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**Statement by Mr. Moreno and Mr. Lopez on Germany  
(Preliminary)  
Executive Board Meeting  
July 18, 2022**

We thank staff for their comprehensive set of reports and Mr. Stephan and Mr. Krahnke for their useful Buff statement. We mainly share staff's appraisal on the German economy and financial system, along with their main policy recommendations. We associate ourselves with Mr. Pösö's statement and would like to offer some additional comments.

**Staff's report is rightly focused on the economic and energy policy priorities and challenges derived from the war in Ukraine and related spillovers.** We share staff's view that the economic outlook for Germany has rapidly deteriorated given its direct links to Russia and its high exposure to supply-side spillovers. We note that despite the spike in inflation, wage-induced pressures are contained so far. We commend the authorities for the measures adopted to cushion the impact of the energy crisis on the population. After an initial phase of more general measures—including temporary subsidies and tax cuts—we share staff's views that these policies should be phased out as planned, giving more prominence, going forward, to well-targeted measures focused on the most vulnerable groups, in order to mitigate potential distortive effects on the energy market and on the climate change policy objectives. Regulatory measures to improve competition in the wholesale energy market should also be explored, in addition to mechanisms to encourage gas savings by households and firms. We especially welcome staff's scenario analysis of a gas shutoff from Russia, which points to a substantial output loss and the potential need for additional policy support. Contingency plans—including liquidity support for firms—are essential to mitigate a further impact of the crisis and increase energy security. In this regard, we reiterate the need for a coordinated approach at the European level to reduce energy dependency, increase storage capacity and interconnection, and advance the commonly agreed green agenda.

**The neutral fiscal policy stance planned for 2022 seems appropriate, although flexibility remains critical.** We agree that under the baseline projections, fiscal policy should be oriented towards stability and consolidation. Nevertheless, in the current context of high uncertainty, fiscal authorities should remain flexible and be ready to act if downside risks materialize, allowing automatic stabilizers to operate and deploying temporary well-targeted measures. The authorities should also consider the activation of the escape clause of the debt-brake rule if needed.

**We agree with staff that Germany should increase its investment spending in strategic areas such as fostering the green agenda.** Although the use of especial extra-budgetary mechanisms could help to boost spending in critical areas such as decarbonization, defense and digitalization, we agree with staff that ensuring transparency and risks management practices is critical to preserve the credibility of the fiscal framework. Furthermore, the development of the green and digital agendas, and addressing transport infrastructures deficiencies, will require structural reforms in the public investment framework. Improving infrastructure planning and processes, including public procurement, and enhancing cooperation across municipalities, will be instrumental to reduce constraints to infrastructure developments and increase efficiency in the use of public resources, especially in the current context of increasing construction costs. Germany also needs to boost investments in knowledge-based capital, while improving business dynamics and addressing the declining labor-force participation and skill shortages. We praise the authorities for their comprehensive approach to help the climate transition and ensure that energy security goals are met. Delivering the climate change strategy should be a priority, including a timely revision of the national carbon pricing mechanisms to converge to European levels and accurately reflect and deliver the ambitious decarbonization goals.

**The boost in investments would also help reduce the high and persistent external imbalance.** Despite its projected reduction in the coming years, the external balance is expected to remain stronger than implied by medium-term fundamentals and desirable policy settings, reflecting both excess of savings and subdued investment. The potential effects of a growth-enhancing fiscal stance in Germany, prioritizing investments in critical areas without jeopardizing fiscal sustainability, would help the rebalancing and spread positive international spillovers. The firm commitment of the German authorities to expand public and private investments, as expressed in the Buff, is a very welcome step that will also contribute to increase potential growth.

**The financial sector remains resilient, although some pockets of vulnerabilities should be addressed.** Capital and liquidity ratios are broadly adequate, and the stress test results point to a banking system resilient to shocks, including those related to rising energy prices,

although some institutions may need additional buffers and risks stemming from large energy companies should be closely monitored. Additionally, some structural vulnerabilities in the banking system remain, such as low profitability and data collection gaps. Developments in the housing market are a source of concern, especially those related to overvaluation in urban areas and loosening lending standards. In line with the FSAP recommendations, the authorities should reinforce the macroprudential toolkit with income-based measures and overcome the operational impediments to activate borrower-based tools. We also welcome staff's recommendation to establish a single mandatory deposit guarantee scheme, which should be pushed forward overcoming the resistance of local and regional corporations.

**Finally, on governance, despite the progress in recent years, deficiencies remain in the AML/CFT framework.** The authorities should continue their efforts to address concerns related to the management and transparency of the control systems of specific financial institutions. Reported cases of money laundering and tax and accounting frauds point out the need to strengthen the regulatory framework, improve data provision and reinforce AML/CFT supervision, including a closer cooperation between competent institutions and limiting the volume of cash transactions.