Public finances*

General government budget

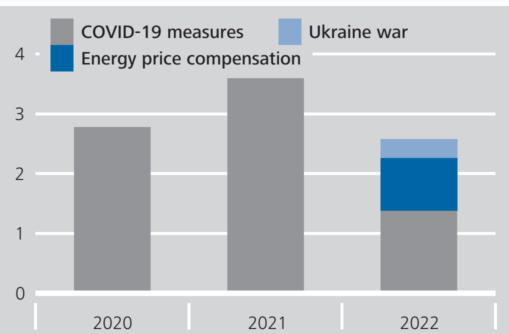
Outlook for 2022

Supportive fiscal policy will continue this year but deficit likely to decline

Fiscal policy continues to stabilise macroeconomic developments, supporting households and enterprises with numerous measures this year as well. Nevertheless, the deficit is projected to decline significantly this year as the fiscal burden caused by the coronavirus crisis eases. Tax revenue rose sharply in the first half of the year, also in the wake of the economic recovery from the pandemic. In addition, some pandemic-related expenditure came to an end. Overall, the budget outturns of central government, state governments and the Federal Employment Agency improved considerably (see the following sections for more details). As things currently stand, new burdens from the war in Ukraine and measures to offset high prices will not outweigh the recovery from the coronavirus crisis (see the chart on key fiscal measures below). So far, the debt ratio also looks likely to fall (2021: 69.3%; first quarter of 2022: 68.2%).

Measures affecting the deficit that are directly linked to the COVID-19 pandemic, high energy costs and the Ukraine war*

As a percentage of GDP



* Bundesbank estimate. For information on the measures, see also Deutsche Bundesbank (2022a, p. 19 f.) and Deutsche Bundesbank (2022b).

Deutsche Bundesbank

Further outlook and risks

From 2023, significant structural deficit likely for some years

At present, the deficit looks set to decline further in the coming years. Unlike before the coronavirus crisis, however, a significant structural deficit is likely. Although the Federal Government is planning to resume compliance with the standard limit under the debt brake from 2023, together with its special funds central government could report annual average structural deficits of just over 1½% of gross domestic product (GDP) in the years from 2023 to 2026 (see also the table on p. 69):

– The Federal Government plans to fully exhaust its standard structural net borrowing limit of 0.35% of GDP through deficits.

– In addition, it will tap the reserve in the central government budget, which can be used to finance deficits without increasing the net borrowing relevant to the debt brake. The pre-financed special funds are likely to record additional deficits. In particular, expenditure by the Climate and Transformation Fund and the Armed Forces Special Fund is to be financed from deficits. All in all, the scope for deficits for the coming years owing to the reserves and special funds amounts to 6½% of this year's GDP.

The other levels of government have significantly lower reserves. Overall, they could post a more or less balanced budget for the remainder of the year.

* 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.

The typical impact of inflation on government finances

Higher inflation usually pushes up both nominal government revenue and nominal government expenditure. When and to what extent this occurs depends, in particular, on how it affects the various macroeconomic aggregates. Another contributory factor is the extent to which policymakers take fiscal measures, say, to offset price effects for households and enterprises.

Revenue

On the revenue side, inflation affects taxes and social contributions, as they are largely calculated on the basis of nominal reference variables. As a rule, VAT is particularly quick to show the impact of inflation, as this type of tax is levied on private consumption and construction investment. Revenue from wage tax and social contributions rises if inflation causes wages to increase at a stronger pace. Wage-dependent taxes and levies account for an especially large share of government revenue. Where profits are higher – a potential consequence of inflation – revenue from profit-related taxes rises. The progressive scale for income tax amplifies the impact of inflation, above all for wage tax. Additional revenue from bracket creep also depends critically on the magnitude and speed of compensatory shifts in the tax scale.[1]

Primary expenditure

On the other hand, higher inflation leads to higher government spending, as government purchases and investment usually become more expensive, too. If public sector wages also rise more sharply, this affects government personnel expenditure. Government transfers are linked to price developments, partly directly and partly indirectly via wages. However, as a rule, there is a delay before benefits are adjusted. Pension expenditure, a large-volume item, is of particular significance here; there is a lag before pensions are adjusted to wage developments.

Interest expenditure

Interest expenditure, too, can increase as a result of inflation because interest rates tend to rise when inflation is higher and higher inflation usually leads to a tightening of monetary policy – especially if inflation rates are expected to persist at high levels. One point to bear in mind is that the average interest rate on government debt reacts only gradually to changes in interest rates. This is because the current rates are initially only relevant for a relatively small part of the debt. Their effect on net new borrowing and the refinancing of maturing securities, in particular, is rapid. For inflation-indexed debt securities, price developments have a direct impact on interest expenditure.[2] At around 3%, however, these securities account for only a small share of German government debt. The discounts or premia incurred when securities are issued – which are sometimes considerable – are of minor importance in the national accounts, as they are generally allocated as

1 For more information on bracket creep, see Deutsche Bundesbank (2022c).
2 For inflation-indexed German government debt, annual coupon payments and nominal repayment amounts increase with inflation. Inflation-induced additional expenditure at the time of repayment is the most significant in quantitative terms. In the national accounts, this is booked as interest expenditure in the year when the inflation was recorded. In the year in question, a payment is made from the central government budget to its special fund for inflation-indexed bonds.

interest expenditure on an accruals basis over the term of the security.[3]

As there is a delay before the average interest rate adjusts to (unexpectedly) higher inflation, the government's real interest burden initially falls.[4] However, it rises again later once higher nominal interest rates are increasingly reflected in the average interest rate. The interest burden ultimately depends on the combination of inflation and nominal interest rates, and thus also on monetary policy. The initial easing effect of inflation on the real interest burden can also go into reverse. Government finances come under particular pressure, for example, if inflation expectations exceed the monetary policy inflation target and first need to be "reined in" again by a restrictive monetary policy stance. Even if inflation risk premia rise as a result of the growing uncertainty, the real interest burden increases.

Profit distributions by the central bank[5]

In addition to the direct impact via interest expenditure, an interest rate reversal due to inflation also affects government finances via central bank profit distributions. In the current constellation involving extensive monetary policy bond holdings, rising interest rates will initially weigh relatively heavily on central bank profits. As things currently stand, the Bundesbank is therefore not expected to make any profit distributions for some time.

Euro area central banks are holding a larger share of domestic government bonds in their monetary policy bond holdings. Their profit distributions thus ultimately return government interest payments to government coffers. De facto, the government thus pays the central bank's short-term, risk-free deposit rate on these bonds rather than the government bond interest rate. This has the same effect as significantly shorter interest rate fixation periods for government debt and makes government finances more sensitive to changes in central bank interest rates.

3 For discounts and premia, the budget account records the payment flow – resulting, in some cases, in very volatile interest expenditure. For a proposed reform of the accounting method used in the central government budget, see Deutsche Bundesbank (2021a).
4 The initially lower burden from existing government debt is illustrated by the fact that, ceteris paribus, higher inflation pushes up nominal gross domestic product (GDP) and the debt ratio therefore falls at first. The GDP deflator may develop differently from the Harmonised Index of Consumer Prices (HICP), which the Eurosystem uses as the basis for its target. At present, the divergence is particularly large because steeply rising import prices (primarily for energy) are sharply driving up the HICP, but these are not included in the GDP deflator. The Bundesbank's June projection for 2022, for example, forecast an HICP rate of 7.1% and an increase of 3.8% in the GDP deflator. See Deutsche Bundesbank (2022a), p. 25.
5 For more details on the effects of rising interest rates on the central bank balance sheet and government finances, see Deutsche Bundesbank (2021b). For more information on the creditor structure and, in particular, on government bonds held by national central banks, see Deutsche Bundesbank (2022d).

Uncertainty still high

However, the outlook for public finances for this and the coming years is highly uncertain, with macroeconomic risks being transmitted directly to public finances, mainly via automatic stabilisers. Furthermore, new deficit-financed fiscal measures are being discussed. To fund them, there have also been calls in some quarters to activate the debt brake escape clause again in 2023 and increase borrowing. There is likewise uncertainty surrounding the reserves of central government's off-budget entities. It is therefore difficult to predict when extensive outflows could take place. In addition, the Federal Constitutional Court is to decide whether the Federal Government's allocation of emergency borrowing authorisations from 2021 to the Climate and Transformation Fund was permissible. If not, the scope for deficits outlined above will be narrower.

Fiscal policy in a difficult macroeconomic environment

Public finances supporting the economy as a whole via the tax and social security system

German public finances are still well positioned to stabilise the economy even in the event of less favourable developments. Should the economy weaken further, the government will first prop up income and demand automatically via the tax and social security system.

Supplementary assistance should not impede price signals

In the event of very high prices or gas shortages, supplementary assistance may be desirable for the hardest hit households or enterprises. Means-tested transfers, such as the basic allowance, usually take price developments into account with a time lag. If, faced with high inflation rates, a certain replacement rate in real terms is to be ensured in the short run, too, adjustments would have to be brought forward as necessary. However, government assistance should allow price signals for supply and demand to take effect largely unimpeded. High energy prices, for example, are a key incentive to reduce energy consumption. Ultimately, the government is only able to redistribute higher energy costs, which are reflected in rising prices – it is not able to provide enterprises and households with comprehensive relief, as the procurement of energy sources from abroad is now absorbing a larger share of economic output.

Broader deficit-financed fiscal stimulus not warranted

From today's perspective, a broader deficit-financed fiscal stimulus is not warranted. This is because price pressures are high, and supply-side disruptions persist. Additional government stimulus to demand is therefore likely to have relatively little impact in real terms and may threaten to amplify price pressures further. Any new measures deemed to be necessary would have to be counterfinanced elsewhere.

Return to regular fiscal rules next year remains advisable …

As things currently stand, a return to compliance with the standard limit under the debt brake next year remains advisable. Incidentally, this will not require slamming the brakes on fiscal policy, which would choke economic development. First, the deficit will shrink automatically, as it were, as coronavirus support measures that are no longer needed come to an end. Second, although the debt brake limits net borrowing in the core budget, there is also considerable scope for deficits from reserves and special funds (see above).

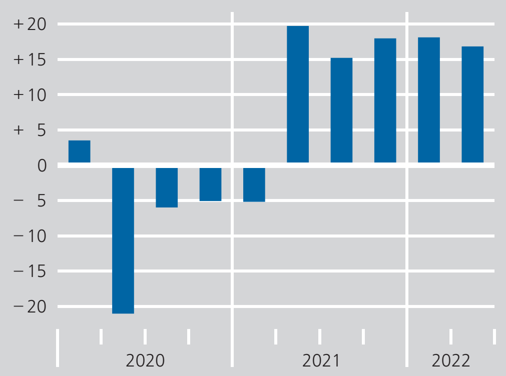
… in order to strengthen confidence in reliable public finances as well

Trust in sound public finances is important to ensure that, amongst other things, the government can provide stability in crisis situations. Fiscal rules can safeguard sound public finances and thus establish confidence, which, in turn, also helps to ensure a stability-oriented monetary policy. To achieve this, however, the regular limits of the rules must be binding and must not be undermined. This applies to the German debt brake, but also to the European rules in particular.[1] Emergency clauses have their place in crisis situations, but their use should remain an exception and plausible explanations should be given for their use. Measures financed by contingency borrowing should also be suited to counteracting the specific emergency situation.

1 For details on the current application of the EU rules and the need for reform, see Deutsche Bundesbank (2022e), pp. 78 ff.

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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Budgetary development of central, state and local government

Tax revenue

Q2 2022

Very strong tax revenue growth continued in Q2

Tax revenue[2] increased by 17% on the year in the second quarter of 2022. This growth was similarly strong to that recorded in the first quarter and was broadly based (see the chart above and the table on p. 67): revenue from wage tax went up by 19%. This reflects a significant increase in nominal gross wages and salaries, partly as a result of the decline in short-time work. The progressive tax scale led to a disproportionately large rise in tax revenue. Another factor was that the child bonus of €150 per child had been deducted from wage tax in the second quarter of last year. Without the revenue shortfalls caused by the 2021 bonus, the growth rate would have been 6 percentage points lower. Looking at profit-related taxes, receipts from corporation tax and assessed income tax rose sharply. Advance payments for profits in the current year also continued to grow, especially in the case of corporation tax. VAT receipts likewise increased significantly (+18%).

2022 as a whole

Tax estimate shows significant revenue rise in 2022 – even including new tax cuts

The official tax estimate in May projected a rise in tax revenue of 7½% for the year as a whole in the definition excluding local government taxes. Tax cuts decided in the intervening period will reduce this growth to 4½%: for example, all employed persons are to receive an energy price allowance of €300 – at the expense of wage tax, above all in September. From June to the end of August, energy tax has also been cut to the level of the European minimum rate. Looking at wage and income tax, moreover, the basic income tax allowance and the standard allowance for employees, amongst other things, have been raised retroactively with effect from the beginning of 2022.

Developments to date suggest a more favourable result

As things currently stand, however, the annual result is likely to be noticeably more favourable: at +17½%, the cash results in the first half of the year were considerably higher than expected. In order to match the annual result in the adjusted tax estimate, revenue in the second half of the year would now have to fall significantly on the year. This is not likely as things currently stand. Nevertheless, the year-on-year rate is likely to be far less favourable in the second half of the year than in the first half. This is because most of the above-mentioned tax cuts will cluster in the second half of 2022. In addition, year-on-year figures will then hardly be affected by the absence of coronavirus special burdens any more. Furthermore, there are plans to temporarily lower the VAT rate on gas consumption from 19% to 7%.

Central government budget

Q2 2022

The central government budget finished the second quarter of 2022 in a better position

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.

Tax revenue

Type of tax	H1 2021 € billion	H1 2022 € billion	H1 2022 Year-on-year change € billion	H1 2022 Year-on-year change %	Estimate for 2022[1] Year-on-year change %	Q2 2021 € billion	Q2 2022 € billion	Q2 2022 Year-on-year change € billion	Q2 2022 Year-on-year change %
Tax revenue, total[2]	347.2	407.9	+ 60.7	+ 17.5	+ 7.4	175.2	204.7	+ 29.5	+ 16.8
of which:									
Wage tax[3]	101.6	116.6	+ 14.9	+ 14.7	+ 8.1	50.8	60.4	+ 9.6	+ 18.9
Profit-related taxes	69.2	81.5	+ 12.2	+ 17.7	+ 0.5	33.7	41.5	+ 7.7	+ 22.9
Assessed income tax[4]	32.2	38.1	+ 5.9	+ 18.4	− 3.1	14.3	17.2	+ 2.8	+ 19.8
Corporation tax[5]	19.1	22.4	+ 3.4	+ 17.6	− 0.9	8.9	11.2	+ 2.4	+ 26.9
Non-assessed taxes on earnings	12.7	16.7	+ 4.0	+ 31.5	+ 17.7	8.5	11.6	+ 3.1	+ 36.8
Withholding tax on interest income and capital gains	5.3	4.2	− 1.1	− 20.0	− 14.3	2.1	1.4	− 0.6	− 30.0
VAT[6]	112.4	141.3	+ 28.9	+ 25.7	+ 12.9	57.6	67.8	+ 10.1	+ 17.6
Other consumption-related taxes[7]	40.9	42.3	+ 1.4	+ 3.5	+ 3.0	21.5	21.8	+ 0.4	+ 1.8

Sources: Federal Ministry of Finance, Working Party on Tax Revenue Estimates and Bundesbank calculations. **1** According to official tax estimate of May 2022. **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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Deficit down significantly in Q2 but still high

than one year earlier. However, it was still €24 billion in deficit (second quarter of 2021: €37 billion). Revenue saw a very steep rise of almost 16%, which was attributable to tax revenue developments. Expenditure was virtually unchanged. Reduced coronavirus bridging aid (-€9 billion) and lower payments to offset the deficit of the Federal Employment Agency (-€5 billion) had an alleviating effect. By contrast, other payments to the social security funds soared (+€9½ billion). This was due, in particular, to higher refunds to the health fund for pandemic-related special expenditure (e.g. public coronavirus tests). In addition, the health insurance institutions are receiving special payments this year to stabilise supplementary contribution rates. Transfers to state governments also rose sharply (+€3½ billion), especially for the temporary €9 ticket for local public transport. Interest expenditure grew only marginally owing to a one-off effect. Although central government posted additional expenditure of €4 billion on inflation-indexed debt instruments and of €3½ billion due to discounts, it did not already record the interest expenditure due at the beginning of July in June, as it had in the preceding years.

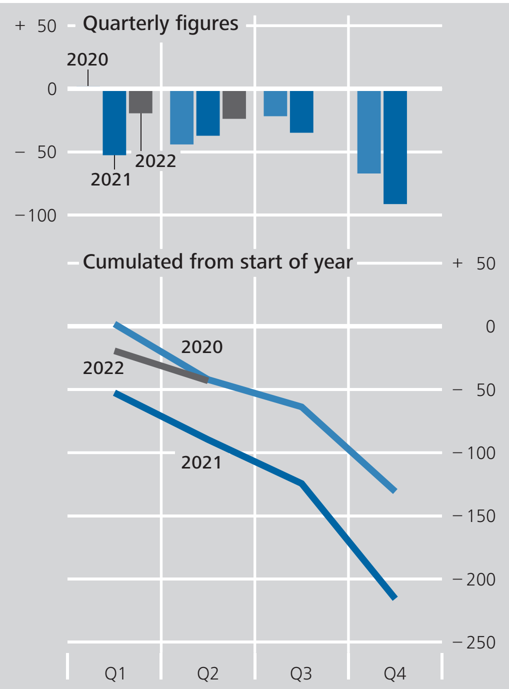
2022 as a whole

Deficit for 2022 as a whole probably significantly lower than estimated

From today's perspective, the central government budget deficit for the year as a whole will probably be significantly lower than planned. The 2022 budget envisages a deficit of €139 billion. Developments up to the middle of the year have been considerably more favourable, with the deficit coming to €43 billion. However, a number of factors are leading to a gloomier outlook for the second half of the year. For example, tax revenue growth is likely to be considerably weaker. This is due, not least, to the two energy price relief packages (see also p. 66 for details on tax developments). The rise in interest rates is also likely to result in further additional expenditure due to discounts. The deferred interest bookings men-

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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tioned above will likewise have a burdening effect. In addition, enterprises are able to apply for transfers in the event of high energy cost increases.[3] By contrast, the gradual end to coronavirus-related additional expenditure, such as transfers to enterprises in response to the coronavirus pandemic and hospital compensation for vacant beds, will probably have an alleviating effect. Furthermore, spending on coronavirus tests is likely to decline, partly because central government is now only covering the costs in full in certain cases. Overall, the outlook therefore remains uncertain – partly because the government may consider new purposes for any unused borrowing authorisations. However, using emergency loans to fund non-crisis spending would be questionable. The Federal Constitutional Court is currently examining whether the advance financing of climate protection measures in the second supplementary budget for 2021 was constitutional.

Draft budget for 2023

Draft budget for 2023 complies with standard debt brake limit, not least by drawing on reserves

The Federal Government intends to resume compliance with the standard limit under the debt brake next year. Net borrowing of €17 billion is planned. In addition, it will cover a remaining funding gap of €41 billion by drawing on reserves. In total, the deficit in the draft budget for 2023 comes to €58 billion, which is €82 billion lower than the target figure for this year. However, the falling deficit is not likely to place an excessive strain on macroeconomic developments. For example, the fact that pandemic spending is coming to an end will not weigh on economic developments provided that such support is no longer needed. Moreover, the significant rise in tax revenue is largely a reflection of the growing economy rather than changes in tax law. In addition, higher net outflows from off-budget entities (resulting in deficits there) are likely to provide a counterweight. Finally, the Federal Government's plans for this year are partly on the generous side.

Risk provisions in draft budget for 2023 …

The draft central government budget for 2023 contains provisions for burdens that have not yet been specified.

– The draft budget estimates a global revenue shortfall of €9 billion. The government is likely to need €2½ billion of this because, from today's perspective, the Bundesbank's profit distribution is not likely to be as projected. Furthermore, revenue shortfalls will result from the announced cut to the VAT rate on gas consumption. The remaining buffer could, for example, partly offset the bracket creep experienced in 2022.

– Interest expenditure is estimated at €30 billion (compared with €16 billion planned for 2022 and an actual figure of €4 billion last

3 The Federal Government also committed to capital deposits of up to €8 billion with an energy supply company. It is apparently allocating this to the Kreditanstalt für Wiederaufbau (KfW), thus initially avoiding any related burden on its own budget. See Federal Ministry for Economic Affairs and Climate Action (2022).

Key central government budget data*

€ billion

Item		Actual 2021	Target 2022	Draft 2023	Fiscal plan 2024	2025	2026
1.	Expenditure[1] of which:	556.6	495.8	445.2	423.7	428.6	436.3
1.a	Investment	45.8	51.5	58.4	51.7	52.1	51.9
1.b	Global spending increases/cuts	–	– 6.5	– 3.7	– 5.7	– 6.2	– 5.7
2.	Revenue[1,2] of which:	341.0	356.2	387.2	403.4	415.6	422.3
2.a	Tax revenue[3]	313.5	328.4	362.3	374.5	388.1	402.3
2.b	Global revenue increases/shortfalls	–	– 1.0	– 9.1	– 3.7	– 2.8	– 10.9
3.	Fiscal balance (2.-1.)	– 215.6	– 139.6	– 58.0	– 20.3	– 13.0	– 14.1
4.	Coin seigniorage	0.2	0.2	0.2	0.3	0.2	0.3
5.	Withdrawal from reserves (+)		0.5	40.5	7.7		
6.	Net borrowing (–) (3.+4.+5.)	– 215.4	– 138.9	– 17.2	– 12.3	– 12.8	– 13.8
7.	Cyclical component in the budget procedure[4]	– 12.5	– 7.9	2.9	1.5	0.8	0.0
8.	Balance of financial transactions	3.0	– 2.8	– 7.7	– 0.6	0.5	0.5
9.	Structural net borrowing (–) (6.-7.-8.)	– 205.9	– 128.2	– 12.5	– 13.3	– 14.0	– 14.3
10.	Amount exceeding limit (12.-9.)	193.8	115.7	–	–	–	–
11.	Memo item: Including previously relevant special funds (10.-14.)	124.8	127.8	12.7	27.4	22.6	19.0
12.	Standard upper limit: structural net borrowing (0.35% of GDP)[5]	– 12.1	– 12.5	– 12.5	– 13.3	– 14.0	– 14.4
13.	Structural balance (3.-7.-8.)	– 206.1	– 128.9	– 53.2	– 21.3	– 14.2	– 14.6
13.a	As above, with estimate of potential output acc. to spring 2022 economic forecast	– 202.6	– 128.9	– 53.2	– 21.3	– 14.2	– 14.6
14.	Balance of off-budget entities included in the debt brake before 2022[6]	69.0	– 12.0	– 17.1	– 27.4	– 22.6	– 19.0
14.a	Climate and Transformation Fund	53.9	– 6.5	– 9.9	– 27.4	– 22.6	– 19.0
14.b	Relief Fund (2013 flood)	– 0.2	– 0.5	– 0.2	.	.	.
14.c	Fund to Promote Municipal Investment	– 1.0	– 1.2	– 0.9	.	.	.
14.d	Digitalisation Fund	0.2	– 0.2	– 2.7	.	.	.
14.e	Fund for Primary School-Age Childcare Provision	0.5	– 0.4	– 0.4	.	.	.
14.f	2021 Relief Fund (2021 flood)	15.6	– 3.2	– 3.0	.	.	.
15.	Balance of the Armed Forces Special Fund (from 2024: e)[7]	.	– 0.1	– 8.5	– 26.0	– 28.0	– 31.0
16.	Balance of central government budget and special funds (3.+14.+15.)	– 146.6	– 151.7	– 83.5	– 74.0	– 64.0	– 64.0
17.	Reserves of special funds for 14.	112.2	100.2	83.1	.	.	.
18.	Borrowing authorisation remaining thereafter	.	99.9	91.4	65.0	37.0	6.0
19.	Central government assets in pension reserves and civil servants' pension fund[8]	28.1	.	.	.	.	.
20.	Level of general reserves	48.2	48.2	7.7	–	–	–
21.	Balance on control account	47.7	47.7	47.7	47.7	47.7	47.7
22.	Total outstanding repayment amount including Armed Forces Special Fund (from 10. and 15.)	263.4	379.3	387.8	414	442	473
23.	Total outstanding repayment amount from NGEU transfers[e,9]	14	36	54	71	89	107

* Sources: Federal Ministry of Finance and Bundesbank calculations. For methodological notes, see Deutsche Bundesbank (2016). **1** Excluding transfers to/withdrawals from reserves and including net tax revenue (see footnote 3). **2** Excluding coin seigniorage. **3** After deduction of supplementary central government transfers, shares of energy tax revenue, compensation under the 2009 reform of motor vehicle tax and budgetary recovery assistance to federal states. **4** For 2021 provisional settlement, for 2022 according to budget plan, for the following years according to fiscal plan. **5** Based on gross domestic product (GDP) in the year before the (comprehensive) budget is prepared. **6** Budgeted figures for 2022 from borrowing plan, for 2023 ff. from Bundestags-Drucksache 20/3100. **7** Armed Forces Special Fund. Figures from 2024: estimated amount required to fulfil the NATO agreement of expenditure amounting to 2% of GDP. **8** Market values according to central government balance sheet for 2021. Continuous inflows; withdrawals from the fund planned from 2030, from reserves from 2032. **9** Actual NGEU figure for 2021 as well as budgeted figures and estimates, each multiplied by Germany's share of 25½% in EU gross national income.

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year). The government is expecting higher burdens primarily from discounts, but also from inflation-indexed Federal securities.[4]

– Almost €10 billion is attributable to claims from guarantees, with guarantees relating to the gas supply accounting for a particularly large share.

– A global additional expenditure item of €6 billion is available for any further needs arising from the pandemic or the war in Ukraine. This is offset by a global expenditure cut, which is to be achieved by budget outturn at the latest. However, it seems realistic that the government will succeed in making the estimated savings.

… given larger budgetary risks

Nonetheless, there are also considerable budgetary risks at play. These are mainly due to potential energy shortages. The government and the opposition are already discussing further support measures that would require additional funds. The provisions made in the draft budget are therefore understandable. There are also risks in view of pending decisions by the Federal Constitutional Court. In addition to the matter of the emergency loans, the court is also examining the solidarity surcharge. It is possible that the Federal Government will have to find other means of funding its plans.

Fiscal plan up to 2026 and further outlook

Fiscal plan up to 2026 tightly calculated: significant risks on both the revenue and expenditure sides

In the medium-term fiscal plan up to 2026, too, the government intends to comply with the standard limit under the debt brake. That said, the budget seems to have been set rather tight. This concerns, in the first instance, global revenue shortfalls. It appears that insufficient provisions have been made in this area to compensate for bracket creep.[5] Furthermore, the fiscal plan includes the Bundesbank's annual profit distribution (€2½ billion). As things currently stand, though, the Bundesbank is not expected to make any such transfers for some time (see p. 64). Increased spending is essentially only planned in the departmental budget of the Ministry of Labour and Social Affairs. These increases primarily reflect higher grants to the statutory pension insurance scheme. For the other government departments, total expenditure has largely been frozen. In an environment of initially steeply rising prices, this ultimately means that real expenditure will decline considerably. However, there is considerable scope for expenditure in central government's off-budget entities.

Central government's financial situation significantly more challenging after 2026

Central government's financial situation is set to be significantly more challenging in the years following the medium-term fiscal plan. For example, considerable additional burdens will arise over the longer term if the government implements its pension policy plans (see p. 74). Furthermore, the repayment obligations for emergency loans taken out between 2020 and 2022 will apply from 2028 onwards. Repayments of European debt from the Next Generation EU (NGEU) programme will also be due then (see the table on p. 69). Taken in isolation, this will result in higher central government transfers to the EU budget. Including the Armed Forces Special Fund, repayment obligations will amount to €19 billion per year over a period of 31 years as from 2028. This will narrow future budgetary leeway accordingly. In addition, the extensive scope of the special funds is expected to expire after 2026 (see below for information on the special funds). If the government subsequently wishes to spend comparable amounts, it will have to finance these in the core budget. If defence spending is to total 2% of GDP, it will have to be over €30 billion higher per year in the core budget. A further €20 billion per year will be needed if the expenditure of the Climate and Transform-

4 For a proposal on how the volatility of interest expenditure could be alleviated by accrual accounting of premia (and discounts) when issuing securities, see Deutsche Bundesbank (2021a).
5 For an estimate of the associated shortfalls at the time of the official tax estimate of May, see Deutsche Bundesbank (2022f), p. 74. The share of the general government shortfalls reported that accrue to central government is around 45%.

ation Fund (formerly the Energy and Climate Fund) is to be stabilised beyond 2026.

Central government's off-budget entities: Q2 2022 and outlook

Considerable surplus overall for central government's off-budget entities in Q2

Central government's off-budget entities recorded a surplus of €6 billion in the second quarter of 2022, following a balanced result at the same time a year earlier.[6] The current surplus was driven by the fund for inflation-indexed securities. Owing to higher inflation, central government made transfers of €4½ billion despite the fund incurring no expenditure. At €1½ billion, the surplus in the Economic Stabilisation Fund was somewhat higher than in the previous year. Enterprises' net repayments of coronavirus assistance loans virtually stagnated in spite of the fact that their profitability had, for the most part, improved. This could be due to the relatively favourable interest rate terms or the fact that enterprises are continuing to hold more liquidity on account of ongoing risks. The Climate Fund, by contrast, posted a deficit of €½ billion.

Broadly balanced result possible for year as a whole

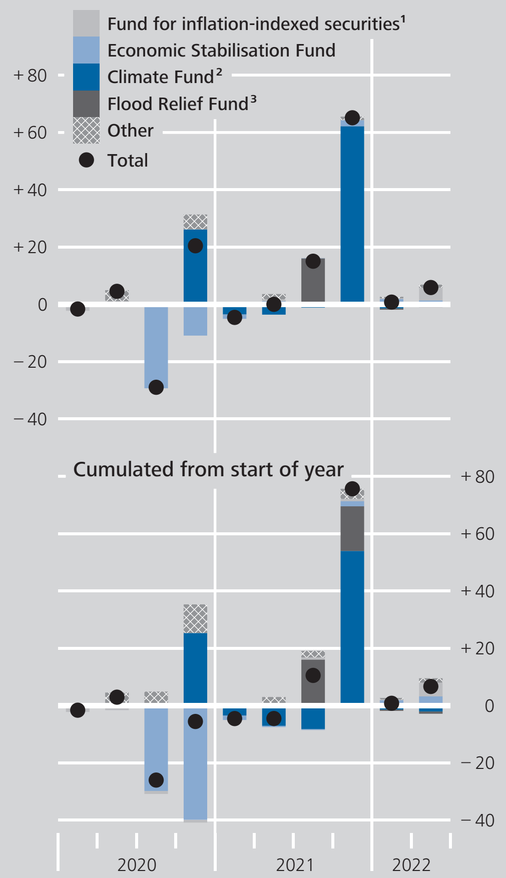
For the year as a whole, the deficits and surpluses of the special funds could be broadly balanced in net terms. The Climate Fund and the 2021 Flood Relief Fund are facing deficits after transfers from central government generated a very high surplus in 2021. By contrast, the Economic Stabilisation Fund and the fund for inflation-indexed securities are likely to generate surpluses for the year as a whole, too. The debt-financed Armed Forces Fund, which was set up in June, is likely to have very limited spending this year. The government intends to use this fund to procure equipment for the Federal Armed Forces. However, such purchases will probably require a longer lead time.

Off-budget entities key drivers of general government deficit in the medium term on account of scope for borrowing and pre-funding

In future, the deficits of the off-budget entities are expected to account for a significant share of general government deficits (see the table on p. 69). Central government has largely used the emergency loans of 2020 and 2021 to pre-finance extensive off-budget entities. A recent addition was the Armed Forces Fund, which has a credit facility of €100 billion. Overall, the special funds shown will have a cumulative scope for deficits of around €200 billion from next year onwards. In addition, the pension re-

Fiscal balances of central government's off-budget entities*

€ billion, quarterly figures



Source: Bundesbank calculations based on data from the Federal Ministry of Finance. * Only entities using a single-entry accounting system, i.e. excluding, in particular, the bad bank FMS Wertmanagement and also SoFFin, which uses a single-entry accounting system and which refinances FMS Wertmanagement. **1** Precautionary fund for final payments of inflation-indexed Federal securities. **2** Climate and Transformation Fund. **3** Relief fund for 2021 flood.

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6 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 FMS Wertmanagement. In return, the direct debt of FMS Wertmanagement, which is attributable to central government, is omitted accordingly. The names of the off-budget entities have been shortened below as follows: Climate and Transformation Fund to Climate Fund; Armed Forces Special Fund to Armed Forces Fund; precautionary fund for final payments of inflation-indexed securities to fund for inflation-indexed securities; and Relief Fund for 2021 Flood to 2021 Flood Relief Fund.

serve and the pension fund have holdings amounting to almost €30 billion. Thus far, the law has made provisions for the longer-term use of these holdings as from the next decade.

Although only moderate deficit initially in net terms next year, …

Next year, the deficit of the off-budget entities is likely to remain well below that of the core budget, however. The Climate Fund is not yet required to grant any subsidies for low-emission electricity. Instead, the large balance from the previous renewable energy (EEG) levy, which is separate from both the Climate Fund and the general government sector, is set to cover this expense. However, extensive aid payments are envisaged, particularly for the purposes of reducing heating energy needs and for e-mobility. This is expected to result in a deficit of €10 billion. A deficit of €3 billion is envisaged in the 2021 Flood Relief Fund for spending on reconstruction aid. Meanwhile, a deficit of €8½ billion is planned for next year in the Armed Forces Fund, matching its level of spending. By contrast, surpluses can be expected in the case of both the special funds for pension provisions and the fund for inflation-indexed securities. In addition, repayments of coronavirus assistance to the Economic Stabilisation Fund should result in a surplus.

… very high deficits in the Climate Fund and Armed Forces Fund thereafter

The deficits of the off-budget entities are set to be significantly higher in the years to come. For example, the Climate Fund will begin granting subsidies in 2024 to compensate for the fact that the EEG levy on the price of electricity has expired. These are initially estimated at €10 billion. As other programme expenditure will also rise, the deficit planned in the Climate Fund will then reach €27 billion and subsequently fall toward €20 billion. If, in addition, the Armed Forces Fund intends to secure NATO defence spending of 2% of GDP, its deficit will have to increase to around €30 billion by 2026. However, there are no medium-term fiscal plans in place for this major off-budget entity or most other off-budget entities. It is crucial that central government increases transparency in this regard.

State government budgets[7]

Core budgets in Q2 2022

High surplus in Q2

The core budgets of the federal states recorded a surplus of €9½ billion in the second quarter of 2022, following a deficit of €1½ billion in spring 2021 when the strain from the coronavirus pandemic was even greater.

Strong tax growth

Revenue saw a steep rise of 9%. This was mainly due to strong tax growth (+12%, or +€9½ billion). Receipts from public administrations remained virtually unchanged. Central government spent less on ongoing coronavirus aid for enterprises but more on regional transport, particularly for the €9 ticket.

Slight decline in expenditure

Expenditure fell slightly (-½%), while current transfers to local government rose by a steep 8% (+€2 billion). In addition, personnel expenditure saw a modest increase (+1½%). In the first quarter, it had risen steeply owing to tax-subsidised one-off payments. Other expenditure either recorded declines (some of which were substantial) or stagnated. North Rhine-Westphalia did not pay the annual grants to its universities until the second quarter. However, on aggregate, spending shortfalls predominated, especially for business aid from central government.

Core and off-budget entities: the year so far and 2022 as a whole

So far, significant improvement in core budgets and off-budget entities this year

The situation of the core budgets and off-budget entities of the federal states as a whole is improving considerably. There was a surplus of €12 billion in the first quarter, representing a €19 billion increase on the previous year. The further strong improvement in core budgets in the second quarter is unlikely to be primarily due to net inflows from off-budget entities. Thus the combined result of the core and off-

7 The quarterly data on state government budgets are based on the monthly cash statistics for the core budgets. Information on the off-budget entities is only available at the end of the following quarter.

budget entities probably also picked up considerably in the spring.

Surplus could increase in 2022 as a whole, but risks could arise given potential energy shortages

For the year as a whole, then, the budget outturn currently stands to be much more favourable than was expected last year (2021: +€½ billion). However, the state government budgets are likely to see more moderate growth in the second half of the year than has been the case to date, with tax revenue growth expected to tail off significantly (see p. 66). Moreover, additional expenditure resulting from higher prices is having a burdening effect. Transfers to local government are likely to gain momentum as the federal states pass on central government funds for the €9 ticket.

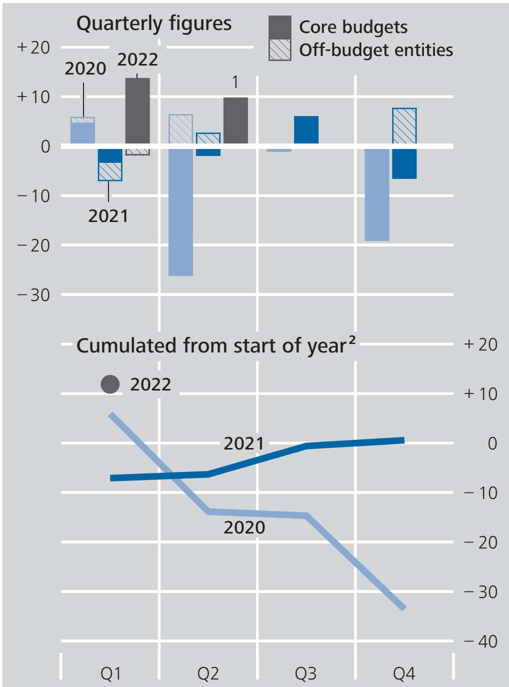
Recourse to debt brake escape clauses

High surplus in first half of the year raises doubts about need for emergency loans

At present, there is nothing to indicate that the coronavirus pandemic this year warrants further exemption from the state government debt brakes. For one, tax revenue is well above the level expected in the last pre-crisis tax estimate for 2022. On the expenditure side, it is central government that is bearing the brunt of the coronavirus-related strains. While national assistance for enterprises and hospitals, for instance, passes through state government budgets, it does not burden them on balance. State governments do have to pay for coronavirus tests in schools, in particular. However, overall, these payments are likely to chiefly affect the first half of the year, which the federal states nonetheless closed very favourably. The individual federal states should therefore carefully consider whether the planned recourse to emergency loans is in fact required.

State government fiscal balance

€ billion



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

Social security funds

Pension insurance scheme

Q2 2022

High quarterly surplus amid steep growth in contribution receipts …

The statutory pension insurance scheme achieved a high surplus of €3 billion in the second quarter of 2022. The financial result thus improved by €3 billion on the previous year. Total revenue increased by just over 4%. At 5½%, contribution receipts continued to rise strongly, bolstered once more by the decline in short-time work. Central government funds grew by only 1%, as they are tied to the weak wage developments of 2020.

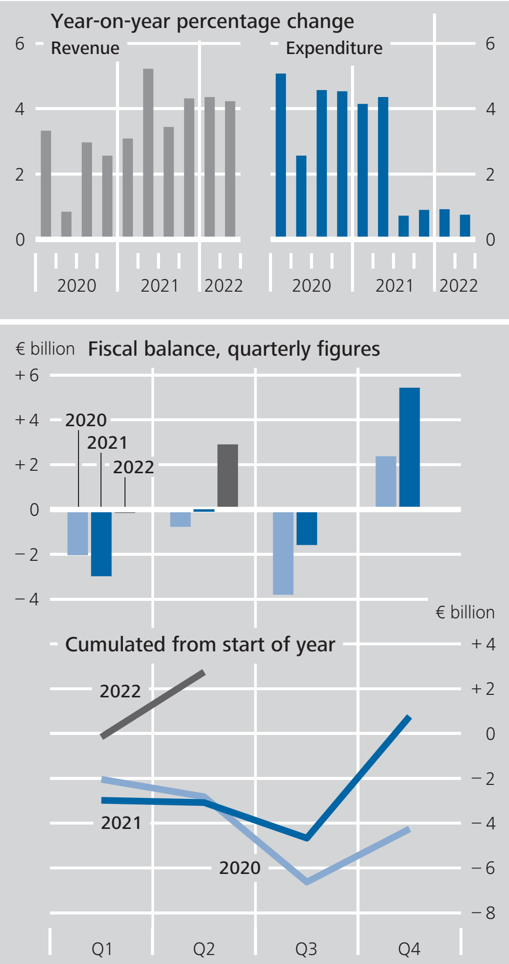
… and relatively low expenditure growth following small pension adjustment in mid-2021

At just under 1%, the increase in expenditure was relatively minimal. This was due to the fact that pensions were not raised in western Germany in mid-2021 (whereas eastern Germany saw a rise of +0.7%). Thus far, it does not appear that (back)payments of the basic pension that was introduced in 2021 or rising pension numbers have had a marked impact.

2022 as a whole

The highly favourable financial developments seen in the first half of the year will not continue over the remainder of the year. Expend-

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

Large pension adjustment accelerates expenditure growth

iture growth in the second half of the year will be much stronger than it has been thus far. First, towards the middle of the year, pensions will rise by a sharp 5½%, averaged across Germany (+5.35% in western Germany and +6.12% in eastern Germany). This reflects the relatively high growth in actual earnings in 2021, which was accelerated by the decline in short-time work, amongst other things. Here, the reactivated catch-up factor dampened the pension adjustment by just over 1 percentage point. This factor is intended to compensate for the fact that the safeguard clause prevented a pension cut in 2021. Second, expenditure on the basic pension is expected to rise. On the revenue side, growth in contribution receipts is currently also likely to be somewhat weaker than before.

Balanced result possible following favourable first half of the year

Overall, the pension insurance scheme could thus close 2022 as a whole with a broadly balanced budget (2021: surplus of almost €1 billion). Yet, there are macroeconomic risks that could weigh on the revenue side.

Medium and long-term outlook

In the medium to long term, demographic developments will put pressure on pension finances

A deficit is projected for 2023 as a result of the strong latest pension increase. In the medium to long term, demographic trends will increasingly weigh on the pension insurance scheme's finances. The Federal Government's plans will further exacerbate funding pressure; it intends to permanently stabilise the pension level at 48% from 2026 onwards and not to raise the statutory retirement age further after 2031. The contribution rate and central government grants would thus have to rise more sharply than already envisaged in the legal status quo.[8]

Federal Employment Agency

Q2 2022

Significantly improved result: budget almost balanced in spring 2022

The Federal Employment Agency reported an almost balanced result for the second quarter of 2022.[9] Back in the spring of 2021, the impact of the coronavirus crisis was still much stronger, resulting in a deficit of €8 billion.

Steep rise in contribution receipts

Revenue rose substantially, by 5½% overall. At 7½%, growth in contribution receipts was stronger still. The decline in short-time work had a far greater impact here than in the pension insurance scheme.

8 For more information on longer-term developments and reform options, see Deutsche Bundesbank (2022g).
9 In the core budget, i.e. excluding the civil servants' pension fund. Transfers to the fund have been suspended since spring 2020 due to the coronavirus crisis.

Expenditure still declining sharply, especially in the case of short-time working benefits

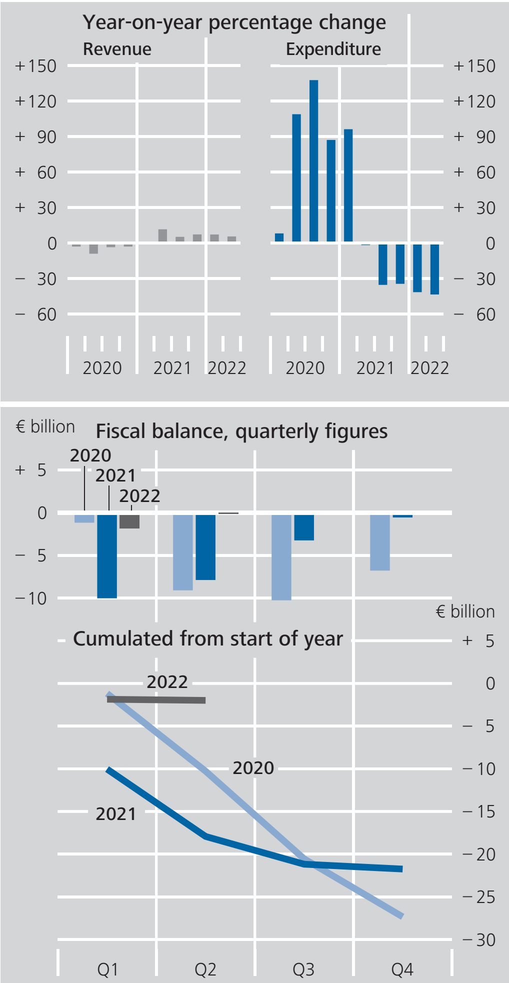
Expenditure continued to decline very sharply on the year (-43%), only slightly exceeding its pre-crisis level of spring 2019 if it is updated to reflect the increase in compensation for employees since then. In a year-on-year comparison, expenditure on unemployment benefits decreased by 19% (-€1 billion), while spending on short-time work fell by as much as 84% (-€6½ billion). Here, the continued recovery of the labour market from the effects of the coronavirus pandemic had an easing effect.

2022 as a whole

Surplus possible for 2022

From the current perspective, the finances of the Federal Employment Agency are expected to improve over the remainder of the year. Spending on short-time working benefits is also set to decline sharply in the second half of 2022, compared with the same period last year. Alongside the decrease in short-time work, the phasing-out of benefits that were previously extended by legislators on account of the pandemic will also provide relief. Expenditure on unemployment benefit I is likely to decline further on the year, too, albeit less sharply than before. As things stand today, the contribution receipts of the Federal Employment Agency should grow significantly. Overall, then, a surplus is possible for the year as a whole, assuming there are no new crisis-related burdens.

Finances of the Federal Employment Agency*



Source: Federal Employment Agency. * Including transfers to the civil servants' pension fund and before payment of central government grants.
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