DOCUMENT OF INTERNATIONAL MONETARY FUND AND FOR OFFICIAL USE ONLY

The contents of this document are preliminary and subject to change.

GRAY/21/1962

July 12, 2021

Statement by Mr. Bevilaqua, Mr. Velloso, and Mr. Coronel on Germany
(Preliminary)
Executive Board Meeting
July 14, 2021

We thank staff for the report and Messrs. von Kleist, Merk, and Krahnke for their informative statement. Since the last Article IV consultation discussions, Germany has continued to grapple with a resurgence of infections and its consequences. Although the outlook remains clouded by considerable risks and uncertainties, the authorities sizeable and nimble policy response has allowed the country to navigate through the pandemic with relative success while enhancing the prospects of economic recovery from last year's sharp contraction. This said, we broadly agree with the thrust of the staff appraisal and would like to offer the following points for emphasis.

The pandemic shock notwithstanding, last year's contraction was sharp but somewhat less pronounced than expected, underpinning Germany's large and effective policy response. The authorities were able to effectively use Germany's sizeable fiscal space to meet the challenges posed by the pandemic shock with relative success, while placing the economy on its way to recovery. Indeed, last year's economic contraction in Germany—with a record decline in private consumption—was the least severe in the Euro area. This suggests that economic activity held up relatively well in the last quarter, despite November's lockdown. This also underpins the effectiveness of Germany's generous fiscal stimulus and well calibrated overall policy response to several consecutive waves of infections.

We take note that Germany's growth is projected by staff at 3.6 percent in 2021, despite a plunge in activity in the first quarter. This year's economic activity has so far been adversely affected by weak private consumption, driving a sharper-than-expected 1.8 percent contraction in the first quarter. However, growth is projected to rebound in subsequent quarters, on the back of a strong recovery in exports, benefiting from strong growth in China and the US and the easing of lockdown restrictions as mass vaccination moves forward. This said, we concur with staff that growth is expected to return to potential over the medium term, but there is likely to be a permanent loss of output due to

the human toll and loss of physical capital.

The authorities should maintain fiscal support until the recovery is firmly underway. This may imply providing support well into 2022, by taking full advantage of the debt-brake exception clause for crisis periods. In our view, Germany is in a strong enough fiscal and public debt position to sustain this effort until pre-pandemic level output is achieved, which could occur with a high probably as soon as 2022. Premature fiscal consolidation should be avoided not only to protect the recovery, but also to send a positive signal to the Euro area's rebalancing efforts, given Germany's economic and political weight. We also believe that fiscal complacency concerns may be negligible given Germany's solid fiscal reputation.

Despite its resilience and low NPLs, the banking sector's pre-existing vulnerabilities have been magnified by the crisis. The pandemic shock led to higher credit risk within the context of a reversal in the commercial real estate cycle, increased firm insolvencies, and lower bank profitability. Though such risks have thus far been managed by sizeable support measures, close monitoring is warranted. Also, the banking system will have to deal with low profitability and its long-term effects on capital buffers.

Finally, we share staff's emphasis on the need for continuing transformation of the German economy. In this regard, we welcome the assurances provided by Messrs. von Kleist, Merk, and Krahnke in their statement of the authorities' commitment to improving inclusiveness through lowering the labor tax wedge on low-income earners, supporting job transitions, and addressing gender inequities in the labor market. We are of the view that social and gender inclusiveness should be an integral part of the structural policies to enhance public and private sector investment in key areas of Germany's structural transformation of the economy.

With these remarks we wish the German authorities success in their future endeavors.