IMF Country Reports 21/153

Germany: 2021 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Germany

INTERNATIONAL MONETARY FUND

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GERMANY

July 2021

2021 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 2021 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 July 14, 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 July 14, 2021, following discussions that ended on May 19, 2021, with the officials of Germany on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 22, 2021.
- 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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Washington, D.C.

IMF Executive Board Concludes 2021 Article IV Consultation with Germany

FOR IMMEDIATE RELEASE

Washington, DC – July 15, 2021: On July 14, 2021, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Germany.

Germany weathered the first wave of the COVID-19 pandemic relatively well. The economy contracted by 4.8 percent in 2020, outperforming most European peers. But new waves of infections—marked by more transmissible virus variants—and associated lockdown measures compounded by supply-side shortages caused economic activity to contract again at the beginning of the year. Mass vaccinations were slow to start but have gathered pace. In 2020, Germany recorded its first fiscal deficit in eight years, reflecting unprecedented policy support to combat the pandemic. The current account surplus narrowed slightly relative to 2019, with the contraction in the goods trade balance largely offset by a commensurate decline in the services deficit and lower oil prices.

Fiscal and financial policies remain accommodative, and most measures supporting households and firms have been extended through 2021, enabled by the continued activation of the escape clause to the debt brake rule. The expansion of short-time work benefits ("*Kurzarbeit*") has played a crucial role in preserving jobs and supporting domestic demand. Following a brief spike at the onset of the pandemic, credit growth eased through the remainder of 2020. German banks have so far weathered the COVID-19 shock relatively well, as the number of business and household insolvencies have remained subdued, aided by fiscal support measures and insolvency moratoria. However, the gradual unwinding of policy support could lead to rises in loan impairments and provisioning requirements, and large segments of the banking sector still struggle with persistently low profitability.

Staff expect growth to gather strength as vaccination becomes widely available and the economy reopens. However, the outlook remains highly uncertain, with further infection waves and mobility restrictions comprising the chief source of risks. Over the medium term, structural changes ushered in by the pandemic could compound longstanding challenges related to population aging, infrastructure gaps, digitalization, and the green energy transition.

Executive Board Assessment[2]

Directors commended the German authorities for their decisive policy actions, enabled by Germany's ample fiscal space, as well as their global efforts, via the COVAX initiative, to fight the COVID-19 pandemic. They noted that a robust recovery is expected in the second half of 2021 as mass vaccinations gather strength, although large uncertainties remain. In this

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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.

[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.

context, Directors underscored that supportive policies should continue, and as the recovery strengthens the focus should shift to addressing long-standing structural challenges.

Directors emphasized that fiscal policy should remain supportive until there is clear evidence of a sustained recovery, while encouraging the frontloading of public investment. To facilitate post-crisis resource reallocation, they stressed that a carefully calibrated fiscal support withdrawal should be accompanied by well-targeted measures. Directors noted the merits of Germany's short-time work program (Kurzarbeit) to contain the impact on unemployment and support aggregate demand, but stressed the importance of additional measures targeted at groups hard hit by the pandemic and not covered by Kurzarbeit, to prevent widening inequality and deeper labor market scarring. Looking ahead, Directors called for Germany to use its fiscal space to scale up public investment to lift potential growth, facilitate structural transformation, and help address Germany's large external imbalances.

Directors supported the authorities' structural reform agenda to boost potential growth and support a green and digital transformation. They welcomed Germany's strong commitment to fighting climate change and further enhancing the multi-pronged climate action plan. A well-specified schedule of carbon prices over a longer-term horizon would enhance efficiency. Directors also noted that the pandemic has increased the urgency of the long-standing need for a digital transformation and greater innovation. They encouraged the government to accelerate the expansion of high-speed broadband networks, increase support for R&D, promote further venture capital, and improve the business environment.

Directors stressed the need to safeguard financial stability during the nascent recovery. In light of the risk of rising bankruptcies as support measures are phased out, they recommended continued targeted liquidity and solvency support for viable firms. Directors also highlighted the need for banks to improve their cost structures to address the chronic low profitability of Germany's banking sector. They welcomed the authorities' efforts to address remaining data gaps and stressed the need for closely monitoring the buildup of financial vulnerabilities in real estate markets. Directors looked forward to the recommendations from the ongoing 2022 FSAP.

Germany: Selected Economic Indicators, 2019–22

	2019	2020	*Projections* 2021	2022
Output		(unadjusted)		
Real GDP growth (%)	0.6	-4.8	3.6	4.1
Total domestic demand growth (%)	1.2	-4.1	3.1	4.6
Output gap (% of potential GDP)	0.4	-2.9	-2.1	-0.3
Employment				
Unemployment rate (%, ILO)	3.2	4.2	4.1	3.7
Employment growth (%)	1.2	0.3	0.4	0.5
Prices				
Inflation (%, headline)	1.4	0.4	2.6	1.2
Inflation (%, core)	1.4	0.9	2.1	1.5
General government finances 1/				
Fiscal balance (% of GDP)	1.5	-4.2	-7.2	-1.8
Revenue (% of GDP)	46.7	46.8	46.2	46.3
Expenditure (% of GDP)	45.2	51.1	53.2	47.9
Public debt (% of GDP)	59.7	69.7	73.0	70.9
Money and credit				
Broad money (M3) (end of year, % change) 2/	4.6	8.2		
Credit to private sector (% change)	5.4	4.9		
10-year government bond yield (%)	-0.2	-0.5		
Balance of payments				
Current account balance (% of GDP)	7.5	7.0	7.4	7.3
Trade balance (% of GDP)	5.7	5.7	6.0	5.9
Exports of goods (% of GDP)	37.8	35.7	37.9	37.5
Volume (% change)	0.6	-9.0	11.6	5.4
Imports of goods (% of GDP)	31.5	30.0	31.5	31.1
Volume (% change)	2.5	-5.4	10.1	6.5
FDI balance (% of GDP)	2.2	0.0	0.9	1.0
Reserves minus gold (billions of US$)	59.2	64.0		
External Debt (% of GDP)	145.1	165.2		
Exchange rate				
REER (% change)	-1.6	1.3		
NEER (% change)	-1.0	2.4		
Real effective rate (2005=100) 3/	95.4	96.7		
Nominal effective rate (2005=100) 4/	101.4	103.8		

Sources: Deutsche Bundesbank, Eurostat, Federal Statistical Office, Haver Analytics, and IMF staff calculations.
1/ Data on fiscal balances and their components are as of February 24, 2021.
2/ Reflects Germany's contribution to M3 of the euro area.
3/ Real effective exchange rate, CPI based, all countries.
4/ Nominal effective exchange rate, all countries.

GERMANY

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION

June 22, 2021

KEY ISSUES

Germany's economy contracted by just under 5 percent in 2020, outperforming most European peers. But renewed waves of infections and associated lockdowns caused economic activity to plunge again in the first quarter of this year. While the pace of mass vaccination has picked up and the economy has started to reopen, the recovery path is beset with risks, particularly with respect to the progress of the pandemic and supply shortages in major industries. The authorities have maintained appropriately accommodative fiscal and financial policies, and most measures supporting households and firms have been extended through 2021.

Policies should aim at setting the economy on a sustained recovery path by reducing labor market scarring, protecting vulnerable sections of the population, and ensuring that viable firms remain in business. Looking further ahead, Germany should use its fiscal space to expand public investment, promote innovation and facilitate structural transformation of the economy, including digitalization and decarbonization. This would also help reduce large external imbalances.

Key Policy Recommendations

- Continue fiscal support for households and firms until there is clear evidence of a sustained recovery, while frontloading public investment.
- Maintain protective labor market policies—underpinned by the expanded Kurzarbeit—until there is evidence of a sustained recovery. Continue income support for more vulnerable population groups and reduce the labor tax wedge on lower incomes to support aggregate demand and ameliorate inequality.
- Further strengthen the multi-pronged climate action plan. A well-specified carbon price path over a longer time horizon combined with sector-specific feebates would enhance efficiency.
- Safeguard financial stability during the nascent recovery. Specify a gradual timetable for banks that find their capital reduced as a result of the crisis to rebuild buffers.

Approved By
Mahmood Pradhan (EUR) and Kevin Fletcher (SPR)

The mission took place in a virtual format during May 7–19, 2021. The team comprised Mr. Aiyar (head), Mmes. Dao, Mineshima, and Mr. Caceres (all EUR), with Mr. Parry (FAD), Mr. Prasad and Ms. Oliva (both MCM) joining a subset of meetings. The mission met with State Secretary Schmidt, Bundesbank President Weidmann, officials from the Finance, Economy, Interior and Building, Environment, Labor and Social Affairs Ministries, the Bundesbank, BaFin, the Chancellery, the Federal Employment Agency, the ECB, EIOPA, as well as representatives from the banking sector, auto industry, employers' associations, trade union, credit rating agencies, and think tanks. Messrs. von Kleist and Merk (all OED) joined the meetings. Mses. Ordonez-Baritz, Chen, and Rubio (all EUR) assisted in preparing the report.

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