FOR INFORMATION

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January 11, 2021

To: Members of the Executive Board

From: The Secretary

Subject: **Germany—Statement by the European Central Bank Representative**

Board Action:	Executive Directors' **information**
Additional Information:	For the Executive Board discussion on Germany to be held on Wednesday, January 13, 2021.

January 11, 2020

Statement by Rasmus Rueffer (ECB representative) and Kleopatra Nikolaou on Germany - 2020 Article IV Consultation IMF Executive Board Meeting

January 13, 2020

We thank Mr. von Kleist, Mr. Merk, and Mr. Buetzer for their Buff Statement and the 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 aggregate outlook and risks for economic activity. In line with Staff projections, we expect growth to strongly rebound in 2021. Looking further ahead, we concur with Staff that damage to human and physical capital may be long-lasting, leading to a permanent loss of output. Risks to the outlook are tilted to the downside, mainly stemming from a resurgence of infections, increased firm bankruptcies and a stronger and more protracted labor market impact of the pandemic. At the same time, as an open, export-oriented economy, the external environment poses an important source of risk for the German economy.

The COVID-19 crisis has magnified pre-existing vulnerabilities in the German banking sector. The main financial stability risks include an increase in credit risk, coupled with a reversal in the commercial real estate cycle in the context of low bank profitability and a low-for-long interest environment. The aforementioned risks have so far not materialized, also due to generous support measures, but downside risks are large and could materialize in case the economic recovery fails to unfold as expected. Moreover, potential underestimation of credit risk from a systemic perspective, given low and declining risk-weights and possibly optimistic provisioning, could amplify bank losses and capital ratio depletion if downside risks were to materialize.

We also broadly concur with Staff's recommendations for the financial sector. Regulatory flexibility should be temporary and time-bound. At the same time, exit from government support should avoid cliff-effects that increase credit risk and weaken the solvency of financial and non-financial companies. The report could emphasize more the importance of communication in ensuring that bank capital buffers remain usable to absorb losses and limit deleveraging. Should credit losses materialize, averting bank deleveraging hinges on banks' willingness to let capital ratios decrease and use capital buffers. With this in mind, the ECB communicated in July 2020 that banks should be allowed to rebuild capital and liquidity buffers gradually to ensure their continued capacity to extend credit. Finally, we agree that guidance by the supervisory authorities to limit dividend payouts is prudent, while certain support measures are in place, and should continue until the shock is weathered. The ECB issued a recommendation in March and July 2020 on dividend distributions and asked banks not to pay dividends or buy back shares until end of 2020. Further communication regarding the year 2021 has been published in December.

Fiscal policies should provide sufficient support to the economy until the recovery becomes self-sustained. 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. Given prudent policies before the COVID-19 crisis there is indeed sufficient fiscal space for such support. We also agree with Staff that the quality of public finances should be considered when designing the fiscal support. Public investment should be geared towards the green and digital transformation of the economy.

We fully agree with Staff that Germany needs to take all necessary measures to effectively address the COVID-19 pandemic and support the recovery with a focus on green and digital investment. Kurzarbeit should remain an important policy tool in supporting the labor market as long as economic activity remains weak. At the same time, further measures will be needed to reintegrate crisis-hit workers and to avoid long-time scarring effects.