Public finances*

General government budget

2023 as a whole

2023 fiscal policy largely financed from emergency loans

The German government will record a significant deficit in 2023, too. It will probably finance this in large part using reserves from previous years, which it has primarily formed from emergency loans. However, the deficit is likely to decline further on the year (2022: 2.7% of gross domestic product (GDP)). The main reason for this is that temporary support measures are putting much less strain on public finances overall than in 2022. Of these measures, the electricity and gas price brakes are still likely to make the strongest impact in 2023 – albeit to a much lesser extent than originally projected. In order to finance the price brakes and other energy support measures, the Economic Stabilisation Fund for Energy Assistance (ESF-E) was filled using emergency loans last year.

Decline in debt ratio continuing

The debt ratio is expected to fall further this year in view of debt growing more slowly than nominal GDP in the denominator of the ratio. By the end of March, the debt ratio had decreased to 65.9%, compared with 66.2% at the end of 2022. This decline could accelerate further over the course of the year, as an above-average proportion of the year's borrowing is likely to have occurred in the first quarter.

Outlook for 2024 and 2025

Expiring crisis measures will reduce deficit further in 2024; expansionary spending stance in other areas

According to the Bundesbank's most recent projection in June, public finances will continue to recover up to 2025.[1] The deficit ratio is expected to decline, standing at just over 1% of GDP in each of the coming two years. The debt ratio is set to fall to 62% by the end of 2025. The decline in the deficit will continue to be driven by the expiry of temporary support measures. This will outweigh the stance in the rest of the general government budget (excluding the temporary support measures), which will increasingly be tilted towards a deficit. The recently presented central government plans do not fundamentally change the budgetary outlook. However, deficits are likely to be somewhat higher as a result of measures taken (see pp. 66 ff.).

Fiscal policy stance amid high inflation rates

Appropriate not to loosen fiscal policy stance given high price pressures

In view of foreseeable high price pressures, it would be appropriate, from a monetary policy perspective, not to loosen the fiscal policy stance. There would otherwise be a risk of increased inflationary pressures in the medium term. Monetary policy would then need to be tightened even further in order to meet the inflation target.

Fiscal policy to be interpreted as fairly expansionary between 2023 and 2025

The fiscal policy stance depends on general government developments as a whole; limiting the focus to the central government budget alone is too narrow. Although the general government deficit is projected to decline in the years from 2023 to 2025, this is solely due to the expiry of temporary support measures. This development is largely in line with the easing of the pandemic burden on the private sector and lower energy payments to foreign countries. On balance, these expiring government measures and the diminishing crisis burdens are therefore unlikely to weigh on macroeconomic developments. From the current perspective, the general government budget balance, excluding cyclical influences and temporary measures, is set to deteriorate. Expiring support

* The section entitled "General government budget" relates to data from the national accounts and the Maastricht debt ratio. This is followed by reporting on budgetary developments (government finance statistics) in the areas for which data are available for the second quarter of 2023.
1 See Deutsche Bundesbank (2023a).

measures aside, then, the basic stance is expected to be expansionary. Amongst other factors, central government is likely to report increasing deficits in its off-budget entities for climate policy and defence. The budgetary stance of state and local governments is also shaping up to be fairly expansionary.

Additional deficit-increasing measures would intensify inflationary pressures

If fiscal policymakers want to avoid creating additional inflationary pressures, it would make sense not to adopt any further deficit-increasing measures. This would also include, for example, not planning other uses for the reserves from the ESF-E that will foreseeably become available. This does not mean neglecting important policy objectives that would improve growth conditions, for instance. However, with a view to reducing price pressures, these objectives would need to be counterfinanced upfront – either by lowering other expenditure or generating additional revenue.

Apply fiscal rules effectively, make public finances transparent

Effective fiscal rules support stability-oriented monetary policy

Effective fiscal rules that safeguard sound public finances are important, not least, for stability-oriented monetary policy. They are not at odds with forward-looking government activity, either. Indeed, sound public finances are what gives a state the ability to take action. Transparent public finances are also crucial in helping the general public to understand budget planning and budgetary developments.

Problems with off-budget entities

Recently, central and state governments have increasingly shifted tasks over to the off-budget entities. In some cases, future expenditure has been funded upfront via the escape clause. The number and size of off-budget entities are impairing the transparency and monitoring of public finances. When the escape clause is used to finance large amounts of future expenditure upfront, it also undermines the binding effect of the debt brake.[2]

Effective debt brake ensures sound public finances; stability-oriented reform is justifiable

It is important that credible and binding fiscal rules are set for central and state government again in future. At present, the debt brake is making the borrowing framework relatively restrictive. In this respect, a reform that moderately raises the regular upper limit of the debt brake would also be justifiable in the interests of stable public finances. The Bundesbank has made proposals for a stability-oriented reform.[3] The scope for deficits, for instance, could be extended if the debt ratio is below 60%. If investment is to be prioritised within the limits, leeway could be reserved for net investment.

Very high debt ratios in some parts of the euro area; binding fiscal rules therefore particularly important

Public finances in some other euro area countries are considerably less favourable than in Germany. For 2023, the European Commission anticipates very high debt ratios in Italy, Spain and France, amongst other countries (140%, 111% and 110% respectively); in some cases, these ratios are not set to fall in 2024, either. It is crucial that the fiscal rules lead governments to bring down their high debt ratios. For this to happen, the Stability and Growth Pact should be more stringent and more binding after the reform. The debate surrounding this reform is still underway. However, the European Commission's current proposal is at risk of failing to meet this objective.[4]

Budgetary development of central, state and local government

Tax revenue

Second quarter of 2023

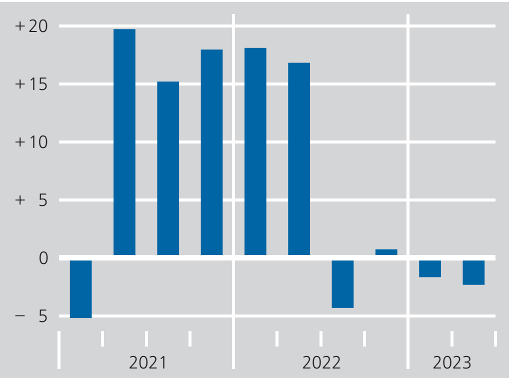
Tax revenue fell significantly in Q2 due to tax cuts

Tax revenue[5] in the second quarter was 2½% lower than a year earlier (see the chart on p. 64

2 For more information, see Deutsche Bundesbank (2023b).
3 See Deutsche Bundesbank (2022a).
4 See Deutsche Bundesbank (2023c), pp. 71 ff.
5 Including EU shares in German tax revenue, but excluding receipts from local government taxes, which are not yet known for the quarter under review.

Tax revenue*

Year-on-year percentage change, quarterly figures



Source: Federal Ministry of Finance. * Comprises joint taxes as well as central government taxes and state government taxes. Including EU shares in German tax revenue, including customs duties, but excluding receipts from local government taxes.

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and the table on p. 65). In the absence of tax cuts, it would have risen slightly.

Wage tax fell due to major legislative changes

Without tax cuts, revenue from wage tax would actually have seen dynamic growth, but instead, it fell by 1½%. The main factor here is the Inflation Compensation Act *(Inflationsausgleichsgesetz),* which adjusted the income tax scale to the high inflation rate of the previous year and raised child benefits. Increased child benefits reduce wage tax receipts because they are deducted from wage tax revenue. Furthermore, until the end of 2024, additional one-off wage payments of up to a total of €3,000 will count as tax-exempt inflation compensation bonuses *(Inflationsausgleichsprämie).*

Profit-related taxes down significantly, but positive underlying trend appears intact

Revenue from profit taxes decreased by 5% overall. The adjustments made to the income tax scale contributed to this. Moreover, receipts from the taxation of dividends, which is generally very volatile over the course of the year, fell sharply. However, the positive underlying trend for profit-related taxes may have remained intact. Although income tax revenue would have fallen even without the income tax adjustments, advance payments for the current year, by contrast, rose considerably (adjusted for legislative changes). In addition, revenue from corporation tax saw continued dynamic growth.

VAT weak, not only because of tax cuts

Revenue from VAT declined slightly in the second quarter (-½%). Here, too, a tax cut had an impact: the tax rate for natural gas and district heating was temporarily lowered. This may have had a stronger impact in the quarter under review if the taxes overpaid on consumption invoices for the last heating period had to be reimbursed. However, even aside from this, VAT saw relatively weak growth.

Real estate acquisition tax revenue still in freefall

Real estate acquisition tax revenue dropped by 33%. This is equivalent to €1½ billion and accounts for almost one-third of the decline in total tax revenue. The fall in revenue from real estate acquisition tax is consistent with the decreased value of sales in the real estate sector. This is likely to reflect the fall in real estate prices, for one thing. For another, transactions in residential real estate have probably declined recently. This latter development is related, in particular, to the significant increase in financing costs.

2023 as a whole

Tax estimate up by 3% for the year as a whole – faster growth envisaged for H2

The official tax estimate projects a rise of 3% in tax revenue (excluding local government taxes) for the year as a whole. In the first half of the year, receipts fell by 2% – and thus developed somewhat less favourably than expected. Over the course of the year as a whole, the projected result could nevertheless still be achieved. This is because, for the remainder of 2023, a much more positive growth rate is anticipated than in the first half of the year: a number of temporary measures, which reduced revenue in the second half of 2022, will then be absent. Specifically, the energy price allowance *(Energiepreispauschale)* for employed persons, in particular, resulted in shortfalls in the second half of last year. In addition, the basic income tax allowance and the employees' standard deduction for income-related expenses increased retroactively from the beginning of 2022. Furthermore, energy tax rates on fuel were lower ("fuel rebate"), and parents received a bonus child benefit payment via lower wage tax revenue.

Tax revenue

Type of tax	H1 2022 € billion	H1 2023 € billion	H1 2023 Year-on-year change € billion	H1 2023 Year-on-year change %	Estimate for 2023[1] Year-on-year change in %	Q2 2022 € billion	Q2 2023 € billion	Q2 2023 Year-on-year change € billion	Q2 2023 Year-on-year change %
Tax revenue, total[2]	407.9	399.8	− 8.1	− 2.0	+ 2.9	204.7	200.0	− 4.7	− 2.3
of which:									
Wage tax[3]	116.6	115.2	− 1.4	− 1.2	+ 6.1	60.4	59.5	− 0.8	− 1.4
Profit-related taxes	81.5	78.2	− 3.3	− 4.1	+ 2.9	41.5	39.4	− 2.1	− 5.0
Assessed income tax[4]	38.1	35.2	− 2.9	− 7.6	+ 0.8	17.2	15.5	− 1.7	− 10.0
Corporation tax[5]	22.4	23.1	+ 0.7	+ 3.0	+ 0.4	11.2	12.4	+ 1.2	+ 10.3
Non-assessed taxes on earnings	16.7	16.4	− 0.3	− 2.0	+ 12.9	11.6	9.8	− 1.8	− 15.2
Withholding tax on interest income and capital gains	4.2	3.5	− 0.8	− 18.0	− 4.7	1.4	1.7	+ 0.3	+ 17.5
VAT[6]	141.3	140.8	− 0.6	− 0.4	+ 1.6	67.8	67.3	− 0.5	− 0.7
Other consumption-related taxes[7]	42.3	43.3	+ 0.9	+ 2.2	+ 5.0	21.8	22.0	+ 0.1	+ 0.6

Sources: Federal Ministry of Finance, Working Party on Tax Revenue Estimates and Bundesbank calculations. **1** According to official tax estimate of May 2023. **2** Comprises joint taxes as well as central government taxes and state government taxes. Including EU shares in German tax revenue, including customs duties, but excluding receipts from local government taxes. **3** Child benefits and subsidies for supplementary private pension plans deducted from revenue. **4** Employee refunds and research grants deducted from revenue. **5** Research grants deducted from revenue. **6** VAT and import VAT. **7** Taxes on energy, tobacco, insurance, motor vehicles, electricity, alcohol, air traffic, coffee, sparkling wine, intermediate products, alcopops, betting and lotteries, beer and fire protection.

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Central government finances

Overview for 2023

Q2: overall deficit down significantly

The central government deficit including off-budget entities[6] was considerably lower in the second quarter than it was one year ago, falling by €13 billion to €5 billion. The core budget and the off-budget entities as a whole saw their results improve by roughly the same amount.

Year as a whole: very high deficit planned, but considerably more favourable outcome likely

A high overall deficit of €232 billion is planned for the year as a whole. Off-budget entities account for €146 billion of this sum.[7] However, their deficit is likely to be significantly lower than planned, mainly due to reduced energy price support needs.

Central government budget: second quarter of 2023

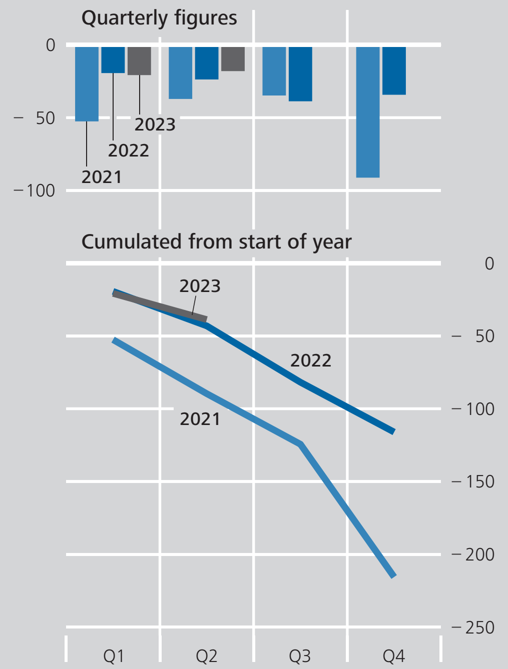
Slight rise in tax revenue and declining expenditure

In the core budget, the deficit fell to €18 billion in the second quarter, compared with almost €24 billion in the same quarter of 2022. Revenue saw moderate growth of 2% (+€2 billion), with tax revenue only rising by 1%. Total expenditure went down by 3% (-€3½ billion). Although pandemic-related spending declined sharply, this was offset by a steep rise in inter-

6 Central government off-budget entities that use the single-entry system and for which quarterly data are already available are included here (see pp. 69 f.). These comprise, in particular, (i) the ESF-E, (ii) the off-budget entities relevant to the debt brake up to 2021 and (iii) the Armed Forces Fund (see the table on p. 67, rows 16, 17 and 20). In addition, the reporting group for off-budget entities includes, above all, (iv) the other funds shown in the central government budget's borrowing plan (for making provisions for repayment and for expanding childcare, both row 18) as well as (v) the precautionary funds for civil servants' pensions. In particular, the bad bank FMSW, the fund for the disposal of nuclear energy waste, the motorway company and the development aid company GIZ are excluded.
7 See Deutsche Bundesbank (2023d), p. 69, items 3 and 21 of the table.

Fiscal balance of central government budget*

€ billion



Source: Bundesbank calculations based on data from the Federal Ministry of Finance. * Excluding off-budget entities. Not adjusted for financial transactions or cyclical effects.
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est expenditure (+€11 billion), with provisions for final payments on inflation-linked Federal bonds seeing a particular increase. Discounts, which mainly occurred in tap issues of long-dated bonds with low coupons, resulted in additional expenditure of €1½ billion. Additional interest expenditure on account of increased debt and higher coupons also contributed to this.

Central government budget: 2023 as a whole

Central government's 2023 budgetary objective could be undershot

The deficit of €86 billion projected in the core budget could be undershot. A reserve of €5 billion, which is planned in for legislative changes, will not be needed as things currently stand. Thus, additional revenue appears likely here. However, when the draft budget for 2024 was presented, it was announced that receipts from the EU would be deferred to the following year. Interest expenditure is difficult to forecast. It also depends, in particular, on the extent to which long-dated bonds with low coupons are tap issued or issued. The resulting discounts are not recorded on an accruals basis and are therefore very volatile.

Upper net borrowing limit lower, according to Federal Government's spring forecast

A better budget outturn than projected seems logical, also in view of the debt brake: specifically, the upper net borrowing limit under the debt brake could be lower this year than assumed in the planning. For instance, according to the Federal Government's spring forecast, the cyclical burden is €7 billion lower than originally planned. Relief of a purely cyclical nature lessens borrowing potential in the context of the debt brake. This is because it is not supposed to open up new fiscal space so as to avoid a procyclical fiscal policy stance.

Draft central government budget for 2024

Core budget deficit expected to fall very significantly

In its draft budget from the beginning of July, the Federal Government intends to comply with the standard limit under the debt brake. It plans to limit net borrowing to €17 billion and to withdraw €1½ billion from the reserve. Hence, the core budget deficit is reduced very significantly, by almost €70 billion compared with the 2023 plan.

Core budget deficit reduction does not equate to highly restrictive fiscal policy

This decline in the core budget deficit does not equate to a correspondingly restrictive fiscal policy stance in Germany. Specifically, it should be borne in mind that deficits in key off-budget entities will increase and that some deficit-reducing factors are not likely to have a restrictive effect overall. For example, the Armed Forces Fund and the Climate Fund are set to expand their deficits sharply in 2024. Although the deficit of the ESF-E is likely to fall steeply, this will chiefly be due to correspondingly lower energy prices. In this respect, its lower expenditure is likely to be accompanied by, at most, a limited rebound in household energy costs, meaning that the overall effect is not restrictive. Several other developments easing the burden on the core budget compared with the previous year are also unlikely to have a restrictive effect. In particular, the burdens arising

Key central government budget data*

€ billion

	Item	Actual 2022	Target 2023	Draft 2024	Fiscal plan 2025	2026	2027
1.	Expenditure of central government budget (CGB)[1]	480.7	476.3	445.7	451.8	460.3	467.2
	of which:						
1.a	Investment	46.2	71.5	54.2	60.2	59.1	57.2
1.b	Global spending increases/cuts	–	– 6.9	– 9.7	– 12.4	– 10.7	– 27.0
2.	Revenue of CGB[1,2]	364.7	389.9	427.6	429.2	444.7	452.0
	of which:						
2.a	Tax revenue[3]	337.2	358.1	375.3	394.6	409.1	421.3
2.b	Global revenue increases/shortfalls	–	– 4.9	1.4	– 1.4	– 1.2	– 2.6
3.	Fiscal balance of CGB (2.-1.)	– 116.0	– 86.4	– 18.1	– 22.6	– 15.6	– 15.2
4.	Coin seigniorage of CGB	0.1	0.2	0.1	0.2	0.2	0.2
5.	Transfer to (–) / withdrawal from reserves (+) in CGB	0.5	40.5	1.4	6.4	.	.
6.	Net borrowing (–) / repayment (+) of CGB (3.+4.+5.)	– 115.4	– 45.6	– 16.6	– 16.0	– 15.4	– 15.0
7.	Cyclical component in the budget procedure[4]	– 0.4	– 15.3	– 2.4	– 2.0	– 0.9	0.0
8.	Balance of financial transactions of CGB	– 4.1	– 17.7	– 0.6	0.4	0.5	0.4
9.	Structural net borrowing (–) / repayment (+) of CGB (6.-7.-8.)	– 110.9	– 12.6	– 13.6	– 14.4	– 15.0	– 15.4
10.	Amount exceeding limit in CGB (13.-9.)	98.4	–	–	–	–	–
11.	Amount exceeding limit incl. Economic Stabilisation Fund for Energy Assistance (ESF-E) (10.-15.)	277.8	–	–	–	–	–
12.	Memo item: Amount exceeding limit with balance of off-budget entities (10.-16.-17.)	123.7	142.5	39.8	.	.	.
13.	Standard upper limit: Structural net borrowing (0.35% of GDP)[5]	– 12.5	– 12.6	– 13.5	– 14.4	– 14.9	– 15.4
14.	Structural balance of CGB (3.-7.-8.)	– 111.5	– 53.4	– 15.1	– 21.0	– 15.2	– 15.6
14.a	As before, with estimate of potential output acc. to 2023 spring forecast	– 109.0	– 61.0	– 15.0	– 21.0	– 15.2	– 15.6
15.	Structural net borrowing of ESF-E	– 179.4	–	–	–	–	–
16.	Balance of ESF-E	– 30.2	– 121.2	– 10.3	.	.	.
16.a	ESF-E funds remaining thereafter	169.8	48.6	38.3	.	.	.
17.	Balance of special funds (SFs) relevant to the debt brake prior to 2022[6]	4.9	– 21.4	– 29.4	.	.	.
17.a	Climate and Transformation Fund	5.3	– 14.1	– 29.2	– 28.2	– 13.4	0
17.b	2013 Flood Relief Fund	– 0.2	– 0.2	– 0.2	.	.	.
17.c	Fund to Promote Municipal Investment	– 0.7	– 1.0	.	.	.	.
17.d	Digitalisation Fund	2.1	– 2.7	–	–	–	–
17.e	Fund for Primary School-Age Childcare Provision	– 0.1	– 0.4	.	.	.	.
17.f	2021 Flood Relief Fund	– 1.6	– 3.0	.	.	.	.
18.	Balance of SFs for making provisions for repayment and for extending childcare[6]	4.4	5.5	.	.	.	.
19.	Balance of other SFs without own constitutional rules[7]	– 9.9	.	.	.	.	.
20.	Balance of Armed Forces Fund	–	– 8.4	– 19.2	.	.	.
20.a	Borrowing authorisation remaining thereafter	100.0	91.6	72.4	.	.	.
21.	Balance of CGB and SFs (3.+16.+17.+18.+19.+20.)	– 146.8	– 231.7	– 77.0	.	.	.
22.	Reserves of SFs for 16. and 17.	286.9	144.4	104.7	.	.	.
23.	Central government assets in civil servants' pension reserves and pension fund[8]	26.3	.	.	.	.	.
24.	Level of general reserves of CGB	48.2	7.7	6.4	–	–	–
25.	Balance on control account	47.7	47.7	47.7	47.7	47.7	47.7
26.	Total outstanding repayment amount including Armed Forces Fund (from 11. and 20.)	539.4	547.8	567.1	567.1	567.2	567.2
27.	Total outstanding repayment amount from NGEU grants[e,9]	30	53	70	87	105	105

* Sources: Federal Ministry of Finance and Bundesbank calculations. For a detailed explanation of debt brake and special fund metrics, see Deutsche Bundesbank (2016) and Deutsche Bundesbank (2023b). **1** Excluding transfers to/withdrawals from reserves and including net tax revenue (see footnote 3). **2** Excluding coin seigniorage. **3** After deduction of supplementary central government transfers, shares of energy tax revenue, compensation under the 2009 reform of motor vehicle tax and budgetary recovery assistance to federal states. **4** For 2022 according to the 2022 budget accounts, for 2023 according to the budget plan, and for the years thereafter according to the spring forecast. **5** Based on gross domestic product in the year before the (comprehensive) budget is prepared. **6** Budgeted figures for 2023 from borrowing plan. **7** Entities with quarterly data, but excluding data on results in borrowing plan. Above all, ESF (excluding ESF-E) and pension provisions. **8** Market values according to central government balance sheet for 2022. Continuous inflows; withdrawals from the fund planned from 2030, from reserves from 2032. **9** NGEU budgeted figures and estimates, each multiplied by Germany's share of 25% in EU gross national income.

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from financial transactions alone are set to fall by €17 billion. Additionally, pandemic-related special expenditure, which is estimated at roughly €10 billion for 2023, will be absent. Moreover, budgetary calls on guarantees, which are currently still heightened as a result of the pandemic and the energy crisis, will decrease. Furthermore, total interest expenditure is projected to be €3 billion lower. Aside from this, central government expects higher receipts from the EU recovery plan in 2024, which also will not have a restrictive impact.

Burdens shifted to special funds

In some cases, central government will directly employ the special funds to ease the burden on the core budget. For instance, compared with the 2023 budget, it will shift expenditure of €3 billion to the Climate Fund, primarily for the promotion of microelectronics. It also intends to dissolve the Digitalisation Fund, thus reducing net borrowing in the core budget by €5 billion.[8] For this purpose, central government will ultimately assume the fund's reserve, which it financed mainly from emergency loans in the years from 2020 to 2022.

Interest burdens still overstated in 2024

Discounts raise interest expenditure significantly in the draft for 2024, too. Generally allocating premia and discounts over the term of the respective security is advisable when recording them in the budget. This would ensure that the interest burdens are recorded appropriately from an economic perspective, and budgetary developments would be less volatile. At the current end, interest expenditure would then be lower.

Fiscal plan up to 2027

Fiscal plan with need for action, but at the same time provision apparently made on revenue side

In its medium-term planning, too, the government will comply with the borrowing limit in its core budget. Net borrowing will continue to fall to €15 billion in 2027, the final year of the planning period. It will be dampened by a withdrawal from reserves (€6½ billion) only in 2025. Expenditure is expected to grow moderately, by a nominal average of 1½%. The rising grants to the pension insurance scheme alone are likely to take up most of this. Additional expenditure on the envisaged basic child allowance and the further increase in generational capital does not, therefore, appear to be reflected yet. Furthermore, the fiscal plan contains large global spending cuts that have yet to be achieved. They amount to between €11 billion and €12 billion per year in 2025 and 2026 and are thus on a similar scale to those in the draft for 2024. In 2027, global spending cuts will rise sharply to €27 billion, which corresponds, after all, to nearly 6% of the total expenditure planned for that year. However, the Federal Ministry of Finance estimates that the remaining need for fiscal policy action will only amount to around €5 billion per year from 2025 onwards. It does not make clear how the differences between the need for action and the reported global items can be explained.[9] Overall revenue (just under +2% per annum) will rise less strongly on average than estimated taxes (+4% per annum). This could be due to provision for tax policy measures. Defaults would be associated, for example, with the announced tax breaks for enterprises. There will also be defaults if compensation for bracket creep in the income tax scale continues from 2025 onwards.

Fiscal policy challenges shifted to special funds without plans for follow-up financing

The medium-term planning presented gives no indication of the extent to which the government envisages large-scale deficits in its off-budget entities. It is unclear how financial challenges are to be overcome once their scope for deficits has been exhausted. This chiefly concerns the high expenditure on defence and climate policy, which is to be financed by the

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8 See Federal Ministry of Finance (2023), pp. 26 f.
9 One factor could be that incomplete expenditure outflows are assumed in a large number of areas. It may also have been expected that the Armed Forces Fund would still be able to finance some of the military procurements planned for 2027. For example, Table 7.12 of the Federal Government's latest Financial Report shows a strong increase in expenditure on military procurements, etc. for 2027. This rise is similar in size to the increase in global spending cuts reported in this table. By contrast, relatively constant expenditure of around €52 billion per annum is envisaged for the Federal Ministry of Defence's departmental budget in the period from 2024 to 2027 (see p. 27 of the Financial Report).

Armed Forces Fund and Climate Fund using borrowed funds. From 2028 onwards, repayment burdens for emergency, defence and EU borrowing will follow, and demographic pressures on the central government budget will increase.[10]

Legal risks surrounding planned use of reserves from emergency borrowing

Fiscal planning is subject to the risk that the Federal Constitutional Court will soon limit special funds' scope for deficits.[11] With respect to the second supplementary budget for 2021, the court is currently examining, in particular, the extent to which the escape clause permits reserves to be formed in the Climate Fund using emergency borrowing of €60 billion. If these reserves were not usable, expenditure would have to be funded directly from other sources.

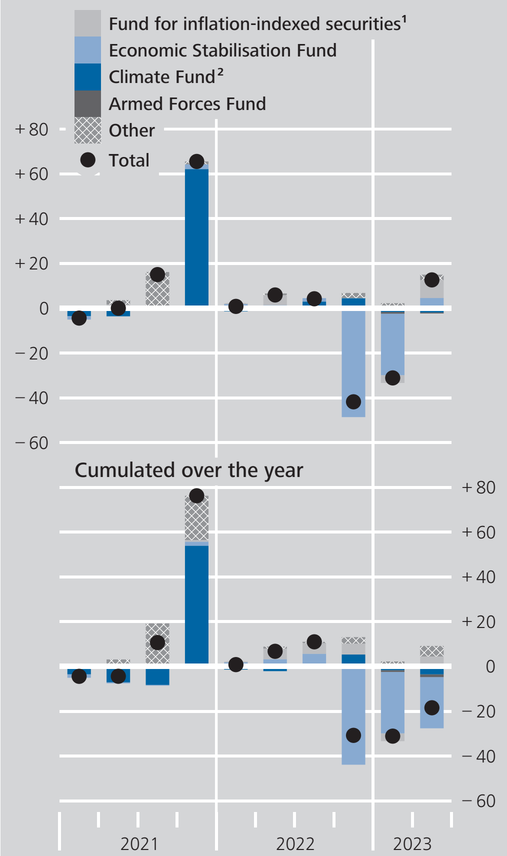
Off-budget entities: second quarter and outlook for 2023 as a whole

Q2: surplus, with energy price assistance of only minor significance

Central government's off-budget entities[12] recorded a surplus totalling almost €13 billion in the second quarter of 2023 (see the adjacent chart), having posted a surplus of €6 billion a year earlier. The Precautionary Fund for Redemptions of Inflation-Indexed Securities posted a higher surplus. It received more funds from the core budget.[13] The balance of the Economic Stabilisation Fund (ESF) excluding its branch for energy assistance (ESF-E) improved to an even greater extent: large-scale aid loans were repaid, while new take-up virtually ceased to play any role.[14] The Financial Market Stabilisation Fund (SoFFin) likewise recorded a surplus as a result of bad bank FMSW repaying loans.[15] Moderate deficits were recorded for most other special funds. It would appear that the energy price brakes are now having only a moderate impact on the ESF-E after it incurred high costs in the first quarter. The outflows from the Climate Fund and the Armed Forces Fund were also rather small compared with projected figures.[16]

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

€ billion, quarterly figures



Source: Bundesbank calculations based on data from the Federal Ministry of Finance. * Only entities using a single-entry accounting system, i.e. excluding, in particular, the bad bank FMS Wertmanagement and, until the end of 2022, also SoFFin, which uses a single-entry accounting system and whose deficits refinanced the bad bank's debts. **1** Precautionary fund for final payments of inflation-indexed Federal securities. **2** Climate and Transformation Fund; up to 2022, Energy and Climate Fund.

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10 See Deutsche Bundesbank (2023d), p. 72.
11 See Deutsche Bundesbank (2023c), p. 63.
12 According to data from the Federal Ministry of Finance, i.e. excluding bad banks and other entities that use commercial double-entry bookkeeping.
13 In the national accounts, these transfers from the core budget count as current interest expenditure. This fund's balance therefore plays no role in the deficit under the European budgetary rules.
14 However, it is not known how the return flows were distributed between aid loans relating to the COVID-19 crisis and those relating to the energy crisis.
15 The deficit incurred a year earlier was not included in this publication's reporting as it involved FMSW refinancing. It therefore did not lead to higher central government debt. FMSW has been paying back its loans in net terms since the start of 2023. This is likely to be linked to the fact that FMSW is further scaling back its portfolio. SoFFin's surplus thus indicates a decrease in overall central government debt and is included.
16 See Deutsche Bundesbank (2023b), pp. 71 and 74 for more on gaps in transparency in central government's off-budget entities.

Deficits in off-budget entities could fall in 2023: ESF-E deficit likely to be significantly below projected figure, …

Overall, the deficit for off-budget entities in the current year will be significantly lower than projected (-€146 billion). It could even be below the previous year's deficit (2022: -€31 billion). While the ESF-E's deficit is substantial, it is likely to remain well below the budgeted figure of €121 billion. It recorded a deficit of €29 billion in the first half of the year. A more precise projection is difficult, though. Not least, the development to date may partly reflect the fact that the fund initially overpaid assistance and that this was offset again in the second quarter. In any case, however, pressure on the fund is set to ease as the year progresses. For example, the skimming of extraordinary revenues from high electricity prices will only start to generate revenue in the second half of the year. Moreover, more suppliers have cut their prices, which will reduce spending on the energy price brakes. All in all, the possibility of the ESF-E recording only minimal deficits in the second half of the year cannot be ruled out. In the rest of the ESF, repayments of coronavirus or energy crisis aid loans could lead to a notable surplus.

… and spending of Climate Fund and Armed Forces Fund set to fall

In addition, deficits are likely to be significantly lower than planned, particularly for the Climate Fund and the Armed Forces Fund. The Climate Fund's programme expenditure was put at €36 billion. By the middle of the year, only €8 billion had been paid out. In the case of the Armed Forces Fund, no more than just over €1 billion of the envisaged €8½ billion had been paid out by mid-2023.

Plans for 2024 foresee further increase in off-budget entities' deficit

The draft plans available for the off-budget entities for 2024 are incomplete. So far as it is possible to tell, a growing deficit is envisaged compared with what is taking shape in 2023. The Climate Fund's deficit is expected to rise sharply to €29 billion. Compared with last year's plan, the fund will also assume additional tasks, e.g. in the area of microelectronics, and will promote the improvement of the rail network. It appears that a deficit of €19 billion is anticipated for the Armed Forces Fund, whilst a deficit of €10 billion plus interest expenditure has been budgeted for the ESF-E. The surplus of the Precautionary Fund for Redemptions of Inflation-Indexed Securities could shrink slightly. Transfers from central government decrease as inflation goes down. However, unlike in the current year, no repayments are due.

Planned use of reserves in conflict with recommendations on deficit reduction

All in all, it is evident that central government uses special funds fairly flexibly to finance additional central government expenditure from their reserves. This leads to additional deficits that – if inflation rates remain high – will increase the pressure on monetary policymakers to take action. Against this background, it would at least seem advisable not to redirect unused funds in the ESF-E to new measures. This is not currently planned, but nor does the Federal Government appear to be intending to liquidate the reserves and the ESF-E when the statutory deadline for assistance expires in mid-2024.

State government budgets[17]

Core budgets in the second quarter of 2023

Far smaller surplus in Q2 due to strong expenditure growth and slight decline in revenue

The state government core budgets recorded a surplus of €2½ billion in the second quarter. This was down €7 billion on the surplus reported in the second quarter of 2022. The main reasons for this were strong expenditure growth and a slight decline in revenue. Although tax revenue rose moderately, revenue from public administrations – not least central government funds for transfers to enterprises in response to the coronavirus pandemic – fell sharply. Expenditure grew by 5½%. In particular, transfers to local government increased very steeply (+10%). In April, for example, substantial additional state government funds for refugee assistance were transferred to local

17 The quarterly data on state government budgets are based on the monthly cash statistics for the core budgets. Information on the off-budget entities is not yet available for the quarter under review.

governments in Baden-Württemberg. Personnel expenditure also saw strong growth (+6½%). This rise was above average, in particular, in Hesse due to supplementary adjustments to civil servant salaries and in Bavaria due to retroactive payments of higher local and family allowances.

Core budgets and off-budget entities: start of 2023 and outlook

State of core budgets and off-budget entities at start of year much worse than a year earlier

In the first quarter, the state government core budgets and off-budget entities combined recorded a deficit of €1½ billion. The balance thus deteriorated by €13 billion on the year. This was due to developments in the core budgets. By contrast, off-budget entities' performance improved.

Considerable deficit expected for 2023 as a whole

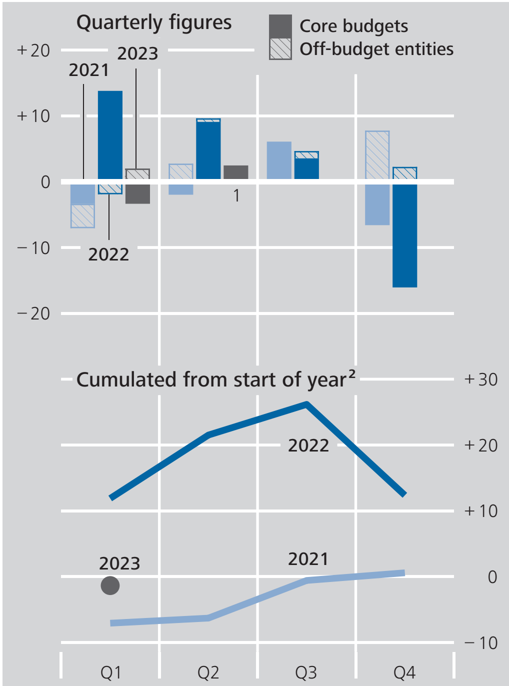
For the year as a whole, too, the outturn for the core budgets and off-budget entities combined is expected to deteriorate sharply. They are likely to slip significantly into deficit. In 2022, they had posted a surplus of just over €12 billion.[18] Tax growth rates are anticipated to recover in the second half of the year. However, transfers to local government look set to continue rising sharply. In addition, personnel expenditure, a particularly large expenditure item, will probably see strong growth, both through wage adjustments and through recruitment. Individual states are also likely to spend more of their own resources on climate change mitigation or economic aid. They have made a substantial amount of money available for this purpose through emergency borrowing in special funds.[19]

No improvement in finances for 2024 noticeable

As things stand, no significant change in the finances of the state governments is to be expected for next year. According to the tax estimate, tax revenue will rise by 4½%. However, significant growth is also envisaged on the expenditure side. In particular, the state governments will be faced with a wage round and adjustments to civil servant salaries. Following the latest wage agreements in other parts of the public sector, it would appear that relatively strong pay increases are on the cards. It remains to be seen how state governments will cover the associated funding gaps within the framework of their debt brakes.

State government fiscal balance

€ billion



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

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Social security funds

Pension insurance scheme

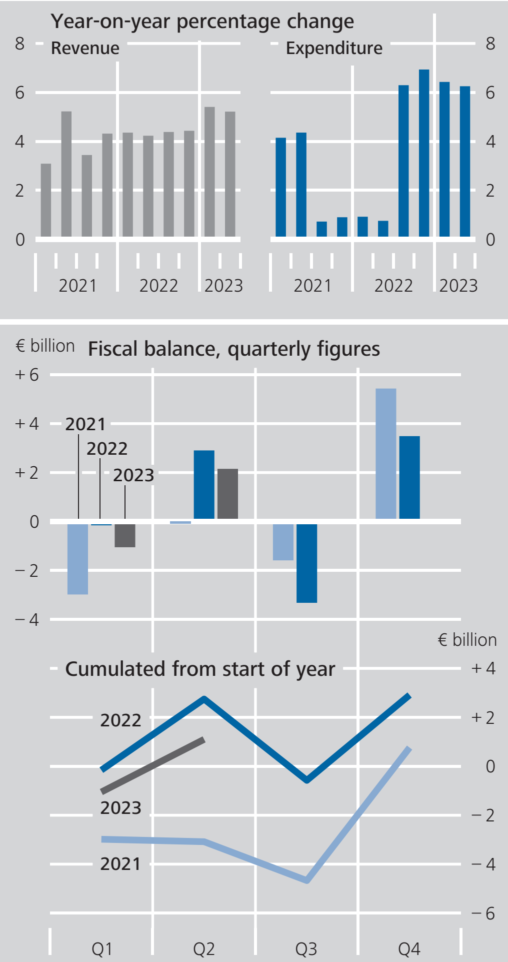
Second quarter of 2023

Lower surplus in Q2 following substantial pension increase in mid-2022

The statutory pension insurance scheme achieved a surplus of €2 billion in the second quarter of 2023. It was thus down by almost €1 billion compared with the same quarter of the previous year. Expenditure was up by just under 6½% on the corresponding prior-year figure. This was mainly due to the substantial

18 An upward revision of just over €1½ billion compared with the data available and reported in May 2023 due to off-budget entities' improved budget outturn.
19 See Deutsche Bundesbank (2023d), pp. 75-76.

Finances of the German statutory pension insurance scheme*



Source: German statutory pension insurance scheme (Deutsche Rentenversicherung Bund). * Preliminary quarterly figures. The final annual figures differ from the total of the reported quarterly figures as the latter are not revised.
Deutsche Bundesbank

pension increase in mid-2022. At a little over 5%, total revenue recorded somewhat slower growth (contribution receipts: +5½%).

2023 as a whole

Deterioration in 2023, but another surplus possible

A surplus also appears possible for the year as a whole (previous year: +€3½ billion). Although the half-year result worsened by €2 billion on the year, the balance should stabilise in the second half of the year. In mid-2023, pensions went up by a national average of just over 4½%,[20] somewhat less than in the year before. On the revenue side, however, contributions are likely to continue rising sharply: this will probably still be the case even if more components of wages and salaries are received as inflation compensation bonuses that are exempt from social contributions.

Outlook

Another surplus possible in 2024, …

The pension insurance scheme is likely to record another surplus next year. Contribution receipts are expected to keep developing favourably. While central government's draft budget for 2024 does envisage an ad hoc cut of €½ billion in central government funds, these will still increase by around 5%, not least because of the strong wage developments in the previous year. On the expenditure side, another large pension increase is expected in mid-2024. This is largely based on the strong per capita growth in wages and salaries this year. All in all, revenue and expenditure could thus roughly balance each other out.

… but high burdens foreseeable in future

In subsequent years, demographic developments will place a growing strain on the pension scheme's finances as the number of pensions rises more rapidly. Funding pressures will be heightened further by the Federal Government's plans, according to which the replacement rate will not fall below 48% after 2025, either. The contribution rate and central government grants would then have to rise markedly more sharply than envisaged in the current legal situation.[21] The generational capital planned by the Federal Government is not likely to significantly reduce this pressure on contributions.

20 For more information on the pension increase, see Deutsche Bundesbank (2023c), p. 66.
21 See Deutsche Bundesbank (2022b). The increase in the contribution rate and central government funds is now somewhat weaker. This is due to more favourable demographic assumptions. The Federal Statistical Office (2022) submitted new updated demographic projections in autumn 2022. The pressure on the pension scheme's finances is being eased by higher migration and a somewhat weaker increase in life expectancy than previously.

Federal Employment Agency

Second quarter of 2023

Moderate surplus for Federal Employment Agency in Q2

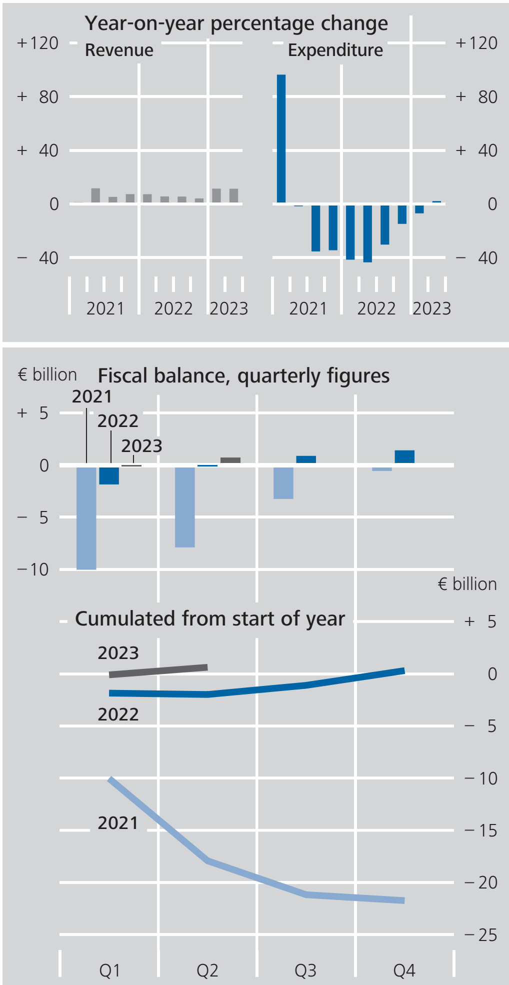
The Federal Employment Agency posted a surplus of just over €½ billion in the second quarter of 2023.[22] This was an improvement of almost €1 billion compared with the same quarter of the previous year. The main reason for this was strong revenue growth (+11%), the bulk of which was due to the contribution rate being raised by 0.2 percentage point to 2.6% at the start of the year. Expenditure rose considerably more weakly, with an increase of just over 2%. The very sharp fall in expenditure on short-time working benefits (-70%, or -€1 billion) had a dampening effect here. By contrast, spending on unemployment benefits rose at an accelerated pace (+13%, or +€½ billion), partly as a result of more insurees receiving benefits. In addition, the resumption of transfers to the civil servants' pension fund had a particularly large impact on expenditure. These transfers had been paused during the pandemic.

2023 as a whole

All in all, significant surplus on the cards for 2023

The Federal Employment Agency is expected to record a significant surplus for the year as a whole. It already posted a surplus after the first half of 2023, following a deficit of €2 billion a year earlier. Its balance is likely to improve in the second half of the year, too, but to a lesser extent. This is because the increase in expenditure on unemployment benefits could be somewhat higher.

Finances of the Federal Employment Agency*



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

22 In the core budget, i.e. excluding the civil servants' pension fund. Transfers to the fund lower the core budget balance.

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