# IMF Executive Board Concludes 2012 Article IV Consultation with Germany

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On June 29, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Germany.[1]

## Background

The German economy's performance has been remarkable despite facing considerable headwinds. Financial market turbulence and weakening external demand led to a broad-based contraction of activity in Germany in the last quarter of 2011, with the notable exception of construction. However, economic growth appears to have bottomed out and activity picked up in the first quarter of 2012 fueled by a rebound in external demand and strong consumption growth.

Several conditions are now in place in Germany for a domestic demand-led recovery. Employment creation has been robust and unemployment at 5.3 percent is at a post-reunification low. Helped by the reforms implemented in the 2000s, the labor market is trending towards a lower natural rate of unemployment, and since 2010, the creation of jobs with full social security benefits has grown faster than atypical employment. Reflecting the tighter conditions, wage growth has picked up. While nominal pay rates increased by about 2 percent in 2011, the normalization of working hours and significant one-off payments have pushed overall wage growth to near 3 percent. Bond yields for banks and the public sector are at record lows, while yields for corporate bonds have remained largely flat. Bank lending rates are lower than elsewhere in Europe, but the rise in bank lending is moderate, reflecting still low demand from households and firms. Headline inflation has fallen to 2.2 percent in April 2012, in line with the moderation of fuel price increases, while core inflation remained low at 1.4 percent. Medium-term price expectations remain well anchored below 2 percent.

Germany’s current account surplus remained large at 5 ¾ percent of GDP in 2011, in part reflecting a relatively comfortable competitiveness position. At the same time, private capital outflows have reversed their course as German banks have withdrawn from Europe’s cross border interbank market and investment positions in economies under stress are being unwound. The net private inflows into Germany are reflected in an increase in the Bundesbank’s claims on the Eurosystem, which had risen to €644 billion by April (approximately 24 percent of GDP). With strong demand for safe assets, German government bond yields have declined to record lows.

The strength of German banks has improved but vulnerabilities remain. While German banks are generally meeting the minimum levels of required regulatory capital and have ample liquidity, they remain highly leveraged, dependent on wholesale funding, have low capital quality and profitability, and some institutions are significantly exposed to the euro area periphery. Some large international financial institutions have substantial cross-border operations, and significant counterparty risk exposures related to their large derivative portfolios. Six larger banks that were called upon to strengthen their capital position as a result of the latest European Banking Authority’s (EBA’s) stress test are well on their way to meet EBA requirements (with one bank in the process of being wound down). The authorities have reintroduced the financial stability support mechanism (SoFFin II) on a preemptive basis with an overall amount of €480 billion available through end-2012.

Fiscal consolidation is on track. The overall deficit narrowed to 1 percent of GDP in 2011 (from 4.3 percent in 2010), reflecting in part the phasing out of one-off financial sector support measures. The structural balance improved by about 1¼ percent of GDP in 2011, reflecting the withdrawal of stimulus and consolidation measures, including unwinding of temporary tax and labor market measures, the removal of some exemptions, and reductions in social spending and administrative costs. Overall, however, the financial crisis has led to an increase in public debt from 65 percent of GDP in 2007 to 81 percent in 2011, including due to financial sector support operations.

### Executive Board Assessment

Executive Directors commended Germany’s strong macroeconomic management, which has resulted in a favorable economic performance despite the uncertain external environment. They noted, however, that the near-term outlook is clouded by downside risks, including a strong intensification of the euro-area crisis and potentially lower global growth prospects. The main priorities in the period ahead will be to manage the transition to domestic demand-led growth, secure financial stability, and address the challenges posed by the euro-area crisis in conjunction with European partners.

Directors underscored Germany′s pivotal role in reducing euro-area and global imbalances. They called on the authorities to continue to work with European partners to outline clearly and concretely the further efforts needed to enhance the broader European response to the ongoing crisis. Furthermore, they urged the authorities to implement policies to spur domestic demand growth, which will have important beneficial spillover effects in the euro area and globally.

Directors agreed that a natural rebalancing of the sources of growth will likely occur in response to tight labor market conditions, ample liquidity and low interest rates, and disinflationary pressures in the euro-area periphery countries. They stressed, however, that structural reforms to encourage higher investment, remove labor market bottlenecks, and increase economic efficiency and productivity will be crucial to boost potential growth and aid the rebalancing process.

Most Directors viewed the current fiscal stance as appropriate, while allowing automatic stabilizers to operate fully. In the event of a serious economic downturn, more active fiscal policies within available fiscal space and consistent with the EU fiscal framework would be needed. A few Directors were of the view that a fiscal stimulus is warranted to aid the regional and global economic recovery. Directors encouraged growth-oriented revenue and expenditure reforms, including measures to enhance tax and expenditure efficiency.

Directors noted that, despite progress in financial reform and in securing financial stability, the banking sector remains vulnerable to external shocks because of high leverage, dependence on wholesale finance, and low capital quality and profitability. They urged the authorities to step up the pace of implementation of the 2011 Financial Sector Assessment Program Update recommendations. In this regard, Directors called for greater efforts to restructure Landesbanken and strengthen the crisis management framework. They also welcomed pre-emptive reactivation of the backstop facility for financial institutions, as well as the steps being taken to establish a framework for implementing macroprudential policies following European Union initiatives. Directors noted that broadening the channels of financial intermediation would facilitate the allocation of resources towards innovation and new engines of growth.

Directors commended the exceptional performance of the labor market resulting from past reforms, and welcomed the ongoing efforts to increase the labor force through the higher participation of female and older workers and the migration of skilled workers. They encouraged further enhancements to the system of education and training.

**Germany: Selected Economic Indicators**

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 [1] | 2013 [1] |
|---|---|---|---|---|---|---|---|
| **Economic activity and prices** | (Change in percent, unless otherwise noted) | | | | | | |
| Real GDP | 3.4 | 0.8 | -5.1 | 3.6 | 3.1 | 1.0 | 1.4 |
| Net exports [2] | 1.5 | -0.1 | -2.8 | 1.4 | 0.7 | 0.5 | 0.2 |
| Total domestic demand | 1.9 | 1.3 | -2.6 | 2.4 | 2.5 | 0.4 | 1.3 |
| Private consumption | -0.2 | 0.6 | -0.1 | 0.6 | 1.4 | 0.9 | 1.3 |
| Gross fixed investment | 4.7 | 1.7 | -11.4 | 5.5 | 6.4 | 0.6 | 2.3 |
| Construction investment | -0.3 | -0.7 | -3.0 | 2.2 | 5.8 | -0.2 | 1.6 |
| Gross national saving (percent of GDP) | 25.9 | 24.8 | 23.2 | 23.6 | 23.9 | 23.2 | 22.6 |
| Gross domestic investment (percent of GDP) | 18.4 | 18.6 | 17.2 | 17.5 | 18.2 | 17.9 | 18.0 |
| Labor force [3] | 43.4 | 43.4 | 43.5 | 43.6 | 43.7 | 43.7 | 43.8 |
| Employment [3] | 39.8 | 40.3 | 40.3 | 40.5 | 41.0 | 41.4 | 41.5 |
| Standardized unemployment rate (in percent) | 8.8 | 7.6 | 7.7 | 7.1 | 6.0 | 5.3 | 5.2 |
| Unit labor costs (industry) | -2.8 | 6.8 | 21.6 | -8.6 | -2.2 | 2.3 | 1.5 |
| GDP deflator | 1.5 | 1.0 | 1.1 | 0.7 | 0.7 | 2.0 | 1.7 |
| Harmonized CPI index | 2.3 | 2.8 | 0.2 | 1.2 | 2.5 | 2.2 | 2.0 |
| **Public finance** | (In percent of GDP) | | | | | | |
| General government balance [4] | 0.2 | -0.1 | -3.2 | -4.3 | -1.0 | -0.7 | -0.4 |
| Structural government balance | -1.1 | -0.8 | -1.2 | -2.3 | -1.0 | -0.7 | -0.4 |
| General government gross debt | 65.4 | 66.9 | 74.7 | 83.5 | 81.2 | 82.2 | 80.2 |
| **Money and credit** | (Change in percent over 12 months) | | | | | | |
| Private sector credit [5] | 3.3 | 6.6 | -0.6 | -1.9 | 1.0 | 0.9 | ... |
| M3 [6] | 10.8 | 9.8 | -1.6 | 4.4 | 5.9 | 6.3 | ... |
| **Interest rates** | (Period average in percent) | | | | | | |
| Three month interbank rate [7] | 4.3 | 4.6 | 1.2 | 0.8 | 1.3 | 0.9 | ... |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Ten-year government bond yield [7] | 4.3 | 4.1 | 3.3 | 2.8 | 2.7 | 1.9 | ... |
| **Balance of payments** | (In billions of USD, unless otherwise noted) | | | | | | |
| Exports [8] | 1,579 | 1,760 | 1,400 | 1,552 | 1,807 | 1,784 | 1,845 |
| Imports [8] | 1,345 | 1,534 | 1,234 | 1,367 | 1,624 | 1,604 | 1,663 |
| Trade balance (percent of GDP) [9] | 7.6 | 6.6 | 5.4 | 5.8 | 5.4 | 5.5 | 5.4 |
| Current account balance | 248.0 | 226.1 | 195.8 | 199.9 | 205.4 | 181.7 | 165.8 |
| Current account (percent of GDP) | 7.4 | 6.2 | 5.9 | 6.1 | 5.7 | 5.2 | 4.6 |
| **Exchange rate** | (Period average in percent) | | | | | | |
| Euro per US dollar [7] | 0.73 | 0.73 | 0.68 | 0.76 | 0.76 | 0.76 | ... |
| Nominal effective rate (1990=100) [7] | 103.8 | 104.1 | 106.1 | 100.1 | 100.1 | 99.2 | ... |
| Real effective rate (1990=100) [5] [10] | 99.9 | 99.1 | 104.6 | 98.0 | 96.5 | 96.2 | ... |

Sources: Deutsche Bundesbank; IMF, International Financial Statistics; IMF, World Economic Outlook; and staff projections.

[1] IMF staff estimates and projections.

[2] Contribution to GDP growth.

[3] National accounts definition.

[4] Net lending/borrowing.

[5] Data for 2012 refer to April.

[6] Reflects Germany's contribution to M3 of the euro area. Data for 2012 refer to April.

[7] Data for 2012 refer to April.

[8] Goods and services.

[9] Trade in goods, including supplementary trade items.

[10] Based on relative normalized unit labor cost in manufacturing.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report,

which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

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