EUROPEAN COMMISSION
DIRECTORATE GENERAL
ECONOMIC AND FINANCIAL AFFAIRS

Brussels, 5 June 2019

Assessment of the 2019 Stability Programme for

Germany

(Note prepared by DG ECFIN staff)

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EXECUTIVE SUMMARY

Germany is subject to the preventive arm of the SGP. With a gross public debt projected to fall below 60% of GDP reference value in 2019 and to continue to decline further in 2020, Germany is expected to be compliant with the debt criterion, as also confirmed by the Commission 2019 spring forecast.

The German economy expanded by 1.4% in 2018 in real terms, but economic growth is expected to decline to 0.5% in 2019 before picking up again to 1.5% in 2020, according to the Commission 2019 spring forecast. Growth is expected to be mainly driven by robust domestic demand, while the external outlook has weakened. With a short-term growth outlook below the level of potential growth, the output gap is forecast to turn slightly negative at around -0.2% of potential GDP. Employment growth is expected to moderate somewhat, while unemployment is projected to continue declining to below 3% by 2020. Inflation is expected to increase moderately in 2019 despite the tight labour market exerting upward pressure on wages. The macroeconomic scenario included in the Stability Programme is favourable.

In 2018, the headline budget balance reached a surplus of 1.7% of GDP. This reflected robust revenue growth as well as an increase in total government expenditure below expectations due to the delayed forming of a government. According to the Stability Programme, the general government budget surplus is set to decrease to ¾% of GDP in 2019 and ¾% in 2020, before falling further to ½% in 2021 to 2023. In structural terms, based on recalculated output gaps, the budget surplus increased to 1.6% of potential GDP in 2018, well above the medium-term budgetary objective (set at -0.5%). The structural budget surplus is expected to decline to 0.8% in 2019, before falling to 0.6% in 2020, reflecting the implementation of the government measures agreed in the March 2018 coalition agreement. Risks to the short-term fiscal outlook mainly come from the macroeconomic side, such as a further worsening of the economic climate and world trade or possible protective trade measures, which would, in particular, negatively affect income tax revenue. The long-term projections of public expenditure and government debt point to low risks for fiscal sustainability.

Overall, Germany is expected to remain compliant with the medium-term budgetary objective in 2019 and 2020.

1. INTRODUCTION

On 17 April 2019, Germany approved and submitted its 2019 Stability Programme[1] (hereafter called Stability Programme), covering the period 2019-2023.

Germany is currently subject to the preventive arm of the the Stability and Growth Pact (SGP) and should preserve a sound fiscal position that ensures compliance with the medium-term budgetary objective (MTO). Germany is also subject to the debt reduction benchmark, as the public debt ratio was 60.9% of GDP in 2018, exceeding the 60% of GDP reference value.

This document complements the Country Report published on 27 February 2019 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 2019 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 SGP, 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. Section 7 provides a summary.

2. MACROECONOMIC DEVELOPMENTS

The macroeconomic outlook in the Stability Programme indicates a real GDP growth of 1.0% in 2019. The domestic growth forces remain in place. They are supplemented by the measures from the coalition agreement. Disposable income is anticipated to increase, as wages and pensions rise significantly and the state relieves citizens of taxes and dues. Job creation is expected to continue, albeit less than in previous years, as labour supply tightens. Gross fixed capital formation is expected to continue to expand despite uncertainty surrounding the external environment, given high capacity utilisation, favourable financing conditions and well-filled order books. Investment in equipment and private construction are seen to increase somewhat less dynamically than in the previous year. The economic outlook for the global economy points to a loss in growth momentum compared to the previous year. In 2020, real GDP in Germany is assumed to recover to 1.6%, of which 0.4 percentage points are attributable to additional working days.

Compared to the macroeconomic scenario of the 2019 Draft Budgetary Plan (DBP), the growth projection has been revised downward by 0.8 pps for 2019 and 0.2 pps for 2020, reflecting the weaker outcome of the second half of 2018, the deterioration of the external environment, business and consumer sentiment.

In line with the usual budgetary procedure, the macroeconomic scenario is based on the January 2019 annual projection of the federal government. However, a more recent official projection was made available shortly before the publication of the Stability Programme, which is largely in line with the Commission Spring 2019 forecast projecting growth at 0.5% for 2019. This further downward revision reflects the protracted delay in the recovery in external demand and the continuing deterioration in German business confidence, especially in manufacturing. Despite the outdated projection on overall growth, the macroeconomic

[1] The German and the English version of the 2019 Stability Programme were both submitted on 17 April 2019.

scenario of the Stability Programme is in line with the Commission forecast as regards domestic demand and labour market developments in 2019. For 2020, both projections are broadly in line in terms of growth dynamics.

Table 1: Comparison of macroeconomic developments and forecasts

	2018		2019		2020		2021	2022	2023
	COM	SP	COM	SP	COM	SP	SP	SP	SP
Real GDP (% change)	1.4	1.4	0.5	1.0	1.5	1.6	1.1	1.1	1.1
Private consumption (% change)	1.0	1.0	1.1	1.3	1.6	1.6	1.1	1.1	1.1
Gross fixed capital formation (% change)	2.6	2.6	2.3	2.4	2.4	2.7	2.6	2.6	2.6
Exports of goods and services (% change)	2.0	2.0	1.1	2.7	2.6	3.1	3.1	3.1	3.1
Imports of goods and services (% change)	3.3	3.3	2.9	4.0	3.3	4.0	4.1	4.1	4.1
Contributions to real GDP growth:									
- Final domestic demand	1.2	1.8	1.4	1.6	1.7	1.7	1.3	1.3	1.3
- Change in inventories	0.5	0.6	-0.3	-0.2	0.0	0.0	0.0	0.0	0.0
- Net exports	-0.4	-0.4	-0.6	-0.3	-0.1	-0.2	-0.2	-0.2	-0.2
Output gap[1]	0.7	0.5	-0.2	0.1	-0.1	0.3	0.1	0.0	0.0
Employment (% change)	1.3	1.3	0.8	0.9	0.5	0.7	0	0	0
Unemployment rate (%)	3.4	3.2	3.1	3.0	2.7	2.8	3 ¼	3 ¼	3 ¼
Labour productivity (% change)	0.1	0.1	-0.2	0.2	1.0	0.9	1 ¼	1 ¼	1 ¼
HICP inflation (%)	1.9		1.5		1.5				
GDP deflator (% change)	1.9	1.9	2.1	2.1	2.1	2.0	1 ¾	1 ¾	1 ¾
Comp. of employees (per head, % change)	3.0	3.0	3.2	3.2	2.9	3.0	3	3	3
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	7.4	7.4	6.6	7.3	6.3	6.9	6.7	6.5	6.3

Note:

[1]In % of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source:

Commission 2019 spring forecast (COM); Stability Programme (SP).

The output gaps as recalculated by the Commission based on the information in the Stability Programme, following the commonly agreed methodology indicate that the economy is still in a situation of slight overuse of capacity and a mild weakening of cyclical conditions in 2019.

The Commission 2019 spring forecast projects lower output gaps, which may be due to different parametrisation of the estimation procedure and the outdated macroeconomic scenario of the Stability Programme. The Commission 2019 spring forecast assesses the German economy as operating just below potential in 2019 and 2020 and identifies a sharper deterioration of cyclical conditions compared to 2018.

All in all, the Stability Programme is based on favourable macroeconomic assumptions, in particular with respect to the assessment of the cyclical position both relative to the most recent official projections and the Commission Spring 2019 Forecast.

3. Recent and planned budgetary developments

3.1. Deficit developments in 2018 and 2019

Germany recorded a general government budget surplus of 1.7% of GDP in 2018, compared to projections of 1% of GDP in the 2018 Stability Programme and of 1½% of GDP in the 2018 DBP. The improved budget outcome was largely due to higher than expected tax revenue together with lower interest spending. The general government structural surplus in

2018 amounted to 1.6% of GDP, somewhat higher than in the projections of the 2018 DBP of 1½% of GDP and of the 2017 Stability Programme of ½% of GDP.

For 2019, the Stability Programme plans a general government budget surplus of ¾% of GDP, compared to 1¼% of GDP in the 2018 Stability Programme and 1% of GDP in the 2019 DBP. The revision is largely due to higher projected expenditure for social payments and stronger public investment. The (recalculated) structural surplus is projected to decrease to 0.8% of GDP in 2019, broadly consistent with the Commission 2019 spring forecast.

3.2. MEDIUM-TERM STRATEGY AND TARGETS

The Stability Programme aims at complying with the medium-term budgetary objective with a margin and steadily bringing down the debt-to-GDP ratio over the programme period. The targeted budget surpluses in 2019 and beyond are somewhat lower than the projections of the 2018 Stability Programme, as the 2019 Stability Programme takes into account the various government measures of the March 2018 coalition agreement.

Table 2: Composition of the budgetary adjustment

(% of GDP)	2018	2019		2020		2021	2022	2023	Change: 2018-2023
	COM	COM	SP	COM	SP	SP	SP	SP	SP
Revenue	**45.6**	**45.6**	**45 ½**	**45.5**	**45 ¼**	**45**	**45**	**45 ¼**	**- ½**
of which:									
- Taxes on production and imports	10.5	10.5	10 ½	10.4	10 ½	10 ½	10 ½	10 ½	0
- Current taxes on income, wealth, etc.	13.1	13.2	13 ¼	13.2	13 ¼	13	13	13 ¼	0
- Social contributions	16.9	17.1	17	17.0	17	17	17	17 ¼	¼
- Other (residual)	5.0	4.9	4 ¾	4.8	4 ¾	4 ½	4 ½	4 ¼	- ¾
Expenditure	**43.9**	**44.6**	**44 ½**	**44.7**	**44 ½**	**44 ½**	**44 ½**	**44 ½**	**¾**
of which:									
- Primary expenditure	43.0	43.8	43 ¾	43.9	43 ¾	43 ¾	43 ¾	43 ¾	¾
of which:									
Compensation of employees	7.6	7.7	7 ½	7.7	7 ½	7 ½	7 ½	7 ½	- ¼
Intermediate consumption	4.8	4.8	5	4.8	5	4 ¾	4 ¾	4 ¾	0
Social payments	23.8	24.3	24 ¼	24.3	24 ¼	24 ½	24 ¾	25	1
Subsidies	0.9	0.8	¾	0.8	¾	¾	¾	¾	0
Gross fixed capital formation	2.3	2.4	2 ½	2.5	2 ½	2 ½	2 ½	2 ½	0
Other (residual)	3.6	3.6	3 ¾	3.7	3 ¾	3 ¾	3 ½	3 ½	0
- Interest expenditure	0.9	0.9	¾	0.8	¾	¾	¾	¾	- ¼
General government balance (GGB)	**1.7**	**1.0**	¾	**0.8**	¾	½	½	½	**-1**
Primary balance	**2.6**	**1.8**	**1 ¾**	**1.6**	**1 ½**	**1 ¼**	**1 ¼**	**1 ¼**	**-1 ¼**
One-off and other temporary measures	-0.2	0.0	0	0.0	0	0	0	0	¼
GGB excl. one-offs	**1.9**	**1.0**	¾	**0.8**	¾	½	½	½	**-1 ¼**
Output gap[1]	0.7	-0.2	0.1	-0.1	0.3	0.1	0.0	0.0	-0.7
Cyclically-adjusted balance[1]	1.4	1.1	0.8	0.8	0.6	0.5	0.4	0.6	-0.7
Structural balance[2]	**1.6**	**1.1**	**0.8**	**0.8**	**0.6**	**0.5**	**0.4**	**0.6**	**-0.9**
Structural primary balance[2]	2.5	2.0	1.7	1.7	1.4	1.2	1.2	1.4	-1.1

Notes:

[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.

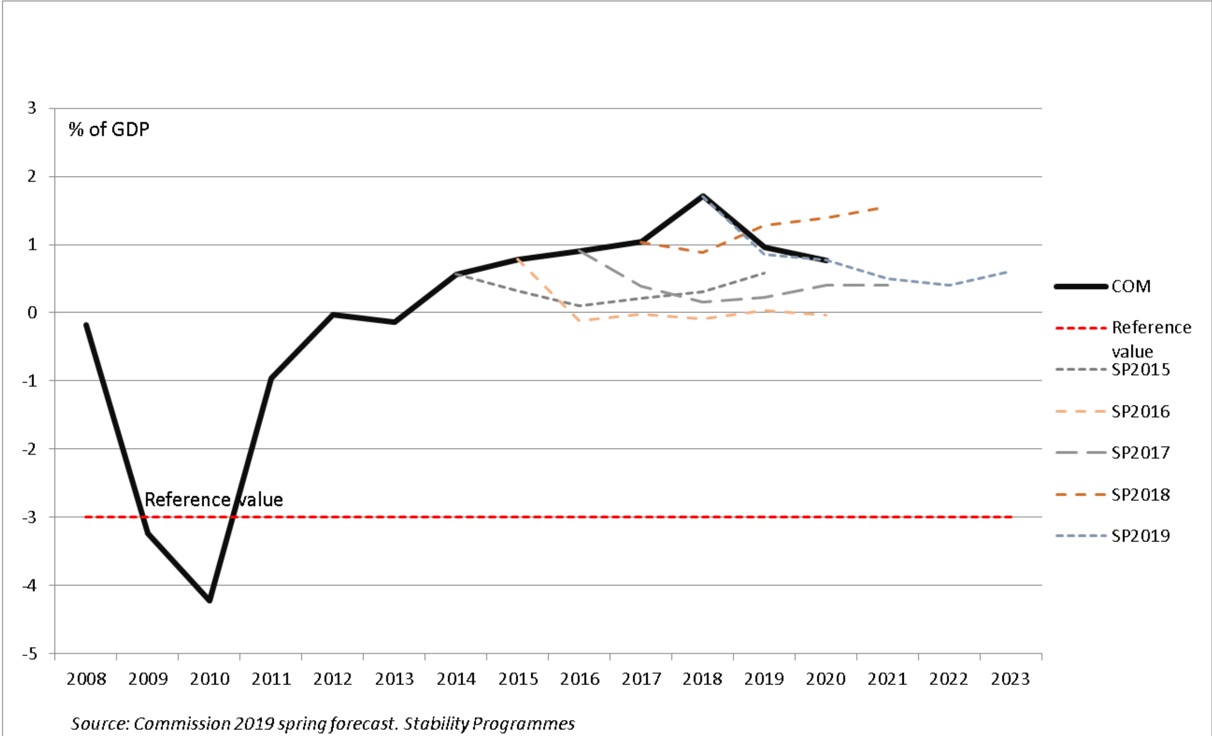
Source:

Stability Programme (SP); Commission 2019 spring forecast (COM); Commission calculations.

The projections at general government level are aimed to be underpinned by balanced budgets or small surpluses at all levels of government. The Stability Programme's targets are broadly in line with the Commission 2019 spring forecast (see also Figure 1) and also show the continued effort over several years and programmes to achieve at least a balanced or positive government headline balance.

The Stability Programme confirms the medium-term budgetary objective of a structural deficit not higher than 0.5% of GDP. The medium-term budgetary objective reflects the objectives of the Stability and Growth Pact. In line with the developments in the headline balance, the Stability Programme foresees (recalculated) structural surpluses of between 0.4% of GDP and 0.6% of GDP over 2020-2023. The projected structural surpluses are largely in line with the Commission 2019 spring forecast and lower than foreseen in the 2018 Stability Programme.

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



3.3. MEASURES UNDERPINNING THE PROGRAMME

The Stability Programme includes the government measures of the March 2018 coalition agreement that were only listed and described in the 2018 Stability Programme, but not yet included in the calculations. These measures are described in detail in the Draft Budgetary Plan 2019 with a budgetary impact of around -2.2% of GDP over the period 2018-2022. These measures concern a variety of policy fields like investment in education, research and digitalisation as well as support for families, children and social housing, infrastructure improvements and tax reliefs regarding the solidarity levy.

The 2019 Stability Programme mentions and describes several government measures, but does not provide a comprehensive overview or table listing the different measures. Also the budgetary impact of these measures is often not mentioned or only provided as the total sum over several years. The missing overview of the main budgetary measures together with an

assessment of their quantitative effects on the general government balance can be regarded as inconsistent with the guidelines laid down in the Code of Conduct.

Some of the main budgetary measures explicitly mentioned in the 2019 Stability Programme can be seen in the following table:

Main budgetary measures included in the Programme

Revenue	**Expenditure**
2019	
• Act to reduce family tax burdens and to modify additional tax regulations (-0.3% of GDP)	• Increase of mothers pension II (+0.1% of GDP) • Additional defence spending (+0.1% of GDP)
2021	
• Elimination of solidarity levy (-0.3% of GDP)	

Note: The table refers to the main measures included in the 2019 Stability Programme that have an incremental budgetary impact over the programme period. The budgetary impact in the table is the impact reported in the programme, i.e. by the national authorities. A positive sign implies that revenue / expenditure increases as a consequence of this measure.

3.4. DEBT DEVELOPMENTS

Table 3: Debt developments

(% of GDP)	Average 2013-2017	2018	2019		2020		2021	2022	2023
			COM	SP	COM	SP	SP	SP	SP
Gross debt ratio[1]	**71.6**	**60.9**	**58.4**	**58 ¾**	**55.6**	**56 ½**	**54 ¾**	**53**	**51 ¼**
Change in the ratio	-3.2	-3.6	-2.5	-2 ¼	-2.8	-2	-1 ¾	-1 ¾	-1 ¾
Contributions[2] *:*									
1. Primary balance	**-2.1**	**-2.6**	**-1.8**	**-1 ¾**	**-1.6**	**-1 ½**	**-1 ¼**	**-1 ¼**	**-1 ¼**
2. "Snow-ball" effect	**-1.1**	**-1.1**	**-0.7**	**-1.0**	**-1.2**	**-1.2**	**-0.9**	**-0.8**	**-0.8**
Of which:									
Interest expenditure	1.4	0.9	0.9	¾	0.8	¾	¾	¾	¾
Growth effect	-1.3	-0.9	-0.3	-0.6	-0.9	-0.9	-0.6	-0.6	-0.6
Inflation effect	-1.3	-1.2	-1.2	-1.2	-1.2	-1.1	-1.0	-1.0	-1.0
3. Stock-flow adjustment	**-0.1**	**0.2**	**0.0**	½	**0.0**	¾	¼	¼	½
Of which:									
Cash/accruals diff.									
Acc. financial assets									
Privatisation									
Val. effect & residual									

Notes:

[1] End of period.

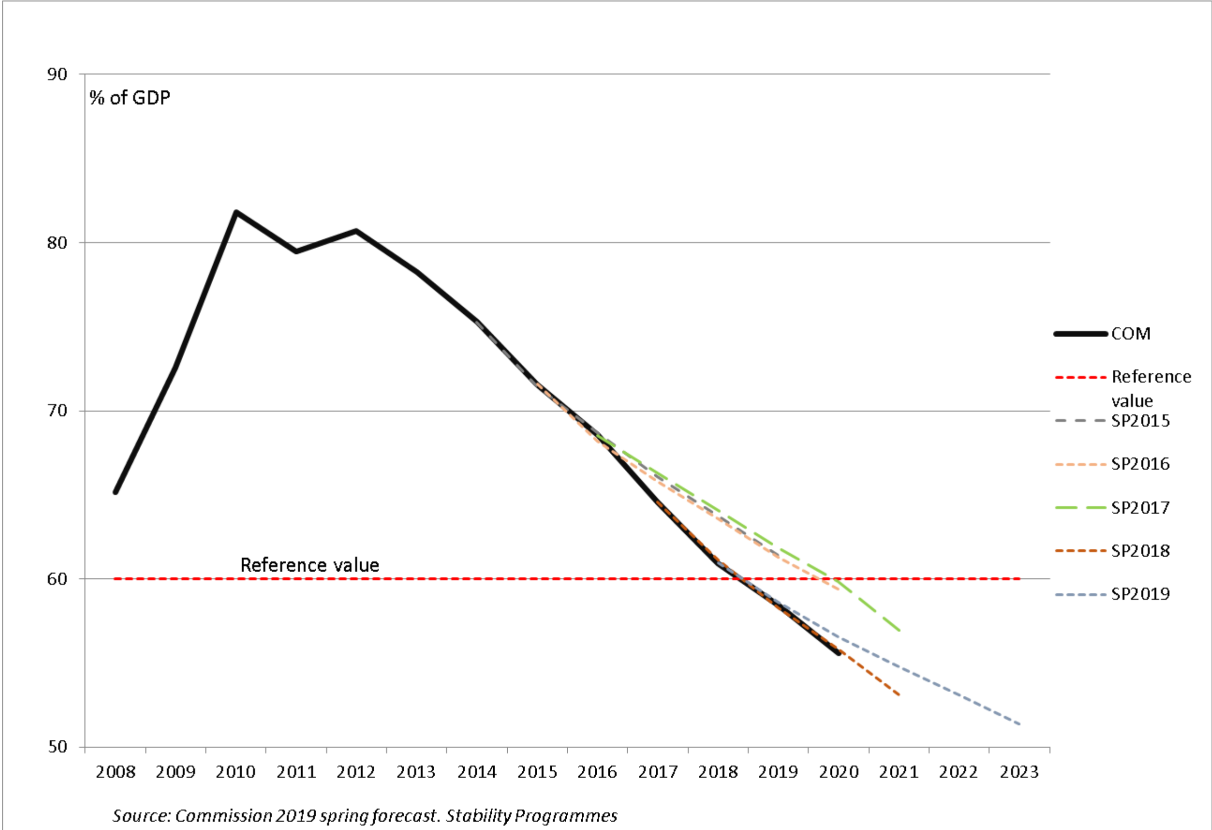
[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets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

Source:

Commission 2019 spring forecast (COM); Stability Programme (SP), Commission calculations.

The debt-to-GDP ratio decreased by 3.6 percentage points to 60.9% in 2018, driven by the headline surplus and favourable macroeconomic developments. Based on projected budget and the denominator effect of GDP growth, the Stability Programme projects the debt-to-GDP ratio to fall to 58¾% of GDP in 2019 and 56½% of GDP in 2020 and to continue diminishing thereafter. This is broadly in line with the Commission 2019 spring forecast. Both expect the debt-to-GDP ratio to fall below the 60% of GDP reference value in 2019 and to remain on a downward trajectory thereafter. Figure 2 shows that the debt projections of the Stability Programme decrease in general faster than in previous programmes except for last year's programme.

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



3.5. Risk assessment

Overall, the Stability Programme's targets in terms of headline balance, structural balance and debt are broadly in line with the Commission 2019 spring forecast. The Stability Programme projects higher employment growth and a lower unemployment rate, leading to partly lower expenditure for social payments but nevertheless to less positive fiscal developments than the Commission forecast. Risks to the current projections may arise from macroeconomic developments, when a slowdown of the economy may weigh on profit related tax revenue. The already low unemployment and high capacity utilisation may restrain the possibilities of the economy to keep up its growth rates. With its highly export-oriented growth model, Germany would be clearly affected by a possible further slowdown in world trade and possible protective trade measures.

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

Germany is subject to the preventive arm of the Stability and Growth Pact and should ensure compliance with its MTO. Currently, Germany is also subject to the debt reduction benchmark. Under the European Semester in July 2018 the Council considered that Germany complied with the Stability and Growth Pact.

4.1. COMPLIANCE WITH THE DEBT CRITERION

Germany complied with the debt reduction benchmark in 2018. According to the Stability Programme and the Commission 2019 spring forecast, as of 2019 the debt-to-GDP ratio is projected to fall below the 60% reference value and to continue to decline in 2020, implying compliance with the debt criterion as stipulated in the Stability and Growth Pact.

Table 4: Compliance with the debt criterion

	2018	2019		2020	
		SP	COM	SP	COM
Gross debt ratio	**60.9**	**58 ¾**	**58.4**	**56 ½**	**55.6**
Gap to the debt benchmark [1,2]	-6.4	n.a.	n.a.	n.a.	n.a.

Notes:

[1] Not relevant for Member Sates 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.

Source :

Commission 2019 spring forecast (COM); Stability Programme (SP), Commission calculations.

4.2. COMPLIANCE WITH THE MTO OR THE REQUIRED ADJUSTMENT PATH TOWARDS THE MTO

In 2018, Germany recorded a structural surplus of 1.6% of GDP, in compliance with its MTO of -0.5% of GDP that it achieved with a margin. According to the Stability Programme and the Commission 2019 spring forecast, Germany is expected to remain above its MTO of -0.5% of GDP in 2019 and 2020. The (recalculated) structural surplus is forecast to reach 0.8% (2019) and 0.6% (2020) of GDP, broadly in line with the Commission 2019 spring forecast.

Table 5: Compliance with the requirements under the preventive arm

(% of GDP)	2018	2019	2020
Background budgetary indicators[1]			
Medium-term budgetary objective (MTO)	-0.5	-0.5	-0.5
Structural balance[2] (COM)	1.6	1.1	0.8
Setting the required adjustment to the MTO			
Structural balance based on freezing (COM)	1.4	1.1	-
Position vis-à-vis the MTO[3]	At or above the MTO	At or above the MTO	At or above the MTO
Required adjustment[4]	0.0	0.0	0.0
Required adjustment corrected[5]	-1.4	-1.9	-1.6
Corresponding expenditure benchmark[6]	6.4	8.2	7.3

Compliance with the required adjustment to the MTO	2018	2019		2020	
	COM	**SP**	**COM**	**SP**	**COM**
Structural balance pillar	**Compliance**				
Change in structural balance[7]					
One-year deviation from the required adjustment[8]					
Two-year average deviation from the required adjustment[8]					
Expenditure benchmark pillar					
Net public expenditure annual growth corrected for one-offs[9]					
One-year deviation adjusted for one-offs[10]					
Two-year deviation adjusted for one-offs[10]					
Finding of the overall assessment					

Legend

'*Compliance*' - the recommended structural adjustment or a higher adjustment is being observed.

'*Some deviation*' - a deviation from the recommended structural adjustment is being observed, but it is below the threshold for a significant deviation.

'*Significant deviation*' - a deviation which has reached or breached the threshold for a significant deviation (i.e. 0.5% of GDP over one year, 0.25% of GDP over two years on average).

Irrelevant for the Significant Deviation Procedure' - a SDP would not be opened only based on the two-year deviation if the MTO has reached (at the time of the freezing or on the base of the last storage) in one of the 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 point 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, 2018 edition, p.38.). In case of a SDP, the requirement corresponds to the Council recommendation when available; otherwise it refers to the Commission recommendation to the Council.

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] 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 adjusting towards its MTO, including in year t.

[7] Change in the structural balance compared to year t-1. Ex post assessment (for 20XX-1) is carried out on the basis of Commission 20XX spring forecast.

[8] The difference of the change in the structural balance and the corrected required adjustment.

[9] Net public expenditure annual growth (in %) corrected for discretionary revenue measures, revenue measures mandated by law and one-offs (nominal)

[10] Deviation of the growth rate of public expenditure net of discretionary revenue measures, revenue increases mandated by law and one-offs 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.

Source:

Stability Programme (SP); Commission 2019 spring forecast (COM); Commission calculations.

5. DEBT SUSTAINABILITY ANALYSIS AND FISCAL RISKS

Germany does not appear to face fiscal sustainability risks in the short run.[2]

Based on the Commission 2019 spring forecast and a no-fiscal policy change scenario beyond the forecast horizon, government debt, projected at 58.4% of GDP in 2019, is expected to decrease to 42.3% in 2029, thus remaining below the 60% of GDP Treaty threshold. Over this horizon, government debt is projected to have its highest level in 2019 and then to decline steadily. Sensitivity analysis shows similar low risks.[3] Overall, this highlights low risks for Germany from debt sustainability analysis in the medium term. The full implementation of the Stability Programme would put debt on a similarly decreasing path by 2029, remaining below the 60% of GDP reference value in 2029.

The medium-term fiscal sustainability risk indicator S1[4] is at -1.5 percentage points of GDP, primarily related to the favourable initial budgetary position contributing -2.2 percentage points of GDP. This indicator thus signals low risks in the medium term. The full implementation of the Stability Programme would put the sustainability risk indicator S1 at -1.7 percentage points of GDP. Based on the debt sustainability analysis and the S1 indicator, overall medium-term fiscal sustainability risks are, therefore, low. Fully implementing the fiscal plans in the Stability Programme would decrease those risks.

The long-term fiscal sustainability risk indicator S2 is at 1.9 percentage points of GDP. In the long term, Germany therefore appears to face low fiscal sustainability risks, primarily related to the favourable initial budgetary position contributing -1.0 percentage points of GDP, which counterbalances the risks associated with the costs of ageing contributing 2.9 percentage points of GDP. Full implementation of the Stability Programme would put the S2 indicator at 2.0 percentage points of GDP, leading to a slightly higher long-term risk.[5] The debt sustainability analysis discussed above points to low risks so that, overall, long-term fiscal sustainability risks are assessed as low for Germany.

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[2] This conclusion is based on the short-term fiscal sustainability risk indicator S0. See the note to Table 6 for a definition of the indicator.

[3] Sensitivity analysis includes several deterministic debt projections, as well as stochastic projections (see Fiscal Sustainability Report 2018 for more details).

[4] See the note to Table 6 for a definition of the indicator.

[5] The projected costs of ageing that are used to compute the debt projections and the fiscal sustainability indicators S1 and S2 are based on the projections of the 2018 Ageing Report.

Table 6: Debt sustainability analysis and sustainability indicators

<table>
<tr><th colspan="3">Time horizon</th><th colspan="2">Commission Scenario</th><th colspan="2">Stability / Convergence Programme Scenario</th></tr>
<tr><td colspan="3">Short-term</td><td colspan="2">LOW risk</td><td colspan="2"></td></tr>
<tr><td colspan="3">S0 indicator [1]</td><td colspan="2">0.0</td><td colspan="2"></td></tr>
<tr><td colspan="3">Fiscal subindex</td><td>0.0</td><td>LOW risk</td><td colspan="2"></td></tr>
<tr><td colspan="3">Financial & competitiveness subindex</td><td>0.0</td><td>LOW risk</td><td colspan="2"></td></tr>
<tr><td colspan="3">Medium-term</td><td colspan="2">LOW risk</td><td colspan="2"></td></tr>
<tr><td colspan="3">DSA [2]</td><td colspan="2">LOW risk</td><td colspan="2"></td></tr>
<tr><td colspan="3">S1 indicator [3]</td><td>-1.5</td><td>LOW risk</td><td>-1.7</td><td>LOW risk</td></tr>
<tr><td rowspan="7">of which</td><td colspan="2">Initial Budgetary Position</td><td colspan="2">-2.2</td><td colspan="2">-1.8</td></tr>
<tr><td colspan="2">Debt Requirement</td><td colspan="2">-0.3</td><td colspan="2">-0.8</td></tr>
<tr><td colspan="2">Cost of Ageing</td><td colspan="2">1.1</td><td colspan="2">0.9</td></tr>
<tr><td rowspan="4">of which</td><td>Pensions</td><td colspan="2">0.6</td><td colspan="2">0.5</td></tr>
<tr><td>Health care</td><td colspan="2">0.1</td><td colspan="2">0.1</td></tr>
<tr><td>Long-term care</td><td colspan="2">0.1</td><td colspan="2">0.1</td></tr>
<tr><td>Other</td><td colspan="2">0.2</td><td colspan="2">0.3</td></tr>
<tr><td colspan="3">Long-term</td><td colspan="2">LOW risk</td><td colspan="2"></td></tr>
<tr><td colspan="3">DSA [2]</td><td colspan="2">LOW risk</td><td colspan="2"></td></tr>
<tr><td colspan="3">S2 indicator [4]</td><td>1.9</td><td>LOW risk</td><td>2.0</td><td>MEDIUM risk</td></tr>
<tr><td rowspan="6">of which</td><td colspan="2">Initial Budgetary Position</td><td colspan="2">-1.0</td><td colspan="2">-0.5</td></tr>
<tr><td colspan="2">Cost of Ageing</td><td colspan="2">2.9</td><td colspan="2">2.6</td></tr>
<tr><td rowspan="4">of which</td><td>Pensions</td><td colspan="2">1.4</td><td colspan="2">1.2</td></tr>
<tr><td>Health care</td><td colspan="2">0.5</td><td colspan="2">0.4</td></tr>
<tr><td>Long-term care</td><td colspan="2">0.4</td><td colspan="2">0.3</td></tr>
<tr><td>Other</td><td colspan="2">0.6</td><td colspan="2">0.6</td></tr>
</table>

Source: Commission services; 2019 stability/convergence programme.

Note: the 'Commission' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commissions' spring 2019 forecast until 2020. The 'stability/convergence 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 2018 Ageing Report.

[1] The S0 indicator of short term fiscal challenges informs the early detection of fiscal stress associated to fiscal risks within a one-year horizon. To estimate these risks S0 uses a set of fiscal, financial and competitiveness indicators selected and weighted according to their signalling power. S0 is therefore a composite indicator whose methodology is fundamentally different from the S1 and S2 indicators, which quantify fiscal adjustment efforts. The critical threshold for the overall S0 indicator is 0.46. For the fiscal and the financial-competitiveness sub-indexes, thresholds are respectively at 0.36 and 0.49*.

[2] Debt Sustainability Analysis (DSA) is performed around the no fiscal policy change scenario in a manner that tests the response of this scenario to different shocks presented as sensitivity tests and stochastic projections*.

[3] The S1 indicator is a medium-term sustainability gap; it measures the upfront fiscal adjustment effort required to bring the debt-to-GDP ratio to 60 % by 2033. This adjustment effort corresponds to a cumulated improvement in the structural primary balance over the 5 years following the forecast horizon (i.e. from 2021 for Commission scenario and from last available year for the SCP scenario); it must be then sustained, including financing for any additional expenditure until the target date, arising from an ageing population. The critical thresholds for S1 are 0 and 2.5, between which S1 indicates medium risk. If S1 is below 0 or above 2.5, it indicates low or high risk, respectively*.

[4] The S2 indicator is a long-term sustainability gap; it shows the upfront and permanent fiscal adjustment required to stabilise the debt-to-GDP ratio over the infinite horizon, including the costs of ageing. The critical thresholds for S2 are 2 and 6, between which S2 indicates medium risk. If S2 is below 2 or above 6, it indicates low or high risk, respectively*.

* For more information see Fiscal Sustainability Report 2018.

6. FISCAL FRAMEWORK

According to the applicable national numerical fiscal rules, in particular the so-called constitutional 'debt brake', the federal budget of Germany as of 2016 must not exceed a structural deficit of 0.35% of GDP.[6]

In 2018, the federal budget recorded a structural surplus of 0.16% of GDP, indicating compliance with the national fiscal rules. For 2019 and 2020 the Stability Programme does not explicitly mention the federal structural balance but only the federal headline balance. In both years the federal government plans a balanced budget, pointing to meeting the national fiscal limit of a federal structural deficit not greater than 0.35% of GDP.

Based on the information provided in the Stability Programme, the past, planned and forecast fiscal performance in Germany appears to comply with the requirements of the applicable national numerical fiscal rules.

At its 18th meeting on 6 December 2018 the fiscal council (Stabilitätsrat) concluded that the federal government adhered to the national fiscal rules in the years 2016, 2017 and expectedly in 2018.[7]

The 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 Article 4(1) of Regulation (EU) No 473/2013. The Stability Programme does not include indications on the expected economic returns on non-defence public investment projects that have a significant budgetary impact.

The macroeconomic scenario underlying the Stability Programme, is based on the federal government's annual projection of macroeconomic trends published on 30 January 2019. This forecast has been endorsed by the Joint Economic Forecast project goup in a statement published on 30 January 2019 on its website (gemeinschaftsdiagnose.de), giving a favourable opinion. According to the Regulation on the Economic Projections of the Federal Government (Vorausschätzungsverordnung) passed by the Ministry of the Economy and Energy in agreement with the Ministry of Finance and effective from July 2018, the Joint Economic Forecast project group has been named as the independent body in charge of assessing and endorsing the economic projections underlying the Draft Budgetary Plans and the Stability Programmes within the meaning of the Law on the Economic Projections (Vorausschätzungsgesetz) codifying the procedure for producing the government's economic forecasts and within the meaning of Regulation (EU) No 473/2013. The Joint Economic Forecast project group comprises the German Institute for Economic research in Berlin (DIW), the IFO institute in Munich, the Instiute for World Economy – Kiel, the Economic Research Insitute in Halle (IWH) and the Economic Research Insitute in Essen (RWI).

The Stability Programme briefly reports on progress on the government's efforts to improve the effectiveness of the federal budget by incorporating the results of spending reviews and

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

[7] For the national stability report see: http://www.stabilitaetsrat.de/SharedDocs/Downloads/DE/Haushaltsueberwachung/Kennziffern-und-Berichte/2018/Haushaltskennziffern_und_Stabilitaetsbericht_2018__Bund.pdf?__blob=publicationFile

regular subsidy reports to the budget planning process. The 27th subsidy report by the federal government is planned for summer 2019.

7. SUMMARY

In 2018, Germany recorded headline and structural budget surpluses in full compliance with the provisions of the Stability and Growth Pact. In addition, Germany complied with the debt benchmark.

According to both the information provided in the Stability Programme and the Commission 2019 spring forecast, Germany is expected to continue to remain above its medium-term budgetary objective in 2019 and 2020. Moreover, Germany's debt-to-GDP ratio is expected to fall below the 60% reference value in 2019 and to continue to decline further in 2020, implying compliance with the debt criterion.

8. ANNEXES

Table I. Macroeconomic indicators

	2001-2005	2006-2010	2011-2015	2016	2017	2018	2019	2020
Core indicators								
GDP growth rate	0.6	1.3	1.7	2.2	2.2	1.4	0.5	1.5
Output gap [1]	-0.7	-0.5	0.1	0.4	0.9	0.7	-0.2	-0.1
HICP (annual % change)	1.6	1.6	1.5	0.4	1.7	1.9	1.5	1.5
Domestic demand (annual % change) [2]	-0.4	1.1	1.2	3.0	2.0	1.9	1.3	1.8
Unemployment rate (% of labour force) [3]	9.5	8.1	5.2	4.1	3.8	3.4	3.1	2.7
Gross fixed capital formation (% of GDP)	19.9	19.8	20.0	20.1	20.3	20.8	21.3	21.7
Gross national saving (% of GDP)	22.4	25.8	27.1	28.3	28.3	28.8	28.3	28.4
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	-3.7	-1.8	0.0	0.9	1.0	1.7	1.0	0.8
Gross debt	62.4	69.9	77.0	68.5	64.5	60.9	58.4	55.6
Net financial assets	-40.0	-43.7	-47.0	-40.8	-36.4	n.a	n.a	n.a
Total revenue	43.2	43.4	44.3	44.8	45.0	45.6	45.6	45.5
Total expenditure	46.9	45.2	44.3	43.9	43.9	43.9	44.6	44.7
of which: Interest	2.9	2.6	1.9	1.2	1.0	0.9	0.9	0.8
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	0.7	2.1	2.3	2.6	1.9	0.5	0.3	0.5
Net financial assets; non-financial corporations	-54.1	-61.1	-57.4	-53.9	-55.7	n.a	n.a	n.a
Net financial assets; financial corporations	-5.1	1.8	13.1	13.4	8.7	n.a	n.a	n.a
Gross capital formation	11.8	11.8	11.4	11.4	11.6	12.4	12.3	12.3
Gross operating surplus	24.9	26.8	25.1	25.5	25.3	24.7	24.0	24.1
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	5.4	5.7	4.9	5.1	5.1	5.2	5.4	5.1
Net financial assets	100.6	111.9	120.5	128.7	131.3	n.a	n.a	n.a
Gross wages and salaries	41.2	39.7	41.1	41.5	41.7	42.3	42.8	42.8
Net property income	12.9	14.5	12.5	11.5	11.6	11.4	11.2	10.9
Current transfers received	22.7	21.3	20.7	20.6	20.6	20.5	20.8	20.8
Gross saving	11.0	11.3	10.9	11.0	11.1	11.5	12.0	11.9
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	2.4	5.9	7.2	8.6	8.0	7.4	6.6	6.3
Net financial assets	0.3	-5.9	-25.2	-43.6	-44.3	n.a	n.a	n.a
Net exports of goods and services	4.0	5.6	6.4	7.8	7.6	6.8	6.1	5.9
Net primary income from the rest of the world	-0.3	1.7	2.2	2.0	2.1	2.1	2.0	2.0
Net capital transactions	0.0	0.0	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2
Tradable sector	42.8	42.9	42.5	43.0	43.1	42.8	n.a	n.a
Non tradable sector	47.6	47.2	47.4	47.1	47.0	47.3	n.a	n.a
of which: Building and construction sector	3.9	3.6	4.0	4.2	4.4	4.7	n.a	n.a
Real effective exchange rate (index, 2000=100)	106.0	101.7	101.3	102.1	104.5	107.7	108.0	107.6
Terms of trade goods and services (index, 2000=100)	101.5	99.8	98.8	103.9	102.8	102.1	102.4	102.7
Market performance of exports (index, 2000=100)	91.0	97.8	105.3	104.1	103.9	103.0	101.3	100.5

Notes:

[1] The output gap constitutes the gap between the actual and potential gross domestic product at 2015 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 data, Commission 2019 spring forecast

Mandatory variables not included in the Stability Programme

The Stability Programme does not include several mandatory variables for the basic assumptions including long-term interest rates, nominal effective exchange rates, GDP growth

for the EU and the world without the EU, world import volumes excluding the EU as well as the mandatory levels for various variables of macroeconomic trends like final domestic demand, inventories, external balance of goods and services and the unemployment rate. Not included mandatory variables do not impede the Commission's ability to assess the Stability Programme on the basis of the Programme's assumptions.