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Economic Briefing

German government agrees on 2025 budget

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The German government today agreed in principle on a draft budget for the coming year and a "growth package". The details will not be presented until July 17. However, it is already clear that the debt brake will be adhered to, although some budget gimmicks will probably be used. The economic consequences can only be roughly estimated when the detailed figures are presented. The most important consequence of today's agreement is that the coalition will probably remain together until the next regular federal election in the fall of 2025.

After lengthy negotiations, Chancellor Scholz (Social Democrats), Economics Minister Habeck (Green Party) and Finance Minister Lindner (FDP) today reached an agreement in principle on the 2025 federal budget and a "growth package". The agreement comprises three parts: A supplementary budget for 2024, the rough key points for the 2025 federal budget and measures to boost the German economy.

Supplementary budget 2024: 11 billion euros in additional debt

The supplementary budget for the current year will allow the federal government to take on an additional 11.3 billion in debt. This is probably primarily due to the weaker economy and therefore lower tax revenues as well as higher expenditure, particularly for social assistance ("Bürgergeld"). In addition, there is higher expenditure from the Climate and Transformation Fund (KTF), which is incurred in particular for price guarantees for producers of renewable energies. According to the Minister of Finance, this higher borrowing is also compatible with the debt brake due to the weaker economy.

2025 Budget: More investment ...

The federal budget for 2025 is expected to include expenditure of 481 billion euros, which would represent a decrease of 8 billion euros compared to 2024 (if the supplementary budget is already taken into account). Of this, 57 billion euros is to be invested, which would be almost 10% more than in the previous year.

When asked about concrete savings, the Federal Minister of Finance pointed out that the budget estimates of the individual ministries would largely correspond to the current financial planning. This meant that some ministers were obviously unable to push through their demands for higher budgets. In some areas, even a little more is to be spent. Among other things, slightly higher benefits for children were mentioned. In addition, private households and companies are to be relieved of a total of 23 billion euros in the next two years through higher tax allowances - which are to be adjusted to inflation in order to prevent tax bracket creep (which in Germany is known as "cold progression").

... and less new debt, ...

In total, net borrowing is expected to amount to 44 billion euros in the coming year. This would be a good 6 billion euros less than in the current year, if the supplementary budget is already included.

... which requires to use some budget gimmicks

With this amount, net borrowing in 2025 would be around 20 billion euros higher than the upper limit resulting from the debt brake based on the federal government's current forecasts. This is due to the fact that so-called financial transactions, in which financial assets are acquired, are not subject to the debt brake limit. One aspect of this is likely to be a further payment into the so-called "generation capital", which is used to build up a capital stock for pensions. Finance Minister Lindner also mentioned considerations to grant at least part of the funds made available to the railroad and highway companies as loans, which would also be a financial transaction.

It should also help to comply with the debt brake that discounts on the issue of federal bonds should be accounted for differently. These arise when federal bonds issued a few years ago during the low-interest phase are topped up and sold below par due to their low coupon. This discount was previously recognized in the year of issue. Now – as proposed by other institutions such as the Bundesbank – it is to be spread over the entire remaining term. More than €10 billion has been set aside for the discount in the 2024 budget. This amount is now likely to be significantly lower in the budget for 2025.

Growth package: more work incentives ...

The planned growth package is primarily intended to strengthen incentives to work. This applies to older people who want to work beyond the statutory retirement age. In future, they are to receive employer contributions to unemployment and pension insurance in addition to their salary. The other target group is recipients of the citizen's income. For them, there are to be additional financial incentives to take up work. At the same time, their obligations to cooperate in the search for a job are to be tightened.

... less red tape ...

The second major block is to be a reduction in bureaucracy. Among other things, significantly fewer companies are to be subject to supply chain regulations in future - Finance Minister Lindner cited a share of 2/3 here. In addition, the European regulations are to be introduced as late as possible.

... and more favorable depreciation options

Last but not least, the depreciation conditions are to be improved. For example, the option of declining balance depreciation is to be retained for longer and the corresponding rate is to be increased from 20% to 25%.

Details will be published on July 17

Many of the points presented remained vague for the time being. It will therefore not be possible to assess the economic consequences of today's agreement until the detailed draft of the federal budget is presented on July 17 at the earliest.

Most important result for today: coalition remains together

The most important conclusion is therefore that the coalition has avoided the most important pitfall between now and the next federal elections in the fall of 2025. There will certainly still be considerable conflict between the three parties when it comes to discussing the exact figures for the federal budget and the precise structure of the growth package. However, with the agreement in principle reached today, a break-up of the coalition has become much less likely.

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