

## Public finances\*

### General government budget

*Only limited decline in deficit expected for 2012*

After falling significantly to 1% in 2011, the general government deficit ratio in Germany looks set to record just a limited decline this year. Despite the low GDP growth rate compared with the previous two years, economic developments are unlikely to have a substantial impact as the macroeconomic aggregates that are particularly relevant to government revenue and expenditure (gross wages and salaries, unemployment figure, nominal private consumption) are proving relatively stable. Although the perceptible incremental consolidation announced in 2010 will be interrupted in 2012, there will be limited structural improvements. Expansionary measures introduced to cushion the impact of the 2008-09 crisis are still being phased out (above all depreciation allowances and investment programmes). Moreover, it is likely that growth in pension payments will remain muted, structural unemployment will continue to decline and interest spending will decrease as a result of favourable funding conditions.

*Debt ratio could start to rise again*

The debt ratio, by contrast, could start to rise again, having fallen perceptibly to 81.2% by the end of 2011. Although the low deficit vis-à-vis nominal GDP growth and the balance sheet contractions which are likely in principle for the bad banks will result in a decline *per se*, assistance for euro-area states and the borrowed capital transferred to the European Stability Mechanism (ESM) will increase government debt. In addition, support for German financial institutions could entail a renewed transfer of liabilities and assets to the government sector.<sup>1</sup>

*Hardly any change in revenue ratio or ...*

The revenue ratio could remain largely stable in 2012. On the one hand, the pension contribution rate was cut perceptibly at the beginning of the year (by 0.3 percentage point to 19.6%) and the Bundesbank's profit distribution was once again significantly reduced due to the

higher level of risk provisioning required. On the other hand, the phase-out of more generous depreciation allowances and the favourable growth structure for government revenue are boosting the ratio.

Expenditure could also largely develop in parallel with nominal GDP. Above all, the cyclical slowdown in GDP growth (in the denominator) masks a decline in the structural expenditure ratio. This decline is due in particular to previous reform measures restricting the pension increase, the structural fall in unemployment, interest cost savings owing to the favourable funding conditions, and the expiry of the investment programmes introduced during the 2008-09 crisis.

*... expenditure ratio*

As things stand, the deficit ratio is set to remain largely unchanged in 2013. No notable cyclical influences are currently on the cards, and, in structural terms, opposing developments could more or less balance each other out. The structural revenue ratio could decline perceptibly, as the pension contribution rate will probably be cut to an even greater extent than in 2012 in order to comply with the upper reserve limit. Even so, the relief factors for both welfare and interest expenditure should continue to take effect, and the structural expenditure ratio is therefore likely to decrease on a similar scale.

*Overall, hardly any change in deficit likely for 2013*

\* The analysis in the "General government budget" section is based on data contained in the national accounts and on the Maastricht ratios. The subsequent reporting on the budgets of the various levels of government and social security schemes is based on the budgetary figures as defined in the government's financial statistics (which are generally in line with the budgetary accounts).

<sup>1</sup> In particular, a further transfer is being discussed in connection with the dissolution of WestLB. As a precautionary measure, the option of SoFFin supporting financial institutions has been extended again, although no specific cases are currently on the horizon.

### Key data of the Federal Government's updated stability programme

| Item  | 2011  | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|-------|------|------|------|------|------|
| Real GDP growth (as %)                          |       |      |      |      |      |      |
| Stability programme April 2012                  | 3.0   | 0.7  | 1.6  | 1.6  | 1.6  | 1.6  |
| Stability programme April 2011                  | 2.3   | 1.8  | 1.6  | 1.6  | 1.6  | –    |
| General government fiscal balance (as % of GDP) |       |      |      |      |      |      |
| Stability programme April 2012                  | – 1.0 | – 1  | – ½  | – 0  | 0    | 0    |
| Stability programme April 2011                  | – 2½  | – 1½ | – 1  | – ½  | – ½  | –    |
| Structural fiscal balance (as % of GDP)         |       |      |      |      |      |      |
| Stability programme April 2012                  | – 0.7 | – ½  | – ½  | 0    | 0    | 0    |
| Stability programme April 2011                  | – 2   | – 1  | – 1  | – ½  | – 0  | –    |
| Debt level (as % of GDP)                        |       |      |      |      |      |      |
| Stability programme April 2012                  | 81.2  | 82   | 80   | 78   | 76   | 73   |
| Stability programme April 2011                  | 82    | 81   | 79½  | 77½  | 75½  | –    |

Source: Federal Ministry of Finance.  
 Deutsche Bundesbank

*Balanced general government budget envisaged by 2014*

On 18 April 2012, the Federal Government presented its updated stability programme,<sup>2</sup> which specifies that the general government deficit is to be eliminated – in both unadjusted and structural terms – by 2014. The programme stipulates that general government must achieve a structural deficit ratio of no more than 0.5% as its “medium-term budgetary objective” within the context of the European Stability and Growth Pact. The Federal Government expects this target to be achieved in 2012, although its calculations admittedly assume noticeable cyclical strains on public budgets.<sup>3</sup> Furthermore, the temporary high surpluses run up by the social security funds will play a role in meeting the objective. After rising slightly to 82% in 2012, the debt ratio is expected to fall to 73% in 2016. Provided the assumed moderately tight budgetary stance is maintained, the plans appear achievable as things stand.<sup>4</sup> However, another important prerequisite is the assumed smooth development of the economy. There is currently a great deal of uncertainty in this respect, particularly because of the sovereign debt crisis.

*Compliance with European rules*

The fact that the German government already met the reference figure for the deficit ratio in 2011, ie two years ahead of the deadline set in the excessive deficit procedure, is welcome and, given the favourable economic condi-

tions, appropriate. It is also in line with the recommendation by the Economic and Financial Affairs (Ecofin) Council to accelerate the reduction of the deficit if the economic conditions turn out to be better than expected at the start of the procedure.<sup>5</sup> The Stability and Growth Pact additionally obligates general government to achieve and maintain a structurally close-to-balance budget or a surplus. If it fails to do so, prompt corrective action is to be taken. According to the Federal Government's budget plans, general government is likely to achieve the self-imposed medium-term budgetary objective (a maximum structural deficit ratio of 0.5% of GDP). However, the objective is unam-

<sup>2</sup> The programme is based on the January 2012 forecast of macroeconomic developments as well as the Federal Government's tax revenue estimates, which were adjusted in line with the forecast. The latest official tax estimate results indicate somewhat more favourable developments. See also pp 66 et seq.

<sup>3</sup> The cyclical adjustment procedure employed in the context of the Stability and Growth Pact and under the debt brake on the central government budget is fundamentally problematic owing to its complexity and vulnerability to manipulation. See Deutsche Bundesbank, On the cyclical adjustment procedure under the German central government's new debt rule, Monthly Report, November 2011, p 71. The prediction of a significantly negative cyclical influence on public finances does not currently seem plausible.

<sup>4</sup> The impact of WestLB's dissolution (which could potentially increase the debt level, as discussed above) is not included in the plans owing to a lack of concrete details.

<sup>5</sup> See Council of the European Union, Council recommendation to Germany with a view to bringing an end to the situation of an excessive government deficit, Brussels, 30 November 2009, p 13.

bitious given the foreseeable financial burdens arising from demographic trends and the high government debt ratio.

*Reduce high debt ratio faster*

In principle, the national fiscal framework restricts new borrowing to a greater extent than the agreements adopted at European level. In particular, the framework enshrines a strict borrowing limit in the form of a (structurally close-to) balanced budget for both central government and the federal states in the constitution. Under normal circumstances, deviations from this rule are only permitted during the current year, if at all. The resulting debt is additionally limited and, where appropriate, must be repaid in line with a rule-bound path. In view of the well-known estimation uncertainties associated with budget forecasting, it would be advisable for central and state government to plan to achieve budget surpluses as a general rule so as to avoid having to make adjustments at short notice and with a procyclical impact. As experience has shown, such adjustments can prove necessary when economic downturns expose previously unseen structural budgetary gaps. For example, growth potential, and thus the scope for expenditure and for cutting tax and social contribution rates, has often been overestimated in the past, causing budgetary objectives to be missed. It is crucial, not least given the demographic challenges ahead and the considerable risks relating to the sovereign debt crisis, to rapidly reduce the debt ratio, which is very high and has seen near-incessant growth. Against this backdrop, it is essential that the 2010 consolidation agreements are not watered down and that the current favourable environment is taken as an opportunity to reduce the central, state and local government deficits faster.

*Loosening the fiscal policy stance in Germany would be inappropriate*

By contrast, the calls from some quarters for German fiscal policymakers to loosen their policy stance in order to stimulate the economy appear inappropriate. Unemployment is already relatively low and a recovery is forecast for Germany in general. Even if there were an unexpected economic slowdown, the auto-

matic stabilisers would be better suited to cushioning its impact. Moreover, the effect of stabilisation measures on demand in the countries on the euro-area periphery would be very limited. A more important point is that sound public finances and rigorous compliance with budgetary rules in Germany are, not least, a key anchor of stability in the European sovereign debt crisis.

Some euro-area countries will need to undergo longer, large-scale consolidation processes, and it is in these states that stability-oriented budgetary rules and confidence that they will be obeyed are of crucial importance. The fiscal compact, which has yet to be ratified, can help to achieve this. Among other provisions, the compact obliges the signatories to enshrine the requirement for a structurally at least close-to-balance general government budget in their national legislation.<sup>6</sup> The extent to which the requirements for national budgetary rules will go beyond the provisions already enshrined in European law is currently unclear. This hinges on general principles for reducing existing structural deficits and the correction mechanisms that are triggered if the upper limit is exceeded. Proposals by the European Commission on both aspects are still outstanding. Although, as in the case of the German debt brake, the recitals of the treaty propose a rule-based repayment of the debt resulting from overshooting the deficit limit, such a provision currently appears unlikely. It is also uncertain whether the correction mechanisms are sufficiently shielded from political influence.<sup>7</sup> Ultimately, the fiscal compact is by no means a fiscal union. National budgetary autonomy remains intact, individual member states are still responsible for the specific national arrangements and subsequent implementation of the rules, and the compact does not provide any

*Fiscal compact can inspire confidence, but strict conditionality not currently foreseeable*

<sup>6</sup> See Deutsche Bundesbank, The fiscal compact and the European Stability Mechanism, Monthly Report, February 2012, pp 60-63.

<sup>7</sup> See also Deutsche Bundesbank, Statement at the public hearing of the Budget Committee on 7 May 2012.

## Fiscal developments in the euro area

### **Significant fall in aggregate euro-area government deficits in 2011 but further rise in debt ratio; development could continue, albeit at a slower pace**

At the end of April 2012, Eurostat published the government deficits and debt levels of the EU member states as part of the European budgetary surveillance procedure. These figures revealed a marked decline in the euro-area deficit ratio from 6.2% to 4.1% in 2011. According to European Commission calculations, this was supported by economic activity, which was slightly positive overall (despite the slowdown in the second half of the year). The main contributing factor was a substantial structural improvement, however, which occurred primarily on the expenditure side, even though a greater amount was spent on interest payments as a result of rising debt levels and a higher average rate of interest. The average euro-area debt ratio continued to increase in 2011, rising from 85½% to 88%.<sup>1</sup> This was attributable first and foremost to deficit ratios, which remained high despite having fallen, but also to deficit-debt adjustments (changes to the debt level not stemming from the deficit). These adjustments include, for instance, the financial assistance granted to euro-area member states during the sovereign debt crisis.

In its spring forecast, the European Commission expects the euro-area deficit to decline further to 3.2% of GDP in 2012, which is based on the assumption that the effect of further sizeable consolidation measures will clearly outweigh the limited negative impact of economic developments. Unlike in 2011, however, the structural improvement is likely to be driven primarily by in-

creased revenues. Without additional consolidation measures, the Commission expects only a minor reduction in the deficit to 2.9% of GDP for 2013. By contrast, the debt ratio is expected to see another sharp rise to just under 92% in 2012. This is attributable to still fairly high deficit levels, comparatively low nominal GDP growth and further extensive debt-increasing deficit-debt adjustments. The debt ratio is expected to rise again slightly to 92½% in 2013.

### **Additional efforts needed in many countries to meet deadlines for correcting excessive deficits**

While the average debt ratio in the euro area has recently hovered at around the same level as in the UK and only slightly below that of the USA (the ratio in Japan is more than twice as high), the euro-area deficit ratio is already well below that of these countries (2011: USA 9.6%, UK 8.3%, Japan 8.2%). The remaining need for consolidation in the euro area in the coming years is therefore considerably lower on the whole. The euro-area aggregate masks large disparities between the individual countries, however. The Commission estimates that eight of the 17 euro-area countries (Finland, Germany, Luxembourg, Italy, Estonia, Malta, Belgium and Austria) will comply with the 3% deficit limit this year. Ireland is likely to record the highest deficit ratio at over 8%, with Greece and Spain expected to perform only slightly better with ratios of over 7% and 6% respectively. Figures of over 4% are forecast for Slovakia,

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<sup>1</sup> Unlike Eurostat, the European Commission also includes lending between euro-area countries in its debt level figures.

Portugal, France, the Netherlands and Slovenia. Cyprus' deficit ratio is expected to be slightly above the 3% reference value. Government debt will exceed 100% of GDP in Greece, Italy, Ireland, Portugal and – albeit only marginally – in Belgium. Yet debt ratios in France, Germany and Spain are also a long way above the reference value of 60%.

The majority of the euro-area member states (apart from Estonia, Finland and Luxembourg) are currently undergoing an excessive deficit procedure. While a number of countries – including Germany – are likely to be released from the procedure in the near future, the Commission's forecast underscores the danger that a large number of countries will not meet the agreements and requirements laid down under the deficit procedures. Based on the figures in the Commission's forecast, considerable additional consolidation measures are still required in a number of countries if they are to comply with the deficit correction deadlines, as is specified in the stability programmes: these include six countries with a 2013 deficit correction deadline (Spain, Slovakia, the Netherlands<sup>2</sup>, France, Slovenia and Portugal) as well as two countries whose deadline is the end of this year already (Cyprus and Belgium<sup>3</sup>). The budgets for 2013 are still being drawn up, however. A large number of measures have therefore still not been fleshed out sufficiently for them to be included in the forecast. Furthermore, overall economic developments have, in some cases, been more unfavourable than anticipated when the deadlines were set, meaning that more extensive measures will be required if the targets are to be met. In principle, it would seem appropriate in future – especially in light of current reactions on the financial markets to failures to meet previously agreed targets – to carefully plan far-reaching adjust-

ment processes and also to make provisions for unexpected unfavourable developments. The fact that a number of countries achieved only below-average improvements to their structural balances at the beginning of the deficit procedure and thus delayed most of the required consolidation is another reason why their remaining consolidation requirement is so large.

Without additional measures, the Commission expects the debt ratios in all euro-area countries apart from Germany to rise until 2013. Particularly sharp increases in the debt ratios compared with 2011 are projected for Spain (more than 18 percentage points), followed by Ireland (+12 percentage points) and Slovenia, Slovakia and Portugal (approximately 10 percentage points). By far the highest debt ratio for 2013 is forecast for Greece, at 168%. Only Estonia, Luxembourg, Slovakia, Slovenia and Finland are likely to comply with the 60% reference value in 2013.

#### **Differing developments in the Troika programme countries Greece, Portugal and Ireland**

Greece has adopted extensive consolidation measures since 2010 and recorded a 1.2 percentage point decline in its deficit ratio in 2011. Following the exceptionally sharp deficit increase in the preceding years, however, the ratio still stood at 9.1%. Greece therefore missed the original target of 7.6% agreed when the programme was drawn up. This was due primarily to worse-than-expected economic developments and

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<sup>2</sup> The Netherlands have adopted additional consolidation measures in the meantime which are intended to ensure that the excessive deficit is corrected on schedule.

<sup>3</sup> Belgium's deficit ratio is expected to stand at precisely 3%. Nevertheless, the correction cannot be regarded as sustainable if – as anticipated – the reference value is exceeded again in 2013.

repeated failures to sufficiently implement the consolidation and reform measures agreed in the adjustment programme.

Less favourable developments forced Greece to postpone its return to the capital markets, which was originally scheduled for 2012. In order to provide Greece with further support and relief in its adjustment efforts, discussions on further assistance in connection with a haircut for private creditors began in July 2011. A second assistance programme was finally adopted in March 2012, with the greatest contribution by far – €145 billion by the end of 2014 – coming from the euro-area countries via the European Financial Stability Facility (EFSF). The haircut and reduced interest rates on public assistance loans are intended to help restore the sustainability of public finances and reduce the debt ratio to 120% by 2020. The requirements for fiscal consolidation have been relaxed discernibly compared with the original agreements. Greece must now achieve a primary deficit (deficit excluding interest expenditure) of 1% of GDP for 2012, whereas the original agreements specified that it had to post a slight primary surplus. The consolidation that began in 2010 is scheduled to be completed in 2014 with a primary surplus of 4.5% of GDP, which will then have to be maintained over a good number of years. The original agreements envisaged a primary surplus of 6% of GDP.

Despite the extensive additional financial support measures and the relief provided by the haircut, the situation in Greece is still extremely tense and characterised by great uncertainty. In particular, it is completely unclear at present what stance a future Greek government might take on the reforms agreed in the adjustment programme.

However, Greece must comply with the agreed deficit targets and implement the measures contained in the adjustment programme in order to receive further financial assistance. Greece's European partners – as well as its private creditors (by means of the haircut) – have provided substantial *ex ante* assistance so far, most recently by expanding the assistance loans. This financial support does buy Greece some time to implement the unavoidable fiscal and macroeconomic adjustments. Nevertheless, Greece has a duty and a responsibility to keep its side of the bargain and thus reduce uncertainty in the euro area as a whole. The fiscal and economic policy decisions ultimately lie with the Greek parliament and the Greek government, however. Under the current euro-area framework, the individual countries are expected to take responsibility for their own economic and fiscal policies and the European level does not have any powers of intervention. This is incompatible with the extensive "communitisation" of liability risks desired by some, which would upset the balance between liability and control even more. Against this backdrop, it is essential to tie aid payments to strict conditions and terminate them in the event of non-compliance. To do otherwise would set a precedent which would drastically undermine the credibility of other and future agreements as well as the incentives for ensuring sound public finances.

Portugal perceptibly reduced its deficit ratio by 5.6 percentage points to 4.2% in 2011, thus improving on its agreed budgetary target of 5.9%. This decline was, however, due primarily to one-off measures, above all a transfer from private banks' pension funds to the state's social security scheme. Given the absence of these measures this year and the growing decline in GDP, the Commission is expecting the deficit ratio to increase again to 4.7% in 2012, despite sub-

stantial consolidation measures. Nonetheless, Portugal would then only just miss the stability programme target of 4.5%. Whether Portugal achieves the forecast deficit-to-GDP ratio of 3.1% for 2013, thus almost meeting its 2013 correction deadline, will ultimately hinge on how it implements the measures contained in the current stability programme, which it has yet to do.

Ireland's deficit reduction is still on schedule and the 2011 deficit ratio, at 9.4%, was more than 1 percentage point below the target set in the adjustment programme, excluding the capital transfer to the financial sector in the amount of 3.7% of GDP. Eurostat has yet to determine the booking amount of this capital transfer as the associated restructuring plans are not yet complete. According to the Commission's estimate, a further deficit decline to 8.3% of GDP is expected for this year, in line with the stability programme and the provisions of the adjustment programme. Nevertheless, Ireland still needs to flesh out its consolidation measures in order to achieve the deficit ratio of 7.5% forecast by the Commission for 2013.

#### **Spain, Italy and Cyprus under pressure from financial market participants**

A number of other euro-area countries are also under close scrutiny from financial market participants, not least with respect to their fiscal policies. Their government bond yields have risen again significantly of late and are now perceptibly above the level of countries with a very good rating. It should be borne in mind, however, that when compared with data from the past, the absolute level of nominal bond yields is by no means excessively high. Interest rates for new borrowing are also significantly lower averaged across the maturity spec-

trum than those for ten-year bonds, which are often used as a benchmark. According to the Commission's forecast, the average rate of interest paid on existing government debt in 2012 is still below the average level since the launch of monetary union. Irrespective of this, risk premiums, in particular, have proved to be a key incentive for consolidation and reform efforts.

Spain clearly missed its deficit target for 2011 (6% of GDP). The deficit ratio of 8.5% initially announced in the Eurostat notification has since been revised upwards again by the Spanish government to just under 9%. On the whole, the significant and unexpected deviation from the target is probably due mainly to lower-than-expected revenues, primarily in Spain's regional governments. This deviation, together with the weakening of the original deficit target for 2012 (5.3% instead of 4.4% of GDP), has fuelled doubts about Spain's adjustment path and its domestic coordination and compliance with the regulations. According to the Commission's forecast, Spain risks missing its weakened deficit target by recording a deficit ratio of 6.4% – partly because the decline in GDP is steeper than the government expected – if no additional measures are implemented. One particularly critical factor is that, according to the Commission's forecast, Spain will miss the 2013 deadline for correcting its excessive deficit by a long way unless additional measures are taken. Furthermore, considerable uncertainty has arisen regarding the state of the Spanish financial system. This could place an additional strain on Spanish public finances. It must be borne in mind, however, that the debt ratio of 87% predicted for 2013 is still perceptibly lower than the euro-area average and 30 percentage points below the figures for Portugal, Ireland and Italy, for instance.

### Forecast and plans for the public finances of the euro-area countries

| Country     | European Commission spring 2012 forecast |       |       |  |       |       | Stability programmes, April 2012      |       |       | Deadline to correct excessive deficit |
|-------------|--|-------|-------|--|-------|-------|---------------------------------------|-------|-------|---------------------------------------|
|             | Budget balance as a percentage of GDP    |       |       | Government debt as a percentage of GDP |       |       | Budget balance as a percentage of GDP |       |       |                                       |
|             | 2011                                     | 2012  | 2013  | 2011                                   | 2012  | 2013  | 2012                                  | 2013  | 2014  |                                       |
| Austria     | - 2.6                                    | - 3.0 | - 1.9 | 72.2                                   | 74.2  | 74.3  | - 3.0                                 | - 2.1 | - 1.5 | 2013                                  |
| Belgium     | - 3.7                                    | - 3.0 | - 3.3 | 98.0                                   | 100.5 | 100.8 | - 2.8                                 | - 2.2 | - 1.1 | 2012                                  |
| Cyprus      | - 6.3                                    | - 3.4 | - 2.5 | 71.6                                   | 76.5  | 78.1  | - 2.6                                 | - 0.6 | 0.0   | 2012                                  |
| Estonia     | 1.0                                      | - 2.4 | - 1.3 | 6.0                                    | 10.4  | 11.7  | - 2.6                                 | - 0.7 | 0.1   | -                                     |
| Finland     | - 0.5                                    | - 0.7 | - 0.4 | 48.6                                   | 50.5  | 51.7  | - 1.1                                 | - 0.5 | - 0.1 | -                                     |
| France      | - 5.2                                    | - 4.5 | - 4.2 | 85.8                                   | 90.5  | 92.5  | - 4.4                                 | - 3.0 | - 2.0 | 2013                                  |
| Germany     | - 1.0                                    | - 0.9 | - 0.7 | 81.2                                   | 82.2  | 80.7  | - 1.0                                 | - 0.5 | 0.0   | 2013                                  |
| Greece      | - 9.1                                    | - 7.3 | - 8.4 | 165.3                                  | 160.6 | 168.0 | - 6.7                                 | - 4.7 | - 2.2 | 2014                                  |
| Ireland     | - 13.1                                   | - 8.3 | - 7.5 | 108.2                                  | 116.1 | 120.2 | - 8.3                                 | - 7.5 | - 4.8 | 2015                                  |
| Italy       | - 3.9                                    | - 2.0 | - 1.1 | 120.1                                  | 123.5 | 121.8 | - 1.7                                 | - 0.5 | - 0.1 | 2012                                  |
| Luxembourg  | - 0.6                                    | - 1.8 | - 2.2 | 18.2                                   | 20.3  | 21.6  | - 1.5                                 | - 1.2 | - 0.9 | -                                     |
| Malta       | - 2.7                                    | - 2.6 | - 2.9 | 72.0                                   | 74.8  | 75.2  | - 2.2                                 | - 1.7 | - 1.1 | 2011                                  |
| Netherlands | - 4.7                                    | - 4.4 | - 4.6 | 65.2                                   | 70.1  | 73.0  | - 4.2                                 | - 3.0 | -     | 2013                                  |
| Portugal    | - 4.2                                    | - 4.7 | - 3.1 | 107.8                                  | 113.9 | 117.1 | - 4.5                                 | - 3.0 | - 1.8 | 2013                                  |
| Slovakia    | - 4.8                                    | - 4.7 | - 4.9 | 43.3                                   | 49.7  | 53.5  | - 4.6                                 | - 2.9 | - 2.3 | 2013                                  |
| Slovenia    | - 6.4                                    | - 4.3 | - 3.8 | 47.6                                   | 54.7  | 58.1  | - 3.5                                 | - 2.5 | - 1.5 | 2013                                  |
| Spain       | - 8.5                                    | - 6.4 | - 6.3 | 68.5                                   | 80.9  | 87.0  | - 5.3                                 | - 3.0 | - 2.2 | 2013                                  |
| Euro area   | - 4.1                                    | - 3.2 | - 2.9 | 88.0                                   | 91.8  | 92.6  | .                                     | .     | .     | -                                     |

Source: European Commission.  
 Deutsche Bundesbank

Following the change of government in 2011 and the adoption of extensive consolidation measures, Italy has succeeded in shoring up confidence on the financial markets, which had previously been experiencing a continuous decline. The deficit ratio fell by 0.7 percentage point to 3.9% in 2011 and is likely to decline again significantly to 2% in 2012 according to the Commission's forecast. Italy would therefore meet the prescribed deadline of 2012 for correcting its excessive deficit despite the unfavourable macroeconomic developments. According to the forecast, the debt ratio will rise to 123.5% in 2012 but will fall again from 2013 onwards. While fiscal consolidation in Italy is making good headway, some important structural reforms – especially with regard to the labour market – have yet to be implemented or risk being watered down. A rigorous implementation of these measures is likely to influence not only Italy's economic outlook, but also the sentiment among financial market participants and therefore play a de-

cisive role in restoring sound public finances.

Public finances in Cyprus have also deteriorated dramatically as a result of the crisis. The deficit ratio rose by 1 percentage point in 2011 to 6.3%. Substantial consolidation is expected for 2012 amid contracting economic output. According to the Commission's forecast, however, Cyprus risks missing its 2012 correction deadline by recording a deficit ratio of 3.4% this year. Although Cyprus' government debt has risen sharply over the past few years, for 2012 it will still be below the euro-area average, at 76.5% of GDP. The fact that Cyprus is nonetheless under scrutiny by market participants is probably due, not least, to its close financial linkages with Greece. Cyprus' financial sector, which is large relative to its GDP, recorded extensive write-downs as a result of the Greek haircut.



powers of intervention at European level even if the rules are persistently violated.

*Further watering down of agreed conditions for some euro-area countries would be problematic*

To ensure confidence in the fiscal rules, it is therefore crucial that they are strictly implemented at national level. It is very important that the crisis resolution mechanisms – the European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM) – impose considerable interest rate premiums on any future financial assistance they provide in order to boost incentives for governments to independently safeguard and achieve sound public finances. Furthermore, it must be ensured that the agreed consolidation and reform measures are rigorously implemented. By contrast, renegotiating the measures only a few months after they were agreed would risk shaking confidence in the success of the adjustment process. This might affect not only the country concerned, but also other countries receiving assistance. Moreover, delaying consolidation could jeopardise confidence in the fiscal sustainability of other countries that are still undergoing an excessive deficit procedure (see pages 60 to 64 for current information on the budgetary surveillance procedures). It appears that the key need is rather to rigorously implement growth-oriented structural reforms in Germany and the other euro-area states without endangering budgetary objectives.

## Budgetary development of central, state and local government

### Tax revenue

*Marked rise in tax revenue in Q1*

Tax revenue<sup>8</sup> rose by 6% in the first quarter of 2012 compared with the same quarter of 2011 (see chart and table on pages 66 and 67). This increase is due to favourable developments in the macroeconomic aggregates that are significant for tax revenue (gross wages and salaries and nominal private consumption) as well as to positive special factors. Revenue from income-related taxes went up by 12%. The growth in

wage tax receipts reflects the positive developments in gross wages and salaries as well as the near-stagnation or fall in deduction amounts (child benefit and subsidies for supplementary private pension plans), whereas legislative changes resulted in slight revenue shortfalls (particularly the retroactive increase in the flat-rate allowance for employees' expenses). Revenue from profit-related taxes rose even more sharply on balance (+26%).<sup>9</sup> However, the decline in the homebuyers grant – which is deducted from revenue, is predominantly paid out during the first quarter of the year (in March) and has been undergoing a successive phase-out since 2006 – accounted for a significant share of this increase. In addition to this, however, advance payments of assessed taxes also continued to grow dynamically. Revenue from consumption-related taxes went up by 2%. Growth in turnover tax was higher, which was in line with the relatively favourable developments in nominal consumption, as well as in nominal private housing investment. By contrast, revenue from other excise duties fell owing, in particular, to the extraordinary effects for tobacco tax.

According to the latest official tax estimate, tax receipts for 2012 as a whole are expected to rise by 4% (including local government taxes).<sup>10</sup> This increase primarily reflects the assumptions regarding macroeconomic reference variables. Furthermore, fiscal drag<sup>11</sup> and legislative

*Marked revenue growth for year as a whole and ...*

<sup>8</sup> Including EU shares in German tax revenue but excluding receipts from local government taxes, which are not yet known for the quarter under review.

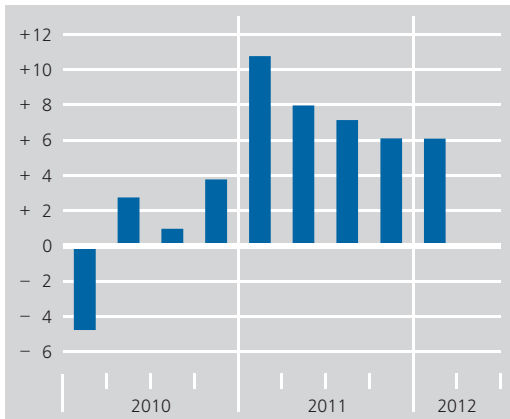
<sup>9</sup> Corporation tax revenue rose particularly strongly, mainly because of a negative base effect. This effect had caused non-assessed taxes on earnings to increase by the same amount in 2011. However, the normalisation of the latter during the reporting quarter was outweighed by new positive special factors.

<sup>10</sup> This estimate is based on the Federal Government's current macroeconomic projection. In 2012, real GDP growth is expected to be +0.7% and nominal growth +2.3% (November 2011: +1.0% and +2.4%, respectively). For 2013, the corresponding figures are +1.6% and +3.2%. In the medium term, nominal annual growth of around 3% is forecast, as was predicted in November 2011.

<sup>11</sup> In this context, this term comprises the revenue effects stemming from the progressive structure of the income tax schedule (positive) and the fact that specific excise duties are largely inelastic to price changes (negative).

### Tax revenue\*

Year-on-year percentage change, quarterly



\* Including EU shares in German tax revenue, excluding receipts from local government taxes.  
 Deutsche Bundesbank

changes will result in additional revenue on balance. Significant legislative changes include the phase-out of more generous depreciation allowances and the homebuyers grant.

For 2013 and on an average of the years from 2014 to 2016, annual revenue growth of around 3½% is forecast. Although in the coming years, and above all in 2013, macroeconomic conditions are expected to be noticeably more favourable than in 2012, the legislative changes included in the calculations will have only a small impact on revenue.<sup>12</sup> The planned cuts in the income tax rate in 2013 and 2014, which were initially rejected by the Bundesrat, have not yet been included. The cuts would lower revenue growth by ¼ percentage point in 2013 and ½ percentage point in 2014 (full annual effect: -€6 billion). The tax ratio (as defined in the government's financial statistics) is projected to increase to 23.2% in 2016 (2011: 22.3%). Fiscal drag accounts for approximately ½ percentage point, or €12 billion, of this rise. Furthermore, the growth structure and, to a limited extent, legislative changes will lead to an increase in the ratio. Overall, it should be borne in mind that the Federal Government's macroeconomic projection and consequently the official tax estimate assume a smooth development of the economy. There is a great

deal of uncertainty in this respect, particularly because of the sovereign debt crisis.

Compared with the November 2011 tax estimate – which forms the basis for central government's regular budget and, to a large extent, the available plans for state government budgets for 2012 – only minor adjustments on balance have been made to the macroeconomic benchmark figures. Although legislative changes made in the intervening period will result in (limited) shortfalls from 2012 onwards, these will largely be offset by a positive base effect (higher-than-expected revenue in 2011). Nevertheless, there was an upward revision to the estimates for 2012 to 2016 compared with the November forecast, particularly owing to the relatively dynamic intra-year developments. After adjustment for legislative changes made in the intervening period, an increase of between €7 billion and €8½ billion per year is expected for general government. Compared with the May 2011 forecast, which served as the basis for the last central government medium-term plan of summer 2011, both the revisions to the macroeconomic benchmark figures from 2012 onward and the legislative changes made in the intervening period imply noticeable revenue shortfalls.<sup>13</sup> However, the positive 2011 base effect is significantly higher than had been expected last May. After adjustment for legislative changes made in the intervening period, the revisions for 2012 to 2015 amount to around €15 billion (½% of GDP).

*Upward revisions compared with last forecast*

*... in rest of planning period, too*

<sup>12</sup> The inclusion of various court rulings also has a (limited) impact on the growth rate's profile. For example, considerable tax refunds are expected, above all in 2013, particularly as a result of a ruling by the European Court of Justice on the taxation of dividends among affiliated enterprises.

<sup>13</sup> By contrast, the fact that estimates for tax refunds were revised in November 2011 in connection with the Meilicke case (treatment of corporation tax paid abroad in the taxation of dividends under the tax imputation procedure that was abolished in 2001) is having a positive effect. In unadjusted terms, revenue was consequently just over €3½ billion higher in 2011 and will be €1 billion higher in 2012.

## Central government budget

*Further decline in deficit at start of year*

In the first quarter of 2012, the central government deficit fell €1½ billion on the year to €17½ billion. Total revenue remained largely unchanged. Tax revenue saw an increase of 3% (€2 billion), although this was muted by the deductions made for transfers to the EU budget, which were €1 billion higher. However, non-tax revenue was significantly lower. This was mainly attributable to the Bundesbank's profit distribution being €1½ billion lower. Expenditure saw an overall decline (-1½%), to which the reduction of €1 billion in transfers to the social security funds made the largest individual contribution. This decrease was chiefly due to the reduced pre-drawn recourse to the regular grant for the Federal Employment Agency, which is based on liquidity demand during the course of the year.

*Draft supplementary budget to finance brought-forward ESM contributions results in higher planned deficit, ...*

However, during the remainder of 2012, the deficit will increase again year-on-year owing to contributions of €8½ billion to the ESM. As the 2012 budget does not contain any authorisations for these contributions, the Federal Cabinet adopted a draft supplementary budget in March. On the basis of a Eurostat decision, the draft supplementary budget classifies the capital transfer as a financial transaction and it is therefore not taken into account in the borrowing limit that is key to the debt brake. The other changes contained in the draft supplementary budget do not affect the deficit on balance, meaning that the authorisation for net borrowing is to be extended from €26 billion to €35 billion. Additional burdens affecting the other items, particularly as a result of the Bundesbank's lower distribution of profits, will primarily be offset by the downward revision of €2 billion to estimates for interest expenditure. Furthermore, tax revenue is forecast to be €½ billion higher.<sup>14</sup> On balance, the Federal Government's budget plan still contains a considerable renewed increase in the structural deficit compared with the actual figure for 2011 (+€4 billion), not least owing to the significant slackening of the consolidation course agreed in 2010.

### Tax revenue

| Type of tax                        | Q1    |       | Estimate for 2012 <sup>1, 2</sup> |                                |
|------------------------------------|-------|-------|-----------------------------------|--------------------------------|
|                                    | 2011  | 2012  | Year-on-year percentage change    | Year-on-year percentage change |
| Tax revenue, total <sup>2</sup>    | 123.1 | 130.6 | + 6.1                             | + 4.0                          |
| of which                           |       |       |                                   |                                |
| Wage tax                           | 32.5  | 34.1  | + 5.0                             | + 5.5                          |
| Profit-related taxes <sup>3</sup>  | 17.9  | 22.5  | + 25.8                            | + 6.6                          |
| Assessed income tax                | 6.8   | 8.5   | + 25.2                            | + 8.5                          |
| Corporation tax                    | 2.5   | 5.5   | .                                 | + 17.1                         |
| Investment income tax <sup>4</sup> | 8.6   | 8.5   | - 0.9                             | - 1.9                          |
| Turnover taxes <sup>5</sup>        | 47.4  | 49.0  | + 3.3                             | + 3.3                          |
| Energy tax                         | 4.5   | 4.4   | - 1.2                             | - 0.2                          |
| Tobacco tax                        | 2.9   | 2.3   | - 20.3                            | - 1.5                          |

<sup>1</sup> According to official tax estimate of May 2012. <sup>2</sup> Including EU shares in German tax revenue, excluding receipts from local government taxes. <sup>3</sup> Employee refunds, homebuyers grant and investment grant deducted from revenue. <sup>4</sup> Withholding tax on interest income and capital gains, non-assessed taxes on earnings. <sup>5</sup> Turnover tax and import turnover tax.

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However, the latest tax estimate foresees additional tax revenue of €2½ billion vis-à-vis the draft supplementary budget. As in the preceding years, lower-than-planned drawdowns of funds from the EU budget may provide additional relief, even though measures have been taken which aim to increase the actual take-up of resources from the structural and cohesion funds. Moreover, given central government's still extremely favourable (re-)financing conditions, debt servicing costs look likely to decrease further. In particular, labour-market-related spending could also prove to be lower than expected. The renewed growth in the deficit compared with the actual figure for 2011 should therefore remain within significantly narrower bounds. From a structural perspective, a further decline in the deficit currently appears possible. In view of the increasingly strict

*... but more favourable developments on the cards*

<sup>14</sup> However, as estimated GDP growth has now been revised downward, the negative cyclical impact imputed for the central government budget is €1 billion higher.



mates on the underlying cyclical components have been published. They expect a significant macroeconomic underutilisation in 2012, which will slowly be scaled back in the period extending to 2016. This is at odds with the prevailing assessment that the German economy is likely to remain within the corridor of normal utilisation in 2012 despite the slight losses owing to the weak phase at the end of 2011. The Federal Government's assumption indicates a lower structural deficit and thus a reduced level of consolidation outstanding.

Overall, the deficits have been significantly reduced compared with the summer 2011 financial plan and the latest tax estimate forecasts a further decrease of around €1 billion (2014 and 2015) and €3 billion (2013) vis-à-vis the benchmark figures set in March 2012. According to government data, the central government structural deficit for 2014 will already be below the 0.35% limit applicable from 2016 under the debt brake. This is essentially a welcome development.

*Plan to bring structural deficit below 0.35% of GDP as early as 2014*

restriction of borrowing through the debt brake, this certainly seems to be advisable.

*Benchmark figures for 2013 to 2016 have limited binding effect*

When drawing up the budget in March this year, as in 2011, the Federal Government set benchmark figures for the next year's budget and the financial plan on the basis of the macroeconomic assumptions in its Annual Economic Report. The benchmark figures are subject to the proviso that they will be adjusted in line with any revisions to the underlying assumptions or in accordance with government decisions. In 2011, the additional budgetary burdens agreed during subsequent budget preparations significantly moderated the binding effect of the benchmark figures. In order to be sure of fulfilling the debt brake requirements in the medium term, it appears imperative to refrain from loosening the planned course any further. Given the absence of data on the net burden resulting from financial transactions, it is not possible to analyse the structural plans more precisely. However, government esti-

However, the forecast reduction in net borrowing by around €5 billion per year vis-à-vis the latest financial plan is primarily due to lower estimates for interest expenditure, with revisions up to 2015 amounting to around €10 billion.<sup>15</sup> By contrast, the additional revenue expected in March 2012 vis-à-vis the May 2011 tax estimate will largely be set aside to fund income tax cuts. The childcare supplement planned from 2013 onward is currently only counterfinanced through global expenditure savings. Cuts in payments to the social security funds are planned to provide relief for the central government budget. In 2013, central government transfers to the health insurance fund are to be reduced by €2 billion on a one-off basis. Transfers to the statutory pension insurance scheme are to be lowered by €1 billion annually. Adjustments to payments between central government and the Federal Employment Agency

*More favourable developments primarily due to lower interest expenditure*

<sup>15</sup> This supersedes the previous global savings of €5 billion from 2014 onward.

are to relieve the central government budget by €2 billion in 2013 and by €1 billion annually thereafter. The statutory health and pension insurance schemes currently have substantial reserves, which appear to be a something of a temptation for policymakers. However, such ideas lose sight of the fact that stronger expenditure growth and legally prescribed pension contribution cuts will probably quickly reduce the current surpluses and that, looking ahead, deficits even appear likely if there are no further corrections. The planned shifting of burdens will thus make it necessary to increase contribution rates or cut benefits within the foreseeable future. It would in principle be desirable to clearly specify the social security funds' "non-insurance-related benefits" and finance these by means of rule-based central government grants. Otherwise, it will repeatedly look like fiscal policymakers are just changing track on a whim.

*Significant safety margin vis-à-vis constitutional borrowing limit advisable*

The benchmark figures contain some savings targets which have yet to be specifically implemented. It is assumed, for example, that defence ministry expenditure will decrease. The financial transactions tax, which is now planned to be introduced in 2014 and produce €2 billion annually in revenue, could be dropped if the current lack of agreement at European level persists. This poses a risk to the achievement of the savings requirements. However, possible negative macroeconomic developments and the repercussions of an intensification of the sovereign debt crisis are the main sources of uncertainty regarding compliance with the benchmark figures. Given the provisions of the debt brake, which will become progressively stricter over time, it would be advisable to use the assumed favourable economic conditions as an opportunity to reduce the deficit more sharply until there is a significant safety margin vis-à-vis the borrowing limit of 0.35% of GDP, rather than providing relief without the necessary counterfinancing.

Central government's off-budget entities are likely to have recorded a surplus in the first

quarter of 2012, compared with a deficit of €1 billion in the same period last year. The discontinuation of the Investment and Repayment Fund's support measures made the largest contribution to the improved result. These measures had resulted in a deficit of €1½ billion in the same period of 2011. In light of the tensions relating to the sovereign debt crisis, SoFFin's mandate was extended further at the beginning of the year. However, like one year previously, no recourse was taken to the assistance available to financial institutions, nor were any repayments made. The post office pension fund and the pension reserve are likely to have once again recorded surpluses. Provided there are no new capital injections to financial institutions, the off-budget entities are currently expected to record a surplus for the year as a whole. This is primarily attributable to revenue from reserves and special funds for outlays on pensions as well as additional costs for redeeming inflation-indexed securities. Even so, the surplus is likely to be significantly lower than the figure recorded in 2011 (€6 billion), which was due to capital repayments to SoFFin.

*Off-budget entities record surplus*

## State government<sup>16</sup>

The deficit in the federal states' core budgets decreased in the first quarter of 2012 compared with the same period one year previously, falling by €1½ billion to €2½ billion. Revenue continued to rise perceptibly (+4%) as a result of the favourable developments in tax receipts (+ 8½%). At 2%, growth in expenditure lagged significantly behind. Personnel costs, a major item of state government expenditure, were up by 3½% on the year, however. Furthermore, current transfers to local government rose by 8% as a result of the favourable developments in state government tax receipts, which are, in principle, key for determining general grants from state government to local

*Further decline in deficit in 2012 Q1, ...*

<sup>16</sup> The development of local government finances in the final quarter of 2011 was analysed in greater detail in the short articles in the Bundesbank's April 2012 Monthly Report. These are the most recent data available.

government, and because the federal states were forwarding central government's increased contributions to the municipalities' basic allowance costs.

*... but plans for the year as a whole currently do not envisage any fiscal consolidation progress*

With a fiscal balance of -€15 billion, state government budget plans for 2012 have largely not been adjusted in line with the favourable developments seen during the implementation of the 2011 core budgets (actual deficit: €9½ billion). According to the May tax estimate, state government is expected to record additional revenue of €2½ billion vis-à-vis the figures in the budget plans. Compared with the actual 2011 figure, consolidation progress thus appears unlikely. Yet the debt brake stipulates that the federal states must completely eliminate their (structural) deficits by 2020, and decisive action should therefore be taken to address the ongoing need for consolidation. Furthermore, the federal states would also be well advised to create an appreciable safety margin with respect to the borrowing limit by 2020.

*Deficit reduction path for consolidation assistance recipients not strict enough*

Particular attention needs to be paid to those federal states entitled in principle to consolidation assistance in the transitional phase of the debt brake. Although these states must provide the Stability Council with evidence that they have carried out the agreed deficit reduction steps, the overly high starting values<sup>17</sup> mean that this is initially unlikely to prove very challenging. In particular, the far-reaching consolidation measures required in **Bremen and Saarland** can probably be postponed further. Given past experience, it appears crucial for the Stability Council to urge these federal states to rapidly make the foreseeable necessary improvements. Otherwise, as in the case of rehabilitation assistance during the last two decades, there is a danger that they will ultimately fail to comply with the constitutional borrowing limits.

*Ensure resolute deficit reduction in other states, too*

However, the other federal states that still have relatively high structural deficits ought to resolutely use the favourable macroeconomic situation as an opportunity to balance their

budgets as quickly as possible through consolidation measures. In Hesse, North Rhine-Westphalia and Rhineland Palatinate, progress on this task is being hampered by imbalances in local government budgets,<sup>18</sup> which are still substantial on average and for which the federal state ultimately shares responsibility. There is currently no recognisable scope for expanding benefits or cutting tax rates. Instead, it seems imperative to immediately set ambitious annual minimum reduction steps for the structural deficits in order to ensure that the debt brake requirements enshrined in the constitution are fulfilled in the future.

## ■ Social security funds<sup>19</sup>

### Statutory pension insurance scheme

The statutory pension insurance scheme recorded a deficit of just under €1 billion in the first quarter of 2012, which was €½ billion lower than one year previously. At 2%, revenue grew by almost twice as much as expenditure. Despite the cut in the contribution rate from 19.9% to 19.6% at the start of 2012, employ-

*Reduced deficit at start of year despite cut in contribution rate*

<sup>17</sup> The May 2010 tax estimate results were used as a basis for the 2010 reference year and the additional revenue that was already known when the starting value was determined was interpreted as being cyclically induced. The 2010 starting structural deficit value was therefore set very high. From 2011 onward, these revisions to the estimate are effectively regarded as structural. The use of this procedure has resulted per se in a significantly lower structural deficit from 2011 onward in unadjusted terms and enabled these states to achieve the required reduction in the structural deficit for 2011. Together with the additional receipts for 2011 vis-à-vis the crucial November 2010 tax estimate, which were initially also classified as cyclically induced, this will probably enable them to achieve the required reduction in 2012, too. This will allow them to postpone consolidation measures. One option worth considering would be to more closely link the deficit reduction for which evidence must be provided to the comparable values for other states. See Deutsche Bundesbank, The role of the Stability Council, Monthly Report, October 2011, pp 20-23.

<sup>18</sup> See Deutsche Bundesbank, Public finances, Monthly Report, April 2012, pp 7-9.

<sup>19</sup> The financial development of the statutory health and public long-term care insurance schemes in the final quarter of 2011 was discussed in the short article in the March 2012 Monthly Report. These are the most recent data available.

ees' compulsory contributions increased by close to 2½%. If the contribution rate had remained unchanged, they would have gone up by 4%. On balance, central government grants were up by just over 2% on the year. Although a lower contribution rate *per se* reduces the general central government grant, the positive wage developments in 2010 – which are also significant for the adjustment of central government grants – had a greater impact. Spending on pensions rose by just over 1% in the first quarter. This roughly corresponds to the mid-2011 adjustment rate (+0.99%). The impact of the slight increase in the number of pensions was once again largely offset by a decline in the average payment amount.

*Cut in contribution rate to below 19.2% on the cards for 2013*

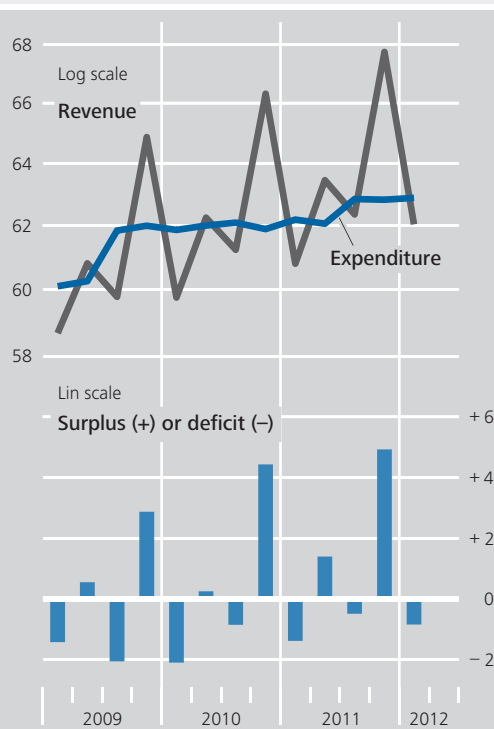
In mid-2012, pensions will be raised by 2.18% in western Germany and 2.26% in eastern Germany. This is the result of relatively strong wage developments in 2011 and the exceptionally powerful adjustment-boosting effect of the sustainability factor,<sup>20</sup> although the impact of both these factors will still be dampened by a reduction in the adjustment to compensate for pension cuts waived in previous years. During the remainder of the year, expenditure will rise at a faster pace owing to this sharper increase in pensions. In spite of the reduction in the contribution rate, growth in revenue could be just as strong as in 2011, when the discontinuation of pension contributions on behalf of recipients of unemployment benefit II resulted in shortfalls. Overall, the 2012 surplus is now likely to be much higher than expected when the contribution rate was set in autumn 2011. If the favourable macroeconomic developments continue, the contribution rate at the beginning of 2013 is likely to be lower than the figure forecast to date (19.2%), even if central government funds are cut by €1 billion, as is planned.

*Current favourable financial situation does not justify permanent expansion of benefits*

The statutory pension insurance scheme's advantageous financial situation at present should not blind us to the fact that demographic developments from around the middle of the current decade will go hand in hand with a higher

### Finances of the German statutory pension insurance scheme

€ bn, quarterly



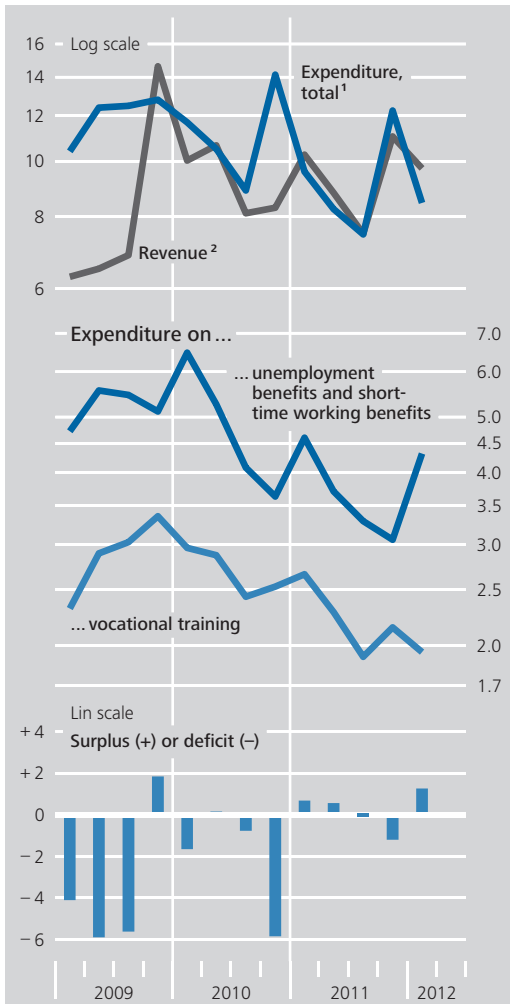
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number of benefit recipients and a lower number of contributors. Notwithstanding the reduced adjustments and the rise in the statutory retirement age, the financial burdens associated with these demographic developments already require a trend increase in the contribution rate, which threatens to exceed the statutory limit of 22% applicable until 2030 in the years thereafter even if the range of benefits is not expanded. Against this backdrop, it appears extremely problematic to propose additional permanent benefits today which will entail increasing costs over time – such as the pension allowances or higher pensions for persons with reduced earning capacity – without

<sup>20</sup> Admittedly, the reduction in the pensioner ratios responsible for this is not solely due to the currently very favourable employment situation and the only moderate increase in the number of pensioners, but also in particular to the fact that the number of “equivalence contributors” is calculated using (outdated) provisional average wages. This special factor will – conversely – perceptibly reduce the pension adjustment in 2013.

### Finances of the Federal Employment Agency

€ bn, quarterly



1 Including transfers to the civil servants' pension fund.  
 2 Excluding central government liquidity assistance.  
 Deutsche Bundesbank

securing counterfinancing on a sustainable basis.

## Federal Employment Agency

The Federal Employment Agency recorded a surplus of just under €1½ billion in the first

quarter of 2012. The improvement of €½ billion year on year is understated by the fact that €1 billion less in central government funds were required to ensure liquidity supply during the first three months of 2012. Contribution receipts were up by 5½% on the year. However, revenue fell by just under 5½% overall owing to lower payments from central government. On the expenditure side, although a decline of almost 12% was recorded on balance, the trend of shrinking negative growth rates continued. By contrast, greater cost savings were made in the area of active labour market policy, which were up by one-fifth on the year at last report.

*Favourable financial result at start of year*

The macroeconomic assumptions underlying the Federal Employment Agency's budget plan are likely to be exceeded. The 2012 surplus is thus likely to be higher than the figure of €½ billion which was forecast despite the cut in the rule-based central government grant (by just under €1 billion). Looking ahead, however, the Federal Employment Agency's finances could come under pressure even without a weakening in the labour market if the central government grant is completely discontinued – as envisaged in the benchmark figures for the 2013 central government budget – and, in return, the reintegration payment which the Federal Employment Agency makes to central government for its half-share in the mediation and administration costs for recipients of unemployment benefit II is abolished. On balance, the more these costs fall, the worse off the Federal Employment Agency will be compared with its situation under the legislative *status quo*. By contrast, only central government would be negatively affected if the costs were to go back up again in the future.

*Surplus for year as a whole likely to be higher than planned*