Public finances*

General government budget

Given economic recovery, public finances will also start to improve again

Public finances continued to provide significant support to the economy in the first half of 2021. Since then, however, the economy has rebounded strongly. Assuming that the economic recovery continues, the role played by government crisis measures such as transfers to enterprises and wage replacement benefits will gradually become smaller. Furthermore, tax and social contribution inflows will become stronger again. In this respect, government finances will recover automatically.

Another large deficit expected in 2021, however

For 2021 as a whole, however, a large deficit is expected once again. As things stand today, this is set to rise to over 5% of gross domestic product (GDP), having stood at 4.5% a year earlier. It should be noted, though, that this increase will be driven largely by measures not connected to the coronavirus crisis. These include the partial abolition of the solidarity surcharge, higher child benefits and government grants to finance climate action. Temporary coronavirus response measures coupled with the unfavourable economic situation could result in budgetary burdens reaching roughly the same heights this year as last year (see the upper chart on p. 72). In the wake of the floods in July, both central government and state governments passed emergency aid and recovery measures. A fund of up to €30 billion (0.8% of GDP) is set to be established for the latter. The deficit will not be affected when transfers are made to the fund, but rather when funds are withdrawn from it. Such withdrawals are likely to be spread over a number of years. The debt ratio rose further in the first quarter of 2021 to 71.1% (end-2020: 69.7%). This puts it much lower than its peak of 82.5%, reached in 2010 during the last crisis. It is relatively low by international standards, too (euro area in 2020: around 98%).

Substantial structural deficit, but deviation from medium-term budgetary objective not too significant

Public finances are currently being placed under significant strain by cyclical and other temporary effects. The structural situation can be determined by filtering out these effects (see the lower chart on p. 72).[1] As things currently stand, the structural deficit ratio for 2021 as a whole is expected to stand at around 1½% once the temporary coronavirus response measures are also factored out.[2] The deviation from the medium-term budgetary objective of 0.5% of GDP under EU rules will therefore not be too significant, even compared with previous years. At around 47%, the structural expenditure ratio excluding interest expenditure will likely reach a historically high level (see the lower chart on p. 72). By contrast, due to persistently low interest rates, interest burdens will be very low despite the relatively high debt ratio. In the current year, the calculated average interest rate on government debt could decline further to ¾%. The structural tax and social contributions ratio will undershoot the peak it reached at the turn of the millennium. Even so, it will be rather high again by historical standards.

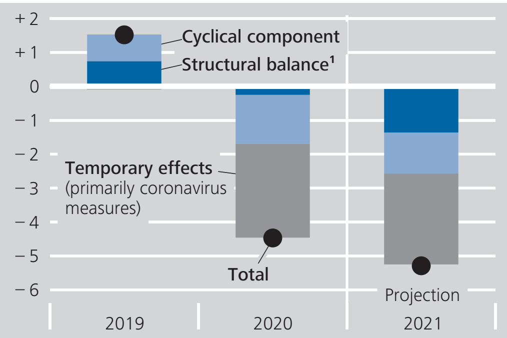
* The section entitled "General government budget" relates to data from the national accounts and the Maastricht debt ratio. This is followed by more detailed reporting on budgetary developments (government finance statistics). No data are yet available for local government or the statutory health and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

1 For an analysis of structural ratios, see also Deutsche Bundesbank (2021a).

2 EU budgetary surveillance generally does not factor coronavirus response measures out of the structural deficit. However, the need for fiscal policy action currently seems less urgent when these temporary measures are also excluded. The Federal Government appears to take a similar view of the situation: according to the April stability programme, it envisages a structural deficit ratio of 7¾% for 2021. However, 6¼ percentage points of this are attributable to coronavirus response measures and other measures. Such effects are set to decrease strongly from as early as 2022 (to 1½% of GDP), virtually vanishing by 2025.

General government fiscal balance*

As a percentage of GDP



Sources: Federal Statistical Office as well as Bundesbank calculations and projections from June 2021 (see Deutsche Bundesbank, Outlook for the German economy for 2021 to 2023, Monthly Report, June 2021, pp. 15-38). * General government budget as defined in the national accounts. **1** As a percentage of trend GDP.

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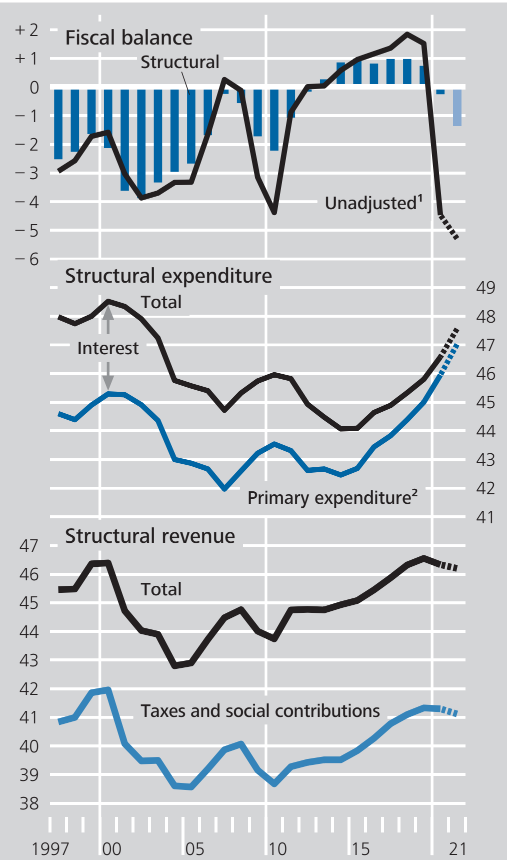
General government structural fiscal ratios*

As a percentage of trend GDP



Sources: Federal Statistical Office as well as Bundesbank calculations and projections from June 2021 (see Deutsche Bundesbank, Outlook for the German economy for 2021 to 2023, Monthly Report, June 2021, pp. 15-38). * General government budget as defined in the national accounts. Structural figures are obtained by deducting cyclical and specific temporary effects. In 2020 and 2021, the latter largely relate to the measures implemented in response to the coronavirus crisis. **1** As a percentage of GDP. **2** Total expenditure less interest expenditure.

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2022: assuming continued economic recovery and end of coronavirus aid, sharp decline in deficit to be expected

The general escape clause will continue to apply to the EU budget rules next year.[3] This has also been announced for central government's debt brake. Additional central government grants towards social security funds, amongst other measures, are anticipated in order to prevent contribution rates from increasing. Furthermore, central government and some state governments are incorporating additional buffers and reserves for any further coronavirus aid into their budgets. It appears that a portion of these funds is also set to be used for measures unrelated to the coronavirus pandemic. This is in the context of the economy being expected to continue on its path of recovery in the year ahead. Budgetary burdens brought about by the coronavirus crisis via, for instance, bridging aid to enterprises and short-time working will subsequently be able to automatically expire. In the absence of new deficit-increasing measures, the deficit ratio could thus fall to around 1½% in 2022. From the current perspective, there is no apparent need to activate the escape clause again in either the EU budget rules or the debt brake in the coming year (for more information on central government fiscal planning, see pp. 76 f.).

Fiscal rules not at odds with prudent measures, but prioritisation required

Given this starting situation, it would seem that only a relatively manageable amount of consolidation has to be achieved in the upcoming legislative period. That said, new financing needs have been identified in a number of areas, including social policy, investment in infrastructure and tax cuts. The fiscal rules are not at odds with new measures that are deemed prudent, even if the escape clauses are not activated. Rather, the objective of these rules is to keep revenue and expenditure in a pre-agreed state of balance. However, the easiest means of financing (in political terms), i.e. through acquiring additional debt, is not an option. Instead, priorities need to be set with regard to expenditure and the revenue required for such spending.

3 For a critical analysis, see Deutsche Bundesbank (2021b), pp. 78 ff.

Budgetary development of central, state and local government

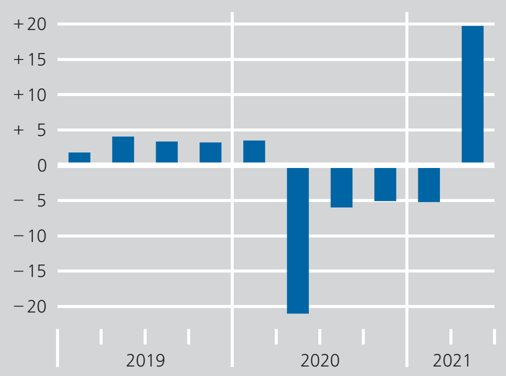
Tax revenue

Tax revenue increased sharply in Q2 following crisis-driven slump in same quarter of previous year

Tax revenue[4] increased sharply in the second quarter of 2021 (by 20% on the year; see the adjacent chart and the table on p. 74). This is chiefly due to the fact that revenue losses from the previous year were recouped. The coronavirus crisis weighed significantly more heavily on the second quarter of 2020, particularly on account of reduced or repaid advance payments and deferrals of profit-related taxes and VAT.

Tax revenue*

Year-on-year percentage change, quarterly figures



Source: Federal Ministry of Finance. * Comprises joint taxes as well as central government taxes and state government taxes. Including EU shares in German tax revenue, including customs duties, but excluding receipts from local government taxes.
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Strong recovery, above all, in VAT and …

The types of tax that slumped last year were thus the main ones to contribute to revenue growth. In the case of VAT, significant sums were deferred from the second quarter of 2020. In addition, special advance VAT payments were reimbursed to enterprises that had previously made them. Deferrals were significantly lower in the second quarter of this year, and there was no reimbursement effect. This was why VAT rose strongly on the year, though this was counteracted by the fact that tax-relevant sales in the second quarter of 2020 had up to then only been relatively mildly affected by the crisis. The reason for this is that VAT is paid with a lag of up to two months in most cases. The fact that a significant portion of import VAT payments were received with a delay also had a dampening effect in the previous quarter. These payments will now strengthen the third quarter.

… profit-related taxes

Profit-related taxes also saw strong growth. Corporation tax increased particularly steeply after having slumped in the previous year. One year ago, advance payments from the first quarter were partially reimbursed, ongoing advance payments reduced and tax payments deferred. These burdens largely dissipated in the second quarter of 2021. However, advance payments for the current year were still somewhat below their 2019 level. On the whole, it was a similar story for assessed income tax, though its development was less volatile. Advance payments of this tax type for the current year slightly exceeded their 2019 level. Non-assessed taxes on earnings – chiefly investment income tax on dividends – rose very sharply. Their development is generally very volatile over the course of the year. Intra-year shifts in dividend payments throughout the year have a role to play in this, which was particularly the case during the crisis. To wit, many shareholders' meetings and dividend payments that should have taken place in the second quarter of 2020 were postponed to subsequent quarters.

Stagnation in wage tax revenue: additional receipts due to reduced short-time working; shortfalls primarily due to bonus child benefit payment

Wage tax revenue stagnated. Reduced short-time working is likely to have resulted in a marked increase in revenue.[5] However, child benefits were raised significantly at the start of the year. As these are deducted from wage tax receipts, this had a dampening effect on overall revenue. Furthermore, a bonus child benefit payment was made in the second quarter. With a financial impact of just under €3 billion, this alone pushed revenue down by 5½%. Adjust-

4 Including EU shares in German tax revenue but excluding receipts from local government taxes, which are not yet known for the quarter under review.
5 Short-time working reduces wages, and short-time working benefits are not taxed.

Tax revenue

Type of tax	H 1				Estimate for 2021[1]	Q2			
	2020	2021				2020	2021		
	€ billion		Year-on-year change € billion	%	Year-on-year change %	€ billion		Year-on-year change € billion	%
Tax revenue, total[2]	327.7	347.1	+19.4	+ 5.9	+ 4.3	146.4	175.2	+28.9	+ 19.7
of which:									
Wage tax[3]	104.1	101.6	− 2.5	− 2.4	+ 1.0	50.8	50.8	+ 0.0	+ 0.0
Profit-related taxes	53.8	69.2	+15.5	+28.7	+ 6.0	19.2	33.7	+14.6	+ 75.9
Assessed income tax[4]	29.3	32.2	+ 2.8	+ 9.6	+ 3.7	10.6	14.3	+ 3.7	+ 34.9
Corporation tax[5]	10.8	19.1	+ 8.2	+75.8	+16.0	2.3	8.9	+ 6.5	+277.3
Non-assessed taxes on earnings	9.9	12.7	+ 2.8	+27.9	− 0.5	5.0	8.5	+ 3.5	+ 69.2
Withholding tax on interest income and capital gains	3.7	5.3	+ 1.6	+44.6	+10.9	1.2	2.1	+ 0.9	+ 73.2
VAT[6]	104.3	112.4	+ 8.1	+ 7.8	+11.8	44.3	57.6	+13.4	+ 30.2
Other consumption-related taxes[7]	40.4	40.9	+ 0.5	+ 1.4	+ 2.0	19.9	21.5	+ 1.6	+ 7.8

Sources: Federal Ministry of Finance, Working Party on Tax Revenue Estimates and Bundesbank calculations. 1 According to official tax estimate of May 2021. 2 Comprises joint taxes as well as central government taxes and state government taxes. Including EU shares in German tax revenue, including customs duties, but excluding receipts from local government taxes. 3 Child benefits and subsidies for supplementary private pension plans deducted from revenue. 4 Employee refunds and research grants deducted from revenue. 5 Research grants deducted from revenue. 6 VAT and import VAT. 7 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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ments to income tax allowances and the income tax scale resulted in additional shortfalls at the start of the year.[6]

Significant rise in revenue expected for year as a whole

The official tax estimate made in May projected a rise in tax revenue of 4½% for the year as a whole. From the current perspective, the outcome could be more favourable. For instance, revenue rose more quickly up to mid-year than had been anticipated at the start of May. Assessed profit-related taxes, in particular, may therefore perform better than estimated.

Central government budget

Central government budget posts another large deficit in Q2 due to pandemic

The central government budget posted a large deficit of €37 billion in the second quarter. However, this was €7 billion smaller than in the same quarter last year. Revenue rose sharply by 22% (€16 billion), mainly because of a €12 billion increase in tax revenue. In addition, negative revenue had been recorded a year earlier: €3½ billion of the Bundesbank profit received in the first quarter was paid out again in the second quarter to the Investment and Repayment Fund. Expenditure rose by 7½% (€8½ billion), primarily as a result of higher transfers and loans to the social security funds (€4 billion and €5 billion respectively). Total expenditure on the basic allowance for job seekers also grew by a considerable €1½ billion. This was mainly due to central government covering a larger share of accommodation costs and paying out a one-off bonus of €150 per person (for those not entitled to child benefits). Interest expenditure saw a sharp rise of €2 billion, as fewer premia were received when new debt instruments were issued. These premia are de-

6 See Deutsche Bundesbank (2021b), pp. 64 f.

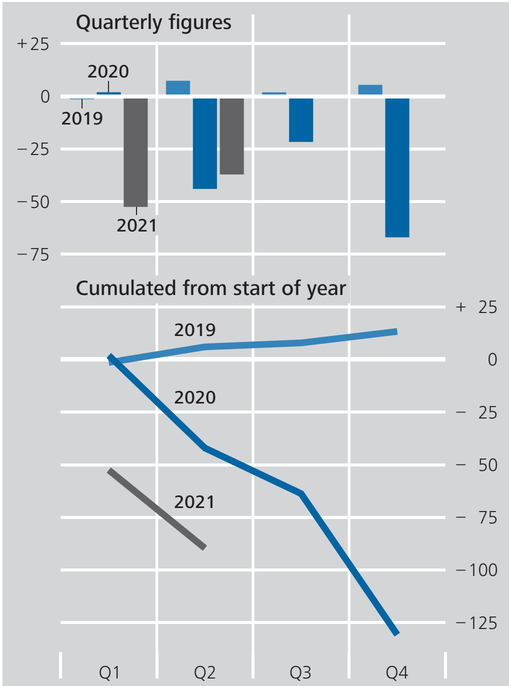
ducted from interest expenditure.[7] By contrast, bridging aid for enterprises (in 2020: emergency aid) fell by €3 billion.

Spending likely to be substantially below planned figures in year as a whole

Up to mid-year, the deficit in the central government budget thus came to €90 billion. In the spring supplementary budget, the whole-year deficit of €180 billion originally estimated in the 2021 budget was increased to €240 billion. Unlike in 2020, however, the burdens on the central government budget should tend to ease in the second half of the year. Although, in particular, transfers to enterprises with high revenue losses were extended beyond mid-year and further expanded, pandemic-related expenditure should gradually come to an end as long as restrictions are not substantially tightened again. As things stand, the estimated reserves, e.g. in the form of global spending increases, appear very generous. The same is true of the allocated amount for bridging aid for enterprises, with only €23 billion of the budgeted €65 billion being paid out in the first half of 2021.

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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Flood assistance entails additional spending

Given the extensive damage caused by the floods in July, central government and state governments are planning to set up a relief fund. The fund is still under parliamentary discussion. It will receive up to €30 billion, just under half of which is to be funded by the state governments. Central government is planning to transfer €16 billion to this special fund in 2021. Net borrowing in the core budget would be increased by close to this amount (the state governments' funding contribution of €7 billion will span around 30 years, from 2021 to 2050). Subsequently, central government intends to inject up to €14 billion more into the fund if necessary – with the state governments contributing half of this amount. The budget balances of such special funds are factored into the debt brake calculations, which means that transfers from the core budget to the fund will not have any impact on the debt brake in and of themselves. Only special fund expenditure that will affect the deficit will count towards the structural new borrowing limit under the debt brake.[8] The total size and timing of outflows from the fund cannot yet be reliably estimated. Notable amounts may already be paid out this year. However, a large portion of the payments are likely to be made over the coming years.

Outturn for year as a whole likely to be much better than planned

All in all, as things stand, net borrowing will be far lower than planned in the supplementary budget (€240 billion). It may even remain under the €180 billion estimated in the original

7 The premia referred to here are those paid by investors to central government when a security's coupon exceeds the market rate. As these premia are booked in full as negative interest expenditure in the same period, they significantly increase the volatility of interest expenditure. For a proposal on recording premia on an accruals basis, thus eliminating this source of volatility, see Deutsche Bundesbank (2021c).

8 If, for example, a fund initially only receives money from the core budget and no money leaves the fund, the associated deficit in the core budget is offset by a surplus of the same size in the fund's budget. Consolidated structural net borrowing then amounts to zero. If the fund subsequently records a deficit, this counts as consolidated structural net borrowing. Only this is relevant to the debt brake.

Central government's fiscal planning up to 2025 and the result for the debt brake*

€ billion

Item	Actual 2020	Supple-mentary budget 2021	Draft budget 2022	Fiscal plan 2023	2024	2025
1. Expenditure[1]	443.4	547.7	443.0	403.4	407.6	408.3
of which:						
1.a Investment	50.3	59.3	51.8	50.9	50.8	50.8
1.b Global spending increases/cuts	0.0	27.3	3.8	– 6.0	– 6.0	– 6.4
2. Revenue[1,2]	312.7	307.3	342.6	367.2	378.9	395.1
of which:						
2.a Tax revenue[1]	283.3	284.0	315.2	332.9	346.4	359.2
2.b Global revenue increases/shortfalls	–	– 3.0	– 1.1	1.6	1.7	7.7
3. Fiscal balance (2.–1.)	–130.7	–240.4	–100.4	–36.2	–28.7	–13.2
4. Coin seigniorage	0.2	0.2	0.2	0.2	0.2	0.2
5. Transfer to (–)/withdrawal from (+) reserves	0.0	0.0	0.5	30.6	16.5	1.2
6. Net borrowing (–)/repayment (+) (3.+4.+5.)	–130.5	–240.2	– 99.7	– 5.4	–12.0	–11.8
7. Cyclical component in the budget procedure[3]	– 42.6	– 24.0	– 1.7	– 1.8	– 1.3	0.0
8. Balance of financial transactions	– 6.6	– 5.4	– 1.8	– 1.2	– 0.6	0.4
9. Balance of incorporated off-budget entities (from 2023: e)[4]	27.7	– 17.6	– 13.8	–12.0	– 0.8	1.1
9.a Energy and Climate Fund	25.3	– 13.8	– 11.3	– 4.9	0.0	1.4
9.b Flood Assistance Fund	– 0.4	– 0.5	– 0.3	.	.	.
9.c Fund to Promote Municipal Investment	– 1.0	– 1.5	– 1.4	.	.	.
9.d Digitalisation Fund	1.3	– 1.8	– 0.3	.	.	.
9.e Fund for Primary School-Age Childcare Provision	2.5		– 0.5	.	.	.
10. Structural net borrowing (–)/repayment (+) (6.–7.–8.+9.)	– 53.6	–228.4	–110.1	–14.4	–10.8	–11.2
11. Amount exceeding ceiling[5] (16.–13.–10.)	41.9	216.4	98.4	–	–	–
12. Outstanding repayment amount, escape clause	41.9	258.3	356.7	356.7	354.6	352.5
13. Repayment amount due	–	–	–	2.1	2.1	2.1
Memo items:						
14. Need for action						6.2
15. Relief from global spending cuts, global revenue increases and withdrawal from reserves (2.b–1.b+5.)	.	.	.	38.2	24.2	21.5
16. Regular ceiling: structural net borrowing (0.35% of GDP)[6]	– 11.7	– 12.1	– 11.7	–12.3	–12.9	–13.3
17. Structural fiscal balance (3.–7.–8.+9.)	– 53.9	–228.7	–110.8	–45.2	–27.5	–12.6
17.a As above, with potential output estimate according to fiscal plan	– 62.9	–233.6	.	.	.	.

* 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 transfers to/withdrawals from reserves. **2** Excluding coin seigniorage. **3** With GDP figures from July 2021 for 2020. **4** Estimated amount makes full use of the scope remaining under the debt brake. **5** Repayment plan for the amount from (a) 2020: 1⁄20 per year from 2023 to 2042; (b) 2021 and 2022: 1⁄17 per year from 2026 to 2042. **6** This refers to gross domestic product in the year before the budget is prepared.

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budget. The regular borrowing limit under the debt brake could thus be overshot by less than €150 billion in 2021. The resulting annual repayments due from 2026 onwards would then be below €9 billion, rather than the projected €13 billion.

Draft budget for 2022: renewed recourse to escape clause intended

The draft budget for 2022 was passed by central government at the end of June. It is intended to activate the debt brake escape clause again next year. The justification given for this is that the budgetary burdens caused by the pandemic are ongoing and the overall economic recovery needs to be further stabilised.

Net borrowing of €100 billion budgeted for

The draft budget envisages net borrowing of almost €100 billion. The debt brake borrowing limit is to be exceeded by almost the same amount. New borrowing is to be more than halved compared with this year because it is assumed that the economy will be much stronger and because significantly fewer pandemic-related support measures have been budgeted for. However, the draft budget still includes €25 billion in expenditure directly related to the pandemic – e.g. for lagging business aid, costs from guarantees, vaccines and, above all, in the form of a general provision item. It also allocates funds for additional assistance not directly connected to the pandemic, e.g. for switching to climate-friendly heating or building up a charging network for electric vehicles. Once again, the social security funds are to receive ad hoc additional central government grants (of €9 billion). The aim is to ensure that the overall contribution rate remains below 40%. However, most of this money is to be used to offset deficits unrelated to COVID-19.

Budgetary burden should remain much smaller

As things stand, it appears quite likely that next year's central government budget outturn will again be much more favourable than projected in the draft budget as long as no additional cost-increasing measures are adopted. Tax revenue could exceed the estimates – also in structural terms. In addition, it currently seems likely that pandemic-related expenditure will remain lower than projected. The outflows from the new relief fund are very difficult to gauge. However, they are likely to play a fairly minor role in the annual outturn as defined under the debt brake.

Activating the escape clause again in 2022 to manage the pandemic …

It will be for the newly elected Bundestag to decide whether the escape clause will be activated again next year in order to manage the coronavirus crisis. By then, it should be possible to get a more reliable gauge of the economic developments and budgetary burdens stemming from the pandemic in 2022. The Federal Government is assuming that the economy will be operating at near-normal capacity. A number of projections by other institutions are even more favourable. In its June outlook, the Bundesbank expects much stronger GDP growth and above average overall capacity utilisation in 2022. A sizeable reserve of €48 billion is also available to bridge gaps in the central government budget without activating the escape clause. Should the need for adjustment go beyond this, the necessary consolidation appears manageable in the expected economic setting.

… not necessary as things stand

As things stand, overall it does not look as though it will be necessary to activate the escape clause again in 2022 in order to manage the coronavirus crisis.[9] Even if the escape clause is not activated, the debt brake rules permit spending and the expansion of expenditure deemed sensible or even necessary, e.g. in connection with climate change or digitalisation. However, this must be funded by reducing other expenditure or from regular revenue, such as taxes. What this ultimately means for the Federal Government and the Bundestag is that they need to clearly and transparently convey to the public which areas of spending have priority or why taxes need to be raised.

Fiscal plan up to 2025 does not address part of upcoming fiscal challenges

The new multi-year fiscal plan envisages that the regular debt brake requirements will be met again from 2023 onwards. The reserve, unused in 2022, is to be drawn on from 2023 to 2025. In 2025, the final year, the plan also includes unspecified consolidation of €6 billion. If the reserve were to be tapped in 2022 already, a markedly larger need for adjustment would arise in these years. Furthermore, it appears that additional needs have not yet been fully accounted for – e.g. in connection with international commitments regarding defence expenditure or development aid. From 2026 onwards, extensive repayments of coronavirus-related debt accrued in 2021 will also be due. Should the escape clause be activated in 2022, the amounts to be repaid will be correspondingly higher. Before the end of this decade, moreover, repayments of EU debt stemming from the Next Generation EU (NGEU) programme will be due. Central government will contribute to these repayments in line with Germany's share of financing in the EU budget. In addition, the demographic burdens facing central government look set to increase significantly from the middle of the decade. As baby boomers increasingly reach retirement age, central government grants are likely to rise sharply.[10] At the same time, the decline in the number of persons in work will dampen tax revenue. All in all, this means there are sub-

9 Regarding the overall assessment, see, in particular, Independent Advisory Board to the Stability Council (2021).
10 According to the Federal Government's Financial Report and its Pension Insurance Report, a sharp rise in the pension contribution rate is to be expected. Central government grants will then also grow strongly as they are tied to the pension contribution rate.

stantial challenges involved in future budgetary and fiscal planning. These provide a further argument against activating the escape clause again in 2022 – provided that the coronavirus crisis does not escalate again. The need for consolidation would then arise earlier than envisaged in the government plans, but central government would not then face any repayment burdens due to borrowing above the standard limit in 2022 in the more difficult environment later on.

Budget of central government off-budget entities balanced overall in Q2

Central government's off-budget entities recorded a balanced budget in the second quarter of 2021, following a surplus of €4½ billion in the same period last year.[11] In the second quarter of 2020, the Investment and Repayment Fund had received €3½ billion from the Bundesbank's large profit distribution. This year, outflows from the Energy and Climate Fund had a negative impact on the balance. Despite relatively high selling prices for European CO_2 emissions certificates, it recorded a deficit of €3½ billion, compared with only €½ billion a year earlier. By contrast, the Economic Stabilisation Fund received revenue from loan repayments for the first time. These exceeded expenditure on new aid by €1 billion.

In 2021 as a whole, significant deficit planned for Energy and Climate Fund but repayments of Economic Stabilisation Fund aid and advance financing of planned relief fund

The Energy and Climate Fund is likely to post a significant deficit for the year as a whole, too. By contrast, provided that the economic recovery continues as expected, the Economic Stabilisation Fund will probably record a surplus due to net repayments. All in all, the off-budget entities covered here so far may close the year in deficit again. However, this deficit could be somewhat smaller than in 2020 (€6 billion). Later in the year, the relief fund for flood assistance will be set up as a new off-budget entity. The planned advance financing of this fund means that its inflows are likely to be higher than its outflows in 2021. The relief fund will then initially record a surplus. As money is withdrawn in the coming years, it will post deficits at that time.

State government budgets

Difficult to interpret state government budget outturns at present as figures for off-budget entities not yet available

Assessing state government budget outturns is very difficult at present. Only monthly data for the core budgets are available without delay. Figures for state government off-budget entities are published later, together with the quarterly statistics for the core budgets. Since the outbreak of the coronavirus crisis, however, the informative value of core budgets alone has been limited. In 2020, many state governments set up sizeable pandemic-related off-budget entities. Some of these received advance financing from the core budgets, which (when taken in isolation) initially results in a deficit in the core budget and a surplus in the corresponding off-budget entity. Other off-budget entities have their own credit authorisations enabling them to support the core budgets, inter alia, by transferring funds. The transfer then yields a deficit for the off-budget entity and a surplus in the core budget. In some cases, off-budget entities also appear to be serving to take pressure off the core budget beyond the acute phase of the crisis and thus to ease debt brake requirements. Given this situation, for a meaningful analysis of state governments' financial situation, it is essential to have the outturns of both the core budgets and the off-budget entities.

Sharp drop in core budgets' deficit in Q2 – but off-budget entities likely to post deficit

The core budgets closed the second quarter with a deficit of €1½ billion (according to the monthly cash statistics), down from the exceptionally high level of €26 billion in the same quarter of the previous year. However, last year's deficit was partly offset by off-budget entities recording a surplus of €6 billion following advance financing in the form of transfers from the core budgets. In the current reporting quarter, by contrast, off-budget entities may also post a deficit – in some cases possibly because

11 According to data from the Federal Ministry of Finance, i.e. excluding bad banks and other entities that use commercial double-entry bookkeeping. SoFFin's deficit is also factored out. It is based on funds transferred to refinance the bad bank FMSW. In return, the direct debt of FMSW, which is attributable to central government, is repaid accordingly.

they have transferred funds to core budgets to relieve the pressure building up there.[12] In spite of this, the coronavirus crisis is likely to be have placed much less of a strain on state government finances overall in the second quarter of 2021 than it did a year earlier. Tax revenue, for instance, was up by 31% (€19 billion) and thus already slightly higher than the pre-crisis level from the second quarter of 2019. The tax revenue figures for the first half of 2021 were likewise just above those from prior to the crisis.

Large deficit again expected for year as a whole, but improvement on previous year

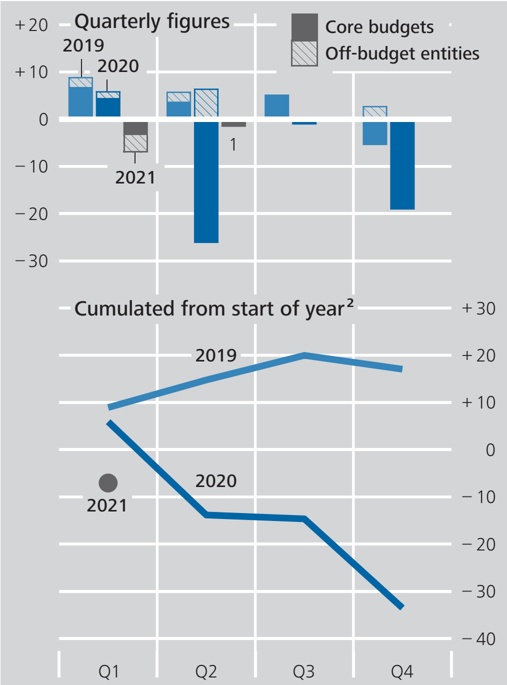
A large deficit is again expected this year for the core budgets and off-budget entities overall. However, this is likely to be much lower than last year (2020: €34 billion). According to the May tax estimate, state governments' tax revenue is forecast to grow by 2½% this year and thus return to its 2019 level. The latest tax figures suggest that growth might actually be somewhat higher. Furthermore, as payments of €5 billion for offsetting local governments' local business tax shortfalls were discontinued, this should alleviate the strain on state government budgets in comparison with 2020.[13] However, the federal states are providing other funds to stabilise their municipalities. For instance, they are, inter alia, stepping up transfers within their local government financial equalisation schemes instead of passing on part of their tax shortfalls to their municipalities in line with the regular rules. They are also continuing to come under pressure from bearing half of the operating costs for vaccination centres and the costs of coronavirus testing at schools.

State governments contribute to relief fund after July flooding

Additional expenditure following the flooding in July 2021 will probably be financed mainly via the planned relief fund to compensate households, enterprises and public entities for damage sustained. Central government will initially provide the fund with €16 billion. State governments will transfer a total of €7 billion (around €230 million per year) in shares in VAT revenue for this purpose from 2021 to 2050. If required, central government will inject a further amount of up to €14 billion into the fund, whereby state governments will provide half of this via the distribution of VAT revenue.

State government fiscal balance

€ billion



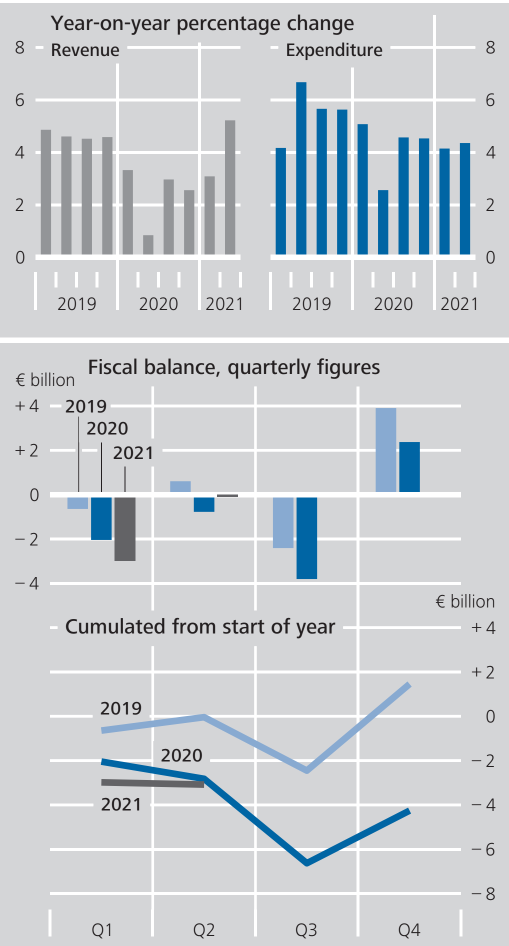
Sources: Federal Statistical Office, Federal Ministry of Finance and Bundesbank calculations. **1** Figures based on monthly data from the Federal Ministry of Finance, quarterly data are not yet available. **2** Core budgets and off-budget entities together.
Deutsche Bundesbank

Clear improvement in state government budgets expected next year

Next year, the state government budget deficit is likely to fall further. Based on the current outlook, as fiscal support and health measures come to an end, pressure on expenditure will then ease. At the same time, tax revenue is expected to return to stronger growth. It is currently still unclear when the federal states' respective debt brakes will again apply in full. The extent of consolidation required will then vary considerably from state to state.[14] In addition to the various budgets having widely divergent structural starting positions and available re-

12 Results including off-budget entities are available for the first quarter of 2021. The core budgets' deficit amounted to €3 billion, and that of the off-budget entities to €4 billion.
13 Local governments received €11 billion in compensation from central government and state governments in 2020 for local business tax shortfalls as a result of the coronavirus crisis.
14 See Deutsche Bundesbank (2020).

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 subsequently revised.

Deutsche Bundesbank

serves, the rules are established on a state-specific basis.

Social security funds

Pension insurance scheme

Quarterly results balanced; revenue recovered from crisis-related burdens; …

In the second quarter of 2021, the pension insurance scheme had a largely balanced budget. In the same period last year, it had posted a deficit of almost €1 billion. Total receipts were up by 5%, with contribution receipts rising sharply (+5½%). This was partly because crisis-related burdens were lower than in the same period last year: in the second quarter of 2020, losses of earnings were even greater and contribution payments were deferred. Central government funds increased by just over 4½%. These include additional grants of €½ billion (year as a whole: €1½ billion) for the basic pension.[15]

… expenditure growth dynamic due to higher annual pension adjustment in mid-2020

At 4½%, growth in expenditure was somewhat weaker than growth in revenue, but still significant. This was chiefly due to the July 2020 annual pension adjustment of 3½% on average across Germany but also to another only moderate rise in the number of pensions. Higher supplementary contribution rates to the statutory health insurance scheme constituted a further – albeit less pronounced – contributory factor.

Relief in second half of year due to no general annual pension adjustment

Pensions in western Germany were not raised in mid-2021. In eastern Germany, they were raised by 0.7%: larger adjustments to eastern German pensions are to ensure that they gradually align with the levels in western Germany by 2024. This constitutes a rise of 0.2% on average across Germany and should rein in expenditure growth in the second half of the year compared with the same period last year.

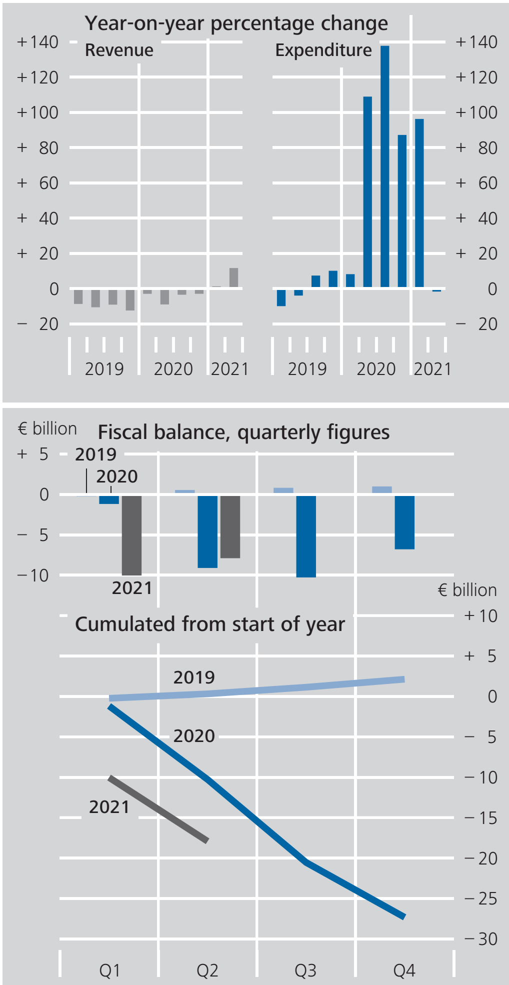
Deficit for 2021 as a whole lower than last year, but initially buffer in reserves

All in all, the deficit for 2021 as a whole is likely to be lower than last year (2020: €4 billion). At the end of the year, the sustainability reserve is set to fall below its upper limit of 1.5 times the scheme's monthly expenditure for the first time since 2011. However, financial pressure on the pension scheme is likely to increase considerably in the coming years. In its current fiscal plan, the Federal Government assumes that the reserve will undershoot the statutory minimum of 0.2 times the scheme's monthly expenditure for the first time in 2023. To meet the min-

15 The basic pension was introduced for the first time at the start of the year. While entitlement to the pension started in January, the actual disbursement of first payments (including back payments) did not begin until the middle of the year. Payments of the basic pension for 2021 are expected to extend into next year. Central government is thus advancing funds because, despite the delay in payments, it is still extending the full annual grant this year.

imum, it will thus have to raise the contribution rate, slightly at first but considerably going forward. Once the baby boomer generation starts entering retirement in the mid-2020s, funding pressure will mount in the medium to long term.

Finances of the Federal Employment Agency*



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

Federal Employment Agency

Deficit again very large

The Federal Employment Agency was hard hit by the coronavirus crisis in the second quarter of 2021, too, recording a deficit of €8 billion in its core budget.[16] This nevertheless constitutes a year-on-year improvement of just over €1 billion.

Very steep rise in revenue mainly due to lower crisis-related burdens and higher contributions for insolvency benefit payments

Revenue increased very steeply, by 12% overall, with contribution receipts going up by 9%. In the previous year, receipts fell considerably as a result of the crisis (-6½%, after adjustment for the 0.1 percentage point cut in the contribution rate in 2020). Furthermore, revenue from insolvency benefit contributions grew sharply because the contribution rate was doubled to 0.12% at the start of the year. The current contribution rate is now on par with the average level since 2010.

Expenditure declining, chiefly due to lower payments for short-time working

Expenditure was 1½% down on the year. In the second quarter of 2020, expenditure had more than doubled on account of the crisis. The decline is due to somewhat lower payments for short-time working: in the second quarter of 2021, €7½ billion was paid out compared with €8 billion in the same period last year. When comparing 2021 figures with those from last year, it is essential to note that the Federal Employment Agency's payments for short-time working are made with a time lag of around half a quarter. This means that last year the full impact of the pandemic was not yet shown in the payments for the second quarter. By the same token, the results for the second quarter of 2021 do not fully reflect the declining short-time working figures. Social contributions paid by the Federal Employment Agency on behalf of enterprises as an exceptional crisis response measure accounted for around €3 billion of the payments for short-time working. There was practically no change in expenditure on unemployment benefits.

Very large deficit for year as a whole, but widespread easing expected in 2022

The Federal Employment Agency's finances are set to improve greatly in the second half of the year. In addition to short-time working, unemployment is expected to fall and revenue should continue to develop favourably. Never-

16 Excluding the civil servants' pension fund. Transfers to the fund are thus recorded as expenditure here, lowering the core budget balance. These transfers have been suspended from the second quarter of 2020 until the end of 2021 because of the coronavirus crisis.

theless, financing needs are forecast to be extremely high overall for the year as a whole. They may even be around twice as high as originally estimated (draft budget: €9 billion). The remaining reserves (€6 billion) and central government funds of €3 billion are available to plug this gap. Additional funds will be required from central government. At the end of 2021, the liquidity loans from central government still outstanding at that time are then to be converted into a government transfer. The economic situation is set to be much better overall in 2022. Central government's draft budget also includes a special transfer of €1 billion. This sum appears appropriate as things currently stand.

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