



Public debt

Return to go (after a run of luck)

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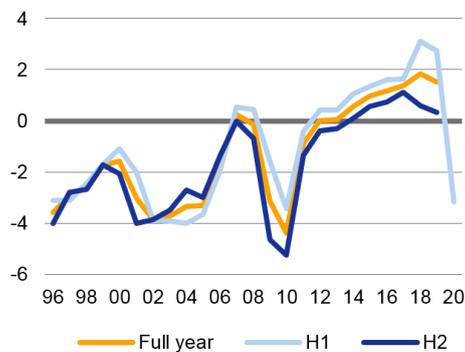
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The sizeable fiscal gaps in 2020/21 caused by the corona pandemic – which, just at the federal government level, are reflected in record new borrowing of around EUR 218 bn and EUR 96 bn, respectively – are a harsh setback for ensuring long-term public debt sustainability. In this week’s debate on the federal budget Finance Minister Scholz assured that no fiscal action in response to the crisis would be more expensive than fiscal action. But for the next federal government this appraisal might also hold true – but then with respect to fiscal consolidation.

German government posted a sizeable deficit in H1 2020

General government financial balance (national accounts), % GDP



Sources: Federal Statistical Office, DB Research

Corona-induced fiscal deficits are a harsh setback

In the first half of 2020, the COVID-19 pandemic led to a sizeable general government budget gap of EUR 51.6 bn or 3.2% of GDP. Thus, the abrupt budget swing in the first half of 2020 was even more pronounced than during the global financial crisis (see Chart 1). Even though the corona recession and the associated deterioration in public finances is likely to turn out less severe than initially feared, the general government’s gross public debt ratio is set to rise sharply within the next two years – up to slightly less than 75% of GDP (see Chart 2). On a positive note, by this, the Maastricht debt ratio is likely to stay below its record high of 82.4% of GDP in 2010. Moreover, even then Germany’s debt ratio will be still relatively moderate in an international comparison. Nevertheless, the spike in the debt ratio of almost 15 percentage points of GDP constitutes a large burden for fiscal policies.

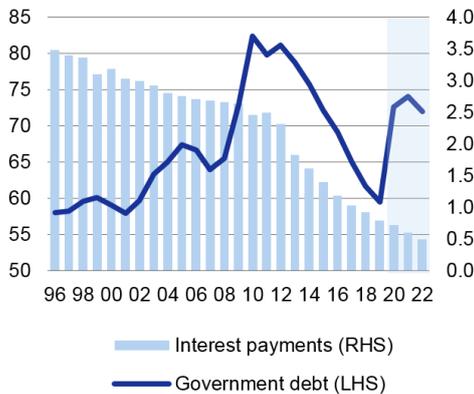
The sizeable fiscal gaps in 2020/21 caused by the corona pandemic – which, just at the federal government level, are reflected in record new borrowing of around EUR 218 bn and EUR 96 bn, respectively – are a harsh setback for ensuring long-term public debt sustainability. That said, the sustainability gap of Germany’s general government sector is estimated at a significant 345% of GDP, according to a recent update by Stiftung Marktwirtschaft on international accounting ([Generationenbilanz](#)). The above indicator not only considers Germany’s explicit (officially disclosed) Maastricht government debt stock of 59.8% of GDP (as of end of 2019) but also captures the government’s implicit (“hidden”) debts, which are set to build up in the future over time due to the government’s current promises regarding public benefits. Because of the corona pandemic this implicit debt stock rose sharply to around 285% of GDP, marking a large increase of 109 percentage points of GDP.



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Public debt dynamics (2020-22) (DB baseline projections)

% GDP (general government sector) (national accounts)



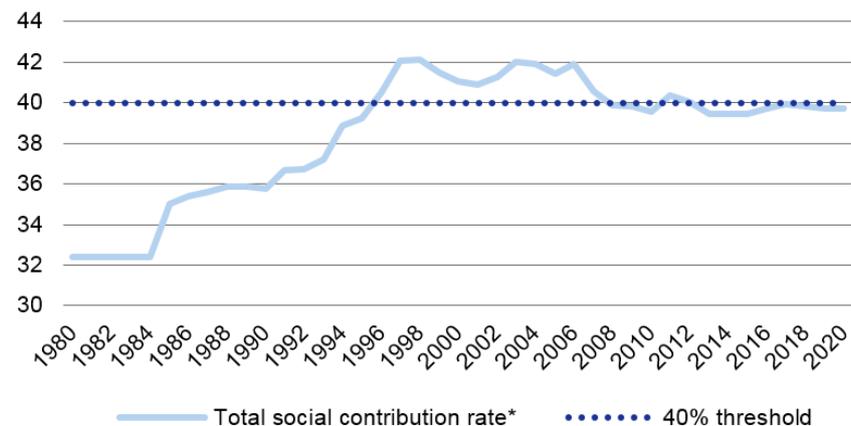
Sources: Federal Statistical Office, DB Research

A rise in social contribution rates is looming

Comparing the latest September 2020 tax revenue estimates with the pre-crisis October 2019 projections, the German government will have to cope with a cumulated tax revenue gap of around EUR 345 bn (period 2020-24). Just in 2020, the government will incur a tax revenue gap of almost EUR 100 bn compared to pre-crisis estimates. Moreover, this gap will still amount to nearly EUR 50 bn by 2024. Looking at these projections it becomes obvious that the essential fiscal consolidation will not be easy. It is already clear by now that the contribution rates to the social security system will rise significantly in the coming years, even though the government wants to cap the total burden on social security contributors at a maximum of 40% of gross compensation of employees for this and next year (“Sozialgarantie 2021”). At the moment, social contributions regarding employees with children are still marginally below 40% (at 39.75%), though they are already at 40% for employees without children (they have to pay an additional contribution rate of 0.25% on their own to long-term care insurance) (see Chart 3).

Social security contributions (employees with children)

Contribution rates* (% of gross compensation of employees)



* Includes contributions rates for the general pension insurance, health insurance, long-term care insurance and unemployment insurance.
Contribution rates: Annual averages. Health insurance: Contribution rate including average additional contribution rate. Long-term care insurance: Starting in 2005 employees without children have to pay an additional contribution rate of 0.25%.
In this chart, the total contribution rate is shown for employees with children.

Sources: German Pension Insurance, Deutsche Bank Research

No fiscal action will become much more expensive for the next federal government

In this week’s debate on the federal budget Finance Minister Scholz assured that no fiscal action in response to the crisis would become more expensive than fiscal action. But, for the next federal government, this appraisal might also hold true – but then with respect to fiscal consolidation. Amid the chronic low interest rate environment, it is sometimes suggested in the public debate



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that debt sustainability does not matter anymore because the German government can satisfy its borrowing requirements at mini or even negative interest rates. But this impression is an illusion.

A world in which the government can always and at any time refinance both its maturing debts as well as any further fiscal deficits – without even incurring any fiscal costs – is not describing real life but is nothing more than a dream world. The truth is that a fiscal policy stance – which is highly dependent on a continuation of the current low interest rate environment – is linked to a risky dependence on future interest rate developments. This is because the permanent rolling-over of maturing debt equals a snowball system which will work only as long as the interest rate paid on public debt remains below the GDP growth rate. Actually, no one can tell today whether the interest rate growth differential will remain permanently negative in the future. However, what seems relatively clear instead is that Germany's economic growth potential will continue to decline over the coming decades because of adverse demographic trends.

In order to restore the fiscal policy buffers lost during the crisis and hence make sure to have the necessary fiscal space to also counteract in future crises the government should start to consolidate public finances as soon as possible. In light of a financial gap (of around EUR 42.5 bn) that still needs to be closed in the current federal financial plan for the period 2022-24, it becomes obvious that fiscal consolidation will be anything but easy. If the economic engine does not run more strongly than expected, the government might be forced to raise the tax burden (taxes, social contributions) and/or cut public spending. In the end, the (next) federal government will ultimately have to decide whether it wants to deliberately accept an even higher tax burden (which raises employment costs further and puts significant further strains on the economy) or if it wants to set clearer and more growth-friendly spending priorities – also with a view to intergenerational fairness.

For more information on Germany's public finances see Focus Germany [More resilient than expected](#) (24th of September 2020).

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