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**Statement by Mr. Trabinski and Mr. Gindrat on Germany
(Preliminary)
Executive Board Meeting
January 13, 2021**

We thank staff for their report and Mr. von Kleist, Mr. Merk, and Mr. Buetzer for their helpful staff statement. We broadly agree with the thrust of the staff appraisal and offer the following comments.

Germany's immediate policy response to counter the Covid-19-shock was substantial and effective. By all accounts, the overall envelope of the measures taken is unprecedented and extraordinary. We commend the authorities for their decisiveness and wide-ranging policy adjustments. The multi-pronged and targeted nature of the policy toolkit employed, as well as the size of the intervention, have mitigated the economic effects from pandemic measures and disruptions. Well-established automatic stabilizers, particularly the Kurzarbeit scheme, as well as non-traditional fiscal and financial policy measures helped prevent an even deeper contraction in 2020.

Fiscal policy has carried the main burden of the Covid-19-response and remains the key policy tool. The vigorous fiscal response illustrates the important role of fiscal rules in ensuring the resilience of public finances and creating the necessary space for fiscal action in times of crisis. Fiscal and debt sustainability should not be the foremost concerns at this juncture, given the government's credible track record of fiscal prudence and the country's overall healthy fiscal condition. The suspension of the constitutional debt brake rule and a substantial upward shift in the public debt level – to a ratio slightly above 70 percent of GDP – appear to have been adequate. Even so, an effective and transparent governance and administration of the various fiscal support schemes will remain essential in a medium-term perspective.

It seems plausible that the authorities' ability to weather setbacks will be tested further. Germany was one of the few countries able to react to the Covid-19 shock from a position of

strength and with sufficient fiscal space. The authorities will want to keep their options open as to when to let the support measures lapse and at what sequence. Staff rightly observes the uncertainties and downside risks related to further delays in lifting restrictions or partial vaccine distribution. Also, the perils of geopolitical tensions, external demand shocks, or a global market correction cannot be dismissed. Here, the regional context will also be important, given the role the German economy plays in the European Union and the impact it has on other member countries.

A gradual phasing-out of extraordinary measures will allow optimizing economic performance, starting as early as this year. The challenge will be to prevent the entrenchment of skewed incentive structures and to focus support on those businesses that are fundamentally viable. A cautious monitoring of the build-up of credit risk in banks' portfolios is warranted to limit moral hazard and credit misallocation that could arise in the process of granting publicly guaranteed loans. An exit strategy that preserves fiscal leeway will likely have to include a reallocation of spending priorities as well as addressing pre-existing impediments to growth such as high non-wage labor costs or infrastructure bottlenecks (e.g. in railway transport).

The potential transmission of rising corporate insolvencies to bank distress calls for particular vigilance. We concur with staff that banks' capital buffers should be rebuilt in the post-pandemic era. Individual, direct, and voluntary agreements between banks and their customers aimed at rendering the private debt service obligations sustainable seem to be helpful and should be encouraged. *Does staff see any impact of the restrictions on dividend distributions on banks' propensity to lend?* We note that staff considers the consolidation among savings and co-operative banks as desirable to enhance financial sector resilience, and we note staff's concerns related to the impact of the low-for-long environment on life insurers. We look forward to a risk-oriented financial sector review as part of the next FSAP as well as to the FATF mutual assessment in October.

Fostering an inclusive recovery is a central challenge. While the Kurzarbeit scheme and its temporary recalibration have been instrumental in mitigating the immediate impact of the pandemic on the workforce, there may be a need for complementary policy action to address potentially persistent effects for those groups of workers that can "fall between the cracks". Labor market regulatory reforms and active labor market policies should be pursued to facilitate a reallocation of resources and to address labor precarity. The authorities should also fully explore the impact the pandemic had on the way people work, to further increase productivity. *We would be interested in staff's view regarding the advantages and challenges stemming from the "work from home" policies in Germany.*

A calibrated approach to structural transformation—which has been accelerated by Covid-19—is advisable. Digital and demographic trends as well as environmental considerations call for proactive, adaptive public policies. In this regard, the crisis offers an

opportunity to seek a society-wide consensus on the general economic framework for the future. Further boosts in public spending from a high level will need to be well designed and targeted to be effective. While tempting in a zero-interest rate environment, large-scale public investment schemes to “build better for the future” must be carefully scrutinized in terms of their life-cycle viability. We note in this context that the EU’s Recovery Fund is expected to bring foremost indirect benefits by spurring demand in trading partners’ economies.