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GERMANY

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2020 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR GERMANY

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2020 Article IV consultation with Germany, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its January 13, 2021 consideration of the staff report that concluded the Article IV consultation with Germany.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on January 13, 2021, following discussions that ended on November 18, 2020, with the officials of Germany economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 17, 2020.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Germany.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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PRESS RELEASE

PR21/13

IMF Executive Board Concludes 2020 Article IV Consultation with Germany

FOR IMMEDIATE RELEASE

Washington, DC – January 19, 2021: On January 13, 2021, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Germany.

Germany entered the COVID-19 crisis with favorable economic conditions, supported by strong domestic demand on the back of record low unemployment and robust wage growth. Consecutive fiscal surpluses had brought public debt down to under 60 percent of GDP. The current account surplus had narrowed slightly to 7.1 percent in 2019, and private balance sheets were strong, although large segments of the banking sector were struggling with persistently low profitability.

The COVID-19 pandemic caused an unprecedented economic contraction of 11.5 percent in the first half of 2020, due to domestic containment measures and a sharp, synchronized global slowdown. Nonetheless, thanks to a successful initial public health response and strong macroeconomic policy support, the economy has proved more resilient than in many peers. The multi-pronged fiscal measures amount to more than 10 percent of GDP over 2020-2021, and together with the expansion of public guarantees, make up one of the largest fiscal packages in Europe. The expansion of short-time work benefits ("*Kurzarbeit*") played a vital role in preserving jobs and supporting household income. Prompt action by the European and German authorities has also sustained the flow of credit, and together with various borrower support measures and tax deferrals, has provided much needed liquidity to affected firms. The pandemic exerted renewed downward pressure on inflation, which slowed sharply since the onset of the crisis, entering negative territory in the summer on the back of falling energy prices, a VAT cut, and slowing aggregate demand. The current account surplus has been narrowing further through 2020, reflecting a large but likely temporary fall in the goods trade balance.

Staff envisage a choppy economic recovery, unevenly distributed across sectors, and with quarterly swings conditioned by volatile infection dynamics through early 2021. The recovery should firm up once there is wide distribution of effective vaccines, but output is not expected to return to its pre-crisis level until 2022. The baseline projection is subject to unusually large uncertainty, with risks tilted to the downside as resurgent infection waves may trigger renewed or prolonged lockdowns and deepen economic scarring. The country's export dependence and financial openness also make it vulnerable to shocks to external demand. Over the medium term, longstanding challenges related to population aging, infrastructure gaps and an impending green energy transition will be compounded by structural changes ushered in by the pandemic.

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[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.

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Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They commended the German authorities for effectively handling the COVID-19 crisis and containing its economic impact. Directors noted the continuing challenge of re-opening the economy while keeping the virus in check amid recurring infection waves, and the downside risks to the economic outlook.

Directors considered managing the health crisis while putting the economy on a sustained recovery path as the near-term priority. They welcomed the large policy support package enacted in 2020 and the intention to maintain considerable fiscal support in 2021, including the suspension of the debt brake rule. Directors encouraged the authorities to stand ready to deploy additional measures should the recovery falter, given ample fiscal space.

Directors agreed that the short-time work program (Kurzarbeit) should remain the main pillar of labor market support during the economic recovery. However, to prevent widening inequality and deeper labor market scarring, they stressed the importance of additional measures targeted at groups hard-hit by the pandemic or not covered by Kurzarbeit, particularly women, youth, and elderly workers. Directors also recommended shifting policies toward facilitating resource reallocation once the recovery gains momentum, including by stepping up skills training and targeted incentives for job creation.

Looking beyond the crisis, Directors highlighted the need to "build better for the future" by supporting the structural transformation toward a smarter, greener economy. Increased public investment is crucial to raise Germany's potential growth, while also helping address the still large external imbalances. In this context, Directors recommended prioritizing investment in infrastructure, climate mitigation, digitalization, and human capital.

Directors welcomed the multi-pronged financial policies deployed to cushion the impact of the pandemic on bank capital and lending capacity. They saw merit in maintaining support for viable firms and capital relief for banks until the recovery proves sustainable. They agreed that capital buffers should be rebuilt gradually to allow banks to support new lending, with restrictions on dividend payouts remaining in place during the recapitalization process. Directors stressed the importance of accelerating restructuring efforts to address the longstanding issue of weak bank profitability. They encouraged continued progress in improving real estate-related data collection and expanding the macroprudential toolkit.

Directors welcomed the action plan announced by the authorities to enhance audit regulation and accounting enforcement. They also acknowledged positive measures taken to further strengthen the AML/CFT system and looked forward to the forthcoming FATF assessment.

[2] 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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Germany: Selected Economic Indicators, 2018–21

	2018	2019	*Projections* 2020	2021
Output		(unadjusted)		
Real GDP growth (%)	1.3	0.6	-5.4	3.5
Total domestic demand growth (%)	1.8	1.2	-3.8	3.0
Output gap (% of potential GDP)	1.2	0.4	-3.1	-2.0
Employment				
Unemployment rate (%, ILO)	3.4	3.2	4.2	4.3
Employment growth (%)	0.6	1.2	0.2	0.2
Prices				
Inflation (%, headline)	1.9	1.4	0.4	1.2
Inflation (%, core)	1.6	1.4	0.9	1.2
General government finances				
Fiscal balance (% of GDP)	1.8	1.5	-6.3	-3.4
Revenue (% of GDP)	46.3	46.7	46.5	46.0
Expenditure (% of GDP)	44.5	45.2	52.9	49.5
Public debt (% of GDP)	61.6	59.5	71.1	70.9
Money and credit				
Broad money (M3) (end of year, % change) 1/	4.5	4.6		
Credit to private sector (% change)	4.9	5.4		
10-year government bond yield (%)	0.4	-0.2		
Balance of payments				
Current account balance (% of GDP)	7.4	7.1	6.6	7.0
Trade balance (% of GDP)	6.2	5.8	5.4	5.9
Exports of goods (% of GDP)	38.5	37.9	35.2	36.4
Volume (% change)	2.3	0.6	-9.9	9.4
Imports of goods (% of GDP)	31.8	31.5	29.9	30.2
Volume (% change)	4.5	2.5	-5.1	7.2
FDI balance (% of GDP)	0.1	1.6	1.0	0.9
Reserves minus gold (billions of US$)	59.2	59.2		
External Debt (% of GDP)	145.0	144.2		
Exchange rate				
REER (% change)	2.3	-1.7		
NEER (% change)	2.9	-1.0		
Real effective rate (2005=100) 2/	97.0	95.4		
Nominal effective rate (2005=100) 3/	102.5	101.4		

Sources: Deutsche Bundesbank, Eurostat, Federal Statistical Office, Haver Analytics, and IMF staff calculations.
1/ Reflects Germany's contribution to M3 of the euro area.
2/ Real effective exchange rate, CPI based, all countries.
3/ Nominal effective exchange rate, all countries.

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INTERNATIONAL MONETARY FUND

GERMANY

STAFF REPORT FOR THE 2020 ARTICLE IV CONSULTATION

December 17, 2020

KEY ISSUES

Germany managed the first wave of the COVID-19 epidemic relatively well thanks to an early and vigorous public health response. Nonetheless, unprecedented disruptions to economic and social activity caused a deep recession in the first half of 2020. The gradual easing of containment measures since late-April has led to a partial revival of growth, but in late-October a "lockdown light" was announced to counter a new wave of infections, and restrictions were further tightened in mid-December. Significant risks remain about the pace and extent of the recovery as the uncertain course of the epidemic continues to impact economic activity.

Germany has swiftly and effectively utilized its substantial fiscal space to mitigate the economic shock from the pandemic and support the recovery. Kurzarbeit, the short-time work program, has been made more generous, helping to keep unemployment in check. A range of financial measures, including loan guarantees and debt service moratoria, have supported firms and households and contained the number of insolvencies. German banks entered the crisis with low profitability but high levels of capital; the latter could be eroded by the macroeconomic shock and a rise in insolvencies as policy measures are withdrawn.

Policies will need to set the economy on a sustained recovery path by avoiding labor market scarring, protecting vulnerable sections of the population, and ensuring that viable firms remain in business. Looking beyond the near-term, the emphasis should be on "building better for the future," focusing on a recovery that addresses Germany's long-term challenges (e.g., climate change, low productivity growth, and demographic change) and supports external rebalancing.

Key Policy Recommendations

- Keep fiscal policy accommodative until there is firm evidence of a sustained recovery. Stand ready to deploy additional measures if the recovery is weaker than expected. While public debt will increase in the near term, it remains sustainable across multiple scenarios and should not pose an obstacle to vigorous policy action.

- Carefully calibrate the pace at which borrower support measures and bank capital relief are phased out. Consider additional support for firms—especially those that

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are illiquid or insolvent yet viable—if the expiration of the insolvency moratorium threatens a surge in bankruptcies.

- Carefully monitor the quality of bank assets and take supervisory action as needed. Banks should be allowed to rebuild capital and liquidity buffers gradually to ensure continued capacity to extend credit.

- Sustain the expanded Kurzarbeit benefits through end-2021 as planned. At the same time, strengthen policies to support the re-integration of crisis-hit workers who have not benefited from Kurzarbeit, especially among the worst affected groups such as women, the youth, and elderly workers.

- Deploy resources to build back a greener and smarter economy. Public investment in climate mitigation, digitization, and innovation would boost growth potential and help with external rebalancing.

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Approved By
Enrica Detragiache (EUR) and Kevin Fletcher (SPR)

Discussions took place by video conference during November 4–18, 2020. The staff team comprised Mr. Aiyar (head), Mses. Chen, Dao, Mineshima, Mr. Natal (all EUR). Mses. Ordonez-Baric and Chen (all EUR) assisted from headquarters. Messrs. von Kleist and Merk (all OED) participated in the discussions. The mission met with State Secretary of the Federal Ministry of Finance Schmidt, Bundesbank President Weidmann, officials from the Federal Chancellor's office, the Finance, Economic Affairs, and Labor Ministries, the Bundesbank, the BaFin, the Federal Office for Employment, the ECB (SSM), the EIOPA, representatives from the automotive industry, hotel and restaurant industry, social partners, banks, think tanks, and academics.

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