



Executive Board Minutes 21/71-2

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Germany—2021 Article IV Consultation

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Staff: Aiyar and Dao, EUR; Fletcher, SPR

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CEDA OGADA
Secretary

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¹ Minutes are the official record of a formal Board meeting in which the Board may adopt decisions and reach understandings related to the business of the Fund. Staff background documents issued before the meeting are the principal basis for the meeting. Preliminary “gray” or “buff” statements by Executive Directors and staff’s responses to Directors’ technical questions are circulated prior to the meeting. Adopted decisions and/or summings up—the Chair’s “sense of the meeting” or policy conclusions/recommendations—are issued after the meeting. The minutes include all these elements, as well as the discussion record (a verbatim transcript of the discussion lightly edited for clarity). Minutes are made public consistent with the IMF’s Transparency Policy and Open Archives Policy.

THE ACTING CHAIR'S SUMMING UP

Executive Directors agreed with the thrust of the staff appraisal. They commended the German authorities for their decisive policy actions, enabled by Germany's ample fiscal space, as well as their global efforts, via the COVAX initiative, to fight the COVID-19 pandemic. They noted that a robust recovery is expected in the second half of 2021 as mass vaccinations gather strength, although large uncertainties remain. In this context, Directors underscored that supportive policies should continue, and as the recovery strengthens the focus should shift to addressing long-standing structural challenges.

Directors emphasized that fiscal policy should remain supportive until there is clear evidence of a sustained recovery, while encouraging the frontloading of public investment. To facilitate post-crisis resource reallocation, they stressed that a carefully calibrated fiscal support withdrawal should be accompanied by well-targeted measures. Directors noted the merits of Germany's short-time work program (Kurzarbeit) to contain the impact on unemployment and support aggregate demand, but stressed the importance of additional measures targeted at groups hard hit by the pandemic and not covered by Kurzarbeit, to prevent widening inequality and deeper labor market scarring. Looking ahead, Directors called for Germany to use its fiscal space to scale up public investment to lift potential growth, facilitate structural transformation, and help address Germany's large external imbalances.

Directors supported the authorities' structural reform agenda to boost potential growth and support a green and digital transformation. They welcomed Germany's strong commitment to fighting climate change and further enhancing the multi-pronged climate action plan. A well-specified schedule of carbon prices over a longer-term horizon would enhance efficiency. Directors also noted that the pandemic has increased the urgency of the long-standing need for a digital transformation and greater innovation. They encouraged the government to accelerate the expansion of high-speed broadband networks, increase support for R&D, promote further venture capital, and improve the business environment.

Directors stressed the need to safeguard financial stability during the nascent recovery. In light of the risk of rising bankruptcies as support measures are phased out, they recommended continued targeted liquidity and solvency support for viable firms. Directors also highlighted the need for banks to improve their cost structures to address the chronic low profitability of Germany's banking sector. They welcomed the authorities' efforts to address remaining data gaps and stressed the need for closely monitoring the buildup of financial vulnerabilities in real estate markets. Directors looked forward to the recommendations from the ongoing 2022 FSAP.

It is expected that the next Article IV consultation with Germany will be held on the standard 12-month cycle.

EXECUTIVE BOARD ATTENDANCE²

G. Okamoto, Acting Chair

Executive Directors

S. Chodos (AG)
 C. Huh (AP)
 A. Bevilaqua (BR)

A. Buisse (FF)
 R. von Kleist (GR)

D. Fanizza (IT)
 T. Tanaka (JA)
 H. Hosseini (MD)

P. Hilbers (NE)
 M. Poso (NO)

R. Lim (ST)
 P. Trabinski (SZ)
 S. Riach (UK)
 E. Shortino (US)

Alternate Executive Directors

W. Nakunyada (AE)
 F. Sylla (AF)

Z. Zhang (CC)
 F. Lopez (CE), Temporary
 F. O'Brolchain (CO)
 C. Just (EC)

R. Goyal (IN), Temporary

A. Alhosani (MI)

L. Palei (RU)
 B. Alhomaly (SA)

S. Bhatia, Acting Secretary
 V. Sola, Summing Up Officer
 L. Briamonte, Board Operations Officer
 M. Eddy, Verbatim Reporting Officer

Also Present

Communications Department: M. Louis. European Central Bank: K. Nikolaou, R. Rueffer.
 European Department: S. Aiyar, C. Caceres Lievano, M. Dao, A. Mineshima, L. Papi,
 M. Pradhan. Institute for Capacity Development: M. Erbenova. Legal Department: H. Pham.

² For countries in each constituency, please see the Constituency Codes in the annex.

Monetary and Capital Markets Department: P. Ananthkrishnan, U. Das, M. Oliva Armengol. Office of Risk Management: B. Boulwood. Strategy, Policy, and Review Department: K. Fletcher. Executive Directors: A. Andrianarivelo (AF), S. Bhalla (IN), I. Mannathoko (AE), M. Mahmoud (MI), P. Moreno (CE), D. Palotai (EC). Alternate Executive Directors: H. Azal (EC), M. El Qorchi (MD), F. Fuentes (BR), A. Grant (AP), A. Guerra (CE), L. Herrera (AG), M. Kashima (JA), M. Massourakis (IT), K. Merk (GR), F. Mochtar (ST), R. N'Sonde (AF), O. Odonye (AE), J. Romero (CE), D. Ronicle (UK), P. Rozan (FF), B. Saraiva (BR), J. Sigurgeirsson (NO), C. White (AP). Senior Advisors to Executive Directors: W. Abdelati (MI), H. Andrianometiana (AF), K. Badsı (MD), E. Cartagena (CE), M. Choueiri (MI), J. Garang (AE), M. Gilliot (FF), L. Johnson (AP), B. Lischinsky (AG), M. Maidu (AE), C. Quagliarini (IT), J. Rojas (CE), C. Sassanpour (MD), S. Senich (US), R. Velloso (BR), M. Zhunusbekova (SZ). Advisors to Executive Directors: F. Al-Kohlany (MI), P. Al-Riffai (MI), D. Andreicut (UK), A. Arevalo Arroyo (CE), M. Bernatavicius (NO), B. Boostani (MD), K. Carvalho da Silveira (AF), M. Coronel (BR), D. Fadhel (MI), T. Krahnke (GR), V. Lankester Campos (CE), R. Lopes Varela (AF), R. Makhammadiev (SZ), M. Merhi (MI), D. Milutinovic (NE), P. Mooney (CO), R. Moral Betere (CE), T. Nagase (JA), L. Nankunda (AF), I. Ogihara (JA), B. Piasecki (SZ), D. Susiandri (ST), I. Valdes Fernandez (NO), A. Zaborovskiy (EC), J. Al Saud (SA), J. Barroso (BR).

DISCUSSION RECORD³

The Acting Chair (Mr. Okamoto):

We will hold our discussion on an important article, which is Germany, our first Article IV in the hybrid format.

I do think all Directors have issued gray statements. We have the benefit of a statement from the representative of the European Central Bank (ECB). We are coming back to Germany on an Article IV, trying to move back on to the standard cycle, which is why this current meeting is just six months after the last time this Board discussed a German Article IV 2020, which was delayed because of COVID, and a decision to kind of re-sequence Article IVs during the crisis. But even though there was just a short amount of time that elapsed between the last Article IV and the current one, a lot has actually happened in Germany, which we can discuss. On the whole, this was also the period where mass vaccination started. There was also a supplementary budget that was put in place for 2021. There was adoption of tighter CO2 emission targets following a ruling from the German Constitutional Court. This year's consultation focuses on the impact of those developments in addition to assessing the unprecedented policy measures to combat the pandemic.

Over one year into the pandemic, the German authorities' economic policy response has proved to be what I think is highly effective. Kurzarbeit and other fiscal measures have safeguarded the labor market while the financial sector remains healthy thanks to ample capital buffers in support of financial policies. With mass vaccination progressing well after a slower start and the economy emerging from lockdowns, the authorities and staff are now rightly focused on policies to support the recovery. Fiscal space does remain ample and should be available to deal with any downside risks and to build better for the future.

Now, as laid out by the team and acknowledged by the German authorities in their buff statement and supported by many Directors in the gray statements, the focus on a sustainable recovery strategy should be centered around green, digital, and an inclusive economy.

³ Edited for clarity.

Mr. von Kleist:

Allow me to make just two comments, which may be a step back broader picture type of comments. One is that Germany has enjoyed a remarkable run of political stability. We have only had three Chancellors during the past 40 years. So stability is something which obviously the German-voting population thinks of very highly. At the same time, interestingly, through each of the three Chancelleries, we had a new party rising. Coming into Parliament, we started with three parties after the war, and that was stable for 40 years, and now we have six.

Everybody will be aware that we have several elections in the Autumn, so we now face a six-party Parliament where two of the parties are so far left and so far right respectively that they probably will not form any part of a government, which will make forming a new government more difficult. So that is the one point.

The other point is on the issue of fiscal space, and Geoffrey just mentioned it. We do have a constitutional debt brake. If things turn out as everybody expects, which means strong economic growth, continued expansion, lower unemployment and so forth and so forth, that will mean that the constitutional debt brake will have to be observed from 2023, which will not leave a lot of fiscal space for the upcoming government.

So in that context, obviously while everybody agrees on what would be good and maybe even better and necessary, the constitutional debt brake will be an obstacle to utilizing a lot of resources if we do not increase taxes, which is quite unlikely, or change the constitutional debt brake, which is also unlikely because you need constitutional changing majorities for that.

The staff representative from the European Department (Mr. Aiyar):

Let me address three issues, two substantive and one procedural. I will start with one substantive issue. Several Executive Directors mentioned that they viewed risks to the outlook as balanced rather than turning to the downside, as in our staff assessment.

To provide background, first quarter growth in Germany was minus 1.8 percent. That implies, in order to reach our 3.6 percent projection for 2021, that we are assuming 6 percent growth for the remaining three quarters of the year. So, there is a lot of optimism built into the baseline. In particular, the baseline implicitly assumes that there will be no new outbreaks of the

virus, there will be no new lockdowns, and that global supply shortages, which are currently hampering manufacturing, will ease during the remainder of the year.

Now, I think these are perfectly reasonable assumptions for the baseline, but they do carry downside risks, and I think that would explain our slight view that risks are tilted to the downside.

A second issue that was raised by Mr. von Kleist and several Executive Directors asked for staff's views on this was on the political feasibility of feebates as one element of our climate change policy advice. Now, I should start by saying that clearly the German authorities know much better than IMF staff about political economic constraints relating to individual policies, our policy advice here should simply be viewed as a constructive suggestion.

But in our view, feebates could relieve some political economic constraints. To make my point, let me point out that feebates are a sector-specific revenue neutral way of penalizing high emitters and using those penalty revenues to subsidize low emitters.

For one thing, because of its sector-specific nature, there would be no contentious disputes about cross-sectoral issues, about which sector benefits and which sector does not.

Secondly, because it is revenue neutral, it does not involve potentially contentious issues about whether there are alternative uses for budgetary funds. In fact, feebates have already been used partially in a range of countries, from France, to the U.K., to the Netherlands, to Norway. Typically, they are applied in the automotive sector. They do require good state capacity, but this often rides up the back of vehicular registration systems.

The novelty of our advice, I suppose, is that we advise that it could be used in other sectors as well. We have a working paper, which is being issued shortly, which will discuss specific proposals of how to apply them in sectors such as buildings and transportation. This paper was actually supposed to be a Selected Issues Paper (SIP) to be released with this staff report, but because of the German Constitutional Court ruling, which tightened CO2 emission targets, we needed to rewrite the paper during the Board preparation process. It will come out in a month or so, and we would be very happy to engage with any Executive Directors who are interested in this bilaterally.

Finally, let me turn to the procedural issue. One part of the procedural question was why these two Article IVs were bunched together. The Chair has already given one the gist of it. The first Article IV was pushed forward by about four months because of the pandemic and the German authorities were keen to resume the normal schedule afterwards this year. We have done that. That means that there are six months between meetings, but if we look at the full 24-month period, there have been two Board meetings.

Let me now ask my Strategy, Policy, and Review Department (SPR) colleague, Mr. Fletcher, to address the lapse of time (LOT) issue.

The staff representative from the Strategy, Policy and Review Department (Mr. Fletcher):

There was a question in one of the gray statements about why this Article IV was not proposed for lapse of time procedures. On this, we note that lapse of time procedures use requires, among other criteria, that there be no general policy issues requiring Board discussion and that policies or circumstances are unlikely to have significant regional or global impact in the near term. So, in this case, staff did not consider that this Article IV consultation met these criteria. Specifically, in the context of the ongoing divergent global recovery from the pandemic, Germany's large economic size implies that many of its policies do have regional and/or global impact.

For example, good economic management of the recovery from the crisis is important to support growth of the German economy, which is in turn important for the region, given the large size of the German economy. Climate policy as one particular focus of this report also has, of course, important spillovers to other countries.

That said, we do take note of the suggestion and we will take it into consideration in other cases, as we do fully support increased use of lapse of time procedures as called for in the Comprehensive Surveillance Review.

The Acting Chair (Mr. Okamoto):

To echo what Mr. Fletcher said, we do want good use of lapse of time procedure on Article IVs that do meet the criteria, so we will be looking to suggest that to the Board for lapse of time consideration on where that is appropriate. I think speaking to a few Directors, I know the Board's workload is quite high, so any efficiencies that can be captured in that process are definitely worth exploring.

Mr. Alhomaly:

At the outset, we believe that the German authorities deserve to be commended for the timely and prudent policy response to the crisis and to boost economic recovery. We have issued a comprehensive joint statement with Mr. Andrianarivelo and Mr. Mohieldin; therefore, I would like to make three brief comments today.

First, we encourage the authorities to maintain supportive policies over the medium-term until the recovery is firmly underway, and here we are reassured by the plan to ensure a careful calibration of any withdrawal of support complemented with well-targeted measures, including to maintain a basic social safety net for vulnerable households and firms.

Second, we welcome the government's medium-term plan to scale up public investment, not only the output gap, and address long-standing structural challenges. Indeed, the authorities should focus on promoting a greener and smarter and more inclusive economy to lift potential growth and rebalance Germany's external position.

My third point is on the financial sector. While we believe that the sector has shown resilience, balancing the need to support the recovery with the need to rebuild buffers and preserve lending capacity would be critical going forward. In this regard, we agree with staff's recommendation to limit financial sector risk and look forward to a more in-depth assessment in the next year's Financial Sector Assessment Program (FSAP).

Finally, I would like to express my authorities' appreciation to Germany's commitment to multilateralism, as demonstrated by its strong commitment to the Access to COVID-19 Tools and COVID-19 Vaccines Global Access (COVAX) initiatives, among other initiatives.

Mr. Poso:

I have issued a gray statement but would like to raise a few points for emphasis. We broadly agree with staff's short-term outlook but expect somewhat higher growth in 2022 due to a faster decline of the savings rate and stronger private consumption and higher net exports.

Also, and despite the high level of uncertainty, we are one of those who assess risk to be broadly balanced rather than tilted to the downside, with

outside risks mainly linked to the external sector and downside risks through the course of the pandemic globally.

In this regard, as Mr. Alhomaly, we would like to highlight the efforts by Germany and the European Union (EU) to make vaccines available to all countries, notably through the COVAX initiative.

We share staff's view that the supportive fiscal stance should be maintained and, as the recovery is firming up, the focus should continue to shift to increasing potential growth and investing in a green and digital transformation, making use of the ample fiscal space, and I do note the remarks by Mr. von Kleist on the debt brake.

Germany's ambitious recovery and resilience plan rightly focuses on these objectives and addresses long-standing structural challenges. We agree with the structural policies identified by staff and note that the policy response continues to fulfill these recommendations. However, we would welcome more concrete policy guidance by staff as regards what further actions are necessary to raise climate objectives. I did note the comments on the feebates. Those were very useful.

We agree that the withdrawal of support should be carefully calibrated to the stage of the recovery and should aim at sustaining sectoral reallocation and avoiding long-term scarring. In this regard, measures to increase labor supply and to ensure that viable firms stay in business could be considered.

In addition, strengthening competition and productivity in the services sector, improving incentives for private investment, and enhancing housing supply should also be structural priorities.

We concur that the German financial sector has remained resilient but note that the crisis-related risks are aggravating existing vulnerabilities. The withdrawal of policy support and a potential rise in insolvencies could affect asset quality. This together with low bank profitability and the continued strong rise in house prices could pose medium-term risks.

In this regard, a tightening of macroprudential policies would be warranted if vulnerabilities in the real estate markets continue building up, whereas supporting the usability of capital buffers and taking actions to improve banks' profitability should also be priorities.

The Acting Chair (Mr. Okamoto):

As Mr. Alhomaly referenced, there is an FSAP that is ongoing that will look at some of these things, not just from a stability perspective, but also from a growth perspective. We need a healthy profitable banking sector that can be profitable and invest back in the local economy in German, so there is a growth aspect to that as well. It is certainly not the only country to be experiencing some of the issues, including in housing and otherwise, that pose certain risks. That is something that we are looking at kind of in a multilateral surveillance manner as well.

Mr. Trabinski:

We commend the authorities for their strong track record of prudent policymaking and a prompt reaction to the pandemic, which helped Germany weather the crisis comparatively well. We also agree with the thrust of the staff appraisal and closing the report and offer the following additional comments for emphasis.

First, we encourage the authorities to continue supporting vulnerable segments of the population by considering more targeted measures, including a reduced labor tax wage on lower incomes.

We note that marginal workers and the self-employed were hit hardest by the pandemic. Hence, we welcome the expanded access to the basic income and a special program for the self-employed.

Second, the authorities should use their fiscal space to expand public investment, promote innovation, and facilitate structural transformation, including digitalization and E-carbonization, to lift productivity growth and build a greener economy.

As Mr. Alhomaly, we welcome the authorities' measures to close digital and infrastructure gaps, especially with regard to Internet connectivity. In a broader context, we support staff's call for implementing structural governance reforms, which could further facilitate public investment. We welcome the introduction of nationwide procurement statistics by the authorities. We also urge the authorities to cut bureaucracy and re-direct resources to productive and innovative use.

Third, as Mr. Poso, we agree that the financial sector is resilient but call for close monitoring of emerging risks and addressing long-standing

problems. The low profitability of banks calls for reviving their business models. Close monitoring of asset qualities is warranted to avoid surprises when the insolvency moratorium expires, and the regulators should also closely monitor developments in the real estate market. We welcome the authorities' recent measures to improve data collection in this area.

Finally, touching a little bit upon Mr. Aiyar's comments earlier today on assessing climate-related issues in different sectors of German's economy, looking a little bit at the juncture between climate change and the financial sector, we would be interested in knowing more about the financial sector's exposures to large emitters and climate risks. It is not clear for us whether the paper announced soon to be published by staff has any reference to this issue, but staff comments would be very much appreciated in this regard.

Mr. Tanaka:

We also appreciate Mr. von Kleist for remarks on the political economic landscape in Germany. We issued a gray statement and would like to offer the following remarks for emphasis.

We commend Germany for responding to the COVID-19 crisis in a comprehensive way with swift fiscal actions under the ample fiscal space and financial sector resilience and accommodative monetary policies.

In addition, thanks to the rollout of vaccines, we see the economy as transitioning from an emergency to a recovery phase. Nonetheless, going forward, vigilance to the balance of risks will still be required as phasing out of contingent support measures would need to be carefully calibrated.

On fiscal policy, we positively note the authorities' plan to maintain supportive measures to firms and households, including the vulnerable, until the recovery is fully under control and stand ready to implement additional measures, if necessary. Having said that, we agree with staff that the supportive policies should gradually become more targeted to facilitate resource reallocation.

In this regard, we appreciate staff's analysis on the need to gradually normalize the scope of Kurzarbeit, as promoting the expanded coverage could carry the risk of exacerbating labor misallocation.

On structural reforms, we commend the authorities' initiatives to facilitate innovation and digitalization. As noted by staff, the need for digital

transformation has become more urgent due to the pandemic, and we expect the authorities' efforts will lead to higher productivity and potential growth. In this sense, we welcome the establishment of the future fund and an illustration to include public sector data availability.

We also commend the authorities for stepping up to tackle climate change by making use of its energy and climate fund and welcome their plan to take a multi-pronged approach ranging from carbon pricing to sectoral measures supporting green infrastructure.

On financial sector policy, under the accommodative monetary condition, we welcome that Germany's financial sector has been resilient and well positioned to provide credit support during the pandemic. Low level of bankruptcy might imply possible existence of sizable zombification in many countries, including Germany. Close monitoring for developments in loan quality and insolvency will be needed as financial support measures are withdrawn.

We all know distinguishing between viable and nonviable firms will be challenging but essential to ensure efficient resource reallocation. We do expect the authorities would pave the way to tackle these challenges in an insightful German manner.

We encourage the authorities to remain vigilant to real estate market developments with effective implementation of recent registrations to reduce data gaps on residential real estate loans.

Last but not least, we appreciate Mr. von Kleist and Mr. Merk for having given a wide-ranging insight in information to the Board meetings, including this consultation during their tenure, which is getting near to the end.

Mr. O'Brolchain:

We have issued a comprehensive gray statement so I will keep my comments brief.

Firstly, Figure 8 in the report illustrates that residential real estate prices have continued to rise in major cities in the last decade even throughout the pandemic. As mentioned by Mr. Poso in his gray statement, we encourage the authorities to prioritize the enhancement of housing supply, including social housing, as the crisis abates. But here I have to note that this issue about

house prices reflects, the move of investment funds into the residential housing sector, and previously well-working European housing markets are now seeing imbalances. In that context, we would welcome what Chair said about looking at this in a multilateral context, and we would strongly encourage Directors to look at all aspects and not just the residential loan elements, but also the Investment Fund aspect of that, which I think deserves a lot of attention.

Secondly, as mentioned by Mr. Fanizza and Ms. Quagliariini in their gray statement, greater support for the completion of banking union, in particular, the adoption of the European Deposit Insurance scheme, would support greater cross-border financial flows and remove impediments to cross-border bank consolidation. We thank staff and Mr. von Kleist for their clarification about the timing of this Article IV.

The Acting Chair (Mr. Okamoto):

Well noted, the suggestions on the multilateral surveillance aspects, including housing finance markets. I have some familiarity with but it certainly a lot to unpack there, including, depending on the structure, bond convexity issues, which are relevant in this environment, and also kind of secondary market liquidity, as policies on the monetary policy side begin to somewhat normalize. We will be looking at these things.

Mr. Hilbers:

I would like to thank Mr. von Kleist for the very interesting political perspective he just put forward in this meeting.

The countries in my constituency are in some cases strongly and in many cases to a significant extent dependent on the German economy. This Chair is therefore following developments in Germany close. In that context, I would like to commend the German authorities for the strong policy response to the COVID crisis, and that applies particularly but certainly not exclusively to the so-called Kurzarbeitergeld scheme, which has been an example of short-term work schemes that effectively mitigated the negative impact of the pandemic.

We issued a gray statement in which we associate ourselves with the statement by Mr. Poso, so I will only make four brief points for emphasis this morning.

First, it is important to continue support while gradually withdrawing measures as the recovery becomes entrenched. Using fiscal policy to raise productivity and potential growth, especially by frontloading public investment, would also speed up the recovery. In that context, we welcome the planned investment through the Recovery and Resilience Plan (RRP) to support a green and digital transformation.

Second, inflation is moving to the top of mind for many economists and policymakers. Also, in Germany, both headline and co-inflation have risen significantly. While endorsing the staff's assessment that the main drivers for this increase are one-off, we do encourage the German authorities to keep monitoring inflationary developments and potential second-bound effects. Staff comments on this issue are also welcome.

Third, like many countries in the world, Germany is faced with a continued strong rise in house prices, as also mentioned by Mr. Poso and Mr. O'Brolchain. Not only can this add to financial sector vulnerabilities, but concerns are also rising regarding housing affordability. Given the challenges on the supply side, we encourage social housing investment as one of the key policy priorities. We also welcome the recent data collection initiative on real estate loans mentioned by Mr. von Kleist in his buff statement and the upcoming FSAP in this context.

Finally, we commend the authorities' ambitious climate policies in the Climate Program 2023 and the recent tightening of emission targets. We agree with staff that complementing carbon pricing with sectoral instruments, green infrastructure investment, and income-based climate protection measures could further improve climate mitigation policies.

The Acting Chair (Mr. Okamoto):

On the climate point, there will be a climate strategy meeting on Friday. I think this is the Eleventh European Department Article IV to feature climate, which is good. They have been stretching to accommodate that and hopefully with Directors' feedback, seeing on how this has gone in the initial round on some of these, not just in the European Department, but elsewhere, a little feed-in for a productive discussion that the Managing Director will have with Directors all on Friday morning.

Mr. Chodos:

We issued a comprehensive gray statement, so I just wanted to make a couple points for emphasis and maybe pointing out, I think that it is very evident for everyone that Germany's response to the pandemic has been exemplary on both ends, on the supportive end but also in the regulation end and the containment end, sometimes taking very tough decisions regarding public mobility that really paid off and avoided a greater impact of the pandemic inside Germany, also understanding that the pandemic anywhere is the pandemic everywhere, so having a view to the COVAX initiative, and I think that is a very important element.

The issue of the housing prices, as I said with others, it is concerning, and we think that increased social spending probably in the housing specific sector would be probably more accurate than just taking it as a general social spending. So it would appear to be an accurately prepared response to the fact of this balance between supply and demand, which obviously has these portfolio investment elements into it, which I also believe it is a good idea to have a look at it from a global perspective since it also impacts other economies.

I want to also commend Germany for being able to comply with the .7 benchmark that the United Nation (UN) establishes for use of national product on development assistance, and I want to point out that this development assistance includes support for vaccines but also for refugees. Again, I think that this is an area where Germany should be recognized for the role they play in the social stability investment in refugees in care, not only for Germany, but for the whole of human.

Mr. Hosseini:

We have issued a gray statement, but we would like to mention a few points for emphasis.

We commend the German authorities for their bold and multi-pronged policy response that helped weather the crisis well compared to most European peers. Recovery is underway and is expected to continue to gain strength by the end of the year, backed by the rapid rebound in both internal and external demand and accelerated vaccination rollout.

We are of the view that, given the considerable uncertainties and the negative output gap, fiscal stimulus should not be withdrawn prematurely. We

also encourage the authorities to support the marginally employed workers, including youth, women, and older workers, which collectively is accounting for the bulk of the vulnerable population.

While the financial sector has managed well through the crisis, policies to preserve financial stability should be expanded to put the nascent recovery on a firmer footing. The real estate market vulnerabilities called for close monitoring and possibly an enhanced macroprudential toolkit.

The flexible job preservation strategy has been key in supporting employment and aggregate demand, and the authorities should be commended for that. We welcome the progress in reducing greenhouse gas emissions along with the authorities' keenness to further support start-ups and their recognition of the urgency of digitalization.

Mr. Bevilaqua:

We have issued a comprehensive gray statement, and I will make only a few points for emphasis.

Let me first congratulate the German authorities on their swift response to the COVID-19 pandemic, which led to an economic contraction somewhat milder than earlier projected by staff and the least severe in the euro area. This underpins the effectiveness of Germany's generous fiscal stimulus and overall policy response, which took full advantage of the country's significant buffers.

Second, the policy response has also enhanced the prospects for economic recovery. Although the outlook for the global economy remains clouded by considerable risks, the strong recovery in China and the U.S. bodes well for Germany's exports. Moreover, as lockdown restrictions ease, vaccination moves forward and stimulus measures support demand, the growth rebound should start unfolding unless, of course, downside risks materialize.

Having said that, as others, we believe that the fiscal stimulus should only be gradually phased out as the recovery takes hold, which might well imply carrying fiscal expansion forward well into 2022, taking full advantage of the debt-brake exception clause for crisis periods. Premature fiscal consolidation should be avoided, not only to protect domestic recovery but also to send a positive signal to the euro area's rebalancing efforts. Possible

concerns regarding fiscal complacency seem negligible given Germany's well-established reputation for fiscal prudence.

Despite the relative success in moderating last year's contraction and setting the stage for the recovery, the pandemic crisis has magnified the need for structural reforms. As noted by previous speakers, the banking system will have to deal with higher credit risk within the context of a reversal in the commercial real estate cycle, increased insolvencies, and lower bank profitability.

Although such risks have so far been managed by sizable support measures, close monitoring remains warranted. Also, social and gender inclusiveness should be an integral part of structural policies. In this regard, we welcome the assurances provided by Mr. von Kleist and his colleagues 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.

Finally, we fully endorse the important point raised in the gray statement by Mr. Huh and Ms. Johnson on giving priority to Article IV consultations with our member countries that have yet to have one under resumed surveillance. This includes many small developing states and low-income countries (LICs) who rely more heavily on Fund advice, particularly as they grapple with economic challenges posed by the pandemic. In this regard, we would be grateful if staff could circulate to the Board a list of countries with information on the date of the last and the next Article IV consultation, particularly with small developing states and low-income countries.

Mr. Just:

We broadly associate ourselves with Mr. Poso's earlier remarks.

Like other Directors, we commend the German authorities for their decisive actions that formed internationally to fight the pandemic. We thank staff for the update on vaccination progress in response to our question and consider risks to the outlook as balanced at this stage. Subject to the worsening of health conditions in Germany and abroad, the major economic challenge now is how to recalibrate the current policy mix to better support the durable recovery, limit scarring, and resource misallocation.

Equally, Germany should rise to the occasion to address long-term structural challenges, which often result from significant under-investment over the years in infrastructure, administrative capacity, digitalization, and education.

We would like to emphasize three points. Sufficient fiscal space could allow for a flexible strategy to a continuously changing environment, including earmarking enough resources to support the economy as needed. We fully share staff's call for vigilance over the financial sector. COVID withdrawal stimulus will be challenging, as it might aggravate some long-standing challenges in the banking sector.

The ongoing FSAP is an opportunity to design a Comprehensive Action Plan for buttressing financial stability as the economy recovers from the pandemic. We also look forward to an in-depth assessment in the FSAP of institutional oversight over the financial sector, governance, anti-money laundering (AML), and whether the macroprudential toolkit is appropriate in view of real estate sector price developments.

We commend the authorities for considering structural reforms for the lenders of green, inclusive, and digital transformation. Germany should use its constitutionally available fiscal space to achieve these goals in a cost-effective way with high economic multipliers. We also concur with the importance of rolling out growth-enhancing public investment to support long-term productivity growth against challenges stemming from an aging society.

Last, all of this will be the prerogative of the incoming government, and we regret that staff did not mention clearer reform priorities the new government should pursue to the benefit of Germany but also its neighbors. In this context, we echo the sentiments expressed by Mr. Huh and Ms. Johnson that this Article IV represents somewhat of a missed opportunity in using some of the surveillance innovations of the Comprehensive Surveillance Review (CSR), as it is difficult to assess the forward-looking aspects of policies in Germany at this stage.

The Acting Chair (Mr. Okamoto):

We note Mr. Just's desire to see a little more on the policy side going forward. I think we will certainly take it under advisement as we see how the election goes and see what the new government's priorities are and engage early and frequently in that regard.

I do think for the moment, I think we tried to balance the forward looking with the continued kind of crisis navigation in the current Article IV, but his intervention is noted, and we will keep that top of mind as we continue our discussions with the German authorities.

Ms. Shortino:

We issued a comprehensive gray statement and much has already been said, so I will just make two points. First, on the fiscal front, we commend the authorities for their strong policy response to the crisis and, in particular, suspending the debt-brake rule and using Germany's substantial fiscal space to put the country on a recovery trajectory.

However, I would echo others on cautioning against the premature withdrawal of fiscal support, and in fact I would go even further and urge the authorities to maintain their use of fiscal space. Given the continued strong fiscal position and staff's assessment of high fiscal multipliers, the authorities should expand and frontload public investment, which will support a strong green recovery and help to reduce persistent external imbalances.

I noted Mr. von Kleist's opening comments on the debt brake, but I would point folks to the staff's responses to the technical questions, which note that in staff's view the debt brake is not binding and does allow for some structural deficits and that the return to the rule could be delayed if economic conditions warrant. I think we agree with both of those points.

Second, as noted during the Comprehensive Surveillance Review (CSR), we are very open to the Fund covering emerging issues, such as digital technology and climate, of course, so long as they meet the bar of macrocriticality and help to inform policy advice on core macro topics.

In this instance, I think the expanded coverage of climate issues very much meets this criteria on climate change measures as well as staff are including coverage in the Article IV. That didn't quite meet the bar with digitalization. We appreciated the discussion on how Germany could increase productivity by fostering innovation, but we would caution that such topics like digitalization should not displace clear macrocritical topics such as external sector imbalances.

And then I would go on to say that Germany has one of the largest current account surpluses in the world. Thus, it was a little odd to us that we saw such little attention to the external sector in the report, even though that is

consistent with the Fund's core mandate, and much greater attention to digitalization.

The Acting Chair (Mr. Okamoto):

We will fully note Ms. Shortino's desire to see more on the external sector. I believe there was some included on this in the annex. I think there was some debate about how much weight we should give this given the very unusual global environment over the past year, but I will let staff talk a little bit about that when it comes back to them at the end of this round of comments.

Ms. Lim:

We issued a gray statement broadly agreeing with staff's assessment, and today I will focus on three points for emphasis. First, we highlight the importance of public investment in infrastructure, technology, and human capital to support the economy's green and digital transformation. We welcome the authorities' efforts in this regard as reflected in the Recovery and Resilience Plan, and strongly encourage efforts towards effective and efficient implementation of public investments.

In this context, we emphasize the importance of policies that will support the transition to the green and digital in the post-crisis future in an inclusive manner. This includes providing essential safety net to protect the vulnerable groups from the impact of the structural transformation agenda as well as income-based climate protection measures and assistance for job transition and training programs that will close the human capital and skills gap and address gender inequities in the labor market.

Second, we support measures to promote innovation to help raise potential growth. To ensure the economy's readiness to post-crisis reallocation, we welcome measures to incentivize innovation as well as increasing the cap for research and development (R&D) tax incentives and improving access to finance. We are also continuing to support viable firms. We look forward to learning in future reports the effectiveness of these measures in lifting productivity and growth.

Lastly, on external sector assessment, we reiterate the need for staff to ensure non-policy factors are better accounted for in the External Balance Assessment (EBA) methodology to enhance the quality and traction of the assessment and to provide a more nuanced presentation of the assessment.

Mr. Nakunyada:

We issued a gray statement in which we broadly share the staff's appraisal and would like to emphasize a few points. First, we commend the authorities for their decisive and significant policy response that has moderated social and economic repercussions of the pandemic. We also appreciate the authorities' international efforts to fight the pandemic through generous contributions made to the Access to COVID-19 Tools Accelerator (ATAC) accelerator in the COVID-19 Vaccines Global Access (COVAX) initiative and strong advocates for advancing global public health.

Second, we view an appropriately accommodative fiscal policy stance is important to mitigate the impact of the pandemic to affected households and firms. In this connection, protective labor market policies, which were the centerpiece of the firm package, should be maintained until the recovery firms up. As such, the rollback of fiscal support measures should be closely tied to progress in curbing the pandemic in the pace of economic recovery.

That said, we welcome the authorities' broad-based public sector investment initiatives that aims to leverage ample fiscal space as important to support the structural transformation, raise growth potential, and reduce external imbalances.

Finally, we welcome the authorities' decisive climate actions, including the tightening of emission targets and increased focus on the development of green infrastructure. Nevertheless, like other Directors, we view the development of a long-term carbon pricing path as important to ensure the efficient allocation of new investments to clean technologies. Nonetheless, we welcome the authorities' efforts to explore measures to mitigate the effects of high carbon prices on vulnerable households.

Mr. Sylla:

We have issued a joint gray statement with Mr. Maher and Mr. Mohieldin, and I will limit my remarks to the following points.

Like most Directors, we commend the authorities for the sizable policy response to mitigate the economic fallout from the pandemic. We encourage the authorities to sustain their fiscal support to ensure a strong recovery. When the crisis subsides, pursuing policies that aim to tackle the economy, the

country's long-term challenges, especially those arising from low productivity growth, climate change, and an aging society will be necessary.

We also associate ourselves with Directors who stress the importance of safeguarding financial stability, notably by improving banks, cost structure, and addressing the long-standing issue of low profitability.

Closely monitoring risk from real estate will also be vital to the sector stability. Let me conclude my remarks by thanking the German authorities for their substantial contribution of EUR 2.2 billion to the global effort to fight the pandemic that Mr. Nakunyada was referring to. This will be very helpful for our countries.

We hope that the ongoing efforts to produce vaccine in Africa for Africa in Senegal or in South Africa will immediately benefit from this important contribution.

Mr. Fanizza:

Let me say that Italy and Germany are the largest manufacturing sectors in the continent, so the destiny of the countries are very closely related. They probably are not without data, so we are really pleased by the term of policies taken in Germany and by the fact they have proved to be effective.

We issued a gray statement; I have only two points that I would like to cover. The first one is that we would like to congratulate the German authorities on their climate change ambitious agenda for having set the goal of reaching greenhouse gas neutrality by 2045 already, according to the recent amendments in Germany's Climate Change Act, as indicated in the buff statement, therefore, earlier than in 2050 as agreed by European (EU) countries.

Second, while we look forward to the ongoing Germany's FSAP review to be available next year, we share other Directors' comments in their gray statements to take advantage of innovation and digitization to improve German banks' business models and bolster weak bank profitability.

The financial sector might have constituted a blind spot in surveillance for my constituency. I am not saying that it is a real problem, but I am saying that we should be careful about looking at the possible vulnerability in how to address it in an effective way, in particular, look at the issues of weak bank

profitability. The reason why, let us say, the consolidation process does not seem to proceed. And that was the last thing I wanted to say.

Very quickly, we have some sympathy with what Ms. Shortino was saying in her statement about the external sector assessment, but at the same time we understand this is not the immediate issue.

Mr. Huh:

We agree broadly with staff's analysis and policy advice. The German economy has fared better than many other domestic economies, mainly due to timely and comprehensive policy response and its strong economic fundamentals, so to speak, improved fiscal space and competent infrastructure. In addition, the government has been initiating broad-based investment to enhance its growth potential successfully, preparing for the post-pandemic era with a green recovery.

However, the financial sector, even though resilient, still seems to require continued monitoring, considering the low margin of financial institutions and potential zombie issues.

As many Directors already mentioned important points, which we agree with them all, and so taking this opportunity, we would like to highlight just one point on the resumption of Article IV consultations. Even though we welcome the Article IV report of the German economy, like Ms. Riach in her gray statement, Mr. Bevilaqua, Mr. Just, we would like to remind staff that there are still many developing member countries which have not yet one Article IV Board meeting but still highly value Fund advice, including many small developing states in my constituency. Therefore, we would like to suggest the gradual resumption of surveillance should be implemented more strategically considering the urgency of demand and evenhandedness.

The Acting Chair (Mr. Okamoto):

We certainly heard Mr. Huh and others asking small states to get Article IV consultations. As soon as we can ramp them up, we will pay due attention to that.

Mr. Lopez:

From the outset, we want to commend the authorities for the impressive response to the pandemic in terms of policy support facilitated by

very sound initial conditions, including ample fiscal space, favorable sector structure of the economy, and well-established safety net mechanisms.

We issued a comprehensive gray statement associating ourselves with Mr. Poso's statement, so I only want to offer a very few comments for emphasis.

First, we are supportive of the authorities' plans to maintain fiscal assistance until the recovery is well underway with a focus on vulnerable groups and firms.

Given the ample fiscal space and low interest rates, we also see merit in frontloading public investment, which should be complemented by regulatory reforms to facilitate public planning and implementation, as well as promoting innovation and labor inclusion.

Although, we recognize that this time of uncertainty makes it very difficult to adequately estimate current account norms, it is evident that Germany will maintain in the future its structural external imbalance.

In order to correct this imbalance, the German recovery plan, we think that goes in the right direction, and efforts to close infrastructure gaps and promote a sustainable and inclusive growth should be maintained in the future, including, we think, proportionate use of the margin provided by the fiscal rules.

Finally, on climate, we strongly commend the authorities for this multi-pronged approach to climate change. We believe mitigation and transition policies should go hand in hand. To this end, we welcome carbon pricing policies that introduce certainty in the future path of carbon price that are gradual and that are socially acceptable. We can maintain substantial support to the climate change policies, thinking also of the situation and effects and complemented by sectoral measures through relation and investments in green technologies and green renewables.

Mr. Buisse:

We commend the authorities for their forceful and timely policy response to the COVID-19 crisis, which by making excellent use of the ample fiscal space available has helped cushion the consequences on affected households and businesses. We generally share the thrust of the report, including its recommendation to maintain supportive policies until the

recovery is fully secure and to make effective progress on long-standing challenges related to the demographic transition, infrastructure gap, digitalization, and the green and energy transition.

We issued a gray statement and associate ourselves with Mr. Poso's statement today. Since the last Article IV discussion was not that long ago, I will keep my intervention focused on three points.

First, the continued expansionary fiscal stance remains appropriate. Uncertainty about the evolution of the pandemic and the path of the recovery remains substantial. The output gap is not yet filled. Fiscal expansion in Germany must also be put into perspective with the importance of addressing the macroeconomic imbalances within the euro area. In light of the past crisis, we must acknowledge that in an environment of low inflation and low interest rates, euro area countries with a weak domestic demand and available fiscal space should maintain an accommodative fiscal policy when the crisis is over. We therefore fully support staff's call to carefully calibrate the pace of withdrawal to the trajectory of the pandemic and of economic recovery.

Second, we note the decline in the current account surplus is meant to be temporary, and like Ms. Shortino in her gray statement, we believe the German authorities have ample fiscal space to scale up investment in areas that could boost domestic demand, increase growth, and reduce Germany's large surpluses. I heard, of course, Mr. von Kleist's comments today on that.

We therefore strongly welcome the German recovery and resilience plan, which really goes a long way in supporting the right priorities, in particular, on climate and on the digital transformation. We feel however that we should not lose sight of the labor tax wedge dynamic also.

Third and final one on Germany's climate action and the very commendable package of ambitious reform, including the Climate Action Program 2030, the amendments to the Climate Action Act recently passed, among other measures, the introduction of a market-based carbon-pricing system. This really goes in the very right direction.

Further, and in line with staff, we support the implementation of a robust price floor under European (EU) Emissions Trading System (ETS), accompanied by compensation measures for households and firms.

Mr. Zhang:

We commend the German authorities for effectively mitigating the impact of COVID-19 crisis and supporting the economic recovery. As we issued a comprehensive gray statement, I would like to limit my comments to the following four points for emphasis.

First, on fiscal policy, Germany has significant fiscal space to frontload public investment while keeping debt levels under control. A broad-based public sector investment initiative is critical to boost growth potential to facilitate structural transformation and reduce external imbalances.

In this regard, we appreciate the draft 2022 federal budget and the medium-term fiscal plan demonstrating high levels of government investment and emphasize the importance of overcoming capacity constraints in implementing this public investment.

Second, on climate actions, we welcome the amendments to the Climate Change Act indicates the government's aggressive ambitions for meeting emission targets. We believe the best way to achieve emission reduction targets is to deploy a comprehensive set of policy measures rather than relying on some single tool. In this regard, we agree with staff that a well-specified carbon pricing schedule should be complemented with a sectoral instrument such as stricter regulations as well as increased public investment in green-funded infrastructure and technologies.

Third, on financial sector measures, we commend the authorities for their achievements in maintaining financial stability. Going forward, we agree risks warrant close monitoring, particularly with the insolvency moratorium to facilitate resource reallocation should be accompanied by targeted support. We see merit in solidifying timetables for banks to rebuild buffers and limit irrelevant payoffs and share buybacks until the recovery is firm. We stress the need for innovation in business models and financial architecture reforms at the European level to address the long-standing issue of big bank profitability.

Finally, we appreciate Germany's contribution to the ACT Accelerator under the COVAX initiative, which demonstrated strong commitment to multilateralism.

Ms. Choueiri:

We issued a joint gray statement with Mr. Mouminah and Mr. Andrianarivelo, and we would like to focus on two points today.

First, Germany's response to the pandemic has been exemplary. We welcome the government's commitment to keeping up appropriate policy support until the pandemic is fully under control and the economic recovery is firmly underway. A central pillar of the COVID-19 policy response is the enhancement of the short-time work allowance, which could be extended if needed.

To prevent widening inequality and deeper labor market scarring, additional measures targeted at groups that are hard hit by the pandemic, particularly women, youth, and elderly workers, would also be useful.

We also welcome the government's attention to the institutional impact of the crisis as outlined in the buff statement.

Second, we would like to take this opportunity to recognize Germany's leading role in contributing to global solutions to overcome the global health and economic crisis. This includes Germany's strong commitment to the ACT Accelerator and the COVAX initiatives in which it is among the largest donors. We also welcome the German government's increased support to development cooperation and humanitarian aid, as reflected in the draft 2022 budget.

In conclusion, Chair, Germany has a significant role in the world economy. A strong German economy would positively benefit its European neighbors as well as other regions, including ours, which enjoys strong economic and development connections with Germany.

Mr. Palei:

In our gray statement, we expressed some surprise that we had such frequent consultations on Germany, but I understand the explanation provided by staff and, of course, the role of Germany as a regional powerhouse, global powerhouse is extremely important for the discussions of other countries, particularly in the euro area. So, organization of the cycle of the consultations is a good idea.

During this pandemic crisis, Germany was one of the most ambitious countries in providing the anti-crisis fiscal response, both above the line and below the line. Of course, this experience in Germany has many implications for the future of the European economy and the future of global imbalances as well. So from this perspective, we would have preferred to see much more analysis of the fiscal policy and its consequences for the future, also external sector imbalances within the currency union, and as we stated in our gray statement, at some point consequences of the recent review of monetary policy by the European Central Bank (ECB) for the countries in the Currency Union.

This is not the last consultation, of course, with Germany, and we will have plenty of opportunities to discuss them later on, both in multilateral and bilateral surveillance cases.

Today, Mr. von Kleist made very useful remarks in the beginning of our meeting. I thank him for his buff statement, for his remarks, and for his able representation of Germany at the Board.

The staff representative from the European Department (Mr. Aiyar):

There were not that many questions that I could see, but I picked up on three. Please do remind me if I have missed something. The first was on digitalization and the question was whether it met the ball for macrocriticality. In staff's view, it does, especially at the current juncture. And as we have seen during COVID-19, there has been enormous reliance on digital infrastructure. We are also of the view that even once the pandemic recedes, there will be a significant change in consumer preferences as well as working habits. In order to address this, it is essential to have good digital infrastructure, which is solely lacking in Germany.

On the question of the external sector, we fully agree that it is a very important issue for Germany. Our policy advice is very similar to previous years. Essentially one can think of it as three strands of advice. First, to have greater fiscal expenditure over the medium term; second, to address the root causes of the imbalance by looking at ways to reduce excess savings and to crowd in more investment.

Two of the items that we really focus on in this Article IV, namely climate change infrastructure and digital infrastructure, are both expected to crowd in private investment. To the extent that they do this, they would necessarily ameliorate the Fund account imbalance.

Finally, on fiscal, we have a box which actually looks at the impact of a 1 percent permanent increase in fiscal spending, particularly in investment, and we lay out the consequences for the current account balance, which would certainly ameliorate imbalances.

Let me turn to another question, which was on financial sector exposures to climate risks. This is certainly something that is going to be the subject of much analysis going forward. It is something that the FSAP is going to be covering extensively. The ECB will be conducting system-wide tests together with the European Systemic Risk Board (ESRB) and the European Commission where they will be reviewing valuation measures and control measures after having done stress tests to assess what are the exposures.

To give the Board a little bit of color about Germany in particular, which is a very bank-heavy financial sector, when we look at total bank exposures, manufacturing only amounts to about 9 percent of bank exposures, and of that there is about 2.6 percent to the automotive sector and about 7 percent to electricity and water, mining, and other utilities, which we might think comprise particular climate risks.

The overwhelming bulk of bank lending in Germany is due to the services sector. That should not be regarded as any kind of panacea because many services, for example, construction and the building industry, will be affected by climate risk policies and climate change, so this is certainly something that staff will endeavor to keep an eye on.

Finally, there was a question on inflation second-round effects. We provided a longer answer in written form so let me just say very briefly that we do not see too many signs just now of second-round effects or of inflation expectations becoming de-anchored. I would point to the latest round of wage bargaining, which has resulted in a 2 percent wage increase, which is actually smaller than what was reached in the pre-pandemic phase, and this could be because there is still a negative output gap and there is still considerable uncertainty about the path of the economic recovery.

*The staff representative from the Strategy, Policy and Review Department
(Mr. Fletcher):*

We certainly take note of the comments and observations that Directors made in their comments. I think my colleague, Mr. Aiyar, covered all of the questions that I noticed.

Mr. von Kleist:

Let me first and most importantly thank the Germany team comprising of Mr. Aiko Mineshima and Ms. Carlos Caceres, under the leadership of Mr. Shekhar Aiyar, for their really excellent work. As in the past, the close communication and cooperation with our office and our authorities has been greatly appreciated. Given that this Article IV was the last mission for Mr. Aiyar for Germany, I would like to thank him for his outstanding work during the past and wish him all the best in his future position. And we very much look forward to continuing this close and constructive dialogue with the incoming mission chief, Ms. Oya Celasun, who was also already participating in the meetings with our authorities.

As has been mentioned, we have an ongoing FSAP, which will continue in the coming months, and we will come to the Board together with next year's Article IV in one year's time.

We would also like to thank all Chairs for their detailed and thoughtful gray statements and their verbal interventions today. Now, I sense a very large degree of agreement between staff's recommendations, Directors' recommendations, and my own authorities' views. Therefore, a very large agreement on what to do, what to avoid, and which risks keeping an eye on. Given this very large degree of agreement, and given staff's excellent answers to the questions, both in written and oral form, I can be quite brief and just touch on three points.

The first is that we fully share staff's and many Directors' recommendations that we should build better for the future. We, thus, welcome the focus of the staff report on climate issues. As we have alluded to in our buff statement, decisive climate action is one of the government's key priorities. This is also reflected in the recent approval of amendments to Germany's Climate Change Act stipulating tighter emission targets and setting of the goal of reaching reanalysis gas neutrality already by 2045.

On Germany's external position, many Directors commented on that. We acknowledge that the current account surplus remains high. At the same time, the authorities emphasized that it is affected by many non-policy variables, including demographic change and non-domestic policy influences, including very strong international demand for German goods, which reflects strong consumer and industry demand for these goods from our trade partners and, of course, euro area monetary policies.

The EBA model underlines staff's assessment also does not identify any major domestic policy gaps. The model continues to perform rather poorly for Germany with the bulk of the EBA estimates gap for 2020 reflecting the regressions residual, so we continue to support staff to further develop and further refine the model so it becomes a better fit for Germany.

That being said, I think that the many policy initiatives that we outlined in our buff, including the envisaged additional public investment, which was also referred to by Mr. Aiyar, will be conducive to external rebalancing going forward.

Lastly, on the timing of this year's Article IV, I find it very fortuitous given that a new government will take over in a couple of months, and thus the advice from the Fund and the international community on economic choices in the future is especially welcome and valuable at this juncture.

The Acting Chair (Mr. Okamoto):

My thanks to the team who put in quite a bit of work to give the breadth of coverage that this Board has come to expect in Article IVs, and certainly the advice taken on what to focus on in the next round is well taken and will be internalized, but thanks to the Germany team in the European Department and those that support them throughout the Fund.

The Acting Chair (Mr. Okamoto) noted that Germany is an Article VIII member and no decision thereunder is proposed.

The Acting Chair (Mr. Okamoto) adjourned the discussion.

ANNEX

- Gray Statements
- European Central Bank Statement
- Staff Responses to Executive Directors' Technical Questions
- Constituency Codes

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BUFF/ED/21/90

July 8, 2021

**Statement by Mr. von Kleist, Mr. Merk, and Mr. Krahnke on Germany
Executive Board Meeting 21/71
July 14, 2021**

On behalf of our authorities, we would like to thank staff for the substantive, insightful and constructive discussions, and the well-written and well-balanced report. We appreciate the high-quality analysis, which rightly focuses on the most pressing challenges posed by the COVID-19 crisis and the necessary policies to set the economy on a path to a sustained recovery.

Our authorities largely concur with staff's key findings and recommendations. Continuous efforts to fully overcome the pandemic and to sustainably stabilize the economy remain top priorities. Furthermore, with its recent draft of the 2022 federal budget and the fiscal plan to 2025, the government announces fiscal measures that will continue to provide financial assistance to firms and households, while also promoting a strong, green, and inclusive recovery. Germany is undertaking a broad-based public sector investment initiative focused on education and research, digital infrastructure, transport infrastructure and, overarchingly, the climate-friendly transformation of the economy. The government also continues to be committed to improve inclusiveness, inter alia through a lower labor tax wedge in particular on low-income earners, assistance for job transition as well as further measures to address gender inequities in the labor market.

Renewed surges in infections and, consequently, reimposed mobility and contact restrictions from late last year up until spring this year have taken a toll on economic activity, albeit to a lesser extent than during previous waves. In the first half of 2021, the vaccination rollout has been gaining speed and restrictive measures have successfully brought down new infections, ultimately enabling the gradual lifting of restrictions since May. Against this backdrop, our authorities project a strong economic rebound in the second half of the year, driven by continued strong external demand and rebounding domestic demand. At the same time, the spread of more transmissible variants of the virus continues to pose risks to the recovery.

Crisis Response

Overall, the German economy has weathered the COVID-19 crisis fairly well so far owing to effective government action. The unprecedented policy support has stabilized

household income and limited economic scarring by safeguarding viable jobs and companies. The extraordinary fiscal measures comprised higher public health spending, grants as well as easier access to loans and tax relief measures like deferrals to firms, subsidies for the extended *Kurzarbeitergeld*, transfers from Federal to subnational governments, a temporary VAT rate cut, and additional public investment. Due to sound fiscal policy in pre-crisis times the overall debt level is still relatively low compared to other countries or to the peak during the last crisis.

The government is committed to keep up appropriate policy support until the pandemic is fully under control and the economic recovery is firmly underway. At the same time, our authorities continue to monitor the situation carefully and stand ready to employ additional measures if needed. The government is guided by the objectives of protecting Germany's well-diversified and highly competitive economic structures and preserving high-quality jobs. The recently announced draft 2022 budget sets aside EUR 10 billion in precautionary funding to cover unanticipated extra pandemic-induced costs. Another EUR 7 billion is dedicated in 2022 to ensure full financing for business assistance programs and a special fund for cultural events.

A central pillar of the comprehensive policy package that was put in place during the crisis is the enhancement of the short-time work allowance (*Kurzarbeitergeld*). Staff's analysis confirms the effectiveness of this tested tool: The *Kurzarbeitergeld* has not only substantially and significantly contained unemployment but has also stabilized disposable income and, therefore, domestic demand. At the same time, it is worth highlighting that this measure complemented an existing set of well-developed and extensive automatic stabilizers embedded in Germany's tax and social security system, playing an important role in swiftly mitigating the adverse impact of the shock. That being said, our authorities acknowledge that marginal and self-employed workers seem to have been bearing the brunt of job and income losses during the pandemic. Against this background, access to the basic income support for jobseekers and a special program for the self-employed ("Neustarthilfe") was expanded to provide a further safety net for these groups.

In addition to a wide range of fiscal measures, Germany has taken a full set of macroprudential, regulatory and supervisory measures to ensure financial stability and cushion the negative economic effects of the pandemic. These measures have helped to prevent the crisis from spreading to the banking sector and have bolstered financial stability. The occurrence of insolvencies was very low in 2020 due to support measures for companies, exceptional borrower support and fiscal measures, and continues to be limited so far in 2021. However, our authorities agree that these developments warrant close monitoring. At the same time, our authorities view existing facilities for solvency support to firms as likely to be sufficient, with take-up having remained comparatively low.

Beyond tackling the economic fallout from COVID-19 domestically, Germany has also been a strong advocate of advancing global public health by effectively containing the virus globally. The view that "this pandemic is not going to be over anywhere until it is over everywhere" and that only a strong and decisive multilateral approach will enable the global

community to overcome this pandemic, has guided Germany's national and international response to the current crisis: Germany has significantly expanded health care spending not only domestically but also internationally, to speed up vaccine development and production and to help achieve a fair distribution of vaccines across the world. To this end, Germany is strongly committed to the ACT Accelerator and the COVAX initiative. Germany is currently among the largest donors to these initiatives, with contributions totaling EUR 2.2 billion; in total, Team Europe has contributed USD 4.8 billion so far. The German government is also stepping up to take its share of international responsibility for development cooperation, humanitarian aid and international climate action and has included roughly EUR 2.4 billion in additional funding for these purposes in the draft 2022 budget.

“Policies for a Strong and Sustainable Recovery”

To sustainably emerge from the crisis with full strength, the German government is continuing to pursue decisive fiscal policy action with a view to expand public investment, promote innovation and facilitate a structural transformation of the economy, including digitalization and decarbonization. To this end, the federal draft 2022 budget provides for EUR 51.8 billion in investment spending. The medium-term fiscal plan envisages government investment levels to remain continuously high, at about EUR 51 billion per year until 2025, demonstrating a firm commitment to reinforce Germany's position as an attractive place to do business. As also outlined by staff in its analysis in Box 1, envisaged additional public investment will have a long-lasting impact on GDP and help to lift Germany's growth potential by expanding physical and human capital investment (inter alia by crowding-in private investment) and incentivizing innovation.

While this will also be conducive to external rebalancing, our authorities agree with staff's assessment that the spillover effects of a fiscal expansion in Germany on the rest of the euro area are likely to be limited. In this context, we note that staff assesses Germany's external position in 2020 to be stronger than the level implied by medium-term fundamentals and desirable policies. Our authorities acknowledge that the current account surplus remains high but emphasize that it is affected by many non-policy variables, including demographic change and non-domestic policy influences, including very strong international demand for German goods and euro area monetary policies. Moreover, the EBA model underlying staff's assessment continues to perform rather poorly for Germany, with the bulk of the EBA-estimated gap for 2020 reflecting the regression's residual rather than gaps in the policy variables included in the EBA model.

Decisive climate action is one of the government's key priorities, which is also reflected in the recent approval of amendments to Germany's Climate Change Act (CCA) stipulating tighter emission targets and setting the goal of reaching greenhouse gas neutrality already by 2045. Hence, targeted investment in research and infrastructure to accelerate the green transformation, as recommended by staff, constitutes a significant part of the above-mentioned investment initiative. In the past two years, Germany has earmarked over EUR 80 billion for climate policy measures. A new immediate action program for 2022 was passed alongside the amendments to the CCA and will add roughly another EUR 8

billion to this amount. This will inter alia contribute to strong investment in decarbonizing the housing sector, a comprehensive charging infrastructure for electric vehicles, an extension of (local) public transport, and the promotion of hydrogen research and development as part of the National Hydrogen Strategy.

Our government concurs with staff that achieving emission targets will require multi-pronged policy measures that accompany green investments. Against this background, a market-based mechanism for pricing the CO₂ emissions from fuels is being introduced. The carbon pricing system aims to be socially fair and burden-neutral to the economy. Revenues raised through selling emission rights will be re-distributed to citizens and companies either directly or indirectly to avoid hardships and to further increase incentives for investments in climate-friendly technologies. Potential adjustments to the mechanism will be re-evaluated in the future, with a view to reliably reach the climate targets, also by the development of a specified carbon price path. At the same time, our government holds the view that a carbon price path in line with the climate goals needs to be complemented by supporting sectoral measures, such as stricter regulations and targeted funding measures, as well as public investments. Our authorities take note of staff's recommendation to introduce feebates, however, in practice, these measures might prove to be rather difficult to implement, also due to political economy factors.

Regarding the distributional impact of the crisis, our authorities broadly share staff's assessment that marginally employed workers have been particularly affected, exacerbating risks of rising inequalities. Moreover, staff's analysis rightly highlights that marginally employed workers are predominantly low-income earners. The government will closely monitor these developments and – absent a strong recovery in hiring rates – provide re-integration support if needed. Moreover, the government has expanded access to the basic income support for jobseekers. The rate of social security contributions will be capped at 40 percent in 2021. The government's draft budget 2022 encompasses an additional cap in 2022. It aims to enhance social cohesion and to avoid excessive cost burdens to the insured and their employers.

The government also agrees with staff on the need to support low- and middle-income earners more generally. In this regard, the near-complete lifting of the solidarity surcharge, the increase of child benefits and the increase in individual tax allowances represent a significant tax relief to these households.

Staff rightly accentuates that the pandemic has highlighted the urgency of a digital transformation and the need to further promote innovation, foster private investment, and facilitate structural transformation of the economy. To this end, the government has embarked on a range of supportive measures, including R&D tax incentives, additional financial support for start-ups at the growth stage, as well as legislative measures aimed at supporting the development of key technologies, such as Machine Learning and Artificial Intelligence. Moreover, a number of measures have been undertaken to expand fixed-broadband and high-speed mobile networks and accelerate the digitalization of schools and public services ("eGovernment").

Financial Sector

The German financial sector has weathered the COVID shock relatively well so far, benefiting from resilience built up before the crisis, including strong capital and liquidity buffers, lessons-learnt from the previous financial crisis. Also, and in addition to a wide range of fiscal measures, Germany has taken a comprehensive set of macroprudential, regulatory and supervisory measures which helped to ensure financial stability.

During the pandemic, the profitability of German banks has continued to be relatively low, also due to the prolonged period of very low interest rates. However, this also reflects the highly competitive banking market that provides substantial benefits to firms and households. While staff's view is that smaller banks will likely suffer more losses than large banks owing to their high exposures to SMEs, our authorities note that the effects of the pandemic on bank groups and individual banks is still highly uncertain. To ensure that banks have the capacity to absorb losses and to support the economy through lending, supervisors have been calling on banks to refrain from – or at least limit – dividends and share buy-backs. These measures – in conjunction with the full release of the countercyclical capital buffer – have helped to prevent the crisis from spreading to the banking sector and have moderated the negative economic effects of the pandemic. At the current stage, most banks' capital and liquidity buffers remain ample, and NPL ratios are still among the lowest in Europe. This notwithstanding, and considering the high degree of uncertainty, it will be of the essence to continue to closely monitor risks to the stability of the banking sector and the financial system as a whole, including risks stemming from an expected increase in insolvencies and an accompanied rise in loan impairments.

While the pandemic has elevated vulnerabilities in the real estate market, our authorities do not see pronounced risks to financial stability from the housing market. Households do not appear to be overly indebted by historical standards and there continues to be no indication of substantially deteriorating lending standards. At the same time, developments in real estate and associated lending activities need to be monitored closely. In this context, our authorities have just initiated a data collection process on residential real estate loans which represents a key step to close existing data gaps. The upcoming FSAP will provide an opportunity to discuss any possible needs for real-estate-specific extensions of the macroprudential toolkit in Germany.

The Wirecard scandal pointed to a need for reforms to Germany's auditing framework and accounting enforcement. The German parliament thus recently passed a bill to strengthen financial market integrity. The bill legislates reforms to accounting enforcement, reinforces the independence of auditors (in relation to audited companies), and strengthens supervisory activities and powers of the Federal Financial Supervisory Authority (BaFin).

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GRAY/21/1956

July 9, 2021

**Statement by Mr. Huh and Ms. Johnson on Germany
(Preliminary)
Executive Board Meeting 21/71
July 14, 2021**

We thank staff for the report and Messrs. von Kleist, Merk and Krahnke for their buff statement. As we indicated in January, the German authorities responded swiftly to the pandemic and their economy has fared well. However as this is Germany's second Article IV discussion within a six-month period and the previous Board discussion covered the German economy and response to the pandemic comprehensively, we do not feel the need to elaborate on their policy actions further at this stage but offer the following comments on process.

The gradual resumption of surveillance is not guided by an overarching strategy and consequently members are not being treated evenhandedly. Many members have yet to have one Article IV Board discussion under resumed surveillance, including many small developing states and LICs who rely on and value Fund advice, noting Fund advice would be particularly welcomed as they grapple with many economic challenges as a result of the pandemic. This is supported by findings from the Comprehensive Surveillance Review (CSR) which outlined that traction of Fund advice is typically stronger for low income countries, relative to advanced economies. Noting that Germany has an upcoming election in September, we wonder whether traction of policy advice will be constrained by political economy considerations.

Staff missed an excellent opportunity to experiment with new modalities as agreed in the CSR. As the pandemic response was already comprehensively covered, we would have preferred to have seen staff prepare a streamlined report or Germany could have been considered for a focused AIV consultation. Further, it seems that consideration on a lapse of time (LOT) basis should have been more thoroughly considered, especially during July where the Board schedule is already busy and bunching is prevalent. *Can staff elaborate on which policies or circumstances would have a regional or global impact in the next year that prevented it from being considered LOT and how they are different to that of the earlier staff report?*

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GRAY/21/1958

July 9, 2021

**Statement by Ms. Shortino and Ms. Senich on Germany
(Preliminary)
Executive Board Meeting 21/71
July 14, 2021**

We thank staff for the thorough report and Mr. von Kleist, Mr. Merk, and Mr. Krahnke for the helpful Buff statement. Germany has fared better than many of its European peers throughout the pandemic, due in large part to the timely policy response. Germany's ample fiscal space provides room for further public investments to support a strong, green recovery and help to reduce its persistent external imbalances. **We generally agree with staff's analysis and welcome the coverage of climate policies in this report.**

We support the authorities' expansionary fiscal policy and continuing use of the escape clause for the debt brake rule. While Germany had allocated approximately €250 billion for COVID relief in 2020, only about half of that was utilized. *We welcome that much of this support has been reallocated for use in 2021–22 but would like to hear staff's comments on what steps the authorities can take to improve implementation and use.* We agree with staff that there are important downside risks to the outlook for Germany's economic recovery this year. That said, we view the specific risk of vaccine supply disruption as overstated in the report given that Germany has now secured adequate supplies for its population. We also appreciate the report's discussion on Germany's inflation path in 2020 and 2021. We agree that it is important to identify the one-off factors that are contributing to the rise in commodity and food prices this year, including policy shifts as well as the strong base effect from prices dropping to record lows last year. *Could staff offer its outlook on when these one-off effects are likely to taper off?*

We strongly support staff's recommendation to expand and front-load public investment, particularly green, transformative investments. The fiscal multipliers in the report provide a very convincing argument for greater investment in the immediate future. Germany has significant fiscal space to invest in measures that could boost domestic demand and increase growth while keeping debt levels low. Such public investment measures will also help to rebalance Germany's excessive current account surplus. We welcome the

investment plans detailed in the Buff statement, and we look forward to the authorities' key findings on how to address bottlenecks at the federal, state, and municipal levels and accelerate the implementation of public investment in 2022. We appreciate the discussion on how Germany could increase productivity by fostering innovation but are not convinced the digitalization topic rises to a macro-critical level; such emerging topics should not displace clear macro-critical topics such as external sector imbalances.

We welcome the expanded coverage of climate issues in the staff report and commend the authorities for prioritizing climate change measures as part of Germany's recovery efforts. We concur with staff's recommendation to enhance measures to cushion the impact of higher carbon prices, particularly on lower-income households. With respect to additional measures to enhance the cost-effectiveness of the mitigation strategy, we note that the Buff statement highlights that the authorities believe some measures, particularly feebates might be difficult to implement. *Staff comments are welcome.*

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GRAY/21/1961

July 12, 2021

**Statement by Mr. Fanizza and Ms. Quagliariini on Germany
(Preliminary)
Executive Board Meeting 21/71
July 14, 2021**

We thank staff for an insightful report and Mr. von Kleist, Mr. Merk and Mr. Krahnke for their helpful Buff statement. We associate ourselves to Mr. Poso's gray and welcome the authorities' comprehensive policy response to address the COVID-19 crisis and the structural transformation of the economy. We agree with staff's policy advice in favor of a more supportive fiscal stance to address the lingering uncertainty about the future evolution of the pandemic and strengthen growth potential focusing on green economy and digitalization, while also reducing the still large external surplus. We appreciate staff's analysis on the real estate market trends and look forward to the next-year Financial Sector Assessment Program (FSAP) for an in-depth assessment of the financial sector and stress the need for more granular information on the extent of its real-estate exposure. We wish to offer the following comments.

- **Germany's economy managed to contain the drop in GDP last year**, which was less pronounced than elsewhere in Europe; economic activity is set to pick up pace and return to more normal conditions this year. We note that staff's projections for 2022 are **more cautious** than those of the European Institutions. As for the risks, we tend to see merit in the authorities' views of an **overall balanced outlook**. We note that staff expect milder **scarring** than in other EU countries. **Nevertheless, one should acknowledge that the outlook continues to be subject to substantial uncertainty.**
- We concur with staff that the **removal of fiscal support should be contingent on the evolution of the pandemic**, which is highly uncertain. Moreover, continued

support may be essential to **address the needs of** women, marginally employed and self-employed workers, who have been impacted disproportionately by the pandemic. We commend the authorities for deploying the **Kurzarbeit** program, which has worked well both to contain the rise in unemployment and stabilize disposable incomes, and the special program for the self-employed (“Neustarthilfe”) to further strengthen the social safety net.

- We found quite revealing that staff estimate that an **increase of one percentage point of GDP in public investment would raise GDP significantly** while preserving the **downward trend in the public debt-to-GDP ratio**. Moreover, this higher investment would help the country to resume the reduction of its large external imbalance started before the pandemic.
- We appreciate the **broad scope of the current Article IV Report** covering **climate change issues, innovation, and inequality** to further enhance medium-term growth. We believe that these topics should be mainstreamed in Article IV consultations across the membership. We also welcome the measures on **green investment, decarbonization, innovation and digitalization**, as envisaged by the Germany’s Recovery and Resilience Plan.
- On climate change issues, we see merit in staff’s advice to provide **additional clarity on the future path of carbon pricing in Germany**, considering the limited progress in greenhouse emissions in the transport sector. We would also encourage staff to identify further specific actions that are necessary for reaching climate objectives, by drawing on international best practice in future reports.
- We note that Germany’s **financial sector weathered the crisis well**. However, weak bank profitability needs to be addressed. Overall, we concur with staff’s advice on financial sector risks and look forward to the FSAP to be discussed together with the 2022 Article IV consultation. We fully share staff’s recommendations to complete the **Capital Market and Banking Unions**, including the adoption of the **European Deposit Insurance Scheme**, building on the strong momentum of common euro area-policy initiatives, at these challenging times for the international economy. Finally, we appreciate staff’s analysis on the evolution and risks from commercial and residential real estate markets. These sectors deserve close monitoring and, on balance, we would see merit in considering the introduction of further standard macroprudential measures.

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GRAY/21/1962

July 12, 2021

**Statement by Mr. Bevilaqua, Mr. Velloso, and Mr. Coronel on Germany
(Preliminary)
Executive Board Meeting 21/71
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 probability 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.

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GRAY/21/1965

July 12, 2021

**Statement by Ms. Lim on Germany
(Preliminary)
Executive Board Meeting 21/71
July 14, 2021**

We thank staff for the insightful report and Messrs. von Kleist, Merk, and Krahnke for the informative buff statement. The German authorities' strong and timely response to the COVID-19 pandemic is commendable. Germany's large policy buffers enabled the provision of significant policy support to firms, households and the financial system, which has in part led the economy to perform relatively better than most of its European peers since the onset of the pandemic. As the economy rebounds in 2021, the output gap is expected to remain negative until 2023 and the outlook is subject to considerable risks. Continued policy support and frontloading of public investments are therefore well justified to combat pandemic-related scarring effects. Over the medium term, a focus on structural reforms to further support digital transformation, a green recovery and a robust labor market will buttress post-crisis resource reallocation and thereby secure future growth.

Maintaining expansionary fiscal policy is critical to support recovery. With Germany's ample fiscal space and sustainable debt, providing ongoing policy support until the recovery is firmly underway is appropriate. We welcome the authorities' continued commitment to pursue decisive fiscal policy actions, including the scaling up of important public investments to close the digital and infrastructure gaps and facilitate immediate actions to meet the stricter emission targets under the amended Climate Change Act. This would help bolster growth, as staff assessed that public investment has the longest-lasting impact on boosting real GDP (Box 1), while supporting external rebalancing. *Nonetheless, the dominant influence of the regression's residual on the EBA-estimated gap for 2020 reinforces the need to consider ways to better account for non-policy variables in the external sector assessment. Can staff elaborate on how this issue can be considered in the EBA methodology.* We also encourage the authorities to continue to undertake the necessary infrastructure governance reforms that would enhance the capacity for, and efficiency of, public investment implementation at the state level. As the recovery is well entrenched, we share staff's assessment that the withdrawal of support should be complemented by targeted measures to facilitate post-crisis resource reallocation.

Structural transformation is key to lifting potential growth and promoting inclusive and sustainable growth. We welcome the measures taken to enhance digital transformation and incentivize innovation which would help to lift productivity. We also encourage the authorities to proceed with the effective implementation of measures to support job transition while addressing gender inequities in the labor market. Furthermore, we note the authorities' ambitious climate agenda and action program and see merit in staff's recommendation for additional measures to enhance the cost-effectiveness and acceptability of the mitigation strategy. We emphasize the importance of measures to cushion the distributional impact of the climate action program on households particularly in the challenging pandemic context.

We support the multi-pronged policy approach to safeguard financial stability while continuing to support economic recovery. Providing targeted solvency support for viable firms and preserving banks' lending capacity are important for bolstering economic activities while remaining vigilant to lingering risks to financial stability, including from the real estate market. We note the recent efforts to improve real estate market data collection, strengthen oversight of non-banks, and address audit shortcomings. The FSAP that is underway will provide a platform for a comprehensive analysis of the financial sector and the effectiveness of these measures in mitigating financial stability risks.

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GRAY/21/1966

July 12, 2021

**Statement by Mr. Tanaka, Ms. Kashima, and Ms. Ogihara on Germany
(Preliminary)
Executive Board Meeting 21/71
July 14, 2021**

We thank staff for the clear and informative report and Mr. von Kleist, Mr. Merk, and Mr. Krahnke for the insightful buff statement. Thanks to the authorities' timely and strong policy responses, Germany weathered the pandemic relatively well. Making use of its ample fiscal space, the authorities need to continue to provide necessary policy support while steadily addressing medium- and long-standing challenges. We broadly agree with the main conclusions of the report but would like to offer a few additional comments.

Economic Outlook

We share staff views regarding Germany's economic outlook. Germany was hit hard by the pandemic including the emergence of renewed surges. However, a rapid upturn in its export countries has continued to support the recovery, and domestic demand is expected to rebound with the vaccination rollout. We agree with staff that high uncertainty surrounding the evolution of the pandemic and the ongoing supply shortage of intermediate inputs could adversely affect the recovery of exports and investment. *Can staff further elaborate on the current supply shortages in Germany and how these risks could affect future policy implementation?*

Fiscal Policy

The pace of withdrawal of policy support needs to be carefully calibrated, but once the recovery is firmly underway, the authorities should make policy more targeted. We welcome the authorities' plan to maintain support measures to firms and households until the recovery is fully under control. In particular, we positively

take note that the enhancement of *Kurzarbeit* has had significant effects on containing unemployment and stabilizing disposable income. We agree with staff that support to firms should gradually become more targeted and facilitate resource reallocation, encouraging the smooth exit of unviable ones while continuing solvency support to the viable.

Structural Policies

Fiscal policies should be used to address long-standing structural challenges. Making use of ample fiscal space to facilitate structural transformation in the areas of digitalization and decarbonization could contribute to lift potential growth. The pandemic has heightened the importance of facilitating digitalization and innovation, which have been longstanding recommendations in previous Article IV consultations. In this regard, we welcome that the authorities will maintain high public investment to expand physical and human capital investment and incentivize innovation in their medium-term fiscal plan.

We also welcome the authorities' strong commitment to address climate change, as reflected in the recent amendments to the Climate Change Act. As noted by the authorities, the implementation of the tighter emission targets under the Act will require multi-pronged measures, ranging from investment initiatives to an essential safety net for mitigating carbon price increases to vulnerable groups. *We welcome staff comments on the divergent views regarding the introduction of feebates.*

As the pandemic has exacerbated risks of rising inequalities, labor market and social security policies should focus on reintegrating marginally employed workers and maintaining a basic social safety net for vulnerable groups. At the same time, we agree that the expanded *Kurzarbeit* protection to cope with the pandemic could also carry the risk of labor misallocation. In this regard, we commend staff's effort to analyze the effectiveness of *Kurzarbeit* during the pandemic (BOX 3) and provide recommendations to shift to policy normalization in the recovery phase.

Financial Sector Policy

While the financial sector has shown resilience in weathering the pandemic, close monitoring of risks is warranted. The ECB's accommodative monetary policy and sizable provision of liquidity have contributed to ease financial conditions and ensure that banks are well positioned to provide credit support. Going forward, it is necessary

to be vigilant to risks stemming from increases in insolvency. We agree with staff that solvency support should be well-targeted and its design tailored to different firm types to encourage resource reallocation toward growing sectors. In this regard, carefully assessing firms' viabilities will be essential. Vulnerabilities in real estate lending also require close monitoring. From a longer-term perspective, we concur with staff that the financial sector should revisit their business models to improve their profitability by streamlining their operations and making greater use of digital technologies.

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GRAY/21/1967

July 12, 2021

**Statement by Mr. Pösö on Germany
(Preliminary)
Executive Board Meeting 21/71
July 14, 2021**

We thank Staff for their clear and insightful report in the context of Germany's Article IV consultation. We also thank Mr. von Kleist, Mr. Merk, and Mr. Krahnke for their informative Buff statement. We commend the national and EU authorities' resolve to fight the health, social and economic consequences of the ongoing pandemic domestically and internationally, including via the COVAX initiative.

Germany has managed the economic impact of the pandemic relatively well, providing strong and timely support to households, companies and society at large. Fiscal policies should remain supportive, and as the recovery is firming up, the focus should continue to shift to increasing potential growth and investing in the green and digital transformation of the economy, making use of the country's ample fiscal space. Germany's ambitious Recovery and Resilience Plan rightly focuses on these objectives and addresses long-standing structural challenges. We broadly agree with the main conclusions and thrust of the report but would like to elaborate on the following points for emphasis.

Macroeconomic developments

Although we broadly agree with Staff's short-term outlook, we expect somewhat stronger growth next year, and assess risks to be broadly balanced rather than tilted to the downside, despite the still very high level of uncertainty. We share Staff's assessment that the German economy has performed relatively well during the pandemic. Thanks to progress with vaccination campaigns and the phasing out of restrictions, the country is poised for a strong rebound in the second half of 2021. As Staff, we expect the recovery to be driven by continued growth in exports, buoyant equipment investment, and a strong rebound in private consumption, supported by the partial release of pent-up savings in parallel with the re-opening of contact-intensive services. Furthermore, we expect higher GDP growth than Staff in 2022 on account of a faster decline in the savings rate and stronger consumer

spending, as suggested by survey data, and of higher net exports. As Authorities, we assess risks to be broadly balanced, with upside risks mainly linked to the external sector, and downside risks mostly related to the course of the pandemic globally. In our view, Staff projections could have more scope for upside risks in 2022 given their lower growth baseline, in particular for private consumption. Beyond the near-term, we share Staff's assessment that scarring effects on human and physical capital are possible, but on a limited magnitude. As Staff, we expect headline inflation to jump this year driven by one-off factors and strengthening demand, and then ease significantly next year. We also broadly agree with Staff's findings on Germany's real exchange rate and current account surplus, which remains above fundamentals and empirical benchmarks. However, we note that, as in other countries, the reliability of normative quantitative assessments is significantly hampered by the impact of the pandemic.

Fiscal Policy

Supportive fiscal policies should continue, and as the recovery strengthens, the focus should shift to addressing long-standing structural challenges to boost potential growth and support a green and digital transformation, in line with Germany's recovery plan.

Germany has adopted several fiscal packages to support companies, protect jobs, and increase healthcare spending to fight the pandemic. The expansionary fiscal policy is supported by the temporary suspension of EU fiscal rules and of the national debt-brake rule. We agree that adequate fiscal support should remain in place until the recovery is firmly underway, and note that Germany's ample fiscal space leaves comfortable margin to adopt additional measures if deemed necessary. Going forward, fiscal policies should focus on increasing the country's growth potential, notably through public investments in infrastructure and human capital geared towards the green and digital transformations of the economy. These objectives are notably reflected in the national Recovery and Resilience Plan (RRP), which devotes at least 42% of the funds to support climate objectives: decarbonizing industry, investments in sustainable mobility, and improving the energy efficiency of housing; and at least 52% to support the digital transition: in the public administration, health services, education and businesses. These targets largely exceed the minimum EU requirements for green and digital investments under the "Next Generation EU Plan".

Structural Policies

We concur that structural policies should aim at securing the recovery by reducing labor market scarring, protecting vulnerable segments of the population, and ensuring that viable firms remain in business. We agree with the policy priorities identified by Staff, and note that the German response to the crisis continues to fulfill these recommendations, as laid out in Germany's RRP. However, we would welcome more concrete policy guidance by

Staff, in particular as to what actions in addition to current efforts are necessary to reach climate objectives, including by drawing on international best practices. As Staff, we consider that the phasing-out of support measures, in particular the short-term work schemes (Kurzarbeitergeld), should be carefully calibrated to the stage of the recovery, and be accompanied by targeted measures to encourage resource reallocation and avoid long-term scarring. Specifically, further measures could be needed to enhance labor supply, including by reducing tax disincentives to work for low-wage and second earners, and to reintegrate discouraged workers. Borrowers' support for sectors, companies and households most affected by the pandemic should continue until the recovery is underway. While we agree that grants and equity could be better tools to target support than loan guarantees under certain circumstances, we also recognize the difficulties of program design for equity support, especially for SMEs. Further actions to strengthen competition and productivity in the services sector and in regulated professions should also be pursued, while incentives for private investment could be improved further, in particular to upgrade the digital infrastructure. Enhancing housing supply in a sustainable way, including social housing, should also be a key priority.

Financial Sector Policies

We broadly concur with staff's assessment and recommendations for the financial sector, which remains resilient, and note that the crisis has exacerbated pre-existing vulnerabilities that warrant close monitoring. The German financial sector has so far weathered the crisis relatively well, and NPL ratios are still low compared to other euro area countries. However, the phasing-out of support measures in the context of a potential rise in insolvencies might lead to a deterioration of asset quality and an erosion of capital levels, with potentially adverse consequences for credit supply. Going forward, low bank profitability amid expected asset quality deterioration and the continued strong rise in house prices pose medium-term vulnerabilities. To address profitability concerns, the banking sector would need to reduce administrative costs, including through mergers, and increase non-interest revenues, as the 'low-for-long' interest rate environment will keep margins under pressure. Governance standards in the financial sector could also be improved. In addition, Authorities should work with EU Partners towards completing the Capital Markets Union and the Banking Union, including the European Deposit Insurance Scheme. Vulnerabilities in the real estate markets call for close monitoring and would warrant a tightening of macroprudential policy if they continue building up. Finally, supporting the usability of capital buffers, also via targeted communication, remains a key priority for the next months.

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GRAY/21/1968

July 12, 2021

**Statement by Mr. Moreno and Mr. Lopez on Germany
(Preliminary)
Executive Board Meeting 21/71
July 14, 2021**

We thank staff for their report and Mr. von Kleist, Mr. Merk, and Mr. Krahnke for the candid Buff statement. We generally concur with the authorities' policy agenda expressed in the Buff, which focused on supporting the economy during the pandemic and addressing structural challenges based on a green, digital, inclusive and sustained recovery. We broadly share staff's appraisal and policy recommendations and associate ourselves with Mr. Poso's statement. We would also like to add some comments for emphasis.

The German economy has shown a relative strong performance during the crisis and prospects point to a swift recovery going forward. The economic downturn has been partially contained by sound initial conditions—including a strong social safety net, ample fiscal space and a favorable sectoral structure of the economy—and a successful implementation of a large and well-designed set of policy measures. Going forward, in line with the gradual reopening of the economy, we expect a strong rebound in growth supported by the recovery of both external and domestic demand. On risks, we tend to agree with the authorities' view of a more balanced assessment, as downside risks from the pandemic may be well-compensated by upside risks from a stronger release of pent-up savings and a further recovery in exports.

The current account balance is expected to remain stronger than implied by medium-term fundamentals and desirable policy settings. The pandemic could make the external imbalance more persistent, in line with increasing wealth and income inequalities, two of the driving factors of the current account surplus identified by staff in the past. We welcome the results presented by staff in Box 1 signaling the potential positive effects of a structurally looser and growth-enhancing fiscal stance in Germany, without jeopardizing fiscal sustainability. This strategy, together with structural policies to promote private investment, the reduction of excessively high saving rates and the increase of the purchasing power of lower- and middle-income households, would help reduce the external imbalances.

We reiterate our call for maintaining fiscal support until the recovery is well underway, while promoting a more inclusive and sustainable growth from a longer-term perspective. The phasing out of fiscal and other support measures, once the pandemic is under control, should be well coordinated to limit potential cliff effects and rightly targeted to protect the most vulnerable and facilitate resource reallocation. We note that several fiscal measures, specially grants and loan guarantees to firms, have shown a low take-up in 2020 and have been reallocated to 2021. *We would appreciate staff's comments on the expected outcome and the trade-off with possible alternative uses of these funds more aligned with recovery and structural needs.* From a more structural perspective, given the ample fiscal space and low interest rates, we see merits in frontloading public investment to help close gaps in public infrastructures. Higher spending must also be complemented with regulatory reforms, especially at the local level, to facilitate project implementation and reduce their costs and administrative burden.

On the structural front, we welcome the authorities' policy strategy to combat climate change, tackle deficiencies in the labor market and promote innovation and digitalization. A holistic strategy is needed to meet the tighter emissions targets, combining carbon-price measures, sectoral instruments and investments in infrastructure and green technologies. Higher carbon prices could have negative effects on the most vulnerable households, and the authorities are rightly exploring measures to mitigate this impact. On the labor market, policies should aim at limiting the scarring effects of the pandemic, enhancing inclusiveness and reducing inequality. We welcome the gradual normalization of the job-retention scheme as the crisis abates and the extension of basic income support to uncovered and vulnerable groups. The authorities should continue to address other structural challenges in the labor market, such as gaps in human capital and skills, or improving inclusion of women and youth. There is also further scope to counteract the drop in productivity by promoting innovation and reducing administrative burden to firms, enhancing competition in the ICT market and improving digital connectivity and training.

The financial sector has navigated the crisis relatively well, although high uncertainty, potential crisis legacies and structural challenges call for a careful monitoring. The German banking system seems to be sufficiently capitalized, but the expiration of loan moratoria and the potential increase in impairments warrant a careful monitoring going forward. *Could staff provide an assessment of the current provisioning policy by banks?* We welcome the transposition of the Community Directive on Preventive Restructuring, which will facilitate firms' restructuring and will mitigate insolvency risks. From a more structural perspective, long-term challenges related to low profitability and oversize of some segments of the banking system remain. We agree with staff that there is room for consolidation in the segments more exposed to SMEs and retail deposits, such as saving banks and credit cooperatives, although implementation could be difficult as shown by the failure of some operations in the past. *Staff's comments and recommendations on existing regulatory or institutional restrictions limiting concentration in the sector would be welcome.*

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GRAY/21/1970

July 12, 2021

**Statement by Ms. Riach and Ms. Andreicut on Germany
(Preliminary)
Executive Board Meeting 21/71
July 14, 2021**

We thank staff for the helpful report and Mr. von Kleist, Mr. Merk, and Mr. Krahnke for their informative buff statement.

Germany has weathered the COVID-19 crisis well. The authorities' comprehensive pandemic response along with the significant policy space available cushioned the impact of the crisis and resulted in a relatively low GDP contraction in 2020 compared to peers. Nonetheless, successive waves of infection and accompanying lockdowns have taken a toll on the economy and uncertainty about the evolution of the pandemic poses some risks to the outlook. We agree with staff that policy support should remain in place until the recovery is firmly underway and that the authorities should focus on reducing scarring and protecting vulnerable groups. Climate change remains a key priority going forward and we encourage the authorities to continue building on their good progress to date.

Fiscal policy

We welcome the authorities' decisive fiscal response combining health spending, grants to firms and subsidies for the Kurzarbeit scheme. The fiscal package played a key role in supporting the economy throughout the pandemic and remains necessary given the still sizeable negative output gap and the uncertain recovery. In this context, we agree with staff that it is preferable to err on the side of doing too much rather than too little. We also share staff's view that, once the recovery is entrenched, policies should become more targeted and facilitate the re-allocation of resources. We note that public debt is projected to resume its downward trajectory as of 2022 and that fiscal space remains substantial. Taking this into account, we agree with staff that the authorities could make further use of fiscal policy to

address long-standing structural challenges such as boosting Germany's growth potential and incentivizing innovation.

Climate change

We welcome the significant progress made by Germany in combating climate change, including the ambitious 2030 Climate Action Program (CAP). We thank staff for the detailed analysis of climate mitigation in the report and for their thoughtful recommendations, including in relation to addressing the distributional impact of carbon price increases. We would have also welcomed references to the Next Generation EU funds, and how they will be used to support Germany's climate commitments. This was an area still being discussed at the time of the previous Article IV consultation. *Staff comments welcome.* We note staff concerns about the slow reduction of emissions in the transport sector and the negative impact this could have on the country's efforts to reduce overall emissions. We therefore welcome plans for a national Emission Trading System which includes transport, as well as planned measures to promote the use of electric vehicles. We also thank Mr. von Kleist for the additional information on Germany's climate mitigation plans provided in the buff statement.

Financial sector

We note the resilience of the banking sector to COVID-19 but also acknowledge staff's concerns about the pressure that rising insolvencies may put on capital ratios. Bank lending remains essential for a successful COVID recovery. We therefore agree with staff that clear supervisory guidance should be put in place to allow banks to build back capital buffers gradually in order to preserve lending to the real economy. As crisis support measures in the financial sector gradually expire, the authorities should closely monitor banks' asset quality.

We welcome the authorities' ongoing efforts to address data gaps in real estate lending, particularly given the impact of COVID-19 on this sector and German banks' exposure to commercial real estate. We note the adoption of a legal framework which allows the Bundesbank to carry out more comprehensive data collection on residential real estate loans. We share staff's view that an assessment of the adequacy of supervisory data should be conducted following the initial data collection. We note remaining gaps in the authorities' macroprudential toolkit and staff's recommendations for income-based instruments. We look forward to the conclusion of ongoing domestic discussions about the expansion of macroprudential tools in this sector.

We welcome the actions taken by the German authorities to reform the existing auditing and accounting enforcement framework in the aftermath of the Wirecard scandal. This includes the passing of a recent bill by the German Parliament to strengthen financial market integrity.

We look forward to the recommendations of the ongoing 2022 German FSAP.

Finally, we note that this is Germany's second Article IV discussion within six months and share the view expressed by Mr. Huh and Ms. Johnson that, given the long pause in Article IV surveillance, staff resource and Board time may have been better directed to those members who have not yet had one Article IV Board discussion under resumed surveillance.

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GRAY/21/1971

July 12, 2021

**Statement by Mr. Palotai, Mr. Just, and Mr. Zaborovskiy on Germany
(Preliminary)
Executive Board Meeting 21/71
July 14, 2021**

We thank staff for the well-written report, and Messrs. von Kleist, Merk, and Krahnke for their informative Buff statement. We commend the German authorities for their skillful use of the accumulated policy buffers to contain the economic fallout from the COVID-19 pandemic and promote a strong, green, and inclusive recovery, as well as for their international efforts to fight the pandemic, including via the ACT Accelerator and the COVAX Initiative. **We broadly concur with the main conclusions and thrust of the report, and associate ourselves with the statement by Mr. Pösö.** As the recent Article IV Consultation with Germany was concluded six months ago, we would like to add only a few points for emphasis.

Regarding the balance of risks to the economic outlook, we note that the pace of vaccination and containment of the more contagious variants of COVID-19 will be a key variable for the German economy's recovery in the next months. In this context, *we would appreciate staff's comments whether the authorities' goal to vaccinate 80 percent of the population by the end of summer 2021 is achievable, given that only over 54 percent are fully or partially vaccinated at the end of June.*

As fiscal space remains substantial, we welcome the authorities' focus on reasonable public investments into the digitalization of schools and administration; speedy internet connections, especially in rural areas; R&D; energy transition; and public infrastructure. However, the careful prioritization and effective implementation of these projects remain critical, particularly in the economic environment where raw material prices and firms' mark-ups are rising.

Going forward, carefully phasing out support programs would be essential. Crisis management and the efficiency of short-time work schemes have been crucial for preserving jobs and domestic demand. These schemes should be gradually suspended once the recovery is firmly under way to avoid hindering the reallocation of the workforce to more viable businesses.

Regarding the inflation rate, we would suggest a more cautious approach than staff. Inflation may well moderate in 2022 after its peak, due to the exhaustion of one-off measures such as temporary VAT reductions. The actual speed of inflation for 2021 may be finally slightly higher than the 2.6 percent projected in the Report. *As Mses. Shortino and Senich in their Gray, we welcome staff's further comments on the one-off effects' duration and interplay.*

On the external sector assessment, we note that the bulk of the EBA-estimated gap for 2020 reflects the regression's residual and cannot be directly traced to the policy gaps. In this regard, we stress the importance of cautiously interpreting the model outcomes and ensuring the consistency of assessments in the cases with big unexplained residuals. *Staff's comments on how to achieve this are welcome.*

The low profitability of banks is a persistent issue of the German financial sector. We concur with staff that a certain consolidation, the greater use of digital technologies, completion of EA- or EU-wide financial infrastructure and enhancing non-interest revenues could bring some benefits to the German banks. However, staff's emphasis on the European Deposit Insurance Scheme or Capital Market Union to address the profitability issue is somewhat too strong in our view, especially against the existing regulatory environment, as well as the long-term low interest rates' dynamic.

In the field of the criminal law, we share staff's call for strengthening the protection for whistleblowers, as well as the law enforcement against legal persons involved in foreign bribe cases. In addition, we would welcome the enhanced efficiency of the German Financial Intelligence Unit, which analyzes and transmits reports of suspicions of AML/CFT criminal activities.

Finally, we commend the authorities' ambitious climate action strategy, including the goal of reaching greenhouse gas neutrality already by 2045. We welcome the respective plans outlined in the Buff statement and wish the authorities every success in their implementation.

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GRAY/21/1974

July 12, 2021

**Statement by Mr. Hosseini and Mr. Badsı on Germany
(Preliminary)
Executive Board Meeting 21/71
July 14, 2021**

We thank staff for the well-written report and Mr. von Kleist, Mr. Merk, and Mr. Krahnke for their informative Buff statement.

We commend the German authorities for the bold and multi-pronged policy response that helped to weather the crisis well compared to most European peers. After the unprecedented contraction of 2020, growth is expected to rebound by the end of the current year, driven by the pick-up in external and domestic demand, but inflation has also been up sharply against the backdrop of relatively resilient employment, thanks to *Kurzarbeit* program. We commend the authorities for ramping up the mass vaccination program which augurs well for an accelerated recovery. Yet, there is still large uncertainty, with the risk of the more transmissible variants of the virus posing a real threat to the economic outlook. We broadly agree with the staff appraisal and would like to offer a few comments for emphasis.

The ongoing expansionary fiscal policy stance seems to be appropriately calibrated. The persistent threat of the pandemic and the corresponding lockdowns argue in favor of maintaining the existing fiscal support as the pandemic evolves. We support staff's recommendation on the need of using the still-substantial available fiscal space to narrow the output gap and to deal with the long-standing structural challenges, including issues related to the capital investment, demographic changes, labor supply, and innovation. We encourage the authorities to enhance infrastructure governance reforms and to allow additional federal government support to help overcome capacity constraints in implementing public investment programs.

With the exception of lingering concerns over the lack of profitability, the banking sector has remained resilient, but considering the mounting bankruptcies and financial losses since the beginning of 2021, potential scarring effects should be expected going forward. Policies to preserve financial stability should be expanded to put the budding recovery on a firmer

footing. In this regard, tailored solvency support should be geared towards firms according to their size and their ability to emerge from the crisis. Particular attention should be paid to the behavior of the real estate market with more focus on CRE. We welcome the passing of the new law on combating financial reporting fraud and strengthening controls over financial markets.

We note positively that, drawing on the GFC experience, the *Kurzarbeit* flexible job preservation strategy has played a central role in keeping unemployment in check and supporting aggregate demand. Nevertheless, the authorities are encouraged to support the marginally employed workers, including youth, women and older worker which collectively accounting for the bulk of that vulnerable population. We commend the German authorities for their efforts in implementing key recommendations of the WGB-OECD Working Group on Bribery to limit fraud. We welcome their readiness to further support start-ups and awareness on the urgency of digitalization and the importance of raising the cap on R&D tax incentives. Germany has made significant progress in reducing greenhouse gas emissions, and the authorities' commitment to re-distribute revenues raised through selling emission rights is encouraging. We look forward to the parliament approval of the revised Germany's Climate Change Act.

We wish the German authorities continued success.

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GRAY/21/1975

July 12, 2021

**Joint Statement by Mr. Andrianarivelo, Mr. Mohieldin, Mr. Mouminah, Ms. Choueiri,
Ms. Al Saud, and Mr. Lopes Varela on Germany
(Preliminary)
Executive Board Meeting 21/71
July 14, 2021**

We thank staff for the well-written report and Messrs. von Kleist, Merk, and Krahnke for their informative Buff statement.

The German authorities deserve to be commended for their prudent economic policies and contribution to global solutions to address the health and economic crisis around the world. Although downside risks to the economic outlook remain a challenge, Germany is recovering from recurring infection waves and associated lockdowns. Looking ahead, stepping up vaccine rollout efforts, sustaining fiscal support until the recovery is deep-seated, and pursuing transformative reforms to a smarter and greener economy after the crisis would be key to a long-lasting economic recovery and growth. Against this background, we broadly agree with the thrust of the staff appraisal and would like to offer the following remarks for emphasis.

We welcome the sizeable fiscal stimulus and the intention to maintain considerable fiscal support in 2021, including the continued activation of the escape clause to the debt brake rule to assist households and firms. Indeed, multi-pronged policies should remain supportive until the recovery proves sustainable to minimize scarring and protect vulnerable groups. Nevertheless, we concur that the withdrawal of supportive measures should be gradual and appropriately targeted as the recovery entrenches.

The expansion of Germany’s well-established program “Kurzarbeit” has been key in keeping unemployment in check during the crisis, but additional measures are needed. In particular, measures targeted at hard-hit groups not covered by Kurzarbeit are critical to supporting their reintegration into the labor markets, addressing inequalities, and

strengthening aggregate demand. In this context, we are comforted by the authorities' commitment to improving inclusiveness and addressing gender inequities in the labor market, including boosting disposable income and undertaking tax and pension reforms, as indicated in the Buff. The government can also consider extending the expanded Kurzarbeit beyond 2021 if needed.

We positively note the authorities' commitment to maintaining accommodative financial policies to support sustainable recovery. Insolvency procedures should be geared towards facilitating efficient restructuring or liquidation where appropriate, while targeted liquidity and solvency support for viable firms should remain available. Adopting the EU Directive on Preventive Restructuring Frameworks under the national law is a step in the right direction. While bankruptcies and financial losses have been contained, insolvency moratoria may have masked emerging vulnerabilities; and thus, the authorities' close monitoring is welcome. Looking ahead, the phasing out of supportive policies should be carefully calibrated to balance the need to support the recovery with the need to rebuild capital buffers and preserve lending capacity. Banks also need to be encouraged to improve their cost structures, including through greater use of digital technologies and enhancing non-interest revenues. Relatedly, the progress made in addressing data gaps in real estate lending, the expansion in the macroprudential toolkit, and efforts to strengthen financial market integrity and enhance AML/CFT enforcement are all welcome, and we look forward to further progress in these areas.

Once the recovery takes hold, a careful and calibrated withdrawal of support should be accompanied by targeted measures focused on addressing long-term structural challenges and facilitating the reallocation of post-crisis resources toward growing sectors. In this context, we welcome the government's plan to scale up public investment to close digital and infrastructure gaps, including expanding connectivity, enhancing technology diffusion, improving access to finance, and promoting the effective use of data for innovation. Over the medium-term, we share the view that Germany should focus on promoting a greener, smarter, and more inclusive economy to lift potential growth and rebalance its external position. *Separately, we share the government's concern that achieving the climate targets solely with carbon pricing would be difficult and would welcome staff's elaboration on the authorities' concerns about the proposed feebates measures.*

With these comments, we wish the authorities of Germany all the success in their endeavors.

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GRAY/21/1977

July 12, 2021

**Statement by Mr. Trabinski and Mr. Makhammadiev on Germany
(Preliminary)
Executive Board Meeting 21/71
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.

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GRAY/21/1978

July 12, 2021

**Statement by Mr. Hilbers and Mr. Milutinovic on Germany
(Preliminary)
Executive Board Meeting 21/71
July 14, 2021**

We thank staff for the excellent paper, and we thank Messrs. von Kleist, Merk and Krahnke for their insightful Buff statement. We commend the authorities' effective response to the health and economic crisis, and we agree with staff and the authorities that the policy support in the recovery phase of the crisis could enhance productivity and facilitate the structural transformation to a digital, green and inclusive economy.

We associate ourselves with Mr. Poso's statement and wish to make the following points for emphasis.

We support the continuation of policy support with gradual withdrawal of measures as recovery becomes entrenched. Germany has used its ample fiscal space for support measures that have proven effective in preventing unnecessary bankruptcies and job destruction, thereby also protecting household and bank balance sheets. As the economy reopens, support measures can gradually be phased out to allow extensive automatic stabilizers to operate fully. However, given the continued high uncertainty, flexibility in the timing of withdrawal remains crucial. Labor market policies should shift focus to those most affected by the crisis, such as marginal workers and the self-employed, and tackle a strong hiring rate decline. Therefore, we welcome the extension of apprenticeship subsidies and the new program for the self-employed, and we support training programs and the reduction of the tax wedge for low-income earners.

Structural policies could significantly improve productivity and raise potential growth. We agree with staff that frontloading public investment through the RRP could entrench the recovery and address the infrastructure and digitalization gaps. In addition, incentivizing innovation, improving firms' access to venture capital, and cutting red tape and compliance costs could support private investment and facilitate structural transformation of the economy. *Staff comments on the impact of potential structural shifts in global supply chains and the recent global supply bottlenecks on the export-oriented German industry are welcome.*

The financial sector requires close monitoring of rising vulnerabilities and balanced support to viable firms. As the rise in bankruptcies in early 2021 could be exacerbated by the expiration of

insolvency moratoria, we support targeted liquidity measures to viable firms and efficient restructuring procedures. Furthermore, we agree with staff that rising insolvency requires clear supervisory guidance that allows banks to build back capital buffers to prevent capital erosion that could curb new lending.

Rising real estate prices call for the extension of macroprudential tools and supply-side measures. Vulnerabilities in the housing market require close monitoring, closure of data gaps, and expansion of the macroprudential toolkit. Supply measures such as social housing investment should also be considered, given the persistent under-supply of new housing and rising housing affordability concerns.

We commend the authorities' ambitious emission reduction targets under the Climate Action Program 2030. Moreover, we agree with staff that carbon pricing could be complemented with sectoral instruments, investment in green infrastructure and income-based climate protection measures. *How does staff assess the impact of carbon pricing on the inflation projections?*

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GRAY/21/1979

July 12, 2021

**Statement by Mr. Buissé, Mr. Rozan, and Ms. Gilliot on Germany
(Preliminary)
Executive Board Meeting 21/71
July 14, 2021**

We thank staff for their insightful report and Mr. von Kleist, Mr. Merk, and Mr. Krahnke for their helpful Buff statement. We broadly share the conclusions of the report, including the assessment of the macroeconomic outlook, the risks to the recovery and the policy recommendations. The authorities' response to the Covid-19 crisis has been timely and appropriate, and benefitted from the resilience of the German economy to shocks and its significant fiscal space. We thus commend the authorities for their prompt action and encourage the authorities to maintain their support to households and firms in the near term to limit scarring effects and foster a swift recovery. Going forward, fiscal policy should remain accommodative and shifted towards greater support to labor market entrants, higher public investment in human capital and infrastructures, digitization and climate mitigation. This should also support the necessary rebalancing of the economy towards domestic demand and the reduction of external imbalances. We associate ourselves with Mr. Poso's statement and wish to make the following comments for emphasis.

In the context of heightened uncertainty around the outlook and the evolution of the pandemic, the fiscal stance should remain expansionary until the recovery is firmly entrenched. An accommodative fiscal policy will not only contribute to the rebound in activity and employment but will also help address Germany's long-term structural challenges, such as infrastructure investment gaps, notably to smooth the transition to a digital and green economy. The Next Generation EU package offers an opportunity to achieve this important objective. We note the authorities' commitment to return to the debt-brake rule over the medium term. *In this regard and considering the need to scale up investment and prepare for the structural transformation of the economy, as well as the substantial fiscal space, we would be interested in staff's opinion on the adequacy of the parameters of this rule.* Further frontloading public investment in 2022-2023 appears warranted to bridge Germany's investment gap. This fiscal expansion should also be put in the context of a monetary union with potentially low for long inflation and interest rates. Insufficient fiscal support, or premature and uncoordinated withdrawal of support in Euro Area countries with existing fiscal room for maneuver can delay the recovery in other countries. Accordingly, we share staff's recommendation to carefully calibrate the pace of withdrawal to the trajectory of the pandemic and of the economic recovery.

We encourage the authorities to pursue policies aimed at narrowing the current account surplus over the medium term, and support staff's policy recommendations presented in Annex I. We welcome the authorities' efforts to accelerate the implementation of public investment in the context of Germany's Recovery and Resilience Plan (RRP). We are looking forward, in the next Article IV consultation, for staff's assessment of the impact of this plan on growth and domestic demand. Looking ahead, labor bottlenecks related to the demographic transition may induce a faster increase in wages over the medium-term. *How does staff assess the impact of this wage dynamic on the external competitiveness and rebalancing of the German economy?*

Beyond pandemic related support, efforts should be maintained to address structural challenges investing in human capital, innovation, and the transition toward a greener and digital economy. Adjustments to the *Kurzarbeit* during the crisis have proven to be efficient and have enhanced the resilience of the labor market and preserving disposable income. The gradual normalization of its parameters this year in line with recovery prospects appears fully justified but should retain enough flexibility to deal with unexpected events. The authorities' commitment to improve assistance for job transition as stated in Mr. von Kleist's Buff is also important and very much welcome. **On climate,** we commend the authorities for their ambitious package of reforms including the Climate Action Program (CAP) 2030 and, among other measures, carbon pricing. To further these efforts, and in line with staff's recommendation, we support the implementation of a robust price floor under the EU ETS, accompanied with compensation measures for households and firms to prevent unintended distributional consequences. However, we caution against supplementing these measures with a reduction in social security contributions for lower-income earners, as suggested by staff, as this would blur the lines between labor and climate-related taxation. **On digital transformation,** we broadly share staff's recommendations and welcome the authorities' focus on this priority.

Finally, we agree with staff's conclusions on the financial sector. The strengthening of the oversight of nonbank operations appears important to enhance financial market integrity. We strongly welcome in this context the reforms undertaken to reinforce the auditing framework and accounting enforcement as well as the new law recently passed by the German parliament in this regard. *Could staff elaborate on the implementation of the action plan devised by the authorities in response to the Wirecard case, including on the BaFin's tools?*

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GRAY/21/1980

July 12, 2021

**Statement by Mr. O'Brolchain and Mr. Mooney on Germany
(Preliminary)
Executive Board Meeting 21/71
July 14, 2021**

We thank staff for the comprehensive report and Mr. von Kleist, Mr. Merk, and Mr. Krahnke for their informative Buff statement. The German economy contracted by 4.8% in 2020, thereby outperforming most European peers. Multi-pronged policy support has cushioned the impact of the pandemic, while the pace of mass vaccination and the re-opening of the economy continues apace. We broadly agree with staff's assessment and offer the following comments for emphasis.

While we share staff's views that uncertainties around baseline projections remain exceptionally elevated, notably the impact that new variants may have on mobility, we agree with the German authorities that short-term risks to the outlook appear to be broadly balanced. Latest epidemiological evidence suggests that the efficacy of already approved vaccines remain very high against new variants of concern, providing good protection against symptomatic infection and even better protection against severe outcome and hospitalization. This, coupled with the relatively high share of Germany's population already vaccinated, reduces the risk that costly lockdowns will need to be re-imposed. We also concur with authorities that excess household savings represent a significant upside risk to consumption.

We concur with staff that the authorities should maintain fiscal support for households and firms until there is clear evidence of a sustained recovery, while frontloading public investment. We agree that the expansionary fiscal stance is appropriate given the still sizable negative output gap and uncertainties regarding the pace of recovery. Post-crisis, the authorities should utilize fiscal space to facilitate structural transformation through greater investment in human and physical capital, in addition to bolstering the labor supply. We positively note the Federal government's financial support to municipalities throughout the crisis, and agree with staff that additional finance should be provided where necessary, as well as measures to enhance greater cooperation between agencies. We welcome the draft Federal 2022 budget, which provides for EUR 51.8 billion in investment spending, as outlined in the Buff.

The financial sector remains resilient, despite the challenges presented by the crisis, and NPL ratios remain low. However, with the lifting of the insolvency moratorium, the risk of seeing a sharp rise in corporate insolvencies has increased. Coupled with stress in the real estate market, this could force banks to restrict lending and delay the economic recovery. As noted by staff, German banks are among the most exposed to commercial real estate, which could come under pressure from post-pandemic structural changes resulting in permanently lower demand. Residential real estate is also experiencing strong valuation gains with the German housing price index, growing at a historical high in the first quarter of 2021. To better monitor potential risks, we agree with staff that authorities should continue to improve the granularity of the data they collect related to real estate loans. Authorities should also consider expanding their macroprudential regime for real estate lending should further signs of housing market exuberance arise.

We welcome Germany's continued progress in reducing greenhouse gas emissions, underpinned by the measures contained in the 2019 Climate Change Act. We agree with staff that price-based measures should be complemented with sectoral instruments and further stepped-up public investment in green infrastructure and technologies. In terms of digitalization, we positively note the implementation of eGovernment and the funding earmarked for schools. We encourage the authorities to facilitate competition in the mobile broadband market and improve access to high speed broadband in rural areas. The Kurzarbeit contributed substantially to containing unemployment and stabilizing domestic demand during the crisis. However, we urge the authorities to keep hiring rates under review as the crisis abates, with a view to introducing hiring subsidies if warranted. Finally, we welcome the new legislation, as outlined in the Buff, which provides for reforms to accounting enforcement, reinforces the independence of auditors, and strengthens the supervisory activities and powers of the Federal Financial Supervisory Authority.

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GRAY/21/1981

July 12, 2021

**Statement by Mr. Bhalla and Mr. Goyal on Germany
(Preliminary)
Executive Board Meeting 21/71
July 14, 2021**

1. We thank Staff for the report on Germany and Mr. von Kleist, Mr. Merk, and Mr. Krahnke for a helpful Buff statement.
2. Although the first wave of the pandemic was well managed, Germany was severely hit by the subsequent second and third waves. After the initial delay, vaccination has picked up rapidly since the beginning of spring. Authorities are targeting to vaccinate the entire adult population by the end of the current year. Nevertheless, uncertainty remains due to new variants of the virus.
3. As repeated pandemic waves “required” stringent containment measures, mobility dipped towards the end of last year and in the first quarter of the current year. Surprisingly, manufacturing and construction activities remained operational and well-behaved. While GDP declined by 4.8 percent during 2020, the contraction was lowest among the major European economies.
4. The fiscal expansion to deal with the pandemic led to the first fiscal deficit in eight years, a rise in debt ratio, and a narrowing of the current account balance. Nevertheless, the current account has remained stronger than the level implied by the fundamentals. The Staff has suggested the continuation of fiscal stimulus, as it will help support the recovery of domestic as well as the economies of trading partners; fiscal expansion would raise imports and reduce current account surplus. As per the Staff assessment, despite the continued fiscal expansion, the debt ratio would remain on the downward trajectory and sustainable. We note that the debt ratio though expected to be on the downward trajectory, would take about a decade to return to the 60 percent level.
5. Under the baseline scenario, growth is expected to return to the long-term trend, and inflation is assumed to rise from 1.4 percent in 2022 to 2.1 percent in 2025. There has been a persistent stability of inflation over the last 11 years (average of 1.3 % per annum, and inflation y-o-y of only 1.7 % over the first four months of 2021); in the last 25 years,

excluding 2007 and 2008, not once has annual average inflation in Germany exceeded 2.1 percent. Staff may like to comment on this accelerating inflation expectation.

6. The report observes that indebtedness of the non-financial corporate sector has risen, but their leverage (debt to assets ratios) remains relatively low in historical terms. This is because increased credit to firms was utilized to buildup liquidity buffers. It would be interesting to understand whether the foregoing observation is true for individual sectors, particularly the contact intensive economic activities. We welcome Staff's comments.

7. We agree with Staff's observations that authorities would need to focus on increasing digitalization by expanding connectivity and enhancing the diffusion of ICT tools by improving access to high-speed broadband networks and imparting training to upgrade skills.

8. As policy support is gradually phased out, corporate bankruptcies may rise. Notably, bankruptcies in the hard-hit sectors have already started to pick up and are expected to rise further with the expiry of the insolvency moratorium. In Europe, German banks are the most exposed to the commercial real estate sector. We encourage authorities to consider closer monitoring of banks' asset quality and credit risk assessment norms.

We wish authorities all the best in their future endeavors.

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GRAY/21/1982

July 12, 2021

**Statement by Mr. Mozhin and Mr. Palei on Germany
(Preliminary)
Executive Board Meeting 21/71
July 14, 2021**

We thank staff for the report on Germany and Mr. von Kleist, Mr. Merk, and Mr. Krahnke for their BUFF statement. Given that, in January, the Board had already discussed Article IV report on Germany, we would have appreciated a clear and upfront explanation in the report of the need to conduct another round of consultations with the authorities, while many other Fund members do not enjoy similarly close attention. With respect to the analysis in the report, we broadly agree with it and support the associated recommendations.

Our views have not changed much since January. We commend the German authorities for a timely and sizeable fiscal response, in addition to employing the loan guarantees and substantial automatic stabilizers. We also welcome the authorities' emphasis on a more prominent state role in upgrading investments in the medium term. We agree with the authorities and staff that the broad-based public sector investment initiative, including in the areas of education, transport, and climate change, is likely to crowd in private sector investment. Steady implementation of the initiative may well positively affect productivity in the economy and stimulate innovations. It is also likely to affect the excessively strong balance of payments position and reduce current account surplus.

In light of the setup of the European Central Bank, the role of the national fiscal policy in Germany, as well as in other euro area countries, is probably more important than in many other advanced economies. In our opinion, relatively limited proposed changes of the recently completed review of the monetary policy by the ECB, call for even more fiscal flexibility in the members of the currency union going forward. *While we note that the German authorities envisage some contingent measures supported by an upfront allocation of resources, we would be interested in staff's opinion on whether such a contingent planning is already sufficient or should be developed further. More generally, we would be interested in staff's preliminary take on the likely consequences for Germany of the ECB review of monetary policy.*

As an integral part of the anti-crisis response, the authorities introduced a wide range of macroprudential, regulatory, and supervisory measures. These measures were effective in containing the damage to the financial and corporate sectors from the major shocks. At the same time, the pandemic is associated with large, and, most likely, significant structural shifts in the economy. Hence, the authorities need to monitor the signs of financial stress due to phasing out of the exceptional support measures. In the environment of low interest rates, it will be challenging to ensure the timely exit of non-viable firms while facilitating the reallocation of resources to the newly emerging players.

With these remarks, we wish the German authorities success in facing challenges ahead.

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GRAY/21/1986

July 12, 2021

**Statement by Ms. Mannathoko and Ms. Maida on Germany
(Preliminary)
Executive Board Meeting 21/71
July 14, 2021**

We thank staff for the informative report and Messrs. Von Kleist, Merk and Krahnke for their insightful Buff statement.

Germany's strong economic fundamentals and resolute policy response to the COVID-19 pandemic, helped to cushion the economic impact of the crisis and avert a sharper contraction in 2020 and significant increases in unemployment. We positively note the high vaccination rate, gradual reopening and the emerging recovery, including the gradual narrowing of sectoral divergence in the manufacturing and services sectors. Notwithstanding these heartening developments, we note that risks to the outlook remain, including with respect to supply shortages in major industries. We agree with the thrust of staff's appraisal and offer the following comments.

Fiscal policy: The authorities' current fiscal policy support remains appropriate to combat the impact of the COVID-19 pandemic on affected households and firms. In this connection, we welcome reallocation of unused grants in 2020 to 2021, and the increase in corporate income tax loss carry-back as well as the approval of the Umbrella scheme to provide more support for firms. Given the uncertainty in the evolution of the pandemic, we are reassured by the authorities' commitment to ensure well-targeted support and a careful calibration of any withdrawal of policy support.

The activation of the escape clause of the constitutional debt brake rule has served Germany well and we agree that to spur recovery, Germany should use its fiscal space to expand public investment, promote innovation and facilitate structural transformation of the economy. We also welcome the ramping up of investment to support digitalization and decarbonization, in the context of the Recovery and Resilience Plan. We support efforts to improve infrastructure governance and the introduction of e-procurement and look forward to the findings of the planned assessment of remaining infrastructure bottlenecks.

Climate Change Policy: We appreciate staff's assessment of climate change policy. We welcome the authorities' efforts to prioritize climate protection, including emphasizing

support for green infrastructure as elucidated in the Buff Statement. We note the amendments to the Climate Change Act (CCA) with stricter emission targets and the proposed action plan for monitoring. We encourage authorities to ensure a strong climate action plan, and to design a well-specified carbon price path over a longer time horizon, including feebates in specific sectors.

Financial sector policies: We commend the authorities for a resilient financial sector and urge them to continue to safeguard financial stability. Nonetheless, the presence of downside risks warrants close monitoring, especially as the insolvency moratorium nears its end and credit risks grow. A gradual approach in the wake of the crisis, allowing banks that need to, to rebuild buffers, is advisable. We also welcome continued efforts to reduce data gaps and strengthen oversight of non-banks; this includes the FISG bill on strengthened financial reporting and financing market integrity. We concur with staff that ongoing vulnerabilities in real estate markets, elevated by the COVID-19 crisis, call for close monitoring. We look forward to the 2022 FSAP to assess the impact of the pandemic on financial sector stability.

Structural reforms: We encourage an acceleration of structural reforms to help set the economy on a sustained recovery path. This includes sustaining labor market policies to reduce scarring and preserving human capital until recovery is entrenched. We welcome the expansion of the Kurzarbeit given its effectiveness in facilitating employment adjustment during the pandemic. We encourage the authorities to address the disproportionate impact of the pandemic on vulnerable jobs and income losses of vulnerable groups to help tackle widening inequality. This includes advancing targeted re-integration support for vulnerable young labor. We welcome measures to support innovation, ICT and prioritize digitalization, especially in schools, and on other metrics where Germany lags peers. We also welcome efforts to enhance the effectiveness of AML/CFT enforcement in the financial sector, and the steps taken to limit fraud.

With these remarks, we wish the German authorities continued success in their reform endeavors.

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GRAY/21/1987

July 12, 2021

**Statement by Mr. Chodos, Mr. Herrera, and Mr. Lischinsky on Germany
(Preliminary)
Executive Board Meeting 21/71
July 14, 2021**

We thank staff for the clear report and Messrs. von Kleist, Merk, and Krahnke for their insightful Buff statement. Germany's swift actions to the challenges from the pandemic and the stabilization of the economy continues to be a main priority. The country has been highly effective thanks to a decisive public health response and the swift use of its fiscal space. In the first half of the year, vaccination was heavily increased and in May most lockdown measures were lifted. For the second half, the authorities project an economic rebound pulled by strong recover of internal and external demand. However, as in other countries, the possibility of new and dangerous variants puts the recovery at risk. The 2022 budget is expected to continue supporting firms and households, as well as promoting a strong, green, and inclusive recovery. The country fulfills the UN benchmark to spend 0.70 of gross national income on total official development assistance (ODA), which includes support for vaccines and to refugees.

The German authorities' use of the fiscal space in the crisis response was appropriate to mitigate the scarring effects and cushion the impact of COVID-19 on businesses, workers, and households. In addition, Germany has faced the challenges of the pandemic from a position of strength, with declining unemployment, rising personal income, stronger investment, and improved labor market conditions supporting a pick-up in economic activity. Germany's large private and public savings-investment surplus allowed the government to inject a sizable fiscal stimulus, mitigating the decline in households' income, also partly complemented using private savings. In 2020, the ambitious fiscal package amounted to 30 percent of GDP including macroprudential, regulatory and supervisory measures, loan guarantees, and insolvency moratoria, which contributed to reduced insolvencies.

We commend the authorities for reassuring to keep fiscal support until the pandemic fully receded and the recovery is well established. The 2021 budget maintains considerable demand support and the same is expected for the next budget. We welcome the ramping up of public investment, especially in green energy and digitalization. Moreover, with a relatively low debt level, compared with peers, it is relevant to maintain the activation of the escape clause of the debt brake rule to ensure the continuity of fiscal support. We encourage the authorities to consider additional

measures if needed, including providing liquidity support to firms in contact-intensive sectors, alleviating the tax burden for low- and middle-income households, and maintaining high priority public investment in infrastructure.

The enhancement of Germany's short-time work program ("Kurzarbeitergeld"), a pillar of the policy package, has successfully helped contain a rise in unemployment. The number of short-time workers increased to 6 million at the peak (a quarter of the labor force), and Kurzarbeit benefits combined with other government transfers, helped mitigate the impact of the crisis on household income. The expansion of the Kurzarbeit program, complemented with other well-developed automatic stabilizers, has also helped firms to retain human capital to avoid the costs of separation, rehiring, and training, limiting scarring risks. Reflecting the priority appropriately given by the German government to job preservation, expansion, and relaxation measures allowed for a higher number of eligible firms and workers, while waiving social security contributions to be paid by employers. Looking ahead, policies to support workers and facilitate efficient allocation of labor should take priority to avoid job and income losses.

The financial sector has performed well during the crisis, buttressed on capital and liquidity buffers built up before the pandemic and lessons learnt in the 2008-2009 crisis. However, the performance of Germany's banking system has been mixed; the results of the pandemic are yet uncertain, which is why supervisors have recommended banks to abstain or limit dividends distribution and share buybacks. Banks' capital adequacy has strengthened, and foreign exposures and leverage ratios have declined. At the same time, profitability remains low. While the financial stress level has increased only moderately, NPL ratios are low, new lending picked up on the back of eased financial conditions, including through the pandemic emergency purchase program (PEPP). We caution the authorities about hidden credit risks that may materialize once special policy support is removed, including debt service moratorium for households, loan guarantees through development banks, use of countercyclical capital buffers and ECB-issued regulatory and operational relief. Regarding the Wirecard scandal, we support the measures taken and to be taken to strengthen financial market integrity to prevent corporate fraud and to overhaul accounting and auditing regulations and financial reporting.

We commend the authorities for considering climate action as key priority. The investment initiative is oriented to research and infrastructure to hasten the green economy, contain carbon emissions and reaching greenhouse gas neutrality by 2045. We highlight measures aimed towards decarbonizing the housing sector, building infrastructure for charging electric vehicles and public transport, and promoting hydrogen R&D. Other multipronged policy measures are related to pricing the CO₂ emissions, selling emission rights and distribute them to increase incentives in climate-friendly technologies, and to develop a carbon price path and its regulations and funding.

We would like to highlight German health care spending not only domestically but for the global community, particularly in contributing to the provision and fair distribution of vaccines across the world. The country provided very important support to the WHO, the GAVI vaccine alliance, the United Nations humanitarian system, and the Access to COVID-19 Tools Accelerator (ACT-A, new pledge agreed at the G7 meeting at the end of February of 2021). Furthermore, German ODA was US\$ 28.4 billion in 2020, this is the second largest in absolute terms within OECD countries including 14 percent of it devoted to fight the COVID pandemic and US\$2.6 billion in-country refugee-hosting costs.

With these comments, we wish the authorities and people of Germany the best in their future endeavors.

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GRAY/21/1990

July 13, 2021

**Statement by Mr. Jin and Ms. Yang on Germany
(Preliminary)
Executive Board Meeting 21/71
July 14, 2021**

We thank staff for the well-written report and Mr. von Kleist, Mr. Merk, and Mr. Krahnke for the helpful Buff statement. We commend the German authorities for effectively mitigating the impact of the COVID-19 crisis and supporting the economic recovery. As the growth path is subject to large uncertainties with downside risks, continuous efforts to fully overcome the pandemic and to sustainably stabilize the economy remain top priorities. We broadly agree with staff's appraisal and would like to limit our comments to the following for emphasis.

On fiscal policy. We welcome the authorities' continued fiscal efforts to support households and businesses, and such support should remain in place until the recovery proves sustainable. Germany has significant fiscal space to frontload public investment while keeping debt levels under control. A broad-based public sector investment initiative is critical to boost growth potential, facilitate structural transformation, and reduce external imbalances. In this regard, we appreciate the draft 2022 federal budget and medium-term fiscal plan envisaging high levels of government investment, and emphasize the importance of overcoming capacity constraints in implementing public investment. We recognize that Germany's long-established job-retention program, Kurzarbeit, has played an important role in containing unemployment, supporting disposable income, and stabilizing domestic demand. Additional measures to assist marginal and self-employed workers who do not have access to Kurzarbeit should supplement the safety net for those groups.

On climate actions. The cabinet's approval of amendments to the Climate Change Act indicates the government's aggressive ambitions for meeting emissions targets. We agree with staff that a well-specified carbon pricing schedule should be complemented with sectoral instruments, such as stricter regulations, as well as increased public investment in green infrastructure and technologies. Meanwhile, to mitigate the adverse impact of higher carbon prices on households, re-distributing revenues generated by the sale of emission rights

and other protection measures to benefit lower-income households are essential. *We would like to know the effectiveness and efficiency of the mitigating measures. The staff report highlights the neutral distributional impact of rising carbon prices, particularly the progressive indirect effects, and we would appreciate a more detailed analysis on this. We also note the varying opinions on feebates between staff and the authorities. Staff elaboration would be welcome.*

On financial sector measures. While bankruptcies and financial losses have been contained so far, lingering risks warrant close monitoring. Lifting the insolvency moratorium to facilitate resource reallocation should be accompanied by targeted support for viable firms. To preserve lending capacity and loss absorption ability, we see merit in specifying timetables for banks to rebuild buffers and limit dividend payouts and share buybacks until the recovery gains momentum. We stress the need for innovation in business models and financial architecture reforms at the European level to address the long-standing issue of weak bank profitability. The recent legislations to reduce data gaps, address auditing shortcomings, and strengthen oversight of nonbanks are commendable.

Finally, we appreciate Germany's contribution to the ACT Accelerator and the COVAX initiative, which demonstrate its strong commitment to multilateralism.

With these remarks, we wish the authorities every success in their policy endeavors.

**Statement by Rasmus Rueffer (ECB representative) and Kleopatra Nikolaou
on Germany - Article IV Consultation 2021
(Preliminary)**

IMF Executive Board Meeting

July 14, 2021

We thank Mr. Mr. von Kleist, Mr. Merk, and Mr. Krahnke for their informative Buff statement and Staff for their report. We associate ourselves with the Statement of Mr Pösö and would like to highlight the following issues:

We broadly concur with Staff on the performance of the German economy and its short-term outlook, while noting that Staff’s projections are significantly more cautious on medium-term growth compared to the Eurosystem. We share Staff’s assessment that the German economy performed relatively well during the pandemic and is poised for a robust recovery in the second half of 2021. The recovery is expected to be driven by continued growth in exports, as production bottlenecks in industry are resolved, and a strong increase in private consumption, supported by the partial release of pent-up household savings, in parallel with the re-opening of contact-intensive services. While the 2021 outlook for GDP growth is very similar to ours, Staff’s projections are significantly more cautious on the expected GDP dynamism in 2022, related to a less pronounced decline in the savings ratio. Instead, the faster decline in the saving ratio in 2022 entailed in the latest Eurosystem projections takes into account the survey evidence collected by the Bundesbank regarding the amount of savings that is expected to be spent in the near future. We broadly agree with Staff on substance as regards nominal developments up to 2022, stressing that inflation projections remain subject to considerable uncertainty, including notably the energy component and the impact of government support measures on compensation. In addition, we broadly agree with Staff’s assessment of Germany’s real exchange rate and current account surplus. The latter is still larger than warranted by economic fundamentals, although the reliability of any normative quantitative assessment is, as in other countries, significantly hampered by the impact of the pandemic. It may also be worth recalling that, as in previous years, the current account gap cannot be traced to any *domestic* policy gaps in Germany.

We broadly agree with Staff’s assessment of the risks surrounding the growth outlook and the potential for scarring effects, although we see more scope for upside risks in 2022. As Staff suggests, upside risks include better than expected external demand. However, we see more scope for upside risks in Staff’s growth projections for 2022, given the potential of a stronger unfolding of pent-up domestic demand. As regards downside risks, those posed by the developments in the pandemic and

supply shortages are indeed the most relevant for the near term. Beyond the near-term horizon, we share Staff's assessment that scarring effects on human and physical capital appear likely, implying a moderate reduction in the level, rather than the growth rate, of potential GDP.

We share Staff's recommendation that fiscal policies should provide sufficient support, and as recovery firms up, the focus should shift to transforming the economy. Emergency measures should be calibrated in line with the evolution of the pandemic and the related lock-down measures to ensure continued income support for households and firms. Once the recovery takes hold, the government should focus on the quality of public finances and accelerate government investment to increase the country's growth potential. In particular, we agree that public investment should be geared towards the green and digital transformations of the economy. In this context, we welcome the recommendations from IMF staff on how to close the digital and infrastructure gaps whilst enhancing the effectiveness and efficiency of policies aimed at reaching climate objectives.

We agree with Staff's analysis on the financial sector and note that, the strength of the banking system notwithstanding, risks to economic recovery and rising vulnerabilities warrant close monitoring. Staff's risk analysis largely coincides with that of the ECB. German banks have so far weathered the COVID shock relatively well, but bank capital could diminish significantly if the economic recovery falters. Certain metrics already indicate a weakening of bank asset quality, but NPL ratios are still very low compared to other euro area countries. As policies have been crucial in supporting borrowers and banks and in helping averting credit supply constraints, their phasing-out might lead to a deterioration of asset quality, potentially restraining banks' risk bearing and financing capacities especially in case the recovery should fall short of current expectations. Going forward, low bank profitability amid expected asset quality deterioration, the continued rise in house prices leading to overvaluation, and a potential underestimation of past credit risk (low and declining risk-weights and provisioning) pose medium-term vulnerabilities that have the potential to amplify losses and challenge financial stability in adverse scenarios.

We broadly agree with staff's recommendations on the financial sector. Support programs continue to be necessary but will need to adapt to evolving circumstances. Gradual stage-dependent phase-out of government support measures, depending on the recovery path, seems warranted. In addition, support extensions should be targeted to the most impacted sectors and adversely affected firms, which are viable. Moreover, we also agree that vulnerabilities in real estate markets call for close monitoring and addressing remaining data gaps. Additionally, if residential real estate vulnerabilities continue to build up, a tightening of macroprudential policy could be considered. When tightening macroprudential policy, policymakers should also be mindful of possible residual downside risks (e.g. in relation to the phase-out of support measures) and of the potential dampening effects of some policies on credit in the near term. Finally, we agree that supporting usability of capital buffers, also via targeted communication, remains a key priority for the next months.

Regarding ML/TF, the ECB views positively the enhanced information sharing between AML/CFT and prudential supervisors that followed EU law amendments introduced in 2019. We would like to note that following these changes and in cases where the supervisory cycle followed transposition into national law, the information shared is being integrated into prudential supervisory activities.

Staff's Responses to Executive Directors' Technical Questions

GERMANY

EBM/21/71, July 14, 2021

Staff's responses to technical and factual questions are below. Broader questions in the areas of risks to the macroeconomic outlook, feebates, and the timing of the Article IV will be addressed in staff's oral intervention at the Board meeting.¹

Outlook/Risks

1. *Can staff further elaborate on the current supply shortages in Germany and how these risks could affect future policy implementation?*

- Supply shortages have been reported across many manufacturing industries and are particularly severe in the automobile industry, where a shortage of semiconductors/microchips and other critical intermediate inputs has been hampering the recovery in production and exports. In general, global demand for goods has recovered strongly, aided by income support and lockdown-related substitution from services to goods consumption. Supply of production inputs, however, has not been able to respond as swiftly due to disruption in maritime transport (e.g. shortage of containers and Suez Canal blockage), pandemic-related capacity reduction along the supply chain (e.g. temporary closures of ports and factories in East Asia) and some one-off shocks to key production facilities (e.g. fire at a major semiconductor factory in Japan). However, the latest high-frequency survey data point to some easing of supply bottlenecks and staff's baseline scenario expects supply conditions to gradually normalize through the second half of 2021. Nevertheless, a longer-lasting supply shortage still poses a downward risk to the recovery in exports and investment. Our policy recommendation is thus for a careful withdrawal of policy support during the recovery as policy makers should remain vigilant and stand ready to support the economy longer should such risks materialize.

2. *Could staff elaborate on the specific criteria that have to be fulfilled to assess the recovery as "well underway"?*

- Staff do not have a fixed set of criteria for when the recovery can be viewed as "well underway" but rely on a range of macroeconomic and financial indicators at different

¹ EDs have requested that staff indicate those areas for which responses will be provided during staff's oral intervention in the Board. This avoids the need for EDs to repeat their questions during the discussion. In addition, staff may also indicate specifically in this document which questions they intend to address orally.

horizons to assess the strength of the recovery. Growth and labor market conditions should improve through several quarters in a broad-based manner, accompanied by sound indicators for financial stability. In particular, confidence about a recovery can only be assured if key downside risks around the baseline scenario regarding the pandemic evolution and supply shortages are materially reduced.

3. *We would appreciate staff's comments whether the authorities' goal to vaccinate 80 percent of the population by the end of summer 2021 is achievable, given that only over 54 percent are fully or partially vaccinated at the end of June.*

- As of July 13th, 2021, around 58 percent of the population has been vaccinated with at least one shot of a coronavirus vaccine while 43 percent are fully vaccinated. As in many other advanced economies, the pace of vaccination has slowed from its peak. The pace of vaccination in Germany has declined from over 1 mn of average daily shots in May-June to around half at present (just over 600K on average over the last 7 days ending on July 13th). A continued push of the vaccination campaign will be important to further widen the coverage.

4. Inflation may well moderate in 2022 after its peak, due to the exhaustion of one-off measures such as temporary VAT reductions. The actual speed of inflation for 2021 may be finally slightly higher than the 2.6 percent projected in the Report.

5. *As Mses. Shortino and Senich in their Gray, we welcome staff's further comments on the one-off effects' duration and interplay.*

- Several one-off effects are driving inflation in the near term: the reversal of the temporary VAT reduction in 2020, the introduction of carbon pricing on energy prices (Box 2 of the SR), and the base effect of lower price levels, particularly sharply lower energy prices, during 2020H2. The interaction of these one-off factors contributed to the observed pickup in inflation rate, which is however not expected to last well into 2022 due to the temporary nature of these factors. Our global assumptions for commodity prices also show easing price pressures for oil and commodities going forward.

6. There has been a persistent stability of inflation over the last 11 years (average of 1.3 % per annum, and inflation y-o-y of only 1.7 % over the first four months of 2021); in the last 25 years, excluding 2007 and 2008, not once has annual average inflation in Germany exceeded 2.1 percent.

7. *Staff may like to comment on this accelerating inflation expectation.*

- The year on year headline inflation rate started to increase to around 1 percent in January and accelerated in March-May to over 2 percent. The acceleration since

March is primarily driven by rapidly rising energy prices, while core inflation has risen relative to 2020 but remains stable around 1.7 percent, similar to pre-crisis rates. Going forward, we expect higher inflation rates through 2020 as the reversal of the temporary VAT reduction starts to feed into year on year inflation from July onward. So far, there has been no sign of inflation expectations becoming de-anchored in Germany, and neither have we observed marked second-round effects; for example, the latest collective bargaining outcomes have resulted in modest wage growth of around 2 percent on average.

Fiscal Policy

- 8. We note that several fiscal measures, specially grants and loan guarantees to firms, have shown a low take-up in 2020 and have been reallocated to 2021. We would appreciate staff's comments on the expected outcome and the trade-off with possible alternative uses of these funds more aligned with recovery and structural needs.**

While Germany had allocated approximately €250 billion for COVID relief in 2020, only about half of that was utilized. We welcome that much of this support has been reallocated for use in 2021–22 but would like to hear staff's comments on what steps the authorities can take to improve implementation and use.

While Germany had allocated approximately €250 billion for COVID relief in 2020, only about half of that was utilized.

We welcome that much of this support has been reallocated for use in 2021–22 but would like to hear staff's comments on what steps the authorities can take to improve implementation and use. We would also appreciate staff's comments on the expected take-up of grants and loan guarantees and the trade-off with possible alternative uses of these funds more aligned with recovery and structural needs.

- The allocation of grants and loan guarantees was intentionally very generous in 2020. It provided a safety net, and likely helped reduce stress for businesses even in the absence of take-up. The underutilization mainly reflects less-than-expected demand for grants on the back of firms' generally strong balance sheets before the pandemic and the less severe economic impact of the crisis.
- Demand is expected to rise as renewed waves of infections started in late-2020 stalled the recovery from the first wave. The government has not only re-allocated the unused budget for 2021 but also expanded the access to grants. For example, monthly aid has been raised to up to €1.5 million, from €50,000 during June-August 2020 and €500,000 during November-December 2020. In addition, the eligibility threshold of maximum turnover of €750 million has been lifted, enabling many medium-sized firms to apply for grants. As a result, the take-up of grants has been rising; for

example, the take-up of the Bridge Aid I program during April-August 2020 was €1.4 bn, while that of Bridge Aid III program during January-May 10, 2021 was €6.1 bn. Staff are of the view that maintaining adequate support for firms until the recovery is well entrenched is important to minimize scarring effects.

- On the question about the trade-offs with other uses, Germany has adequate budget space to support the recovery and address structural, even without re-allocating unused grants. As part of the recovery measures adopted in June 2020, Germany introduced a “future package” of around €50 bn to promote green transition and innovation. The majority of this package has not yet been disbursed, and its use can be frontloaded if recovery or structural needs arise. In addition, the German government has set aside 1¼ percent of GDP in 2021 for potential future measures that may be required to fight the pandemic.
- Germany has also been facing long-standing challenges in implementing public investment. To make public procurement during the COVID-19-pandemic smoother and easier, the federal government has adopted detailed guidelines for public contracts. The COVID measures have also provided sizable financial relief for the municipalities, which implement around a third of total public investment. This, together with ongoing efforts to speed up planning and procurement through e.g., Partnerschaft Deutschland and the Bund/Länder Commission, has helped municipal governments continue to execute public investment during the pandemic. The government is assessing remaining bottlenecks, with key findings to be published in 2022.

9. *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?*

- In the context of the Debt Sustainability Analysis, staff considered a growth shock scenario. Under this scenario, real GDP growth rates are assumed to be lower than in the baseline by one standard deviation over 2022–23 (i.e., by 2.4 percentage points). The assumed decline in growth also leads to lower inflation (0.25 percentage points per 1 percentage point decrease in GDP growth), while the interest rate on new debt is assumed to increase 25 basis points for every 1 percent of GDP worsening of the primary balance. Under this scenario, public debt would peak at 78 percent of GDP in 2023, but decline to 70 percent of GDP by 2026. If we were to assume higher inflation, as oppose to lower inflation, while retaining the assumptions on growth and interest rates, the rise in the debt ratio would be less.

- Under the baseline scenario, staff project Germany to return to the normal application of the debt-brake rule in 2023, when the negative output gap closes. This is also in line with the government's plan presented in the context of the draft 2022 federal budget. That said, staff advise that the pace of withdrawal of policy support should be carefully calibrated to the progress of the pandemic and the economic recovery. Given Germany's substantial fiscal space, returning to the rule can be delayed if economic conditions warrant.

10. *We note the authorities' commitment to return to the debt-brake rule over the medium term. In this regard and considering the need to scale up investment and prepare for the structural transformation of the economy, as well as the substantial fiscal space, we would be interested in staff's opinion on the adequacy of the parameters of this rule.*

- For several years staff have pointed out that the debt brake rule (DBR) is not a binding constraint, in the sense that the authorities could loosen fiscal policy considerably without breaching the DBR. This continues to be the case. Staff project a return to a structural budget surplus of around 0.5% per annum by 2025, while the DBR allows structural deficits of (at least) 0.35% of GDP. Therefore, even if the DBR were to return unaltered, there would still be ample scope for greater productivity-enhancing public expenditure, for example, in infrastructure.
- That said, it is likely that there will be broader discussions about how to reform the European fiscal rules (the Stability and Growth Pact) after the German federal election in September. When that happens, the German authorities may wish to consider whether their domestic rules should be altered to remain in line with the SGP framework.

11. *The recently completed review of the monetary policy by the ECB call for even more fiscal flexibility in the members of the currency union going forward. While we note that the German authorities envisage some contingent measures supported by an upfront allocation of resources, we would be interested in staff's opinion on whether such a contingent planning is already sufficient or should be developed further. More generally, we would be interested in staff's preliminary take on the likely consequences for Germany of the ECB review of monetary policy.*

- Staff are of the view that the completion of the ECB's Strategy Review does not imply a major change to the current monetary stance. As monetary policy is currently close to the effective lower bound, the role of fiscal policy in undertaking counter-cyclical measures if downside risks materialize has become more important. Germany has responded to the pandemic with a large fiscal stimulus, invoking the escape clause to its debt brake rule. In addition to the reallocation of unused grants to firms for 2021, the German government has set aside 1¼ percent of GDP in 2021 for potential future measures that may be required to fight the pandemic. They have also emphasized – appropriately, in staff's view -- that they stand ready to deploy more

resources as dictated by the evolution of the pandemic and the recovery, for which they have ample fiscal space. The ECB's new strategy commits to further incorporating climate change considerations into monetary policy framework. However, key operational details need to be fleshed out, therefore it is too early to speculate on the likely consequences for Germany.

Climate mitigation policies

12. *We would welcome staff's views on the authorities' concerns about the proposed feebate measures.*

- Staff will respond to this question during the Board meeting.

13. *How does staff assess the impact of carbon pricing on the inflation projections?*

- According to the Bundesbank's recent analysis, an introduction of domestic carbon pricing of €10/tonnes would increase inflation by about ¼ percent. This suggests that the impact of the introduction of carbon pricing of €25/tonnes in 2021 could raise inflation by around 0.6 percent. Staff's analysis based on the responsiveness of prices of electricity, natural gas, gasoline, and coal to changes in carbon pricing and their CPI weights also suggests a similar—or somewhat smaller—impact. The impact on inflation is projected to be significantly smaller in 2022 as the incremental increase in carbon pricing is expected to be €5/tonnes (i.e., the carbon price is expected to be €30/tonnes in 2022, up from €25/tonnes in 2021).

14. *We would have also welcomed references to the Next Generation EU funds, and how they will be used to support Germany's climate commitments. This was an area still being discussed at the time of the previous Article IV consultation. Staff comments welcome*

- On June 21, 2021, the European Commission endorsed Germany's Recovery and Resilience Plan (RRP)—the plan that underpins the disbursement of the Recovery and Resilience Facility (RRF), which is the heart of the Next Generation EU (NGEU) funds. This is an important step towards the disbursement of €25.6 bn (0.7 percent of the projected 2021 GDP) from the NGEU funds. According to the RRP, at least 42 percent of its total allocation goes to measures that support climate objectives, including €2.5 billion to support the energy efficient renovation of buildings and €2.5 billion to promote electric cars. In addition, the RRP also contains strategies to decarbonize using renewable hydrogen, which is also part of the three "Important Projects of Common European Interest." Although the amount of grants for Germany is relatively small compared to other EU countries, the RRP is well-tailored to support a green recovery.

15. The staff report highlights the neutral distributional impact of rising carbon prices, particularly the progressive indirect effects, and we would appreciate a more detailed analysis on this. Staff elaboration would be welcome.

- Higher carbon prices affect households directly by raising the price of energy and indirectly through driving up costs and prices for consumption goods in general. For the direct impact, we calculate additional household expenditure under higher carbon pricing by accounting for the impact of carbon pricing on fuel and electricity prices and reductions in household demand for energy products. To estimate the indirect impact, we calculate indirect price increases for other consumer goods by assuming full pass-through of the burden from producers to consumers, using the World Input-Output tables (demand responses for these products are ignored but are likely of minor significance for overall incidence impacts). The composition of the consumption basket—including the share allocated for fuels and utility bills—differs greatly across income groups, leading to the different impact of higher carbon pricing. We, therefore, calculate the composition of private consumption by income quintile using the Household Budget Survey by Eurostat, supplemented with the CPI weights. Further details in the methodology can be found in [Online Annex 1.8. of October 2019 Fiscal Monitor](#).

External Sector

16. The bulk of the EBA-estimated gap for 2020 reflects the regression’s residual and cannot be directly traced to the policy gaps. In this regard, we stress the importance of cautiously interpreting the model outcomes and ensuring the consistency of assessments in the cases with big unexplained residuals. Staff’s comments on how to achieve this are welcome.

- The relatively large EBA residual for Germany—which was present in previous years’ assessment—can be generally interpreted as reflecting fundamentals and policy distortions not included in the model, most notably structural distortions. The EBA team has conducted additional analysis on the residual, which pointed to the importance of reforms, including product market reforms (e.g. reducing the burden of licensing and permits), to foster investment in Germany.
- More broadly, staff has conducted extensive analysis on Germany’s external sector, with a view to better understanding high corporate and private savings. Results suggest that these factors are associated *inter alia* with Germany’s corporate structure, ownership concentration, and rising income inequality (see e.g. [Dao \(2020\)](#); [Box 1](#) in the 2019 Article IV Staff Report; and [Box 1](#) in the 2017 Article IV Staff Report). Staff has proposed certain measures to address some of these shortcomings. For example, a reduced labor tax wedge on lower incomes would help ameliorate

income inequality and support aggregate demand (given the high marginal propensity to consume among lower income households).

17. Looking ahead, labor bottlenecks related to the demographic transition may induce a faster increase in wages over the medium-term. *How does staff assess the impact of this wage dynamic on the external competitiveness and rebalancing of the German economy?*

- Faster wage growth in Germany in the medium-term is indeed expected as a result of population aging and continued skill shortages. Wage growth had already increased to around 3 percent annually before the pandemic. As the impact of the pandemic subsides, wage growth should resume to these levels. Stronger wage growth relative to euro area trading partners should contribute to realigning price competitiveness within the monetary union and help rebalance the current account. However, the projected adjustment through wage growth alone is partial and further policy action is needed for external rebalancing.

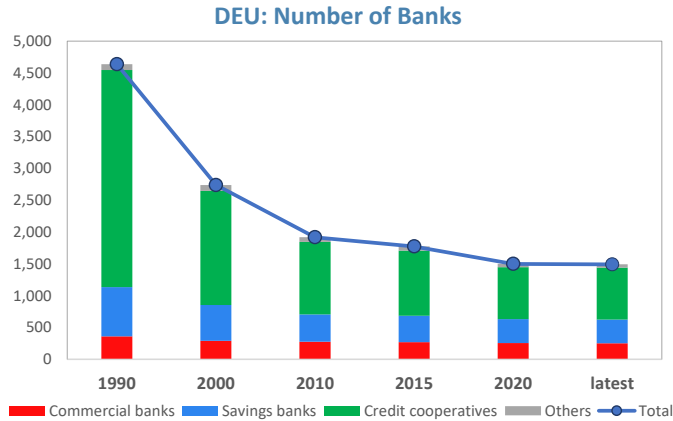
Financial sector

18. *Could staff provide an assessment of the current provisioning policy by banks?*

- German banks' provisioning remains broadly adequate, and provisioning rates remain among the highest in the Euro Area—with relatively low levels of non-performing loans (NPLs) translating into relatively high NPL coverage (provisions-to-NPL) ratios, aided by lower-than-expected NPLs throughout the ongoing COVID-19 crisis. Staff calls, nevertheless, for continued monitoring of NPL dynamics as support measures are phased out, to ensure that provisioning and other bank buffers remain sufficient if a higher-than-expected increase in NPLs were to materialize.

19. *Staff's comments and recommendations on existing regulatory or institutional restrictions limiting concentration in the sector would be welcome.*

- There are no legal or regulatory impediments to further bank concentration per se, and bank consolidation is ultimately a decision made by individual entities. Such decisions depend on several factors, including business and political economy considerations. Note that some consolidation has taken place in Germany over the past three decades. However, there is still a large number of banks and branches operating in Germany relative to peers. Completing the Banking Union, including the implementation of a common deposit insurance scheme, could help facilitate cross-border mergers and acquisitions, but this should not be viewed as a panacea. This is one of the areas that will be analyzed in the ongoing FSAP, whose findings and recommendations will be presented to the Executive Board jointly with the 2022 Article IV Consultation.



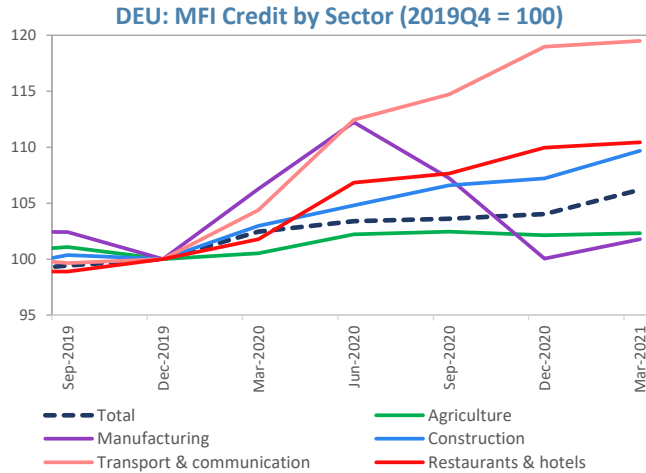
20. Could staff elaborate on the implementation of the action plan devised by the authorities in response to the Wirecard case, including on the BaFin’s tools?

- In response to the Wirecard case, the “Finanzmarktintegritätsstärkungsgesetz” (FISG) bill was enacted, and was passed by Parliament in May 2021, to strengthen financial reporting and financial market integrity. The FISG includes reforms to financial reporting enforcement, reinforces the independence of auditors (in relation to audited companies), and strengthens BaFin supervisory activities and powers. In particular, the FISG aims to combat accounting fraud by strengthening BaFin’s investigative powers over financial statements and outsourced financial activities. It also, from January 2022, discontinues the “two-stage” framework—where two entities were in charge: the Financial Reporting Enforcement Panel (“DPR”) in the first stage, and BaFin in the second stage, which empowered BaFin to step in only when the DPR failed to resolve an issue. Starting January 1st 2022, the FISG also tightens audit regulation to strengthen the independence of auditors in relation to corporate clients and increases auditor’s maximum civil liabilities for breaching fiduciary duties. A detailed assessment on this issue will be conducted as part of the ongoing FSAP, whose findings and recommendations will be presented to the Executive Board jointly with the 2022 Article IV Consultation.

21. The report observes that indebtedness of the non-financial corporate sector has risen, but their leverage (debt to assets ratios) remains relatively low in historical terms. This is because increased credit to firms was utilized to buildup liquidity buffers. It would be interesting to understand whether the foregoing observation is true for individual sectors, particularly the contact intensive economic activities. We welcome Staff’s comments.

- The observation of rising indebtedness (debt-to-GDP) and relatively lower leverage (debt-to-assets) of Germany’s corporate sector relate to longer-term trends over the past couple of decades (Text Figure 7), predating any sectoral differentiation due to the COVID-19 pandemic. However, at the onset of the pandemic, sectors largely affected by the crisis and social-distancing norms (leisure and hospitality services, transportation services, etc) were generally associated with a larger increase in bank

credit—as companies made use of credit lines to cover liquidity shortages from falling revenues. Credit to the manufacturing sector also rose sharply by mid-2020—largely driven by automakers, which faced a significant loss of revenue—but their liquidity position has since improved alongside the sector’s relative recovery.



Structural policies

22. Staff comments on the impact of potential structural shifts in global supply chains and the recent global supply bottlenecks on the export-oriented German industry are welcome.

- It is too early to confidently predict structural shifts resulting from the recent supply bottlenecks. Currently there is little indication that German firms are onshoring production to Germany / Europe from other parts of the world since the outbreak of the pandemic or the supply shortage. Chip production, currently concentrated in East Asia, is very capital- and knowledge-intensive, and would likely require many years of lead-time to shift geographically. Nonetheless, manufacturers are anecdotally reported to be drawing lessons from the recent disruptions, with a view to improving supplier and inventory management.

Procedure

23. Can staff elaborate on which policies or circumstances would have a regional or global impact in the next year that prevented it from being considered LOT and how they are different to that of the earlier staff report?

- Staff will respond to this question during the Board meeting.

CONSTITUENCY CODES

OEDAE

Angola, Botswana, Burundi, Eritrea, Eswatini, Ethiopia, The Gambia, Kenya, Lesotho, Liberia, Malawi, Mozambique, Namibia, Nigeria, Sierra Leone, Somalia, South Africa, South Sudan, Sudan, Tanzania, Uganda, Zambia, and Zimbabwe

OEDAF

Benin, Burkina Faso, Cameroon, Central African Republic, Chad, Comoros, Democratic Republic of Congo, Republic of Congo, Côte d'Ivoire, Djibouti, Equatorial Guinea, Gabon, Guinea, Guinea Bissau, Madagascar, Mali, Mauritania, Mauritius, Niger, Rwanda, São Tomé & Príncipe, Senegal, Togo

OEDAG

Argentina, Bolivia, Chile, Paraguay, Peru, and Uruguay

OEDAP

Australia, Kiribati, Korea, Marshall Islands, Federated States of Micronesia, Mongolia, Nauru, New Zealand, Palau, Papua New Guinea, Samoa, Seychelles, Solomon Islands, Tuvalu, and Vanuatu

OEDBR

Brazil, Cabo Verde, Dominican Republic, Ecuador, Guyana, Haiti, Nicaragua, Panama, Suriname, Timor-Leste, and Trinidad and Tobago

OEDCC

China

OEDCE

Colombia, Costa Rica, El Salvador, Guatemala, Honduras, Mexico, and Spain

OEDCO

Antigua and Barbuda, The Bahamas, Barbados, Belize, Canada, Dominica, Grenada, Ireland, Jamaica, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines

OEDEC

Austria, Belarus, Czech Republic, Hungary, Kosovo, Slovak Republic, Slovenia, and Turkey

OEDFF

France

OEDGR

Germany

OEDIN

Bangladesh, Bhutan, India, and Sri Lanka

OEDIT

Albania, Greece, Italy, Malta, Portugal, and San Marino

OEDJA

Japan

OEDMD

Afghanistan, Algeria, Ghana, Islamic Republic of Iran, Libya, Morocco, Pakistan, and Tunisia

OEDMI

Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Maldives, Oman, Qatar, United Arab Emirates, and Yemen

OEDNE

Andorra, Armenia, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Georgia, Israel, Luxembourg, Moldova, Montenegro, Netherlands, Republic of North Macedonia, Romania, and Ukraine

OEDNO

Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway, and Sweden

OEDRU

Russian Federation and Syrian Arab Republic

OEDSA

Saudi Arabia

OEDST

Brunei Darussalam, Cambodia, Fiji, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Nepal, Philippines, Singapore, Thailand, Tonga, and Vietnam

OEDSZ

Azerbaijan, Kazakhstan, Kyrgyz Republic, Poland, Serbia, Switzerland, Tajikistan, Turkmenistan, and Uzbekistan

OEDUK

United Kingdom

OEDUS

United States