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COVER NOTE

From:	Secretary-General of the European Commission, signed by Mr Jordi AYET PUIGARNAU, Director
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To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union
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Subject:	COMMISSION OPINION of 27.6.2018 on the updated Draft Budgetary Plan of Germany
Enclosed:	C(2018) 4064 final

Delegations will find attached document C(2018) 4064 final.



Brussels, 27.6.2018
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COMMISSION OPINION

of 27.6.2018

on the updated Draft Budgetary Plan of Germany

{SWD(2018) 363 final}

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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area for ensuring that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact (SGP) and the European Semester for economic policy coordination.
2. Article 6 of Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a Draft Budgetary Plan presenting by 15 October the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

CONSIDERATIONS CONCERNING GERMANY

3. Following the general elections on 24 September 2017, a Draft Budgetary Plan on the basis of unchanged policies had been submitted by the outgoing government on 16 October 2017.
4. On the basis of the updated Draft Budgetary Plan for 2018 submitted on 5 June 2018 by Germany, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.
5. Germany is subject to the preventive arm of the SGP and should preserve a sound fiscal position which ensures compliance with its medium term budgetary objective (MTO) of -0.5% of GDP. As its public debt exceeds the 60% of GDP reference value of the Treaty, Germany also needs to comply with the debt reduction benchmark.
6. The updated Draft Budgetary Plan is based on plausible macroeconomic projections which could be subject to downside risks. The macroeconomic scenario underlying the updated Draft Budgetary Plan implies a continuation of moderate real GDP growth rates with a slight increase from 2.2% in 2017 to 2.3% in 2018 and a slight deceleration to 2.1% in 2019, compared to the Commission ad-hoc forecast of 2.0% in 2018 and 2019. The updated Draft Budgetary Plan is based on more optimistic growth and employment projections than the scenario underlying the 2017 Stability Programme.
7. Germany does not yet comply with the requirement of Regulation EU No 473/2013 that the draft budget has to be based on independently endorsed or produced macroeconomic forecasts. In the meanwhile, Germany has enacted a regulation and a law on Economic Projections of the Federal Government that will become effective in July 2018, naming the Joint Economic Forecast Group representing leading economic research institutions as the independent body for assessing and endorsing the macroeconomic forecasts.
8. The updated Draft Budgetary Plan reports a general government headline budget surplus of 1.3% of GDP for 2017 and projects 1¼% of GDP in 2018. This is above the projection from the 2017 Stability Programme, of respectively ½% and ¼% of

GDP. The difference is mainly due to lower-than-expected expenditure and higher surpluses at the level of social security funds, but also methodological changes to the statistical recording of interest expenditure of about ¼% of GDP. Total revenue broadly remained stable, while total expenditure in the updated Draft Budgetary Plan is planned to be lower by about 1% of GDP, notably due to lower-than-expected social payments. In contrast to the 2017 Stability Programme, which projected a decrease of the (recalculated) structural balance¹ from 0.5% of GDP in 2017 to 0.2% in 2018, the updated Draft Budgetary Plan forecasts a decrease of the (recalculated) structural balance from 1.5% of GDP in 2017 to 1.1% in 2018. The updated Draft Budgetary Plan projects the debt-to-GDP ratio, after having dropped to 64.1% in 2017, to decline further to 61% of GDP in 2018.

Germany has benefitted from windfall savings in interest expenditure in recent years, having a positive impact on the structural balance, but which have been largely offset by a structural increase in primary expenditure. Based on the information included in the updated Draft Budgetary Plan, interest expenditure in Germany is expected to fall from 1.1% of GDP in 2016 and 2017 to 1% in 2018.

9. The updated Draft Budgetary Plan contains various discretionary measures on the expenditure and revenue side that show most of their impact as of 2019 and thereafter, whereas the overall impact in 2018 is negligible. This is partly due to the longer than usual process of forming a government and consequently the delay in implementing policy measures throughout the year. Those measures aim to strengthen potential growth and investment in the areas of education, research, universities and digital technologies as well as to support families, children and low- and medium-income earners. All those measures together are estimated to have a cumulative negative fiscal impact, totalling 1.9% of GDP over the period 2018 to 2022, and attaining 2.8% of GDP taking into account additional planned but not yet adopted measures.
10. The updated Draft Budgetary Plan's projections for 2018 are broadly in line with the Commission ad-hoc forecast, which projects headline and structural surpluses of 1.0% of GDP, respectively. The debt projections underlying the updated Draft Budgetary Plan show a faster decline than in the 2017 Stability Programme and are in line with the Commission ad-hoc forecast.
11. The information provided in the updated Draft Budgetary Plan points to compliance with the debt reduction benchmark both in 2017 and 2018. This is in line with the Commission ad-hoc forecast.
12. Germany registered a structural surplus of 1.2% of GDP in 2016, well above its medium-term objective. According to the information provided in the updated Draft Budgetary Plan also in 2017 and 2018, Germany is expected to remain above its MTO with a (recalculated) structural surplus of 1.5% and 1.1% of GDP respectively, which is in line with the Commission ad-hoc forecast.
13. The country-specific recommendations adopted by the Council on 11 July 2017² call on Germany to use fiscal and structural policies to support potential growth and domestic demand by accelerating public investment at all levels of government. The recommendation on the economic policy of the euro area, adopted by the Council on

¹ Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

² OJ C 261, 9.8.2017.

14 May 2018³, calls on Member States with large current-account surpluses to create the conditions to promote wage growth in a manner that respects the role of social partners and implement as a priority measures that foster investment and support domestic demand and growth potential, thereby also facilitating rebalancing in the euro area. The updated Draft Budgetary Plan shows increasing investment expenditure for digital and transport infrastructure as well as additional funds for education, research and universities. Those measures are expected to be beneficial for supporting potential growth and domestic demand. Measures to reduce the tax wedge, especially for families as well as low- and medium-income earners will benefit private consumption and further increase domestic demand. However, based on the updated Draft Budgetary Plan, public investment is expected to remain at 2¼% of GDP in 2018, the same level as in 2017. Further efforts are thus needed to increase public investment in a sustained manner and clear the investment backlog, especially at municipal level. With the planned stable development of revenues and expenditures, the positive balance of public finances would allow for financing those measures.

14. Concerning the structural part of the fiscal recommendations contained in the Council Recommendation of 11 July 2017, Germany's updated Draft Budgetary Plan reports measures in relation to the reform of federal fiscal relations, additional funds for public investment in school buildings and the continuing modernisation of the tax administration. The updated Draft Budgetary Plan further contains measures to reduce the tax wedge on labour by increasing the basic personal tax-free allowance, the child benefit and tax-free child allowance as well as by the planned reduction of the solidarity surcharge. The announced reduction of the contributions to the unemployment insurance by 0.3 percentage point as well as the return to the equal funding by employers and employees of the health insurance system support the lowering of the tax wedge from the side of social security contributions. Overall, those measures are expected to positively contribute to growth and employment.
15. Overall, the Commission is of the opinion that the updated Draft Budgetary Plan of Germany, which is currently under the preventive arm and subject to the debt reduction benchmark, is compliant with the provisions of the Stability and Growth Pact. Germany's favourable budgetary situation provides scope to undertake additional expenditure for supporting potential growth and domestic demand, including through public investment in infrastructure, education, research and innovation, as recommended by the Council in the context of the European Semester, and to reduce the accumulated investment backlog, especially at municipal level.

The Commission is also of the opinion that Germany has made limited progress with regard to the structural part of the fiscal recommendations contained in the Council Recommendation of 11 July 2017 in the context of the 2017 European Semester and thus invites the authorities to accelerate progress.

Done at Brussels, 27.6.2018

For the Commission
Pierre MOSCOVICI
Member of the Commission

³ OJ C179, 25.5.2018.