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July 12, 2021

**Statement by Mr. Trabinski and Mr. Makhammadiev on Germany
(Preliminary)
Executive Board Meeting
July 14, 2021**

We commend the authorities for their prudent management of the pandemic and share their view that short-term risks appear balanced. Looking forward, we agree with staff's suggestion to phase out various crisis support measures and note that it should be contingent on "clear evidence of a sustained recovery". *Could staff elaborate on the specific criteria that have to be fulfilled to assess the recovery as "well underway"?* We are of the view that disruptions in the value chain will ease with the adjustment of the supply side, both globally and domestically. We also concur with staff that the longer-term economic developments in Germany may be subject to more downside risks, including those related to demographic change and productivity growth in the post-pandemic environment.

The authorities rightly provided substantial fiscal support, but careful monitoring of public debt is warranted going forward. Staff assesses debt to remain sustainable based on the temporary nature of the COVID-19 policy measures and the expected economic recovery. *Could staff comment on the debt dynamics in a downside scenario in which the pandemic prevails through the medium term and/or in which interest rates are raised faster than anticipated amid higher-than-expected inflation? In addition, could staff provide its views on when the authorities should return to the regular application of the debt-brake rule?*

A prudent exit from pandemic-related support measures for the financial sector and monitoring of emerging vulnerabilities will be important. Regarding potential vulnerabilities, we see merit in monitoring (i) bank capital levels in case of a protracted recovery, (ii) bank exposures to commercial real estate, and (iii) non-financial corporate sector debt. In addition, financial institutions and supervisory authorities need to embrace the digital transformation, also to account for new ways and models used by fintech companies. We also welcome the draft legislation on strengthening the independence of auditors. We look forward to more detailed findings and recommendations from the 2022 FSAP.

Accelerating reforms to support productivity growth, decarbonization, and new businesses is important to lift long-term growth prospects. We welcome the authorities' plan to scale up targeted public investment to strengthen digital and climate infrastructure. We agree that improving internet connectivity could significantly boost Germany's digitalization through the greater use of ICT tools and data-based technologies, and, therefore, support productivity growth. We share staff's view that reaching greenhouse emissions targets in a cost-effective and socially acceptable way requires measures that complement carbon pricing. To improve conditions for new market entrants, we strongly encourage the authorities to reduce administrative red tape and offer support to start-ups with viable prospects beyond the seed stage. Raising the cap for research and development tax incentives would help promote competitiveness of medium-sized enterprises.