

Country note, July 2018

## Key messages:

- The German economy exhibits positive cyclical effects on public finances
- Additional fiscal measures initiated by new federal government will lower the general government surplus
- Germany continues to meet its upper limit for the structural deficit (MTO) with a certain margin

## Macroeconomic outlook

According to the German government forecast, real GDP is projected to grow by 2.3 % and 2.1 % in 2018 and 2019, respectively, after 2.2 % in 2017. In this environment, the government projects a positive output gap. The projected level of overutilization is higher than the one estimated by the European Commission but is at the lower end when compared to estimates of other institutions. A further stimulus is to be expected from additional fiscal measures by the new federal government as those are not fully accounted for in most projections.

## Short-term fiscal outlook

The latest fiscal forecast presented by the Federal Ministry of Finance (MoF) in Germany's updated draft budgetary plan includes a substantial fiscal surplus for the general government in 2018 of 1¼ % of GDP. This reflects surpluses at the federal, the state and the municipal levels as well as for the social security funds. When adjusted for the cyclical component and temporary effects the fiscal surplus translates into an expected structural surplus of about 1 % of GDP in 2018. This is rather on the upper end of the estimations of other institutions given the comparatively small cyclical component implied by the EU method.

## Medium-term fiscal outlook

According to the MoF, the government continues to achieve fiscal surpluses in the medium-term despite the significant expansionary measures announced by the new government and included in the fiscal projection. The annual financial volume of these measures is expected to increase from 0.4 % of GDP in 2019 to around 1 % of GDP in 2021 and 2022. In structural terms, the budget balance first decreases, but remains positive at ¼ % of GDP in 2019. Afterwards it rises again to ¾ % of GDP in 2022. The debt-to-GDP ratio is expected to decrease below 60 % in 2019 and to reach 52 % in 2022. Uncertainty with regard to the announced fiscal policy measures is still significant. Besides, the Independent Advisory Board perceives both upside chances and downside risks related to economic developments. The former may be the result of stronger than expected growth mainly owing to the expansionary fiscal policy, while the latter arises from external risks, in particular the danger of an escalating global trade war.

## Fiscal framework and national fiscal rules

The Stability Council, which consists of the federal finance minister and the federal minister of economic affairs as well as the states' finance ministers, assesses the compliance with the general government structural deficit ceiling of 0.5 % of GDP with support from the Independent Advisory Board the Council. In its latest report (June 2018) the Independent Advisory Board sees Germany in compliance with the 0.5 % deficit ceiling this year and in the medium term. Compared to the MoF forecast, the Board believes that the output gap in Germany is likely to be higher in 2018 and 2019. The Board recommends to better align the delineations for the deficit ceilings under the national debt brake with the general government structural deficit rule (e.g. with regard to financial transactions and extra budgetary entities). This would help avoid a situation in which the federal and state governments are in compliance with the debt brake, but meeting the general government deficit target still requires budgetary adjustments.

## Key indicator forecast

		2017	2018	2019 <sup>d</sup>	2020 <sup>d</sup>	2021 <sup>d</sup>	2022 <sup>d</sup>
Real GDP growth (MoF)	[% y-to-y]	2,2	2,3	2,1	1,4	1,4	1,4
Potential growth (MoF)	[% y-to-y]	1,8	1,9	1,8	1,8	1,7	1,6
Output gap (MoF)	[% of potential]	0,2	0,6	0,9	0,5	0,2	0
Fiscal balance (MoF) <sup>a</sup>	[% of GDP]	1,3	1¼	¾	¾	½	¾
Fiscal balance reduction due to new government measures (MoF) <sup>b</sup>	[% of GDP]	-	0	-0,4	-0,6	-1	-0,8
Cyclical budgetary component <sup>c</sup>	[% of GDP]	0,1	0,3	0,5	0,3	0,1	0
Structural balance (MoF) <sup>a</sup>	[% of GDP]	1,5	1	¼	½	½	¾
Debt to GDP ratio (MoF) <sup>a</sup>	[%]	64,1	61	58¼	56¼	54¼	52

<sup>a</sup> Update to the Draft Budgetary Plan from June 2018. Figures are rounded to one quarter % from 2018 onward.

<sup>b</sup> Impact of Coalition Agreement's priority measures and other quantifiable measures on the general government budget balance.

<sup>c</sup> Source: MoF and computations by the Independent Advisory Board

<sup>d</sup> Forecast

Chart 1: Real GDP and GDP Potential (% growth y-on-y, MoF)

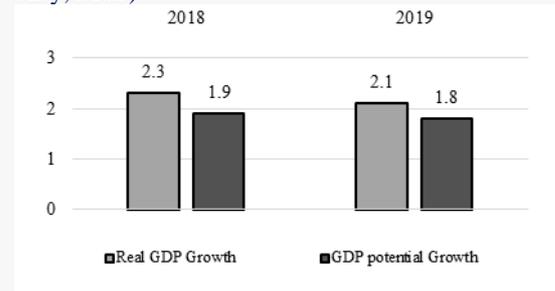


Chart 2: Output Gap (% of Potential)

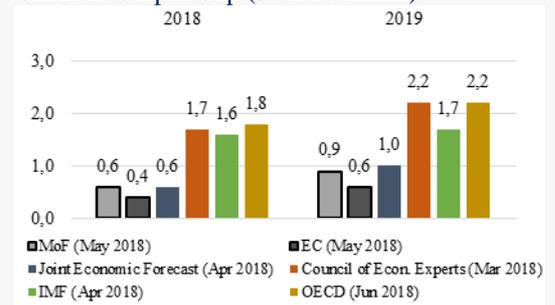


Chart 3: Structural Balance (% of GDP)

