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Germany: Government will present another XXL supplementary budget

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Supplementary budget could drive total 2021 net federal borrowing up to a record-high of EUR 240 bn

Tomorrow, the federal government will make some important fiscal announcements. First of all, it will present a supplementary budget for 2021, which would be the third supplementary budget over the past year. Secondly, it will present the cabinet's first budgetary draft for 2022. Thirdly, it will lay down the updated medium-term fiscal plan until 2025. As regards the first point, the volume of the supplementary budget could reach as much as EUR 60 bn (1.7% of GDP), according to press reports (see for instance FAZ). This extra borrowing would actually come on top of the already planned borrowing of EUR 180 bn (5.1% of GDP). As a result, 2021 net federal borrowing could possibly rise to as much as EUR 240 (6.8% of GDP), an all-time high in German history. Out of the additional EUR 60 bn, which could boost federal spending to almost EUR 550 bn, 25 ½ bn should be spent on additional financial aid paid to lockdown-stricken firms. Moreover, nearly EUR 9 bn each will be needed to cover for tax revenue shortfalls and to finance measures to fight the pandemic (probably money on testing, hospitals, etc.). While a further EUR 8 bn should be used to boost financial buffers for unanticipated spending needs, EUR 2.5 bn are needed to close a budget whole due to the cancelled 2020 Bundesbank surplus. Other extra-expenses relate to higher interest payments (EUR 4 ½ bn) or legally-decided compensation payments to energy producers (EUR 2.4 bn).

Debt brake will remain suspended in 2022

As regards the 2022 budget draft, it seems that the federal government is now targeting a deficit of EUR 81½ bn (2.2% of forecast 2022 GDP) – a number that is clearly incompatible with the normal debt brake rule and which will require reusing the special clause in the debt brake ("excess borrowing for extraordinary circumstances"). Until recently, at least officially, the C DU/C SUand SPD government was still aiming to comply with the debt brake rules from 2022 onwards. Now, it is clear that fiscal consolidation will be pushed out at least by another year.

Fulfillment of the normal debt brake rules by 2023 will require full use of financial buffers and further significant consolidation steps

As regards the medium-term financial plan until 2025, it seems that the federal government wants to adhere to the normal debt brake rulings by 2023 as it plans to cut the deficit to just around EUR 10 bn by 2023, a level at which the deficit should also stay in 2024 and 2025. To lower the deficit accordingly, the government plans to make full use of its substantial fiscal reserves (specifically, around EUR 32 bn should be used to partially fund the deficit in 2023, a further EUR 16 bn should be used in 2024). Still, this would not suffice alone. The finance ministry seems to have identified further consolidation needs of roughly EUR 20 bn for 2024/25, which would need to come either through tax increases (higher GDP growth and/or higher tax rates) and/or spending cuts.

We keep our 5.9% deficit forecast for 2021 as we doubt that all of the money will be spent

Overall, there are a couple of open questions with respect to above fiscal plans. It is not yet clear why the federal government needs to come up again with such a large supplementary budget. This is because of (a) it sits on the above mentioned untouched reserves worth around EUR 48 bn (which it could use in 2021 already), (b) the regular 2021 budget already includes sizable buffers (EUR 39 ½ bn alone for financial aid to firms and a global spending item of EUR 35 bn for unexpected fiscal expenses), (c) financial disbursements to firms affected by the lockdown are still progressing slowly (as of mid-March 2021, we understand that only roughly EUR 10 bn of the aid budgeted for this year were paid out; also in 2020 actual numbers did not get nearly close to budgeted numbers) and (d) continued pent-up demand due to bureaucratic hurdles and supply-side issues (just alone in the extra-budgetary “energy and climate fund”, the government accumulated a high surplus of EUR 25.3 bn in 2020 that is still waiting to be spent).

Because of the above points, it remains unclear if the federal government will actually (need to) spend all of the above mentioned amounts. In this context, last year’s budget outcome could be reference point: The actual net federal borrowing reached “only” EUR 130 ½ bn (3.7% of GDP) and was thus far below the target level of EUR 217.8 bn (6.2% of GDP). On the general government level (federal government plus states, municipalities and social security funds; Maastricht definition), the fiscal deficit amounted to “just” 4.2% of GDP in 2020 compared to an initial government forecast of 6 ¼% of GDP back in October 2020.

As said, the supplementary budget could reach EUR 60 bn (1.7% of GDP), pushing the net federal borrowing to an all-time high of EUR 240 bn (6.8% of GDP). Still, we stick with our 5.9% headline deficit forecast for the general government level (way above most other German economic institute forecasts) as we doubt that all the money will be spent. This implies a structural deficit of nearly 5% of GDP this year (2020: -1.8% of GDP).

Appendix 1

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