The billion euro trick

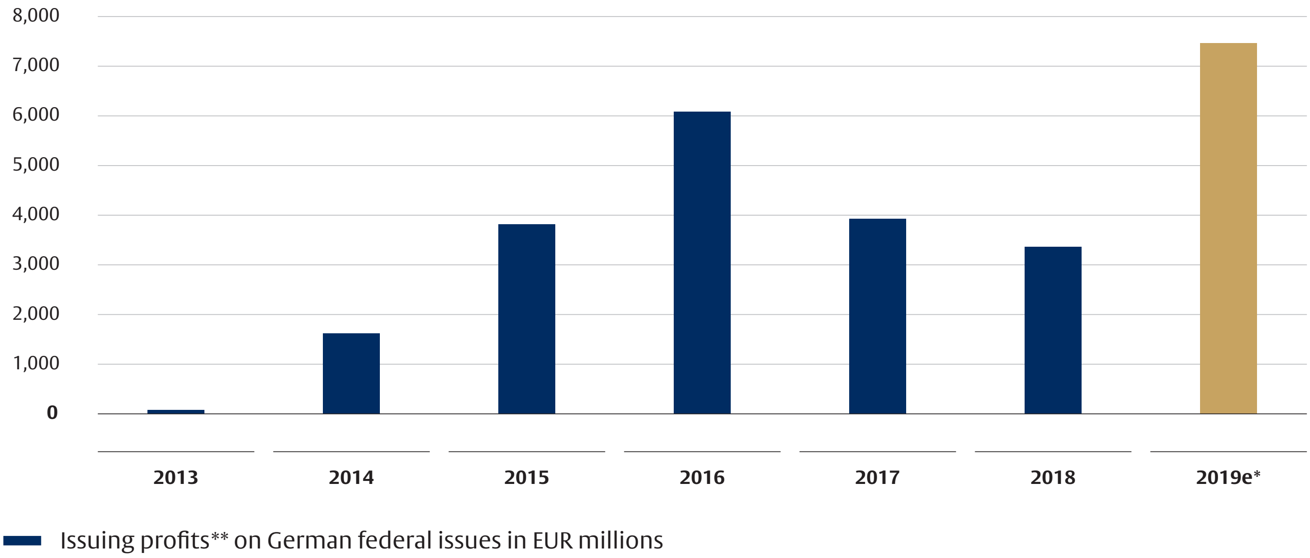
One cannot blame the finance ministers for gratefully accepting the massive interest savings. Nevertheless, revenues that future taxpayers are actually entitled to are also being used in the process. If this intertemporal redistribution (the older generation receives and the young generation pays) was performed by companies, it would be considered accounting fraud aimed at making current earnings look better to the detriment of future periods.

This is how the billion euro trick works: if a zero coupon bond is issued with a market yield less than zero, the issue price of the bond has to be greater than par value, for example 104 for a five-year bond with an issuing yield of minus 0.8 per cent. At maturity, however, only the nominal value of 100 has to be repaid. The German Minister of Finance records the difference of four per cent as profit for the federal government that flows directly into the current budget. The Federal Republic of Germany has collected around EUR 25 billion in profits from bond issues in this way since 2013. It will likely be EUR 7.5 billion in 2019 alone (see Figure 3 on the following page).

Zero and negative interest rates allow the German federal government to collect profits from bond issues that flow directly into the current budget – at the expense of future generations.

The effects are negligible for short-maturity bonds. It leaves a bad after-taste, however, when long-maturity bonds that were still being issued with comparatively high coupons years ago are issued at prices far above par value and the large profits generated by the issues flow into the current government budget. A particularly stark example is given by the issue of a 30-year bond that was previously issued in 2014 with a generous coupon of 2.5 per cent. The yield was only 0.26 per cent when the bond was issued on 19 June and the bond had a correspondingly high price of 158.80. The federal government therefore received EUR 1.588 billion for issuing a bond with a par value of EUR 1 billion. The German Minister of Finance was able to immediately allocate the resulting issuing profit of EUR 588 million to the current budget. Taxpayers, however, have to pay the relatively high coupon of 2.5 per cent for 27 years. Although this is not illegal, it is not particularly fair to future generations. The issuing profits should be placed in a reserve

Figure 3 **Earning money from debt** – Issuing profits collected by the Federal Republic of Germany



* Flossbach von Storch estimate
** Revenue less expenses from premiums/discounts on issues of German federal securities and zero-coupon treasury notes.

Source: German Federal Ministry of Finance, German Finance Agency, Flossbach von Storch, data as at 11 October 2019

Past performance is not a reliable indicator of future performance.

instead and released in 27 annual instalments of EUR 21.8 million until 2046 for the benefit of future budgets and taxpayers.

The lack of generational fairness in government budgetary policy is not just a German phenomenon.

This trick is also popular in other eurozone countries. In September, for example, Spain issued a bond maturing in 2066 with a generous coupon of 3.45 per cent at a price of 168, allowing it to collect issuing profits of EUR 675 million. Italy issued a 30-year bond paying 3.85 per cent to generate an issuing profit of EUR 603 million. This profit also went directly into the current government budget, thereby burdening an entire generation with unnecessarily high coupon payments.

And the game goes on. Regardless of existing zero coupon bonds, the Federal Republic of Germany will issue a 30-year bond with a coupon of 1.25 per cent and a par value of EUR one billion on 16 October. The current price is 137, which means the Minister of Finance will likely collect further profits of EUR 370 million to add to the budget. In the interests of our children, we can only hope that issuing profits will one day also be allocated in a generationally fair way in Germany, Italy and Spain as is already the case in some EU countries such as Austria.

PUBLICATION DETAILS

Publisher Flossbach von Storch Invest S.A.
6, Avenue Marie-Thérèse, 2132 Luxembourg, Luxembourg
Telephone +352 264 584 22, Fax +352 264 584 23
info@fvsinvest.lu

Executive Board Dirk von Velsen, Markus Müller, Karl Kempen

VAT Number LU 25691460
Commercial register Luxembourg No B 171513
Competent supervisory authority
Commission de Surveillance du Secteur Financier (CSSF), Luxembourg
283, Route d'Arlon, 2991 Luxembourg, Luxembourg

Editors Dr. Bert Flossbach, Thomas Lehr, Julian Marx,
Christian Panster, Tobias Schafföner, Philipp Vorndran
Editorial deadline 11 October 2019

Graphic design Heller & C and Markus Taubeneck
Printing Druckerei Gebrüder Kopp

LEGAL NOTICE

This document is intended, among other things, as advertising material. The information and opinions contained in this document represent the views of Flossbach von Storch at the time it was published, and are subject to change at any time without notice. The information in forward-looking statements reflects the views and future expectations of Flossbach von Storch. Nonetheless, actual performance and results may differ materially from such expectations. All information has been compiled with care. However, no guarantee is given as to the accuracy and completeness of the information. The value of any investment can fall as well as rise, and you may not get back the amount you invested. This document does not constitute an offer to sell, purchase or subscribe to securities or other ownership rights. The information and assessments contained in this document do not constitute investment advice or other recommendations. In particular, this information is no substitute for appropriate investor-specific and product-related advice. Statements concerning tax or legal issues are no substitute for professional advice provided by a tax or legal adviser. This document is not intended for individuals who are prohibited by applicable law, based on their nationality, place of residence or other circumstances, from accessing the information it contains. All copyrights and other rights, title and claims (including copyrights, trademarks, patents, other intellectual property rights, and other rights) to, for and arising from all information in this presentation are subject without restriction to the applicable conditions and ownership rights of the current registered owner. You have no rights to the contents of this document. Flossbach von Storch retains the sole copyright to published content prepared by Flossbach von Storch itself. The reproduction or use of such content, in full or in part, is not permitted without the written consent of Flossbach von Storch. **Past performance is not a reliable indicator of future performance.**