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**Assessment of the 2015 Stability Programme for
GERMANY**

(Note prepared by DG ECFIN staff)

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1. INTRODUCTION

This document assesses Germany's April 2015 Stability Programme (hereafter called Stability Programme), which was submitted to the Commission on 16 April 2015 and covers the period 2014-2019. It was approved by the federal government and transmitted to the federal parliament, the conference of finance ministers of the federal states (*Länder*) and the stability council.

Germany is currently subject to the preventive arm of the Stability and Growth Pact and should preserve a sound fiscal position which ensures compliance with the medium-term objective. As the debt ratio was 77.9% of GDP in 2011 (the year in which Germany corrected its excessive deficit), exceeding the 60% of GDP reference value, during the three years following the correction of the excessive deficit Germany was also subject to the transitional arrangements as regards compliance with the debt reduction benchmark. In this period, it had to ensure sufficient progress towards compliance. After the transition period, as of 2015, Germany is expected to comply with the debt reduction benchmark.

This document complements the Country Report published on 26 February 2015 and updates it with the information included in the Stability programme. Section 2 presents the macroeconomic outlook underlying the Stability Programme and provides an assessment based on the Commission 2015 spring forecast. The following section presents the recent and planned budgetary developments, according to the Stability Programme. In particular, it includes an overview on the medium term budgetary plans, an assessment of the measures underpinning the Stability Programme and a risk analysis of the budgetary plans based on Commission forecast. Section 4 assesses compliance with the rules of the Stability and Growth Pact, including on the basis of the Commission forecast. Section 5 provides an overview on long term sustainability risks and Section 6 on recent developments and plans regarding the fiscal framework and the quality of public finances. Section 7 summarises the main conclusions.

2. MACROECONOMIC OUTLOOK

Economic growth was uneven in the course of 2014. A strong increase in GDP in the first quarter was followed by virtual stagnation in spring and summer and again a dynamic rise in the final quarter. While weather effects and declining oil prices contributed to the volatility of activity, the German economy overall showed weakness.

The macroeconomic scenario underlying the Stability Programme is based on the federal government's macroeconomic forecast published on 28 January 2015. Therefore, the updated National Accounts statistics for the year 2014, which were published at the end of February 2015, could not be taken into account in the macroeconomic forecast, although they have been reported in the Stability Programme.

The macroeconomic scenario underlying the Stability Programme projects real GDP to increase by 1.5% in 2015 and 1.6% in 2016. Growth is expected to be driven notably by private consumption and housing investment on the back of a robust labour market, marked real wage growth, low interest rates, and the decline in oil prices. Improvements in the external environment, including a lower euro exchange rate underpinning exports, are expected to support corporate investment, though the recovery is projected to resume only hesitantly given external uncertainty related to geopolitical tensions. Declining oil prices are projected to lower inflation in 2015. Annual potential growth is estimated at 1.4% over the period 2014 to 2016 and to decelerate gradually thereafter to 1.1% in 2019.

Table 1: Comparison of macroeconomic developments and forecasts

	2014		2015		2016		2017	2018	2019
	COM	SP	COM	SP	COM	SP	SP	SP	SP
Real GDP (% change)	1.6	1.6	1.9	1.5	2.0	1.6	1¼	1¼	1¼
Private consumption (% change)	1.2	1.2	2.4	1.6	1.8	1.5	1¼	1¼	1¼
Gross fixed capital formation (%)	3.4	3.4	2.1	2.1	4.4	3.0	2	2	2
Exports of goods and services (%)	3.9	3.9	4.7	3.6	5.6	4.3	4½	4½	4½
Imports of goods and services (%)	3.4	3.4	5.9	4.1	6.7	4.9	5¼	5¼	5¼
<i>Contributions to real GDP growth:</i>									
- Final domestic demand	1.5	1.2	2.1	1.5	2.1	1.6	1½	1½	1½
- Change in inventories	-0.4	-0.4	-0.1	0.0	0.0	0.0	0	0	0
- Net exports	0.4	0.4	-0.1	0.1	-0.1	0.1	0	0	0
Output gap ¹	-1.0	-0.9	-0.7	-0.7	-0.2	-0.5	-0.4	-0.1	0.2
Employment (% change)	0.9	0.9	0.7	0.4	0.7	0.3	¼	¼	¼
Unemployment rate (%)	5.0	4.7	4.6	4.7	4.4	4.8	4	4	4
Labour productivity (% change)	0.7	0.7	1.1	1.1	1.3	1.4	1¼	1¼	1¼
HICP inflation (%)	0.8	n.a.	0.3	n.a.	1.8	n.a.	n.a.	n.a.	n.a.
GDP deflator (% change)	1.7	1.7	1.7	2.2	2.0	1.7	2	2	2
Comp. of employees (per head, % change)	2.5	2.5	3.0	3.0	2.7	2.6	2¾	2¾	2¾
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	7.6	7.6	8.0	7.8	7.8	7.6	7	7	7
<u>Note:</u>									
¹ In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.									
² The Stability Programme (SP) reports values for 2017-2019 rounded to ¼ percentage point of GDP.									
<u>Source :</u>									
Commission 2015 spring forecast (COM); Stability Programme (SP).									

The Stability Programme's macroeconomic scenario is less dynamic than the macroeconomic scenario underlying the Draft Budgetary Plan submitted in October 2014. It expects considerably lower GDP growth in 2015, notably because of weaker investment projections.

The macroeconomic scenario underlying the Stability Programme also uses cautious growth assumptions for 2015 and 2016 in comparison with the Commission 2015 spring forecast.¹ The Commission forecast projects stronger GDP and employment growth in both years. In particular, with similar oil price assumptions and largely the same projected growth rate for gross wages and salaries per employee, the Commission 2015 spring forecast projects lower inflation in 2015 and a correspondingly stronger boost to real private consumption.²

¹ The federal government's macroeconomic spring projections, published after the submission of the Stability Programme, are more closely in line with the Commission 2015 spring forecast.

² The external outlook behind the Stability Programme's macroeconomic scenario is qualitatively broadly in line with the external outlook underlying the Commission forecast, although quantitative differences exist. Notably, the euro depreciation assumed in the Stability Programme is less pronounced. Moreover, in contrast to the Commission forecast, the Stability Programme's constant oil price assumption for 2016 might partly explain its projection of a lower increase in consumer prices in 2016.

The output gaps, as recalculated by the Commission based on the information in the Stability Programme following the commonly agreed methodology, are broadly in line with the Commission estimate, which projects the utilisation of production capacities to approach normal levels in 2016.

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. Deficit developments in 2014

Germany recorded a general government budget surplus of 0.7% of GDP in 2014. This compares to projections of a balanced budget for 2014 by both the 2014 Stability Programme and the Draft Budgetary Plan for 2015.³ The better-than-expected budget outcome is due to slightly higher revenue and somewhat lower expenditure than planned across categories. Special factors have also contributed to the surplus, notably a high profit transfer from *Deutsche Bundesbank* in 2014. Given the headline budget surplus and a slightly bigger-than-expected output gap, Germany registered with 1.2% of GDP a markedly higher structural surplus in 2014 than the 0.6% planned by both the previous Stability Programme and the Draft Budgetary Plan. Moreover, the federal budget showed a structural surplus of 0.3% of GDP in 2014 and therefore complied with the national balanced-budget rule ('debt brake') with a margin of about 1.3% of GDP and also overachieved already the deficit ceiling of 0.35% of GDP that will apply only in 2016 when the 'debt brake' will be fully phased in.⁴

3.2. Target for 2015 and medium-term strategy

The target for 2015

The Stability Programme plans a headline budget surplus of ¼% of GDP for 2015, compared to a balanced budget as projected by both the 2014 Stability Programme and the Draft Budgetary Plan for 2015. The Stability Programme plans the revenue-to-GDP ratio to be slightly higher by ¼ percentage point (pp.) compared to the Draft Budgetary Plan. Higher-than-previously projected revenue from taxes on production and imports, property income and other sources are expected to more than offset somewhat lower revenue from taxes on income and wealth. Despite the new measures reported in the Stability Programme, no significant changes in relation to the Draft Budgetary Plan are foreseen in terms of the overall expenditure-to-GDP ratio. Slightly higher compensation of employees and intermediate consumption are projected to be offset by lower gross fixed capital formation and capital transfers. Moreover, the Stability Programme foresees a fall in the (recalculated) structural balance by 0.5 pp. to 0.7% in 2015, compared to 0.5% projected by the Draft Budgetary Plan. It also plans a structurally balanced federal budget and hence compliance with the national 'debt brake' in 2015. All levels of government are expected to show balanced budgets or surpluses of ¼% of GDP except social insurance, which is projected to register a deficit of ¼% of GDP due to diminishing reserves notably of the statutory pension insurance.

The Stability Programme's targets for 2015 are broadly in line with the Commission 2015 spring forecast, although the latter projects a somewhat higher headline budget surplus of

³ The budgetary targets of both the 2014 Stability Programme and the Draft Budgetary Plan for 2015 were rounded to half a percentage point of GDP. In contrast, the budgetary targets of the 2015 Stability Programme are rounded to ¼ percentage point of GDP.

⁴ The constitutional 'debt brake' stipulates that as of 2016 the structural balance of the federal budget must not exceed a deficit of 0.35 % of GDP, with a gradually decreasing ceiling along an agreed transition path in the preceding years. The *Länder* must have structurally balanced budgets as of 2020.

0.6% of GDP. In particular, the Commission forecast projects expenditure to be slightly lower by ¼% of GDP compared to the Stability Programme, also in view of the relatively stronger GDP and employment growth projections. This is also reflected in a somewhat higher structural surplus of 1% of GDP projected by the Commission forecast.

Table 2: Composition of the budgetary adjustment

(% of GDP)	2014	2015		2016		2017	2018	2019	Change: 2014-2019
	COM	COM	SP	COM	SP	SP	SP	SP	SP
Revenue	44.6	44.3	44¼	44.0	43¾	44	44	44	- 1/2
<i>of which:</i>									
- Taxes on production and imports	10.8	10.7	10¾	10.7	10¾	10½	10½	10½	- 1/4
- Current taxes on income, wealth, etc.	11.9	12.0	12	12.0	12	12	12¼	12½	1/2
- Social contributions	16.6	16.5	16½	16.3	16½	16½	16½	16¾	1/4
- Other (residual)	5.2	5.1	4 3/4	5.0	4 3/4	4 1/2	4 1/2	4 1/4	-1
Expenditure	43.9	43.7	44	43.5	43¾	43¾	43½	43½	- 1/2
<i>of which:</i>									
- Primary expenditure	42.1	42.1	42 1/4	42.0	42 1/4	42 1/4	42 1/4	42	- 1/4
<i>of which:</i>									
Compensation of employees	7.7	7.7	7¾	7.6	7½	7½	7½	7¼	- 1/2
Intermediate consumption	4.6	4.7	4¾	4.7	4¾	4½	4½	4½	- 1/4
Social payments	23.8	23.8	24	23.7	24	24¼	24¼	24¼	1/4
Subsidies	0.9	0.9	1	0.8	1	1	1	1	0
Gross fixed capital formation	2.2	2.2	2¼	2.2	2¼	2¼	2¼	2¼	1/4
Other (residual)	2.9	2.9	3	3.0	3	2¾	2¾	2¾	-0
- Interest expenditure	1.7	1.6	1½	1.5	1½	1½	1½	1½	- 1/4
General government balance (GGB)	0.7	0.6	¼	0.5	0	¼	¼	½	-0
Primary balance	2.4	2.2	2	2.0	1½	1½	1¾	2	- 1/4
One-off and other temporary measures	0.0	0.0	-0	0.0	-0	-0	-0	-0	-0
GGB excl. one-offs	0.7	0.6	1/4	0.5	0	1/4	1/4	1/2	-0
Output gap ¹	-1.0	-0.7	-0.7	-0.2	-0.5	-0.4	-0.1	0.2	1.1
Cyclically-adjusted balance ¹	1.2	1.0	0.7	0.6	0.4	0.4	0.4	0.5	-0.7
Structural balance (SB)²	1.2	1.0	0.7	0.7	0.4	0.4	0.4	0.5	-0.7
Structural primary balance ²	2.9	2.6	2.3	2.1	1.9	1.8	1.8	2.0	-1.0
<i>Notes:</i>									
¹ Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.									
² Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.									
³ The Stability Programme (SP) reports revenue and expenditure targets rounded to ¼ percentage point of GDP.									
<i>Source:</i>									
Stability Programme (SP); Commission 2015 spring forecasts (COM); Commission calculations.									

The medium-term strategy

Germany's 2015 Stability Programme aims at complying with the medium-term objective with a margin and steadily bringing down the debt-to-GDP ratio over the programme period. The general government budget is planned to be balanced in 2016 and to turn again into a small but increasing surplus as of 2017.

The targeted balanced budget in 2016 is in line with the previous Stability Programme, while the planned surpluses for the following years have been slightly reduced by ¼% of GDP. The projections at general government level are aimed to be underpinned by continued small

surpluses or balanced budgets at federal, *Länder* and municipal level, while social insurance is expected to run small deficits up to 2018.

The Commission 2015 spring forecast projects a headline budget surplus of 0.5% of GDP in 2016. Based on the relatively stronger GDP and employment growth projections, revenue is expected to be slightly higher by ¼% of GDP and expenditure to be slightly lower by ¼% of GDP compared to the Stability Programme.

The Stability Programme confirms the medium-term objective of a structural deficit no higher than 0.5% of GDP, in line with the requirements of the Stability and Growth Pact. The structural balance is planned to remain in surplus throughout the programme period, thus well above the medium-term objective. The (recalculated) structural surplus is projected to fall to 0.4% of GDP in 2016 and to stabilise at this value until 2018, still well above the medium-term objective. The Commission forecast projects a somewhat higher structural surplus of 0.7% of GDP in 2016.

Measures underpinning the programme

The Stability Programme factors in additional revenue and expenditure-related measures. The minimum income tax allowance and child allowances would be increased in two steps in 2015 and 2016 with a view to aligning them with the adjusted subsistence level. As regards expenditure, additional EUR 10 billion are planned to be provided over the period 2016-18 for public investment, notably in public infrastructure, energy efficiency, IT infrastructure, climate protection and urban development. Further EUR 5 billion would be provided from the federal budget over the coming years to support public investment by municipalities, of which EUR 1.5 billion are foreseen to increase municipalities' financial scope for investment and EUR 3.5 billion would be transferred in a special fund supporting investment by financially weak municipalities.

The Stability Programme does not specify the budgetary impact of the revenue measures or the allocation of additional expenditure across years. While the measures can be expected to have overall a small expansionary effect, no significant impact on revenue and expenditure-to-GDP ratios is planned compared to the projections at unchanged policies. Moreover, no significant one-off measures are foreseen during the programming period.

3.3. Debt developments

The debt-to-GDP ratio decreased by 2.4% of GDP to 74.7% in 2014 thanks to the headline budget surplus and the denominator effect of GDP growth, despite a noticeable upward stock-flow adjustment due to an accumulation of various types of financial assets at all government levels. Based on the projected continued positive budget balance, further falling interest expenditure, the on-going winding up of 'bad banks' and the denominator effect of GDP growth, the Stability Programme projects the debt-to-GDP ratio to fall to 71½% of GDP in 2015 and 68¾% in 2016 and to steadily diminish thereafter. This is broadly in line with the Commission 2015 spring forecast, although it does not take into account potential gains from the winding up of 'bad banks' and differs to some extent in terms of the impact of inflation on the gross debt-to-GDP ratio as a result of divergent inflation projections for 2015 and 2016 compared to the macroeconomic scenario underlying the Stability Programme.

Table 3: Debt developments

(% of GDP)	Average 2009-2013	2014	2015		2016		2017	2018	2019
			COM	SP	COM	SP	SP	SP	SP
Gross debt ratio¹	77.5	74.7	71.5	71½	68.2	68¾	66	63¾	61½
Change in the ratio	2.4	-2.4	-3.2	-3 1/4	-3.3	-2 3/4	-2 1/2	-2 1/4	-2 1/4
<i>Contributions²:</i>									
1. Primary balance	-0.8	-2.4	-2.2	-2	-2.0	-1 1/2	-1 1/2	-1 3/4	-2
2. “Snow-ball” effect	0.9	-0.7	-1.0	-1.1	-1.3	-0.8	-0.8	-0.6	-0.5
<i>Of which:</i>									
Interest expenditure	2.4	1.7	1.6	1 1/2	1.5	1 1/2	1 1/2	1 1/2	1 1/2
Growth effect	-0.4	-1.2	-1.3	-1.1	-1.4	-1.1	-0.9	-0.8	-0.8
Inflation effect	-1.1	-1.3	-1.2	-1.6	-1.4	-1.1	-1.2	-1.2	-1.2
3. Stock-flow adjustment	2.3	0.8	0.0	-1/4	0.0	-1/4	-1/4	0	1/4
<i>Of which:</i>									
Cash/accruals diff.									
Acc. financial assets									
<i>Privatisation</i>									
Val. effect & residual									

Notes:

¹ End of period.

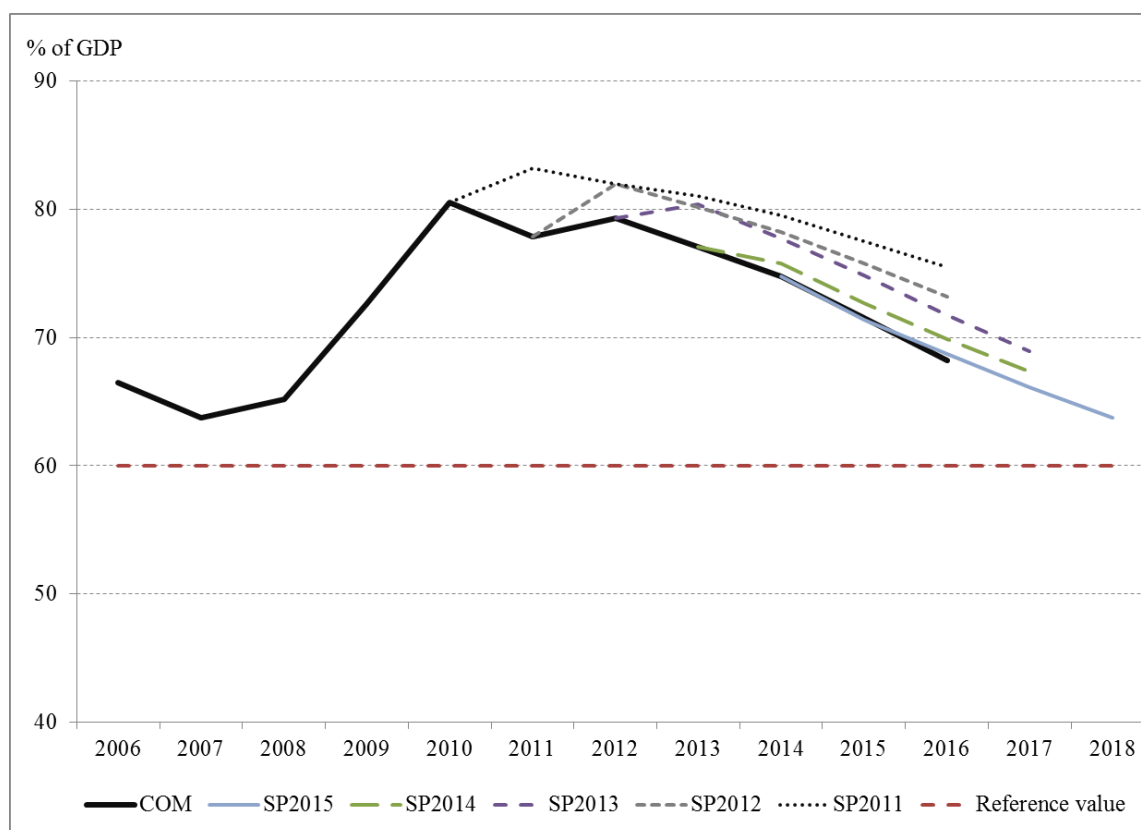
² The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

³ The Stability Programme (SP) reports debt projections rounded to ¼ percentage point of GDP.

Source:

Commission 2015 spring forecast (COM); Stability Programme (SP), Commission calculations.

Figure 1: Government debt projections in successive programmes (% of GDP)



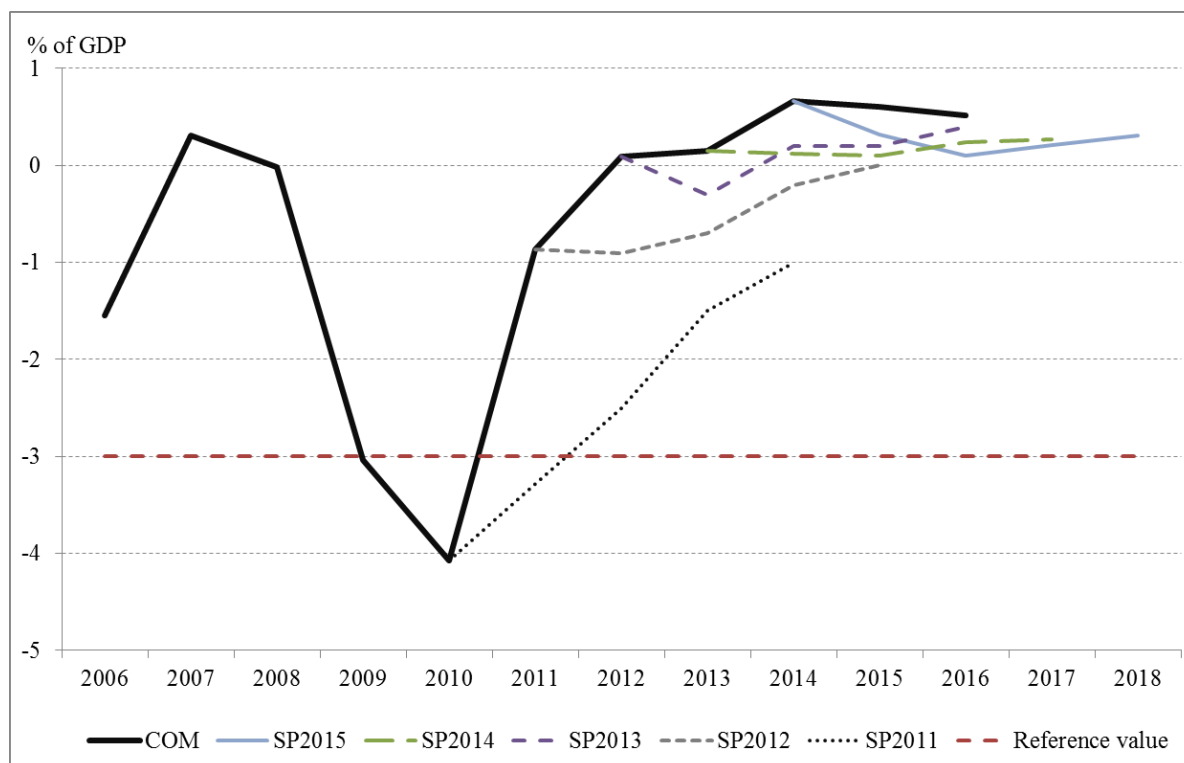
Source: Commission 2015 spring forecast, Stability Programmes

3.4. Risk assessment

Overall, the Stability Programme's targets in terms of headline balance, structural balance and debt are broadly in line with the Commission 2015 spring forecast and appear realistic, although somewhat cautious. In fact, the Stability Programme projects lower headline and structural surpluses for 2015 and 2016 than the Commission forecast, which also reflects more cautious GDP and employment growth assumptions of the macroeconomic scenario underlying the programme. Moreover, budgetary targets have been set rather cautiously in previous Stability Programmes. In particular, debt targets have been reduced in successive programmes (see Figures 1 and 2).

Falling interest rates caused total interest expenditure to decline by 25% from EUR 67.1 billion in 2011 to 50.6 billion in 2014, despite a slight increase in gross debt over the same period. This contributed to a decline in total interest expenditure as a proportion of GDP from 2.5% to 1.7%, which corresponds to almost one third of the improvement in the structural budget balance of 2.4% of GDP between 2011 and 2014. Based on the projected falling debt ratio, the Stability Programme plans interest expenditure to stabilise at 1½% of GDP over the programme horizon, assuming increasing interest rates but still favourable financing conditions. This suggests limited risks associated with a return to higher interest rates at this juncture, also in view of the projected structural surpluses.

Figure 2: Government balance projections in successive programmes (% of GDP)



Source: Commission 2015 spring forecast, Stability Programmes

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

Germany is subject to the preventive arm of the Stability and Growth Pact. The general government budget deficit was below 3% of GDP in 2014 and is planned to remain so in 2015 and 2016, which is confirmed by the Commission 2015 spring forecast.

Germany was in a transition period and, according to the Commission 2015 spring forecast, made sufficient progress towards compliance with the debt criterion as the debt benchmark was met at the end of the transition period in 2014. According to the Stability Programme as well as the Commission 2015 spring forecast, the debt reduction benchmark is expected to be met in 2015 and 2016, and according to the Stability Programme also in 2017.

Germany registered a structural surplus of 1.2% of GDP in 2014, well beyond its medium-term objective of a structural deficit not exceeding 0.5% of GDP. According to the information provided in the Stability Programme, with a (recalculated) structural surplus of 0.7% and 0.4% of GDP, respectively, Germany is expected to remain above its medium-term objective also in 2015 and 2016, which is confirmed by the Commission 2015 spring forecast.

Table 4. Compliance with the debt criterion

	2014	2015		2016		2017
		SP	COM	SP	COM	SP
Gap to the debt benchmark ^{1,2}	n.r.	-4.3	-5.8	-4.2	-5.2	-4.3
Structural adjustment ³	0.4	-0.4	-0.2	-0.3	-0.3	0.0
<i>To be compared to:</i>						
Required adjustment ⁴	-3.7	n.r.	n.r.	n.r.	n.r.	n.r.

Notes:

¹ Not relevant for Member States that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.

² Shows the difference between the debt-to-GDP ratio and the debt benchmark. If positive, projected gross debt-to-GDP ratio does not comply with the debt reduction benchmark.

³ Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.

⁴ Defines the remaining annual structural adjustment over the transition period which ensures that - if followed - Member State will comply with the debt reduction benchmark at the end of the transition period, assuming that COM (SP) budgetary projections for the previous years are achieved.

Source:

Commission 2015 spring forecast (COM); Stability Programme (SP), Commission calculations.

Box 1. Council recommendations addressed to Germany

On 8 July 2014, the Council addressed recommendations to Germany in the context of the European Semester. In particular, in the area of public finances the Council recommended to Germany to pursue growth-friendly fiscal policy and preserve a sound fiscal position, ensuring that the medium-term budgetary objective continues to be adhered to throughout the period covered by the Stability Programme and that the general government debt ratio remains on a sustained downward path; in particular, use the available scope for increased and more efficient public investment in infrastructure, education and research; improve the efficiency of the tax system, in particular by broadening the tax base, in particular on consumption, by reassessing the municipal real estate tax base, by improving the tax administration and by reviewing the local trade tax, also with a view to foster private investment; make additional efforts to increase the cost-effectiveness of public spending on healthcare and long-term care; ensure the sustainability of the public pension system by (i) changing the financing of new non-insurance/extraneous benefits ('Mütterrente') to funding from tax revenues, also in order to avoid a further increase of social security contributions, (ii) increasing incentives for later retirement, and (iii) increasing the coverage in second and third pillar pension schemes; complete the implementation of the debt brake consistently across all *Länder*, ensuring that monitoring procedures and correction mechanisms are timely and relevant; improve the design of fiscal relations between the federation, *Länder* and municipalities also with a view to ensuring adequate public investment at all levels of government; improve conditions that further support domestic demand, inter alia by reducing high taxes and social security contributions, especially for low-wage earners; and take measures to reduce fiscal disincentives to work, in particular for second earners, and facilitate the transition from mini-jobs to forms of employment subject to full mandatory social security contributions.

Table 5: Compliance with the requirements under the preventive arm

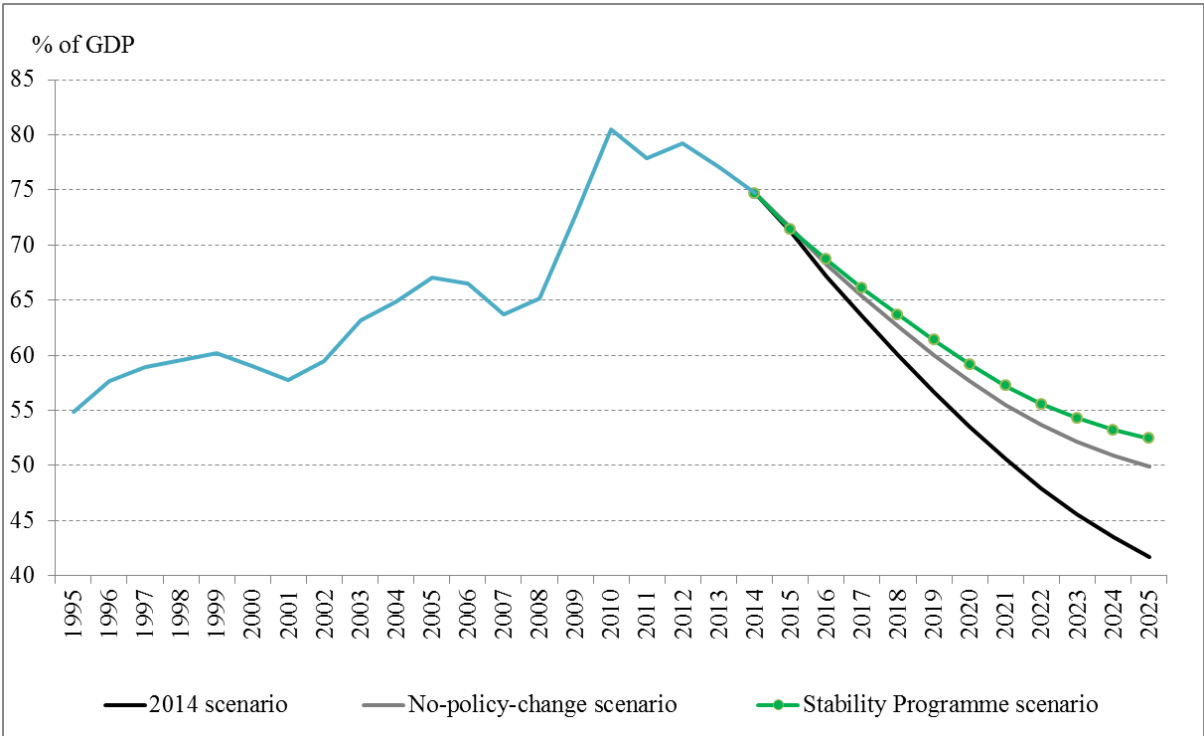
(% of GDP)	2014	2015		2016	
Initial position¹					
Medium-term objective (MTO)	-0.5	-0.5		-0.5	
Structural balance ² (COM)	1.2	1.0		0.7	
Structural balance based on freezing (COM)	1.2	1.0		-	
Position vis-a-vis the MTO³	At or above the MTO	At or above the MTO		At or above the MTO	
(% of GDP)	2014	2015		2016	
	COM	SP	COM	SP	COM
Structural balance pillar					
Required adjustment ⁴	0.0	0.0		0.0	
Required adjustment corrected ⁵	-1.3	-1.7		-1.5	
Change in structural balance ⁶	0.4	-0.4	-0.2	-0.3	-0.3
<i>One-year deviation from the required adjustment⁷</i>	1.7	1.3	1.5	1.2	1.2
<i>Two-year average deviation from the required adjustment⁷</i>	1.4	1.5	1.6	1.2	1.3
Expenditure benchmark pillar					
Applicable reference rate ⁸	n.a. (structural balance above the MTO)				
<i>One-year deviation⁹</i>					
<i>Two-year average deviation⁹</i>					
Conclusion					
Conclusion over one year	Compliance				
Conclusion over two years					
Notes					
¹ The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points is allowed in order to be evaluated as having reached the MTO.					
² Structural balance = cyclically-adjusted government balance excluding one-off measures.					
³ Based on the relevant structural balance at year t-1.					
⁴ Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 28.).					
⁵ Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.					
⁶ Change in the structural balance compared to year t-1.					
⁷ The difference of the change in the structural balance and the required adjustment corrected.					
⁸ Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is not at its MTO.					
⁹ Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.					
<i>Source:</i>					
<i>Stability Programme (SP); Commission 2015 spring forecasts (COM); Commission calculations.</i>					

5. LONG-TERM SUSTAINABILITY

The analysis in this section includes the new long-term budgetary projections of age-related expenditure (pension, healthcare, long-term care, education and unemployment benefits) from the 2015 Ageing Report⁵ published on 12 May. It therefore updates the assessment made in the Country Reports⁶ published on 26 February.

Government debt stood at 74.7% of GDP in 2014. It is expected to fall below the 60% of GDP Treaty threshold by 2025 both in a no-policy-change scenario based on Commission forecasts (to 49.9%) and in a scenario based on the full implementation of the Stability Programme (to 52.5%). Germany appears to face low fiscal sustainability risks. The medium-term sustainability gap, at -0.9% of GDP and primarily related to the initial budgetary position (-2.3% of GDP in 2015) that more than offset the projected ageing costs (contributing with 0.8 pp. of GDP), indicates low risks. Germany also appears to face low fiscal sustainability risks in the long-term. The long-term sustainability gap, which shows the adjustment effort needed to ensure that the debt-to-GDP ratio is not on an ever-increasing path, is at 1.5% of GDP, despite the projected ageing costs over the very long run (contributing with 2.5 pps. of GDP). In particular the increase in pension expenditure over the period 2013-2060 is among the highest in Europe (+2.7% versus 0% and -0.2% at euro area and EU level, respectively). Further containing growth of age-related expenditure would therefore contribute to the sustainability of public finances in the long term.

Figure 3: Gross debt projections (% of GDP)



Source: Commission calculations

⁵ See http://ec.europa.eu/economy_finance/publications/european_economy/2015/ee3_en.htm

⁶ See http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index_en.htm

Table 6: Sustainability indicators

	Germany			European Union		
	2014 scenario	No-policy-change scenario	Stability Programme scenario	2014 scenario	No-policy-change scenario	Stability/Convergence Programme scenario
S2*	0.7	1.5	1.8	1.4	1.7	0.4
<i>of which:</i>						
Initial budgetary position (IBP)	-1.8	-0.9	-0.7	0.4	0.5	-0.7
Long-term cost of ageing (CoA)	2.4	2.5	2.4	1.0	1.1	1.1
<i>of which:</i>						
pensions	1.6	1.7	1.6	0.0	0.1	0.1
healthcare	0.5	0.4	0.3	0.8	0.7	0.6
long-term care	0.1	0.0	0.0	0.7	0.7	0.6
others	0.3	0.4	0.6	-0.4	-0.3	-0.2
S1**	-1.8	-0.9	-0.8	1.4	1.8	0.5
<i>of which:</i>						
Initial budgetary position (IBP)	-3.4	-2.3	-1.8	-0.4	-0.3	-1.6
Debt requirement (DR)	0.9	0.6	0.1	1.7	1.9	1.8
Long-term cost of ageing (CoA)	0.8	0.8	0.9	0.1	0.3	0.4
S0 (risk for fiscal stress)***	0.00	:		:		
<i>Fiscal subindex</i>	0.00	:		:		
<i>Financial-competitiveness subindex</i>	0.01	:		:		
Debt as % of GDP (2014)	74.7			88.6		
Age-related expenditure as % of GDP (2014)	23.8			25.6		
Source: Commission, 2015 Stability Programme						
Note: the '2014' scenario depicts the sustainability gap under the assumption that the structural primary balance position remains at the 2014 position according to the Commission 2015 spring forecast; the 'no-policy-change' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commission 2015 spring forecast until 2016. The 'stability programme' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented over the period covered by the programme. Age-related expenditure as given in the 2015 Ageing Report.						
* The long-term sustainability gap (S2) indicator shows the immediate and permanent adjustment required to satisfy an inter-temporal budgetary constraint, including the costs of ageing. The S2 indicator has two components: i) the initial budgetary position (IBP) which gives the gap to the debt stabilising primary balance; and ii) the additional adjustment required due to the costs of ageing. The main assumption used in the derivation of S2 is that in an infinite horizon, the growth in the debt ratio is bounded by the interest rate differential (i.e. the difference between the nominal interest and the real growth rates); thereby not necessarily implying that the debt ratio will fall below the EU Treaty 60% debt threshold. The following thresholds for the S2 indicator were used: (i) if the value of S2 is lower than 2, the country is assigned low risk; (ii) if it is between 2 and 6, it is assigned medium risk; and, (iii) if it is greater than 6, it is assigned high risk.						
** The medium-term sustainability gap (S1) indicator shows the upfront adjustment effort required, in terms of a steady adjustment in the structural primary balance to be introduced over the five years after the forecast horizon, and then sustained, to bring debt ratios to 60% of GDP in 2030, including financing for any additional expenditure until the target date, arising from an ageing population. The following thresholds were used to assess the scale of the sustainability challenge: (i) if the S1 value is less than zero, the country is assigned low risk; (ii) if a structural adjustment in the primary balance of up to 0.5 p.p. of GDP per year for five years after the last year covered by the spring 2015 forecast (year 2016) is required (indicating an cumulated adjustment of 2.5 pp.), it is assigned medium risk; and, (iii) if it is greater than 2.5 (meaning a structural adjustment of more than 0.5 p.p. of GDP per year is necessary), it is assigned high risk.						
*** The S0 indicator reflects up to date evidence on the role played by fiscal and financial-competitiveness variables in creating potential fiscal risks. It should be stressed that the methodology for the S0 indicator is fundamentally different from the S1 and S2 indicators. S0 is not a quantification of the required fiscal adjustment effort like the S1 and S2 indicators, but a composite indicator which estimates the extent to which there might be a risk for fiscal stress in the short-term. The critical threshold for the overall S0 indicator is 0.43. For the fiscal and the financial-competitiveness sub-indices, thresholds are respectively at 0.35 and 0.45.						

6. FISCAL FRAMEWORK AND QUALITY OF PUBLIC FINANCES⁷

6.1. Fiscal framework

As pointed out by the Commission Opinion on Germany's Draft Budgetary Plan for 2015 and the Country Report Germany 2015, no independent body in charge of producing or endorsing macroeconomic forecasts has been put in place. Nor is there an endorsement procedure of forecasts involving an independent body within the meaning of Regulation (EU) No 473/2013. This also holds for the macroeconomic scenario underlying the Stability Programme, which is based on the federal government's macroeconomic forecast published in January 2015. In this context, the Stability Programme states that the federal government is currently reviewing options to address this shortcoming as well as suitable changes.

Moreover, the 2015 Stability Programme states that by its submission the federal government also complies with the obligation to make public national medium-term fiscal plans in accordance with Regulation (EU) No 473/2013. Neither the Stability Programme nor the 2015 National Reform Programme includes indications on the expected economic returns on non-defence public investment projects that have a significant budgetary impact.

6.2. Quality of public finances

The Stability Programme includes measures aimed to enhance competition in statutory health insurance with a view to improving cost-effectiveness while ensuring high quality healthcare. Since the beginning of 2015, individual insurers are allowed to raise supplementary premiums from employees as an element to increase competition between insurers. An independent Institute for Quality Control and Transparency in Healthcare has been established and a draft law aims to foster innovative and cross-sectoral approaches in healthcare provision, including for example more freedom for insurers to design contracts. Moreover, representatives of the federal government and the *Länder* governments endorsed the main features of a hospital care reform, which aims to enhance efficiency and quality in the hospital sector.

The Stability Programme also includes additional measures to increase public investment, namely EUR 10 billion over the period 2016-18 for public investment notably in public infrastructure, energy efficiency, IT infrastructure, climate protection and urban development,⁸ and additional EUR 5 billion over the coming years to support public investment by financially weak municipalities. The additional EUR 5 billion for municipal investment is welcome, but overall the planned measures still appear unlikely to be sufficient to tackle the investment backlog in public infrastructure in Germany.

7. CONCLUSIONS

In 2014, Germany recorded headline and structural budget surpluses well beyond its medium-term objective. According to both the information provided in the Stability Programme and the Commission 2015 spring forecast, the structural balance will remain above the medium-term objective in 2015 and 2016. Moreover, Germany met the debt benchmark at the end of the transition period in 2014, which, according to the Stability Programme and the Commission forecast, is also expected to be the case in 2015 and 2016.

⁷ This section complements the Country Report published on 26 February 2015 and updates it with the information included in the Stability Programme.

⁸ The additional EUR 10 billion over the period 2016-18 for public investment had already been taken into account by the Commission's Country Report Germany 2015, which identified *some progress* in terms of both increasing the cost-effectiveness of public spending on healthcare and raising public investment.

ANNEX

Table I. Macroeconomic indicators

	1997-2001	2002-2006	2007-2011	2012	2013	2014	2015	2016
Core indicators								
GDP growth rate	2.1	1.0	1.3	0.4	0.1	1.6	1.9	2.0
Output gap ¹	0.5	-1.1	-0.2	0.1	-1.1	-1.0	-0.7	-0.2
HICP (annual % change)	1.2	1.6	1.8	2.1	1.6	0.8	0.3	1.8
Domestic demand (annual % change) ²	1.7	0.2	1.1	-0.9	0.7	1.3	2.2	2.2
Unemployment rate (% of labour force) ³	8.7	10.0	7.3	5.4	5.2	5.0	4.6	4.4
Gross fixed capital formation (% of GDP)	22.5	19.5	19.8	20.0	19.8	20.0	20.0	20.3
Gross national saving (% of GDP)	22.2	23.1	26.1	26.4	25.9	26.4	26.7	27.0
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	-1.8	-3.3	-1.5	0.1	0.1	0.7	0.6	0.5
Gross debt	59.1	64.2	72.0	79.3	77.1	74.7	71.5	68.2
Net financial assets	-33.4	-44.3	-45.6	-49.0	n.a	n.a	n.a	n.a
Total revenue	45.2	43.1	43.5	44.3	44.5	44.6	44.3	44.0
Total expenditure	47.0	46.4	45.1	44.2	44.3	43.9	43.7	43.5
<i>of which: Interest</i>	3.2	2.8	2.6	2.3	2.0	1.7	1.6	1.5
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	-2.8	1.3	2.2	2.2	2.0	2.2	2.7	2.9
Net financial assets; non-financial corporations	-52.8	-53.2	-54.3	-52.3	n.a	n.a	n.a	n.a
Net financial assets; financial corporations	-4.1	-4.8	1.2	8.3	n.a	n.a	n.a	n.a
Gross capital formation	13.2	11.5	11.9	10.8	10.7	10.6	10.4	10.9
Gross operating surplus	23.1	25.6	26.4	25.2	24.7	24.6	24.8	25.5
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	3.6	5.6	5.5	5.0	4.8	4.8	4.7	4.4
Net financial assets	91.9	104.9	116.6	122.7	n.a	n.a	n.a	n.a
Gross wages and salaries	42.1	40.7	39.9	41.2	41.5	41.7	41.8	41.5
Net property income	11.7	13.3	14.3	14.1	13.6	12.9	12.8	12.9
Current transfers received	22.2	22.6	21.1	20.5	20.6	20.5	20.3	19.9
Gross saving	10.6	11.0	11.3	11.0	10.9	11.0	10.9	10.6
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	-0.9	3.7	6.1	7.3	7.0	7.6	8.0	7.8
Net financial assets	-0.2	-0.7	-14.2	-24.7	n.a	n.a	n.a	n.a
Net exports of goods and services	1.1	4.7	5.5	5.9	5.8	6.5	6.9	6.7
Net primary income from the rest of the world	-0.7	0.3	2.0	2.6	2.6	2.4	2.4	2.4
Net capital transactions	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1
Tradable sector	42.5	42.8	42.6	42.7	42.4	42.1	n.a	n.a
Non tradable sector	47.9	47.7	47.3	47.1	47.5	47.8	n.a	n.a
<i>of which: Building and construction sector</i>	4.9	3.7	3.7	4.1	4.1	4.3	n.a	n.a
Real effective exchange rate (index, 2000=100)	110.3	105.4	101.1	98.8	103.1	105.0	100.8	100.8
Terms of trade goods and services (index, 2000=100)	101.3	101.5	99.5	97.1	98.5	99.8	101.6	101.8
Market performance of exports (index, 2000=100)	86.2	91.7	99.2	106.2	105.8	105.9	106.7	107.2
Notes:								
¹ The output gap constitutes the gap between the actual and potential gross domestic product at 2005 market prices.								
² The indicator on domestic demand includes stocks.								
³ Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.								
Source:								
AMECO, Commission 2015 spring forecast								