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**Statement by Mr. Mozhin, Mr. Palei, and Mr. Shestakov on Germany
(Preliminary)
Executive Board Meeting
January 13, 2021**

We thank staff for the comprehensive report and Mr. von Kleist, Mr. Merk and Mr. Buetzer for the helpful buff statement. Germany quickly responded to the first wave of the COVID-19 pandemic, but the second wave in the fall proved harder to address, triggering the renewed lockdown measures. Continuing challenge of reopening the economy amid the resurgence of infections clouds the economic outlook for Germany. Staff envision an uneven recovery, with large quarterly swings and prolonged adverse impact on contact-intensive industries. The authorities are pursuing timely and targeted fiscal stimulus to provide income and liquidity support and to bolster confidence.

We commend the German authorities for using the accumulated fiscal space to combat the adverse impact of the pandemic. According to staff, the total envelope of announced measures amounted to 7.5 percent of GDP in 2020, which becomes 30 percent of GDP if loan guarantees and automatic stabilizers are included. Germany's enhanced use of the short-term work program (Kurzarbeit) significantly mitigated the impact on unemployment, while supporting household disposable income and preserving matches on the labor market. We agree with the authorities that it is too early to normalize Kurzarbeit's parameters now, given the significant uncertainty over the near-term outlook. While end-2021 might be the appropriate time to scale back the program, we would encourage the authorities to follow the data in their decision-making. The crisis is likely to exacerbate the pre-pandemic trend in inequality and cause the fall of incomes in the lower deciles. *We would welcome an update on the projected impact of the COVID-19 pandemic on inequality.*

Monetary accommodation and financial sector support are crucial, but an exit strategy should be formulated early on. The ECB provided significant monetary accommodation with expanded asset purchase programs, which was supported by releasing countercyclical capital buffers and extending operational relief to German banks. To preserve financial

stability, unwinding of these measures should be smoothed, to ensure banks' ability to continue lending. However, we concur with staff that in the recovery phase financial support should become more targeted to prevent further increase in the share of "zombie" firms. Extended financial support poses a risk of entrenching long-standing excess capacities and inefficiencies in the German banking sector, exacerbated by low-for-longer interest rate environment. Regulatory cracks in terms of financial reporting and the AML/CFT framework are mentioned in the staff report. *Do the authorities have a well-formulated structural reform agenda for the banking sectors during the recovery phase, and what would be staff recommendations in this area?*

The medium-term strategy should be focused on supporting structural changes in the post-pandemic environment. Staff projected significant scarring for the potential economic growth in Germany, while there will be some positive spillovers from the demand created by the EU Recovery Fund in other EU members. The permanent loss of output due to the current crisis might be partially counteracted with the envisaged support for digital learning, 5G infrastructure, and climate-friendly recovery. We agree with staff that active labor market policies should be deployed to support the reintegration of the crisis-hit workers, particularly for the vulnerable demographic groups. *Staff's comment on possible modalities for such support would be welcome.* According to staff, the REER in 2020 has been undervalued in the range of 2 to 12 percent, and the current account surplus is in excess of the estimated "norm" by about 1.6 to 3.6 percent of GDP (Annex I). Going forward, the crisis might further exacerbate long-standing imbalances in the German economy. *We would invite staff to comment on the possible REER adjustment in light of persistently low inflation and declining inflation expectations.*

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