

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

GRAY/21/117

January 11, 2021

**Statement by Mr. Bevilaqua, Mr. Velloso, and Mr. Barroso on Germany
(Preliminary)
Executive Board Meeting
January 13, 2021**

We thank staff for the comprehensive and insightful report and Messrs. von Kleist, Merk and Buetzer for the helpful statement.

Germany has so far coped relatively well with the pandemic, on the back of a large multi-pronged response. Before tightening up lockdown measures most recently, the economy was recovering strongly. Recent high frequency indicators for industrial output and retail sales confirm a recovery well into the fourth quarter, while mobility indicators suggest a rough start for the new year. During this period, time-tested policy frameworks such as the national job retention program (Kurzarbeit) and the public loan guarantees scheme were generously deployed, effectively limiting bankruptcies, curtailing unemployment growth and loss of income, partially supporting consumption. Tax exemptions were also instrumental to sustain domestic demand in the face of faltering export markets. With uncertainty still high, the authorities should stand ready to provide additional support as warranted.

We welcome the sizable fiscal stimulus and see additional room to accommodate both the authorities' current commitments and further action if necessary. The brake rule should remain suspended at least through 2021. Further tax incentives and liquidity support measures could be implemented if conditions deteriorate, on top of the already announced public investment programs, and continuing incentives for private investment and job retention. Of course, such fiscal activism is not without risks. Given the size and scope of the programs, they have the potential to distort private incentives to economic reallocation and risk-taking. It is therefore crucial to strengthen monitoring requirements and to progressively tighten eligibility criteria and governance standards. In this context, we welcome the Kurzarbeit renewal with sensible tightening of program conditions.

Economic scarring is an important risk from the pandemic and structural reform policies can help minimize it. We take note of staff's concern with the long-term impact on

the German labor market. Indeed, lower participation rates at older cohorts and lower productivity at younger cohorts should readily translate into lower potential output—and possibly wider skill premium worsening inequality. We welcome the measures taken to increase disposable income of low- and middle-income households and encourage the authorities to pursue policies to mitigate the disproportionate impact of the crisis on women, youth and the elderly. While the authorities highlight the uncertain environment and mitigation policies already in place, we agree with staff that stronger policy action is warranted. Fostering targeted investment in research and technology, as recommended by staff, augurs well for the recovery phase. We take note of the estimate in Annex IV of a 2 percentage-point adverse long-term impact on potential output. The report also mentions a drop of 2½ percentage points in output until 2025 as a result of lower human and physical capital. *Staff comments are welcome on the relation between these estimates if any, as well as on additional factors that could explain significant economic scarring.*

While the financial sector has so far been resilient, corporate insolvency poses a significant risk as debt moratorium expires. We take note of the stress-test results for the banking sector. The exercise is based on the fraction of insolvent and illiquid firms had the mitigation policies not been issued. Staff attributes the favorable results to the larger impact on smaller firms that make up a small share of the overall debt. Yet, small firms are large employers and knock-on and feedback effects of massive job losses could be significant, triggering a cycle of bankruptcies and tightening credit. Moreover, it is not clear what this implies for the public loan guarantee scheme extended during the pandemic, considering risk-sharing arrangements with public and private sector with the corresponding implications to fiscal balances and financial institutions bottom line. *Staff comments are welcome.*

With these remarks, we wish success to the German authorities in coping with this challenging period.