose significantly once more. Following a slow start to the year, investment spending climbed steeply. Revenue rose by 3½%. Tax revenue increased by €2 billion, despite shares in turnover tax revenue being transferred to state government. Non-tax receipts were €1½ billion higher, primarily on account of the increased and extended heavy goods vehicle toll.

For year as a whole, development far more favourable than planned; potential for surplus

In the first half of the year, the result, adjusted for the special effect on interest expenditure, worsened by €5½ billion. The budget plan foresees a deterioration of €16½ billion and a deficit of €6 billion for the year as a whole (relative to the actual figure for 2018). By this yardstick, recent developments have been very favourable and may remain so, as things currently stand. For instance, interest payments are set to be far lower than was anticipated in the plans, looking likely to decline significantly rather than rise by the estimated €1 billion. As in recent years, the outflow of investment grants may also be considerably weaker than accounted for in the budget. All in all, the central government budget could once again end the year with a surplus. If this were to be the case, the refugee reserve would once again not be needed to balance the budget, as was originally planned, and could be topped up further instead.

Draft budget for 2020 foresees moderate expenditure growth …

At the end of June, the Federal Government adopted the draft budget for 2020. Expenditure is set to rise by only 1% on the 2019 budget plan. Considerable increases in specific areas are planned here: grants to the pension insurance scheme, which are linked to wage growth, will rise most of all, but there will also be greater spending in the areas of defence and family policy, inter alia. Here, the amounts budgeted for parental benefits and additional children's allowance for parents with low incomes have increased. The Federal Ministry of Family Affairs, Senior Citizens, Women and Youth is also contributing to central government's efforts to establish the planned legal entitlement to all-day childcare for children of primary school age. To this end, a new off-budget entity will be funded with half of the €2 billion stipulated in the coalition agreement. By contrast, declining interest expenditure and, above all, considerably higher global spending cuts will provide relief. A global spending cut represents reduced spending across the board in budget planning. Accordingly, the intention is to avoid fully exhausting expenditure appropriations in other areas when implementing the budget.

… and slight decline in revenue

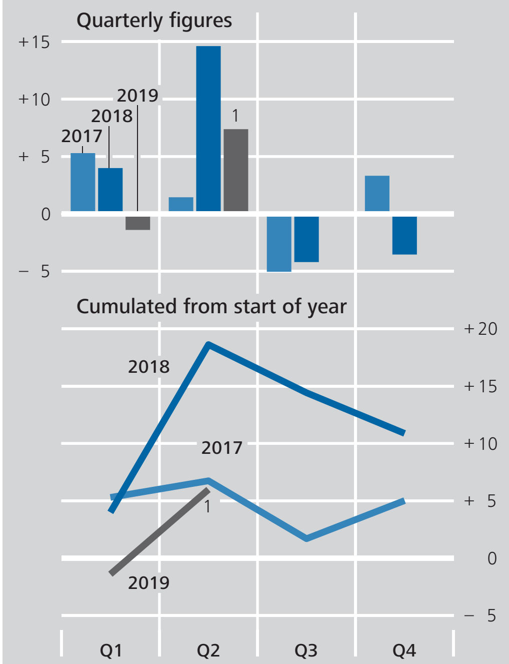
Revenue is expected to dip slightly in 2020. Tax revenue is thus set to rise by only €2 billion, according to the plans. One contributing factor here is that central government will transfer turnover tax revenue to the federal states under the new financial equalisation scheme. In addition, it will also make a transfer of €1 billion in the context of the new Good Childcare Act *(Gute-Kita-Gesetz)*. The promised continued contributions towards the refugee costs of state governments are not included in the tax revenue. However, provision has been made for this in the form of a €4 billion global revenue shortfall.

Relatively high structural deficit and …

The draft budget foresees a deficit of €9½ billion in the core budget. In order to achieve a balanced budget with no net borrowing, it is intended to withdraw €9 billion from the refugee reserve. The debt brake imposes limits on the level of structural net borrowing, including relevant off-budget entities. The planned level stands at €7 billion. This is primarily due to anticipated deficits for the off-budget entities. In addition, pressure on the budget will be eased slightly by economic growth and financial

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. **1** Including interest burdens recorded ahead of time (€7 billion).

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transactions. This has been factored out of the structural analysis, resulting in a higher structural deficit. The €12 billion ceiling for structural net borrowing will be significantly undershot. However, the structural deficit, which is not influenced by withdrawals from the reserve, is considerably higher than this.

… further fiscal loosening planned

The Federal Government proposes further loosening fiscal policy in its 2020 draft budget. The structural primary balance (excluding interest expenditure) should thus fall by €8 billion on the year.

More favourable outturn possible once again

Overall, however, the 2020 draft budget appears to have been drawn up rather conservatively, just as the 2019 budget was. Thus, relief on the expenditure side could be significantly greater than estimated via global spending cuts. Revenue could also develop more favourably. For instance, transfers to the EU budget have been cautiously estimated, and, as in previous years, higher return flows are likely. In the

Central government's fiscal planning up to 2023 and the result as defined in the debt brake rules*

€ billion

Item	Actual 2018	Target 2019	Draft 2020	Fiscal plan 2021	2022	2023
Expenditure[1]	336.7	356.4	359.8	364.2	370.4	373.7
of which:						
Investment	38.1	38.9	40.0	39.8	39.8	39.8
Global spending increases/cuts	–	– 1.2	– 4.0	– 3.9	– 3.0	– 1.7
Revenue[1, 2]	347.6	350.6	350.3	352.4	365.1	375.4
of which:						
Tax revenue[1]	322.4	325.5	327.7	334.2	345.5	356.1
Global revenue increases/shortfalls	–	– 0.2	– 4.0	– 13.2	– 11.0	– 10.2
Fiscal balance[3]	10.9	– 5.8	– 9.5	– 11.8	– 5.3	1.7
Allocations to (–)/withdrawals from (+) reserves[4]	– 11.2	5.5	9.2	11.5	5.0	– 2.0
Net borrowing (–)/repayment (+)	–	–	–	–	–	–
Cyclical component[5]	6.7	0.7	1.3	– 0.1	– 0.4	0.0
Balance of financial transactions	0.7	0.7	0.7	1.8	1.9	0.8
Balance of relevant off-budget entities	4.0	– 3.6	– 4.9	.	.	.
Energy and climate fund	2.9	– 0.7	– 2.5	.	.	.
Relief fund (2013 flood)	– 0.6	– 0.7	– 0.5	.	.	.
Fund to promote municipal investment	– 0.7	– 1.9	– 2.0	.	.	.
Digitalisation fund	2.4	– 0.2	– 0.9	.	.	.
Fund for primary school-age childcare provision[6]	–	–	1.0	.	.	.
Structural net borrowing (–)/repayment (+)[7]	– 3.5	– 5.0	– 7.0	.	.	.
Memo items:						
Ceiling	– 11.4	– 11.5	– 11.9	– 12.2	– 12.6	– 13.0
Structural fiscal balance	7.5	– 10.8	– 16.5	.	.	.

* For methodological notes, see Deutsche Bundesbank, Key central government budget data in connection with the debt brake, Monthly Report, February 2016, pp. 68 f. **1** After deduction of supplementary central government grants, shares of energy tax revenue, compensation under the 2009 reform of motor vehicle tax and consolidation/budgetary recovery assistance to federal states, excluding allocations to/withdrawals from reserves. **2** Excluding coin seigniorage (consistently €0.3 billion). **3** The difference between revenue and expenditure. Equals net borrowing/repayment less allocations to/withdrawals from reserves and less coin seigniorage. **4** Includes annual allocations of €2 billion to the reserve for demographic challenges as of 2021. **5** Notwithstanding legal requirements, data for all years taken from the Federal Government's 2019 spring forecast. **6** Newly included in the 2020 draft budget. **7** 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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absence of any negative surprises, next year's budget outturn could once again be significantly better than planned. In view of this leeway, it would be possible, for instance, to start phasing out the solidarity surcharge soon, which has been problematic for a number of reasons (for more information on this, see p. 67).

Fiscal plan for 2021 and beyond disregards significant expenditure burdens

In its medium-term fiscal plan up to 2023, the Federal Government continues to forgo new net borrowing. Significant deficits are planned initially, and the refugee reserve will be used up by the end of 2022 in order to offset these. Annual average expenditure is forecast to increase by less than 1½%. This target appears very ambitious; additional spending is likely to be necessary. Defence expenditure, amongst other things, will once again decrease markedly relative to GDP up to 2023. Here, it is thus unclear how Germany will meet its NATO spending pledge. Development aid will also decline, despite this meaning that the internationally agreed spending level will not be met. Furthermore, the Federal Government has acknowledged that the funds necessary to cushion Germany's exit from coal power have not been fully accounted for. Likewise, the fiscal plan does not take into consideration staff wage increases after 2021 or the introduction of a basic pension. In addition, Germany is unlikely to reduce its carbon dioxide emissions to the level agreed upon within the EU, and the estimated compensatory payments it will have to make seem low. The planned entitlement to all-day childcare for children of primary school age is also likely to trigger rather high costs; the budgeted total funds of €2 billion would therefore only go a short way towards covering this. The federal states are already calling for a far greater contribution from central government.

Funds set aside for tax measures limited

It was intended to make provision for the partial abolition of the solidarity surcharge and the rise in child benefits with global revenue shortfalls as of 2021. However, these have been scaled back so much compared to the previous fiscal plan that, as of 2022, they will no longer be sufficient for this purpose. No further provision has been made to guarantee continued central government contributions towards the federal states' refugee costs, either. Nor have any funds been put aside to continue offsetting bracket creep resulting from inflation in the income tax scale.

Solidarity surcharge: shortfalls and repayments possible due to legal risks

On the revenue side, there is also a substantial default risk attached to the funds stemming from the solidarity surcharge. This risk extends beyond planned annual revenue. The President of the Federal Court of Auditors, in his capacity as Federal Performance Commissioner, notes that sizeable repayment obligations may arise. This is ultimately due to the concern that the continuation of the solidarity surcharge, in whole or in part, may be in conflict with constitutional law.[3] Germany's Basic Law stipulates that a surtax on income taxes, such as the solidarity surcharge, can only be imposed if central government has particular financing needs. Two factors may make it difficult to justify such a need. First, central government has repeatedly generated surpluses in recent years and allocated them to a de facto discretionary reserve. Second, special assistance for infrastructure reconstruction in eastern Germany – payments which featured prominently when the surcharge was introduced – will be phased out by the end of 2019. Yet, the surcharge is not to be abolished until 2021, and even then only partially. The plan is to introduce an exemption limit to ensure that the vast majority of those currently paying the surcharge will be completely exempt. Only a relatively small group of people should then be liable to pay the surcharge, but the revenue generated should still amount to around half of the current volume.

Abolish solidarity surcharge faster and revise income tax if necessary

Not least given the risks of continuing the solidarity surcharge, there have also been calls to do away with the surcharge entirely. This would give rise to additional revenue shortfalls compared with the budget planning to date. While there is currently some remaining scope and reserves are still available for now, action would have to be taken in the medium term. One option would be to revise regular income taxation, for instance by eliminating exceptions or adjusting rates. In the process, the desired tax burden for the various income groups could be made transparent.

Lack of information pertaining to debt brake

It is difficult to see why the medium-term plans from 2021 onwards contain no information about the structural result for the debt brake – after all, it is the key element of central government's fiscal rule, which is anchored in Germany's Basic Law. While the planning for the special funds included under the debt brake has not yet been completed, it is still possible to at least set the deficit ceilings and include them in the plans with a view to ensuring compliance with the debt brake.

Central government's off-budget entities: slight improvement in Q2 and …

According to data from the Federal Ministry of Finance, central government's off-budget entities recorded a slightly improved surplus of €1½ billion in the second quarter of 2019.[4] The impact of the auction of 5G frequencies has yet to filter through to the figures. The auction closed in June with bids totalling €6½ billion, and payments of close to €6 billion are set to fall due this year. These proceeds are earmarked for the digitalisation fund to support the expansion of the broadband network and the procurement of computers for schools. The additional revenue from the auction of CO_2 certificates received by the energy and climate fund was partially offset by higher expenditure.

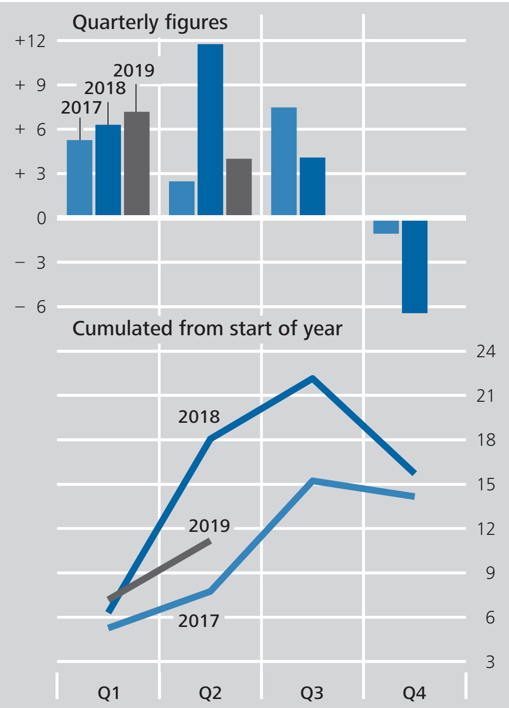
… prospect of somewhat higher surplus for year as a whole

As far as the annual result is concerned, central government transfers to the energy and climate fund and the digitalisation fund will shrink. However, this should be more than offset by auction proceeds of €2 billion. There will

3 See also Federal Performance Commissioner (2019), pp. 16 f.
4 As of the current year, central government posts financial resources borrowed to refinance its bad bank as affecting the balance. These are not taken into account here. The results of the restructuring fund were not yet available as this report went to press.

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

also be no repeat of the €1 billion burden resulting from the redemption of an inflation-linked central government security. Overall, the off-budget entities' surplus should slightly outperform the high level (€6 billion) recorded last year.

State government budgets[5]

Surplus fell significantly in Q2, mainly due to special factors

In the second quarter of 2019, the state government core budgets posted a surplus of €4 billion. This represents a significant decline on the previous year (€11½ billion). Revenue rose by only ½%. While tax revenue continued on its clear growth path (+4½%), transfers from public administrations suffered a considerable fall (-11½%), evidently largely due to the fact that these were recorded at a later date. Baden-Württemberg received revenue of €½ billion stemming from fines on account of the diesel scandal; however, in the same quarter of the previous year, Lower Saxony also received €1 billion. Expenditure grew by just over 9½%. A major factor here was that North Rhine-Westphalia brought forward lump-sum payments to universities into the second quarter.[6] In addition, personnel expenditure – a major expenditure item – rose sharply by 6%. Growth increased temporarily as a result of back-payments from the March pay agreement as well as changes in civil servant remuneration occurring earlier than in the previous year.

No special burdens for remainder of year, surplus may again be high

In the first half of the year, the surplus thus fell significantly by almost €7 billion to €11 billion. This deterioration was due, in particular, to special intra-year factors that are likely to have a positive effect as the year progresses. The payments brought forward in North Rhine-Westphalia and the transfers booked at a later date will ease the pressure on state government budgets going forward. In addition, unlike last year, no guarantee payments are due for HSH Nordbank this year. By contrast, the tax estimate foresees a more moderate development of tax revenue in the second half of the year. All in all, however, the surplus for the year as a whole is likely to once again be very high.

Continued favourable outlook provides room for manoeuvre …

In the medium term, conditions are set to remain positive for state government finances. According to the tax estimate, tax receipts should continue to develop favourably. Furthermore, central government has confirmed that it will continue its contributions towards the federal states' refugee costs. Thus, overall, there is still leeway in the budget, for instance, to sustainably strengthen those areas, such as education and research, that are key for future development.

Looking at the local government level, action is needed in some areas. While surpluses are high overall at this level, too, thanks to the favourable underlying conditions, some municipalities

5 The following data are based, unless other sources are stated, on the monthly cash statistics for the core budgets.
6 The other expenditure that makes up this category was €3½ billion higher than in the second quarter of 2018.

… to address, inter alia, problematic developments at local government level

are still experiencing financial difficulties. These accumulated in the past, in particular, and the respective state governments are therefore partially responsible as they organise local governments' financial equalisation schemes and provide local government budgetary oversight. They thus have a major responsibility to address these issues promptly, and, above all, to stop new unsound developments at an early stage. Multi-year cash advances should thus be avoided in the future. If local authorities with budgetary shortfalls were only allowed to obtain such advances from their respective state government, the responsibility would lie directly with the state government. If these advances were also to be counted towards that state government's debt brake, this would create an additional incentive to take effective countermeasures in a timely manner.[7]

Stability Council confirms required consolidation

The Stability Council confirmed that the five states in receipt of consolidation assistance adhered to the agreed paths for reducing their structural deficits in 2018.[8] The safety margins indicated are, in some cases, low. The structural budget outturn of several states even benefited from the fact that certain grants were classified as an acquisition of financial assets (financial transactions) and thus did not count towards their structural deficits.[9] However, a number of states prevented favourable developments from having an impact on their outturns by choosing to build up reserves rather than repay debt, which is high in some cases. Overall, the consolidation reports do not always demonstrate how well equipped the federal states are to deal with the debt brake.

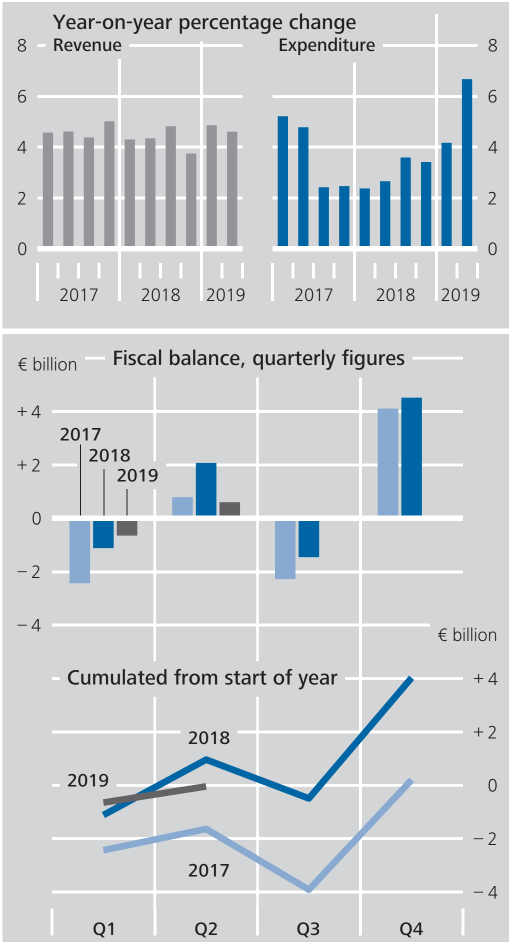
Social security funds

Pension insurance scheme

Surplus down in Q2 due to expansion of "mothers' pensions"

The German statutory pension insurance scheme recorded a surplus of €½ billion in the second quarter of 2019. This constituted a year-on-year decline of €1½ billion and was mainly driven by additional expenditure on

Finances of the German statutory pension insurance scheme*

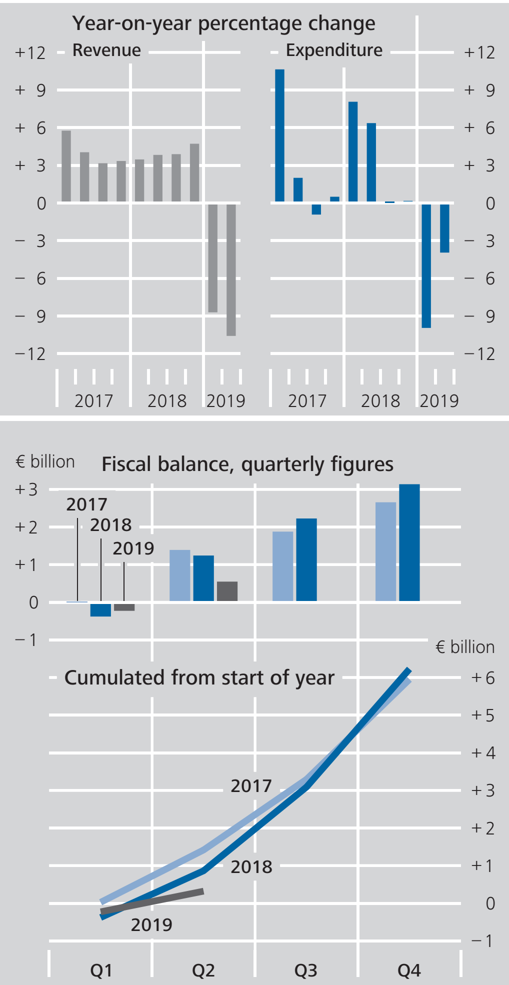


Source: German statutory pension insurance scheme (Deutsche Rentenversicherung Bund). * Preliminary quarterly figures. The final annual figures differ from the total of the reported preliminary quarterly figures as the latter are not revised subsequently.
Deutsche Bundesbank

"mothers' pensions". The expansion has been in place since the beginning of the year, but the first payments did not occur until the second quarter – and thus partly retrospectively. Overall, these payments came to just under €2 billion and thus account for almost half of the steep rise (+6½%) in pension expenditure. The

7 See also Deutsche Bundesbank (2019a), p. 9.
8 Berlin, Bremen, Saarland, Saxony-Anhalt and Schleswig-Holstein receive consolidation assistance of €800 million per year for the budget years 2011 to 2019. To qualify for this assistance, the federal states have to eliminate their structural deficits by at least reducing them in equal increments along a steady path by 2020. Central government and the state governments as a whole each provide half of the financial resources.
9 See Deutsche Bundesbank (2019b), pp. 68 f.

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

pension increase of July 2018 stood at just under 3½%; the number of pensions went up only slightly. In a separate development, payments to the statutory health insurance scheme soared. Since the beginning of the year, the statutory pension insurance scheme has been paying half of the supplementary contributions of pensioners. Revenue continued to rise significantly (+4½%) as a result of the favourable employment and wage developments.

Result likely to be worse for year as a whole, too, but another surplus still possible

In the first half of the year, the result fell by €1 billion on the previous year. On 1 July 2019, pensions rose by 3.2% in western Germany and 3.9% in eastern Germany and thus by only a little more than in the previous year. Irrespective of this, developments going forward are likely to be similar to those from the first half of the year. As a result, the outturn is likely to be much worse than in the previous year. However, a moderate surplus still appears possible.

Higher retirement age could ease demographic pressure on pension level

In future, the demographic pressure on the pension insurance scheme will increase gradually. Immigration may ease this pressure somewhat.[10] However, the burdens will increase significantly when, as of the mid-2020s, the baby boomer generation enters retirement. The statutory pension insurance scheme will come under additional pressure as of 2030 if the statutory retirement age is not raised any further then. Up until 2030, the ratio of pension-drawing periods to contribution periods is broadly stable; however, after that date, it will grow again with increasing life expectancy. This will be a further factor inflating the ratio of pension recipients to contribution payers. To ease this burden, the statutory retirement age could be tethered to the life expectancy of the 65+ generation for the post-2030 period.[11] Countries such as Sweden and Denmark are pursuing such a strategy already.

Federal Employment Agency

Lower surplus due to contribution rate cut

In the second quarter of 2019, the Federal Employment Agency posted a surplus of €½ billion in the core budget.[12] In year-on-year terms, the surplus fell by roughly half. Revenue declined by €1 billion, or 10½%, on the back of the contribution rate cut at the beginning of the year (by 0.5 percentage point to 2.5%). However, the fact that the Federal Employment

10 The new population projection assumes, in particular, a slightly higher level of immigration than the previous projection. See Federal Statistical Office (2019), medium variant (G2-L2-W2).
11 For more information, see Deutsche Bundesbank (2016), p. 71.
12 Excluding the civil servants' pension fund. Transfers to the fund are recorded as expenditure and thus reduce the core budget balance.

Agency did not have to make a special transfer of almost €1 billion to the civil servants' pension fund this year again eased the strain on its finances.

Higher expenditure on unemployment benefits

Both per capita earnings and employment continued to develop favourably. Had the contribution rate not been cut, the Federal Employment Agency's revenue would have risen by just over 4½%. By contrast, at almost 6½%, expenditure growth (adjusted for the absence of the special transfer to the civil servants' pension fund) was even higher. Spending on unemployment benefits was up by 7%. Registered unemployment fell further in the second quarter. However, unemployment in the statutory unemployment insurance scheme recorded a perceptible rise from a very low level after years in decline. Short-time working benefits, which are currently being discussed given the cyclical trend, account for only a very small amount of expenditure at present and are down on the previous year as at last count. Expenditure on active labour market policy measures rose by 4½%. This is likely due to higher costs of vocational training measures.

Significantly lower surplus for year as a whole – but probably again higher than budgeted

The impact of cutting the contribution rate will be seen in a significantly lower surplus for the Federal Employment Agency for the year as a whole. The growth in unemployment benefits and active labour market measures recorded to date is not likely to let up as the year progresses. However, expenditure should remain well below the budget estimates. As a result, the surplus for the year as a whole is likely to again be much higher than planned (€½ billion).

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