Stabilitätsrat
Unabhängiger Beirat

Twelfth Statement

regarding compliance with the upper limit to the structural general government budget deficit

pursuant to Section 51 (2) of the Budgetary Principles Act (HGrG)

9 December 2019

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1. Summary and assessment

The federal government's autumn projection on macroeconomic development appears to be plausible and only differs marginally from the projections made by other institutions. According to the projection, the business cycle is expected to be weak in the present and coming year. Nevertheless, economic growth will accelerate in the year 2020 due to a considerably higher number of working days. In the course of next year, growth is expected to remain constant at just over 1%. As in the past, risks relating to the projection may arise from the international context. Trade conflicts are still smouldering and could escalate further any time; moreover, the Brexit issue remains unresolved. In contrast, the domestic economy still appears to be robust. **The assessment of potential output is plausible and is within the spectrum of calculations by other institutions.** Evidently, potential growth will weaken as of the year 2022, primarily due to demographic trends. From the current year, the economy is assessed as having a roughly normal level of capacity utilisation.

The Advisory Board considers the projection by the Federal Ministry of Finance (MoF) for the general government budget balance to be acceptable. It is within the spectrum of forecasts by other institutions. On the other hand, the **Advisory Board perceives uncertainties looming in both directions. For one thing, they concern the macroeconomic environment,** including the assessment of cyclical impacts on public finances **and, for another, future fiscal policy**. As far as fiscal policy is concerned, the **expansionary course of spending** is assumed to prevail until 2021. An argument in favour of lower expenditure on the one hand could be that the past expenditure estimates frequently were not fully exploited, such as interest expenditure, payments to the EU, investments or labour market-related spending. On the other, estimates of individual items appear to be rather restrained. This applies to expenditure on defence and development aid, in the context of which international agreements indicate substantially higher growth rates. Moreover, substantial wage (and, hence, cost) increases are on the horizon with regard to expenditure on nursing care. Current resolutions, such as on the basic government pension agreed, are not yet included in the projection. On the **income side**, relief provided by company pensions and reduced contributions to unemployment insurance have not yet been taken into account. Moreover, there are risks regarding the constitutionality of the “solidarity” surcharge. **Furthermore, climate policy will entail fiscal risks.**

There is some uncertainty regarding the discussion surrounding an additional, extensive cyclical stimulus package. From the Advisory Board’s perspective, against the backdrop of largely unanimously expected normal economic capacity utilisation, active cyclical stimulus measures are currently not necessary. **Both the federal budget as well as the general government budget are already expansionary and additionally support economic development through automatic stabilisers.** The latter are not restricted, which is in harmony with European and national budget rules and regulations aimed at structural balances adjusted for cyclical factors. **In particular,** due to the adjustment for cyclical factors, **compliance with the upper limit of the structural general government budget deficit** in accordance with Section 51 (2) of the Budgetary Principles Act (HGrG) **will basically not call for a procyclical adjustment to fiscal policy if cyclical development turns out to be less favourable.**

To some extent, the impression has recently emerged in the course of public discussion that Germany’s fiscal policy seems to be lagging behind in combating cyclical weakness. From the Advisory Board’s point of view, the partly obscure information on the federal budget and public finances is likely to have contributed to this wrong impression. **The Advisory Board therefore believes it is important, *inter alia*, to increase the level of transparency with regard to planning activities on the federal budget**. In this respect, the unadjusted budget balance of the federal government budget including its extra-budgetary funds should be specified. In addition, the level and derivation of the structural budget balance should be communicated plausibly and consistently over time. The change to the structural budget balance reflects the underlying fiscal stance, whereas the achievement of a “black zero” in a number of years may conceal a structural surplus and, in other years, a structural deficit.

As far as social security funds are concerned, the Advisory Board points out that in the event of fundamental adjustments, the long-term impacts in their interaction with demographic trends must be taken into account. At present, the financial situation of social security funds is considered to be positive. During the projection period, however, an increase in contributions to social security is already assumed, while the balances will deteriorate substantially. Policymakers should show how they plan to secure the level of financial sustainability in view of the forthcoming demographic burdens. It should be documented within the scope of long-term projections how any additional strains are to be offset.

On the whole, the Advisory Board considers the fiscal estimate submitted to the Stability Council and macroeconomic development assumed for the period until the year 2023 to be acceptable. The upper limit for the structural deficit equivalent to 0.5% of gross domestic product will thus be met by a safety margin.

2. Preliminary notes

The Advisory Board supports the Stability Council in monitoring compliance with the upper limit of the structural general government budget deficit pursuant to Section 51 (2) of the Budgetary Principles Act (HGrG). To this end, the Advisory Board issues a statement on the question of compliance with this upper limit prior to the relevant resolution being adopted by the Stability Council. The statements by the Advisory Board are published and intended to contribute towards identifying budgetary risks at an early stage.

The present statement extends to include the following public information, among other sources:

- the assessments of the Stability Council Working Group of 21 November 2019;
- the updated estimate by the MoF of November 2019 (updated fiscal projection; *inter alia*, taking account of the autumn projection by the federal government and the tax estimate of October 2019), the fiscal projection by the MoF for the German Draft Budgetary Plan 2020 (of October 2019), based on the spring projection by the federal government of April 2019 as well as the German Stability Programme 2019;
- the autumn projection by the federal government on macroeconomic development of 17 October 2019 and the assessment on which it is based, by the Working Group on Tax Estimates of 28 to 30 October 2019;
- the projections by the European Commission (November 2019), by the Joint Economic Forecast (October 2019), by the German Council of Economic Experts (GCEE; November 2019), by the International Monetary Fund (IMF; October 2019), and by the Organisation for Economic Co-operation and Development (OECD, November 2019);
- the statement as part of the Joint Economic Forecast on the autumn projection 2019 by the federal government;
- the budgetary outcomes according to the national accounts and in delineation from the Maastricht Treaty as well as according to the financial statistics of November 2019.

Additional background information was provided by the MoF and the Central Data Office of the State Finance Ministers for internal use by the Advisory Board, which was taken into account in the qualitative analysis.

The Stability Council Working Group submitted a consultancy document to the Stability Council. Except as otherwise indicated, in its assessment of the Stability Council's basis for decision-making the Advisory Board refers to this document, to the autumn projection by the federal government on macroeconomic development and to the updated fiscal projection. In doing so, the Advisory Board relies on developments in delineation from the European System of National Accounts (ESA 2010) and the key Maastricht figures in the absence of any other delineation indicated.

3. Recommendations at European level

In June 2019, the European Commission assessed the German Stability Programme of April 2019.[1] It expected Germany to comply with the medium-term objective of a structural budget deficit of no more than 0.5% of GDP in the years 2019 and 2020. The European Commission forecast structural budget surpluses of 1.1% and 0.8% of GDP in 2019 and 2020, respectively. In addition, it confirmed that the rules and regulations on the debt-to-GDP ratio were presumed to be complied with. According to the German Stability Programme, the debt-to-GDP ratio will decline below the reference value of 60% in 2019 and continue to decrease to 51¼% by the year 2023.

In July 2019, the Council of the European Union (EU) shared this assessment, confirming that Germany will most probably remain in compliance with the aim of a maximum structural budget deficit of 0.5% of GDP in the medium term.[2]

The European Commission confirmed its assessment in November 2019 on the basis of updated budgetary planning figures of the federal government (German Draft Budgetary Plan 2020 of October).[3] At present, the European Commission perceives a structural budget surplus for the year 2019 amounting to 1.1% of GDP and a decline to 0.7% of GDP in the year 2020. Accordingly, the debt-to-GDP ratio will decline to 59.2% in 2019.

4. On the macroeconomic projection by the federal government

a) On macroeconomic development

Brief description of the projection by the federal government[4]

In its autumn projection, the federal government anticipates a relatively weak cyclical development for the current and for the coming year. However, in 2020 growth will be supported by a higher number of working days. In 2021, growth is expected to be in the order of potential growth. Evidently, due to the cyclical weakness, price-adjusted GDP in the current year, at 0.5%, is rising at a significantly lower rate than in the previous year (1.5 %, cf. Overview 1). Whereas the cyclical momentum will remain low in 2020, economic output is expected to rise more sharply again at approx. 1.0%, especially due to a higher number of working days. For the year 2021, the government anticipates an increase in economic output of 1.3% and 1.1% in the medium term (2022 to 2024).

According to the autumn projection, macroeconomic expansion will be impeded this year and next year especially due to the weak level of exports. In view of robust domestic demand, imports will rise sharply, resulting in a substantially lower contribution by net exports in arithmetical terms. This means that the change in the contribution made by net exports will constitute a negative

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[1] See COM (2019) 505 final dated 5 June 2019.

[2] Cf. reasons for consideration (6) and (23) in European Council recommendation of 9 July 2019 on the 2019 National Reform Programme and delivering a Council opinion on the 2019 Stability Programme of Germany (2019/C 301/05).

[3] See SWD (2019) 913 final dated 20 November 2019.

[4] Also see Project Group Joint Economic Forecast (2019): "Stellungnahme der Projektgruppe Gemeinschaftsdiagnose zur Herbstprojektion 2019 der Bundesregierung" (Statement by the Project Group Joint Economic Forecast on the 2019 autumn projection by the federal government), Berlin.

growth factor. The rate of change in capital investment is likewise forecast as comparatively subdued. In contrast, the rate of expansion in private consumer spending and investment in construction will be higher year-on-year.

For consumer prices (deflator of private consumption) an increase of 1.4% is expected this year and of 1.5% in each of the following two years. The GDP deflator will rise considerably more sharply in these years. The main reasons for this are price increases for construction services and higher public-sector consumption, in addition to terms-of-trade effects. In the medium-term projection, an increase of 1.7% annually is expected for consumer prices and the GDP deflator, slightly less than in the spring projection. Nominal GDP will therefore grow by 2.8% in 2019, by 2.9% in the year 2020 and by 3.1% in 2021.

According to the estimate by the federal government, employment growth will slow down significantly during the projection period. Nevertheless, initially employment will grow despite bleaker cyclical development. A slight decline is anticipated as of the year 2022. The unemployment rate according to ILO (cf. Overview 1) reflects an increase in the projection from currently 2.9% to 3.5%. As far as labour productivity is concerned, a decline is assumed for the year 2019. Labour productivity will surge again in the coming years, with growth stabilising at 1.3% in the medium term. According to the projection, growth in gross wages and salaries is still relatively robust at 4.1% and will decline to just under 3% in the medium term. The decisive factor in this respect is the slight decline in employment expected to occur at that stage. For effective wages (gross wages and salaries per employee), growth rates in the order of approx. 3% are anticipated across the entire projection period.

Assessment

On the whole, the federal government's autumn projection appears to be plausible. It only differs marginally from the projections of other institutions (cf. Overview 1). For the year 2020, the federal government shares the view of other institutions, expecting slightly less dynamic private consumer spending than in 2019.[5]

Risks to the projection arise in particular from the international environment. Trade conflicts are still smouldering and can escalate at any time. The Brexit issue still remains unresolved. The short-term risks arising in the process should not be underestimated. In the event of a hard Brexit, the institutions assume that growth will turn out approx. 0.4 percentage points lower in the coming year. In contrast, the domestic economy appears to be rather robust.

[5] According to the Joint Economic Forecast, the momentum will remain unchanged. On the other hand, its views were still based on assumptions of a robust pension adjustment in 2020 and a weaker pension adjustment in 2021. Meanwhile, the strong pension adjustment has been smoothened by legislation owing to the pension adjustment mechanics used. Disposable private household incomes will temporarily reflect a correspondingly weaker development.

Overview 1: Current[1] projections of macroeconomic development

Year-on-year percentage change (unless otherwise stated)	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**
1. Federal government (October 2019)							
1aa. GDP, price-adjusted	1.5	0.5	1.0	1.3	1.1	1.1	1.1
1ab. GDP deflator	1.5	2.3	1.9	1.8	1.7	1.7	1.7
1ba. Private consumption, price-adjusted	1.3	1.4	1.2	1.3	1.2	1.2	1.2
1bb. Private consumption, deflator	1.5	1.4	1.5	1.5	1.7	1.7	1.7
1c. Gross wages and salaries per employee[2]	3.2	3.0	2.7	2.7	3.0	3.0	3.0
1d. Employees	1.6	1.1	0.4	0.5	-0.2	-0.2	-0.2
1e. Unemployment rate in % (acc. to ILO[3])	3.2	2.9	3.0	2.9	3.2	3.4	3.5
1f. Short-term interest rates in % (technical assumption)	0.00	0.00[4]	0.00[4]				
2. European Commission (November 2019)							
2aa. GDP, price-adjusted	1.5	0.4	1.0	1.0			
2ab. GDP deflator	1.5	2.0	2.0	1.7			
2ba. Private consumption, price-adjusted	1.3	1.3	1.1	1.1			
2bb. Private consumption, deflator	1.5	1.2	1.2	1.4			
2c. Compensation of employees per head[2]	2.9	3.3	2.5	2.5			
2d. Total employment	1.4	0.8	0.1	0.2			
2e. Unemployment rate	3.4	3.2	3.4	3.5			
3. Joint Economic Forecast (October 2019)							
3aa. GDP, price-adjusted	1.5	0.5	1.1	1.4	1.3	1.3	1.2
3ab. GDP deflator	1.5	2.1	1.8	1.7	1.5	1.4	1.3
4. GCEE (November 2019)							
4aa. GDP, price-adjusted	1.5	0.5	0.9				
4ab. GDP deflator	1.5	2.1	2.0				
5. Deutsche Bundesbank[5]							
5aa. GDP, price-adjusted							
5ab. GDP deflator							
6. IMF (October 2019)							
6aa. GDP, price-adjusted	1.5	0.5	1.2	1.4	1.3	1.2	1.2
6ab. GDP deflator	1.5	2.3	2.0	2.0	1.8	2.1	2.1
7. OECD (November 2019)							
7aa. GDP, price-adjusted	1.5	0.5	0.8	0.9			
7ab. GDP deflator	1.5	1.9	1.9	1.9			

1) The projections published in the past three months are reflected in this statement. – **2)** Values at current prices. – **3)** International Labour Organization – **4)** Values according to the German Draft Budgetary Plan 2020. According to the MoF, the values for the years 2019 and 2020 from the Stability Programme of April 2019 were used. – **5)** The December projection by Deutsche Bundesbank will only be published after this statement has been finalised.

b) On the potential output and the output gap

Brief description of the projection by the federal government

For the current and the coming year, the federal government anticipates potential growth of 1.4% and 1.5%, respectively (cf. Overview 2). In the further course of time, declining growth is forecast until the year 2024 and is then expected to amount to as little as 0.9%. A decisive factor in this regard is that the dynamics in the potential volume of labour will decline substantially in the course of time. This is primarily due to demographic trends. It is assumed in this context that migration will decline: net migration will decrease step by step from 364,000 persons in 2019 to 251,000 persons in the year 2024. Despite a positive level of net migration, the population trend will have a negative impact on medium-term growth prospects. The decline in the potential labour force in the projection is offset by slightly higher productivity on the whole. **The potential rates projected by the federal government correspond more or less to those of the spring projection.**

The federal government has identified a substantial overutilisation for last year (output gap: +1.3%). In the current year, it assumes that this overutilisation will be reduced but will still remain in positive territory (+0.4%). In view of weaker cyclical development anticipated for the year 2020, a slight underutilisation has been forecast; this is also expected for the further planning period.

Assessment

On the whole, the potential rates and output gaps are within the spectrum of calculations by other institutions (cf. Overview 2). The European Commission expects a sharper underutilisation (-0.6%) for the year 2021, due above all to the less favourable estimate of GDP growth.

Overview 2: Current estimates of growth of potential output[1)] and the output gap

Year-on-year percentage change (unless otherwise stated)	2018	2019	2020	2021	2022	2023	2024
1. Federal government (October 2019)							
1a. Potential output	1.5	1.4	1.5	1.5	1.2	1.0	0.9
1b. Output gap (in % of the potential)	1.3	0.4	-0.1	-0.2	-0.3	-0.2	0.0
1bb. Output gap (in € billion)[2)]	43.5	12.2	-2.5	-8.8	-11.5	-8.3	0.0
2. European Commission (November 2019)							
2a. Potential output	1.5	1.4	1.4	1.4			
2b. Output gap (in % of the potential)	1.2	0.2	-0.2	-0.6			
3. Joint Economic Forecast (October 2019)							
3a. Potential output	1.6	1.5	1.5	1.4	1.3	1.2	1.1
3b. Output gap (in % of the potential)	1.1	0.1	-0.2	-0.2	-0.2	-0.1	0.0
3c. Potential output according to MODEM	1.6	1.5	1.4	1.3	1.2	0.9	0.8
4. GCEE (November 2019)							
4a. Potential output	1.5	1.5	1.4	1.4	1.2	1.2	1.1
4b. Output gap (in % of the potential)	1.6	0.6	0.1				
5. Deutsche Bundesbank[3)]							
5a. Potential output							
5b. Output gap (in % of the potential)							
6. IMF (October 2019)							
6a. Potential output	1.3	1.3	1.6	1.4	1.4	1.3	1.2
6b. Output gap (in % of the potential)	1.1	0.4	0.1	0.1	0.1	0.0	0.0
7. OECD (November 2019)							
7a. Potential output	1.5	1.4	1.3	1.3			
7b. Output gap (in % of the potential)[4)]	1.3	0.5	0.0	-0.4			

1) price-adjusted. – **2)** In relation to nominal GDP. – **3)** The December Forecast by Deutsche Bundesbank will only be released after this statement has been finalised. – **4)** Own calculations based on Economic Outlook No. 106 of the OECD.

5. On the fiscal estimate by the Federal Ministry of Finance

a) On the fiscal estimate (excl. adjustment for temporary and cyclical effects)

Description of the estimate by the Federal Ministry of Finance

The MoF estimates that the general government budget surplus will decline in the current year to 1½% of GDP and will vanish completely by the year 2021. Following a sideways movement in the year 2022, in 2023 it will rise again to ½% of GDP (cf. Overview 3). This assessment is based on the macroeconomic assumptions by the federal government and the official tax estimate of October 2019. The following have been taken into account: the federal budgetary plan for 2020, additional draft legislation on the 2030 Climate Protection Programme as well as budgetary planning of the federal government for the years 2021 to 2023, as of the summer of 2019. Various new agreements between the ruling parties in the federal government have not been included as yet. These are estimated as additional budget burdens of 0.1% to 0.2% of GDP (including a compromise on the basic government pension, a reduction of the Federal Employment Agency contribution rate, and a statutory health insurance fund allowance for company pensions). For payments to the EU, a substantial increase is assumed in the budgetary plan, taking account *inter alia* of additional expenditure due to the United Kingdom no longer being available as a contribution payer. For the EU's new medium-term fiscal governance framework, the past upper limit of 1% of GDP is still assumed to apply.[6]

The decline in the surplus is, above all, a consequence of the projected fiscal easing. In contrast, interest expenditure will mean relief for public-sector budgets. According to the MoF, the ratio of interest expenditure to GDP will decline in the current and next year. It will then remain unchanged in the further course of time. It was probably assumed in this regard that interest rates would increase discernibly once again; if this is not the case, then the ratio would remain in decline. According to the projection, other expenditure (primary expenditure) will rise considerably in the current and next year, outstripping both GDP and potential output growth. In addition to social expenditure, in particular this concerns investments and subsidies – the latter probably above all due to higher expenditure on account of the Climate Protection Programme. In contrast, the tax ratio will hardly change at all. While the partial repeal of the solidarity surcharge as of the year 2021 will constitute a burden on public finances, at the same time the non-compensated proportions of the tax progression, the newly introduced emission certificates and rising contribution rates to social security funds will generate additional income on the whole. The development of public sales, in particular those yielding fee income, is assumed to be weak in the course of time, without any explanations being provided. The fact that the surplus will rise again in 2023 is solely attributable to the federal government and probably reflects tax progression effects to a minor degree and, above all, the partly stagnating expenditure on past budgetary planning by the federal government.

The surpluses are declining at all levels. For the federal government, a noticeable deficit will even occur at times. The German states are the only level for which a surplus is expected in all years. **Unlike**

[6] For the year 2020, the federal government has assumed that payments relating to EU funds will rise to approx. EUR 38 billion. By the year 2023, an increase to EUR 43 billion is assumed.

the MoF, for their core budgets (financial statistics), the German states assume that the surpluses will decrease considerably faster. While the revenue estimates are similar, the German states evidently plan to raise their expenditure significantly next year, particularly in favour of their municipalities. The exact meaning of these different estimates for the national accounts balance cannot be derived from the available documents. Amongst other things, the deviation depends on the extent to which the German states believe that the local government bodies will actually spend the higher allocations. **For social security funds, surpluses are forecast to decrease in the projection period as a whole.**

Compared to the projection for the meeting of the Stability Council in June 2019, the surplus in the current year is noticeably higher and will turn out somewhat lower in the following years (2020 to 2022). A positive impact on the balance is attributable to the revised national accounts of summer, indicating a small positive base effect for the years as of 2019 (which will grow weaker, however, as of 2021). A weightier effect is that intra-year development in 2019 has proceeded more favourably than had been forecast by the MoF in the spring. In the years to come, this will not continue any further, not least because the assessment of macroeconomic development for the year 2020 has been lowered considerably. The Climate Protection Programme hardly reflects a burden for the balance. The reason for this is that full funding is planned; in particular, CO_2 pricing in the fields of transport and heating for buildings starting in the year 2021. The additional expenditure is then largely to be funded by resulting revenue collected in the process.

Overview 3: Current projections of the budget balance[1)]

In % of GDP	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
1. Stability Council (November 2019)	1.9	1½	½	0	0	½
1a. Draft Budgetary Plan 2020 (October 2019)	*1.9*	*1¼*	*¾*	*¼*	*¼*	*½*
1b. Update (September 2019)	*1.9*	*1¼*	*¾*	*¼*	*¼*	*½*
1c. Calculatory update (May 2019)	*1.7*	*1*	*¾*	*¼*	*¼*	*½*
1d. Stability Programme 2019 (April 2019)	*1.7*	*¾*	*¾*	*½*	*½*	*½*
1e. Stability Council (December 2018)	*1¾*	*1*	*¾*	*½*	*½*	
2. European Commission (November 2019)	1.9	1.2	0.6	0.2		
3. Joint Economic Forecast (October 2019)	1.9	1.5	0.6	0.1		
4. GCEE (November 2019)	1.9	1.4	0.5			
5. Deutsche Bundesbank[2)]						
6. IMF (October 2019)	1.9	1.1	1.0	0.7	0.8	1.0
7. OECD (November 2019)	1.9	1.0	0.3	-0,2		

1) The values under 1.-1e. for the projection years as of 2019 are rounded to quarter percentage points. **– 2)** The December Forecast by Deutsche Bundesbank will only be released after this statement has been finalised.

According to the MoF projection, the debt-to-GDP ratio will continue to fall. The 60% mark may be undercut in the current year. The ratio is expected to fall continually – to 54% by the year 2023. Contributions to the decline will stem from the primary surpluses of central, state and local authorities (surplus excl. interest expenditure) as well as from the negative interest growth differential (difference of the average rate of interest paid for serving accumulated debt and nominal GDP growth). Moreover, the portfolios of the "Bad Banks" will be reduced in the course of time.

Overview 4: Means derived from the limits of the bandwidths estimated by the Federal Ministry of Finance1)

In € billion	2018	2019	2020	2021	2022	2023
1. General government budget balance	62.4	53	19½	1½	3	17
of which:						
1a. Central government	20.1	16	-6	-13½	-6½	11
1b. State governments	12.8	18	13½	8½	8½	7
1c. Local governments	13.7	9	6½	4½	1	0
1d. Social security funds	15.9	10	5½	2	0	-1

1) Includes the mean values from the estimate bandwidths according to the "Derivation of the general government budget balance of the public sector ("Maastricht budget balance") from the budget balance of the whole of Government Accounts" of 20 November 2019.

b) On the derivation of the structural general government budget balance

Description of the estimate by the Federal Ministry of Finance

In the projection by the MoF, the expansionary fiscal stance will lead to a substantial decline in the structural surplus, especially as of the year 2020. A sideways movement in the current year (2018: 1.3% of GDP, 2019: 1¼% of GDP), will be followed in the year 2020 by a sharper reduction to ½% of GDP. After that, the structural budget balance will remain within a bandwidth of ¼% to ½% of GDP.

Overview 5: Current projections of the structural budget balance1)

In % of GDP or potential output	2018	2019	2020	2021	2022	2023
1. Stability Council (November 2019)	1.3	1¼	½	¼	¼	½
1a. Draft Budgetary Plan 2020 (October 2019)	*1.5*	*1¼*	*½*	*¼*	*¼*	*½*
1b. Update (September 2019)	*1.5*	*1¼*	*½*	*¼*	*¼*	*½*
1c. Stability Council (June 2019)	*1.3*2)	*¾*	*½*	*¼*	*¼*	*½*
1d. Stability Programme 2019 (April 2019)	*1.4*	*¾*	*½*	*½*	*¼*	*½*
1e. Stability Council (December 2018)	*1¾*	*½*	*½*	*¼*	*½*	
2. European Commission (November 2019)	1.4	1.1	0.7	0.5		
3. Joint Economic Forecast (October 2019)	1.1	1.3	0.6	0.0		
4. GCEE (November 2019)	1.3	0.8	0.2			
5. Deutsche Bundesbank2)						
6. IMF (October 2019)	1.4	0.9	1.0	0.7	0.7	1.0
7. OECD (November 2019)3)	1.3	0.7	0.4	0.0		

1) The values under 1.-1e. for the projection years as of 2019 are rounded to quarter percentage points. **– 2)** The December Forecast by Deutsche Bundesbank will only be released after this statement has been finalised. **– 3)** The OECD refers to the budget balances adjusted according to its method for cyclical and one-off effects as "underlying balances".

The unchanged structural budget surplus in the current year shows that the **decline in the unadjusted surplus is attributable to the cyclical cool-down**. Last year the favourable cyclical climate was still decisive for a discernible proportion of the surplus. According to the MoF, this positive factor will largely be reduced in the current year and will therefore lower the surplus. In this context, the cyclical adjustment applied in the EU is likely to overrate the burden on public finances by the current cyclical weakness driven by external factors. The burden on public budgets is likely to be comparatively low, because even though real GDP growth is weak, development in the domestic sector continues to be rather stable. **From the year 2020, according to the MoF cyclical effects will hardly have any influence on public finances as it is assumed that the economy as a whole will move sideways in the event of normal capacity utilisation.** In the coming year, however, public finances will benefit from positive calendar effects, raising the number of working days appreciably.[7] On the whole, though, one-off and temporary measures only play a minor role. Public finances will be slightly relieved in the current year due to the elimination of temporary burdens caused by support measures for HSH Nordbank in the year 2018.

Compared to the estimate of June 2019, the structural budget surplus is appreciably higher. However, in the year 2020 this will be compensated by markedly less favourable development, and the prospects will remain unchanged in the further course of time. In this respect, the cyclical effect on the level of the budget balance in the years 2018 and 2019 was adjusted slightly upwards and, in the years 2020 to 2023, slightly downwards.

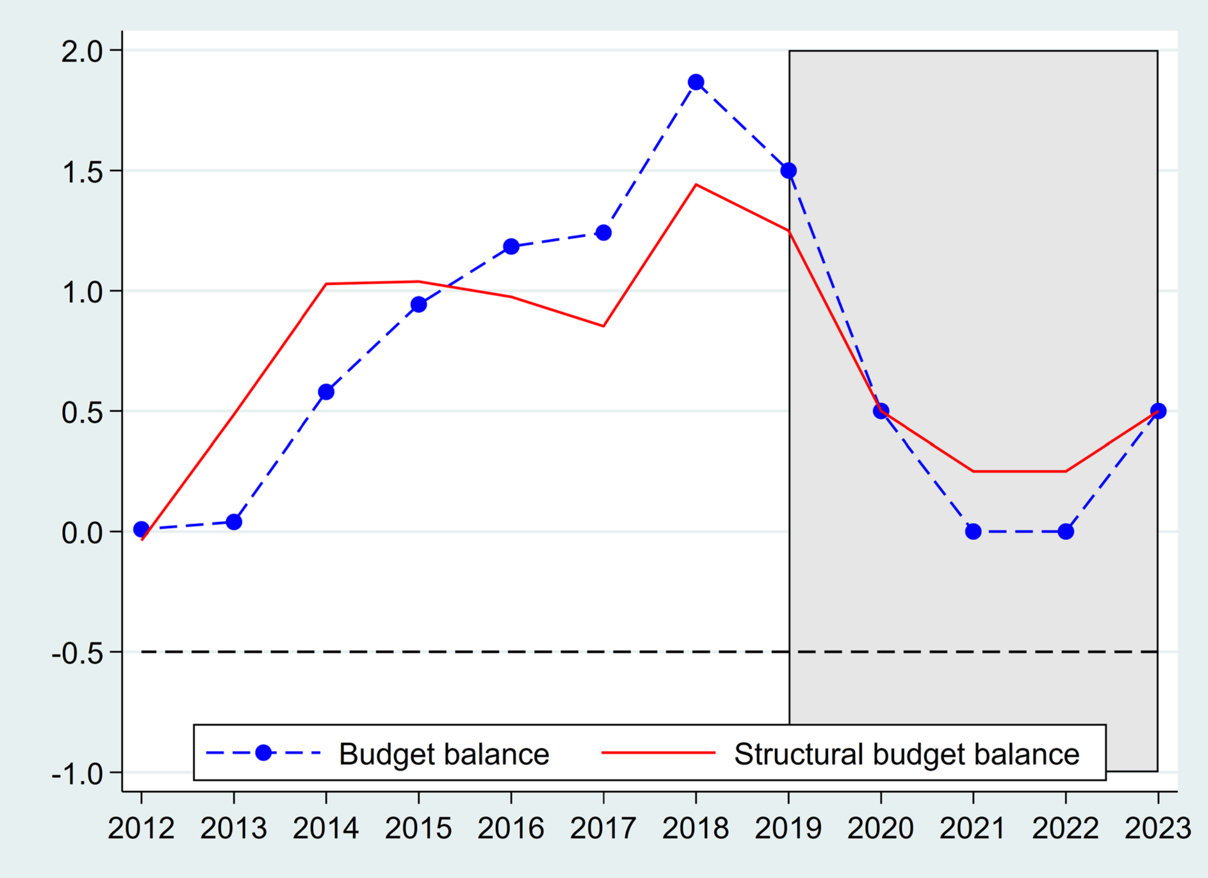
Overview 6: Components of the structural budget balance[1,2)]

In % of GDP	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
1. General government budget balance	1.9	1½	½	0	0	½
2. Cyclical component	0.7	0.2	0.0	-0.1	-0.2	-0.1
3.a in € billion[2)]	21.9	6.1	-1.3	-4.4	-5.8	-4.2
3. Cyclically adjusted balance[4)]	1.2	1¼	½	¼	¼	½
4. One-off and temporary measures	-0.1	0	0	0	0	0
5. Structural budget balance[5)]	1.3	1¼	½	¼	¼	½
6. Cyclically adjusted primary balance[7)]	2.2	2¼	1¼	¾	1	1¼
7. Output gap	*1.3*	*0.4*	*-0.1*	*-0.2*	*-0.3*	*-0.2*

1) The values for the balances are rounded to a quarter per cent for the projection years starting in 2019. The cyclical component and the output gap are rounded to one digit after the decimal point. – **2)** The figures presented are based on the projection in the resolution proposal for the meeting of the Stability Council on 13 December 2019, the autumn projection by the federal government on macroeconomic development of 17 October 2019, as well as calculations by the Advisory Board.**– 3)** The cyclical component is calculated by multiplying the output gap (in € billion) with the budget semi-elasticity for the general government (0.504). **– 4)** Difference arising from the budget balance and the cyclical component**. – 5)** Cyclically adjusted balance less one-off and temporary measures – **6)** Cyclically adjusted balance plus interest expenditure in % of GDP.

[7] The real GDP growth rate in the year 2020 will be up by 0.4 percentage points in relation to 2019 due to the higher number of working days. As part of the EU's cyclical adjustment procedure, this calendar effect will increase the cyclical component. (Cf. in detail: Advisory Board, spring statement 2019, p. 10.)

Fig. 1: Development of budget balance and structural budget balance[1)]



1) Values as of the year 2019 are rounded to a quarter per cent. **– 2)** The solid line reflects the development of the structural budget balance in % of GDP or potential output (cf. Overviews 3 and 5). The dotted line shows the unadjusted budget balance in % of GDP. For the years until 2018, the values reflect the current figures of the European Commission. The figures as of 2019 were derived from the current projection by the MoF.

c) Assessment

The Advisory Board considers the projection by the MoF acceptable, both for the unadjusted as well as for the structural general government budget balance. Thus, the upper limit for the structural deficit of 0.5% of GDP according to the current fiscal stance will be met in the medium term with a safety margin.[8]

The Advisory Board perceives uncertainties in both directions with regard to the projection by the MoF. For one thing, they concern the macroeconomic environment, including the assessment of cyclical impacts on public finances and, for another, future fiscal policy. Save for a fundamental fiscal policy reorientation or economic downturns, compliance with the rules does not appear to be in danger in the medium term. Specifically, the Advisory Board considers the following uncertainties to be meaningful in nature:

[8] The German states submitted a less favourable forecast, especially for their core budgets. To be able size up precisely what impact the different assessment will have on the balance in the national accounts, various pieces of additional information would be necessary: in addition to the payments between the levels, information is needed on the extra-budgetary funds of the German states and the weightiest reconciliation items from financial statistics to the national accounts. Examples of the latter are financial transactions or support payments for banks. The relevant information is not made available by the German states.

Fiscal policy is assumed to reflect a **course of expansionary spending** until the year 2021. This appears to be plausible in view of current planning activities. An argument in favour of lower expenditure on the one hand could be that the past expenditure approaches frequently were not fully exploited, such as interest expenditure, payments to the EU[9], investments or labour market-related spending. On the other hand, the federal budget already provides for appreciably lower global expenditure. An argument in favour of even higher spending growth is that the increase in investments in relation to GDP by 0.1 percentage points until the year 2023 appears to be very moderate in view of the efforts communicated. Estimates of other items still appear to be reserved in nature in the medium term. This applies, for instance, to expenditure on defence and development aid, in the context of which international agreements indicate substantially higher growth figures. Another example is expenditure on nursing care, where substantial wage (and, therefore, cost) increases are on the horizon. At the same time, discussions are under way on imposing a cap on cost participations by those in need of nursing care. The basic government pension recently agreed is not yet included in the projection. While it is to be fully funded, it still remains to be seen what the planned financial transaction tax will look like in reality.

Revenues sourced from taxes and social security contributions depend sharply on macroeconomic development (cf. the uncertainties in this regard, p. 5). In recent years, profit-dependent taxes have mostly given rise to positive surprises. The reasons for this are unclear; they may be due to lower tax avoidance, amongst other factors. Accordingly, it seems possible that the positive tendency will continue and that the revenue collected in the next several years will outgrow the value of the national accounts for corporate and asset income. In contrast, the steady-state level of expenditure may also be exceeded in the wake of the protracted economic upturn in previous years. In this case, there may be a substantially less favourable income development. The medium-scale approach selected for the official tax estimate therefore is plausible, but **also subject to uncertainties in both directions**. Moreover, a reduction of corporate taxation is under discussion since ongoing international tax competition is said to lower Germany's attractiveness as a location and to impair the competitiveness of German companies. If a corresponding adjustment should become necessary, then the level of tax revenue collected would be expected to fall.[10] A special risk applies to the "solidarity" surcharge, the constitutionality of which is controversial, at least after the end of the Solidarity Pact II in the coming year.[11] In this context, significant refunds might even be imposed by courts of law. Legal risks might also become relevant with regard to discounting of pension provisions, the property tax as well as inheritance tax. In contrast, there is upside potential with reference to income from sales (in particular, fee income), which is estimated to be at a low level in the projection. Risks to income may arise not least due to items planned but not yet taken into account in the projections. These include the reduction in the contribution rate to unemployment insurance, the introduction of an exemption limit on contributions to statutory health insurance for company pensions and in connection with

[9] In the financial statistics, transfers of tax resources to the EU are segregated from tax revenue collected by the federal government. In the national accounts, they are recognised on the expenditure side as a current transfer.

[10] The shortfall in tax revenue if the corporation tax rate were lowered from 15% to 10% in relation to the initial values of 2017 is estimated at close to 14 billion euros (cf. Scientific Advisory Board of the MoF, "Stellungnahme zur US-Steuerreform 2018: Steuerpolitische Folgerungen für Deutschland" (Statement on the U.S. tax reform 2018: tax policy conclusions for Germany), Berlin 2019.)

[11] Cf. in detail: Advisory Board of the Stability Council, spring statement 2019, p. 15.

the budget negotiations for the EU's new multiannual financial framework. Uncertainties also exist with regard to the development of income collected by the statutory health insurance fund. While a significant increase in the additional contribution is assumed in the federal government's forecast, the level of reserves might be reduced to a sharper degree. **There are indications in the medium term of a decline in the volume of labour owing to demographic factors,** which will have a negative impact on a large number of income categories. From the year 2022, a decline in the volume of labour is expected in the macroeconomic projection. This will continue after the end of the projection period and will then further dampen income trends.[12]

Climate policy likewise entails uncertainties. One of the main reasons for uncertainty is that in the opinion of numerous experts, the increases in CO_2 prices agreed to date will not be sufficient to achieve the climate targets set. If subsequent adjustments were carried out, then the level of government revenue would be higher. It is probable, however, that an approach with hardly any balance impact will continue to be followed. Additional income from CO_2 certificates would then be used for correspondingly higher compensation of private households and companies and/or additional stimulus programmes. However, burdens are looming beyond those referred to above. For instance, only a minor proportion of foreseeable additional spending is planned for abandonment of coal-based power generation. Moreover, no compensation payments foreseeable in the medium term are included in federal government planning if the assured reduction paths of CO_2 emissions in the EU fail to be achieved. And last but not least, there are macroeconomic risks due to the additional burdens on private households and companies regarding the energy supply costs – with compensation payments having been announced in this case.

There is some uncertainty regarding the current discussion concerning an additional, extensive cyclical stimulus package. A package of this kind is partly demanded immediately; others recommend preparing precautionary stabilisation measures in case a major downturn eventuates. The federal government does not plan to take any additional economic support measures at this time. From the Advisory Board's perspective, against the backdrop of the cyclical normality largely expected in the projections, this does not appear to be necessary, either. **At present, the fiscal stance already is expansionary and allow the automatic stabilisers to take effect.** This is reflected in the change in the primary government budget surplus (primary surplus: surplus without taking account of interest expenditure). According to the MoF projection, this primary surplus in relation to GDP will decline by 1.1 percentage points from 2019 to 2020 and by 2.1 percentage points in the lengthier period from 2018 to 2021. **Accordingly, in this period, primary government spending outstripped public-sector revenues by about €70bn.** Public finances are therefore facilitating a "soft landing" of the economy in the wake of a phase of substantial overutilisation. It is advisable in principle to align fiscal policy in such a manner that will allow the automatic stabilisers to develop their full impact. The underlying European and national budgetary rules provide a suitable framework in this regard. In this connection, a debate is raging in fiscal policy discussions on the target of achieving a balanced

[12] The macroeconomic volume of labour (measured in hours) will reach its zenith in the projection in the year 2021 and will decline thereafter by about half a percentage point per annum.

federal budget, referred to as the "black zero". Unlike the budgetary rules, a target of this kind leaves the cyclical situation out of the equation and therefore contradicts demands in conceptual terms to allow the automatic stabilisers to exert their effect. On the other hand, at present the "black zero" does not call for a procyclical course, seeing as extensive buffers are available in the form of surpluses and the copious "refugee" reserve.

It does not always appear to be known in public discussions that the federal budget and the whole of Government Accounts are expansionary at present and that Germany is certainly not lagging behind in saving for a phase of cyclical weakness. In view of the partly obscure information on public finances in general and the federal budget in particular, this is not surprising in the opinion of the Advisory Board. **The Advisory Board therefore believes it is important, *inter alia*, to increase the level of transparency with regard to planning activities on the federal budget**. In this respect, the unadjusted budget balance of the federal government budget including its extra-budgetary funds should be specified. In addition, the level and derivation of the structural budget balance (i.e. including extra-budgetary funds less cyclical effects and the balance of financial transactions) should be communicated plausibly and consistently over time. should be readily understandable and consistently reflected in the course of time. This would be more informative with regard to the fiscal stance than reporting a "black zero", which might conceal a structural surplus in some years and a structural deficit in other years.[13] Moreover, information on the current level of the "refugee" reserve should be transparently indicated. The Advisory Board believes it would be expedient not to fully spend the "refugee" reserve budgeted, but to keep a sizeable buffer in place for unexpected unfavourable developments.

In the opinion of the Advisory Board, more detailed overviews of unadjusted and structural budget balances and reserves should also be available for the German states and their municipalities. In its last statement, the Advisory Board referred to the inadequate data material from its point of view.[14] At present, on the whole the German states and municipalities have high surpluses, even though financial difficulties still exist in some cases. The Advisory Board does not share the impression that these government levels are not capable of taking action in financial terms and advocates that own scope for action should be exploited for projects with a promising future on the protagonists' own responsibility.

With regard to social security funds, the Advisory Board points out that in the event of fundamental adjustments, the long-term impacts should be taken into account in tandem with demographic trends. At present, the financial situation of social security funds is considered to be positive. For the projection period, however, an increase in social security contributions is already assumed, along with a simultaneous reduction in surpluses. For this reason, measures to secure financial sustainability should be considered in view of the foreseeable demographic burdens. It would be especially important to show, within the framework of long-term projections, how any additional strains are to be compensated. Three years ago, the Fourth Sustainability Report of March 2016 already identified a sustainability

[13] Cf. for a corresponding presentation: Deutsche Bundesbank, "Öffentliche Finanzen, Monatsbericht" (Public Finances, Monthly Report), August 2019, p. 68.
[14] Cf. Advisory Board of the Stability Council, 11th Statement in the spring of 2019, pp. 19 ff.

gap equivalent to 1.2 to 3.8% of GDP.[15] While employment has since grown more sharply than predicted, social security benefits have increased and additional measures (such as the introduction of a basic government pension) are planned.

Due to the adjustment for cyclical factors, compliance with the upper limit of the structural general government budget deficit in accordance with Section 51 (2) HGrG **will basically not call for a procyclical adjustment to fiscal policy if cyclical development turns out to be less favourable.** Even a more pronounced cyclical weakness basically has no influence on compliance with the rules, which is aimed at structural balances adjusted for cyclical effects. However, experience has shown that in times of sharper economic weaknesses, corrections to cyclical expectations and to the structural outlook frequently coincide. Moreover, the methods employed for cyclical adjustments may not make it possible to achieve a clean separation between cyclical and structural developments – this problem occurred in the past in the context of profit-dependent taxes, for instance. Considering the present fiscal stance, a further limited structural burden, e.g. on account of the realisation of fundamental macroeconomic risks, would not directly violate compliance with the provisions laid down, but it would reduce the distance to the upper limit.

[15] The Federal Ministry of Finance has already commissioned the model calculations for the Fifth Sustainability Report. The final report is not available as yet, however.

The Advisory Board to the Stability Council on 9 December 2019

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