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IMF Executive Board Concludes the 2016 Article IV Consultation with Germany

On June 24, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Germany.

The growth momentum has remained steady as strong domestic demand has offset weak foreign demand. Private consumption growth has been supported by the persistently strong labor market and lower energy prices, while public consumption and investment have also been buoyant. Core inflation has been low and stable around 1 percent. The current account surplus has continued to widen significantly, reaching 8.5 percent of GDP in 2015, reflecting lower commodity prices and currency effects. The fiscal stance was neutral last year.

Credit growth, long subdued, has picked up, while housing prices have kept trending up in the context of a slow supply response to surging housing demand. The banking sector faces multiple challenges, which translate into low profitability. Negative interest rates erode profits from retail banking, the aggregate cost-to-income ratio is high in international comparison, while technological changes and the new regulatory environment—which is still being implemented—require business model adaptation. Low interest rates, if protracted, would also weaken life insurers' ability to meet guaranteed commitments.

Looking forward, domestic demand is expected to keep underpinning the moderate growth momentum. A sizable fiscal expansion, the recent further ECB monetary stimulus, and still supportive energy prices should continue to offset the weakness in some key trading partners. GDP is projected to grow by 1.7 percent this year and 1.5 percent next year. A small positive output gap should open up which, together with the effects of recent ECB policy actions, should very gradually push up core and headline inflation towards 2 percent. However, this forecast does not yet reflect the economic impact of the U.K. referendum decision in favor of

[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.

leaving the European Union. In addition, growth over the medium term is expected to decline against the backdrop of a still uncertain global outlook, a population aging fast, and slow progress on structural reforms.

Executive Board Assessment[2]

Executive Directors welcomed the increased contribution to growth from domestic demand, supported by lower energy prices, rising real wages, declining unemployment, and accommodative fiscal and monetary policies. These developments will continue to underpin growth in the period ahead. Directors noted that risks to the outlook are tilted to the downside, including weaker growth in Germany's trading partners and heightened uncertainty following the outcome of the referendum on the U.K. membership in the European Union. Meanwhile, the large current account surplus persists, and an aging population and refugee inflows continue to pose challenges.

Against this backdrop, Directors agreed that policies should focus on raising potential growth and reinforcing rebalancing, which will also support the fragile recovery in the euro area. To this end, Directors broadly concurred that, to the extent that there are fiscal resources available within the fiscal rules, they should be used to boost high quality public investment and finance growth enhancing reforms. They welcomed the authorities' ongoing efforts to enhance the overall efficiency of public investment and plans to address administrative and regulatory constraints to investment. Directors also commended the German government for shouldering the burden of absorbing a large inflow of refugees.

Directors underscored that faster progress on structural reforms is essential for boosting medium term growth in a rapidly aging society. They called for well targeted measures to increase labor supply by promoting labor force participation of women, older workers, and immigrants; and reforming taxation, the pension system, and health insurance contributions. Directors also encouraged decisive steps to enhance competition and productivity in the services sector.

Directors welcomed recent actions to ease supply constraints in the housing sector. They supported reforming the real estate transaction tax and improving the macroprudential toolkit targeted at the real estate sector and the supervisory database. Continued close monitoring of house price developments and mortgage credit is also warranted.

Directors observed that the overall banking sector remains strong, resilient, and well capitalized. Nevertheless, given prolonged low interest rates, high operating costs, and technological and regulatory changes, it is important that banks accelerate their efforts to adjust to these challenges and improve risk management. Directors recommended that the authorities monitor the insurance sector closely, require action plans from troubled firms, and keep safety nets under review.

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[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.

Directors welcomed the progress made in implementing the recommendations of the 2011 Financial Sector Assessment Program. They considered it a high priority for Germany to complete the agenda on the new bank recovery and resolution framework, consolidating the positive effects of the European Single Supervisory Mechanism and Single Resolution Mechanism. Further efforts are needed to improve the coverage and granularity of supervisory data, complete resolution planning for large international banks, and broaden crisis management coordination arrangements with European authorities.

Directors noted the globally systemic importance of large German banks and the potential spillover effects of their withdrawal from correspondent relationships. They encouraged the authorities to promote better risk management by these banks, strengthen cooperation with other national supervisors to harmonize regulatory frameworks, and facilitate cross border information sharing.

Germany: Selected Economic Indicators, 2014–18

	2014	2015	*Projections* 2016	2017
Output				
Real GDP growth (%)	1.6	1.4	1.7	1.5
Total domestic demand growth (%)	1.3	1.4	2.3	1.8
Output gap (% of potential GDP)	-0.2	-0.1	0.2	0.4
Employment				
Unemployment rate (%, ILO)	5.0	4.6	4.3	4.5
Employment growth (%)	0.9	0.8	1.3	0.6
Prices				
Inflation (%)	0.8	0.1	0.4	1.5
General government finances				
Fiscal balance (% of GDP)	0.3	0.6	-0.1	0.1
Revenue (% of GDP)	44.6	44.6	44.4	44.5
Expenditure (% of GDP)	44.3	44.0	44.5	44.4
Public debt (% of GDP)	74.7	71.2	68.5	66.2
Money and credit				
Broad money (M3) (end of year, % change) 1/	4.9	9.2		
Credit to private sector (% change)	0.6	2.4		
10 year government bond yield (%)	1.2	0.6		
Balance of payments				
Current account balance (% of GDP)	7.3	8.5	8.2	7.7
Trade balance (% of GDP)	7.8	8.7	8.5	8.4
Exports of goods (% of GDP)	38.2	39.0	38.7	39.3
volume (% change)	4.2	5.0	3.0	4.0
Imports of goods (% of GDP)	30.5	30.3	30.2	30.9
volume (% change)	4.7	5.8	5.2	5.0
FDI balance (% of GDP)	-2.7	-1.9	-0.7	-0.7
Reserves minus gold (billions of US$)	62.3	58.5		
External Debt (% of GDP)	154.5			
Exchange rate				
REER (% change)	0.5	-5.3		
NEER (% change)	0.8	-4.8		
Real effective rate (2005=100) 2/	96.0	90.9		
Nominal effective rate (2005=100) 3/	102.0	97.1		

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.