CONCLUDING STATEMENT

Germany: Staff Concluding Statement of the 2020 Article IV Mission

FOR IMMEDIATE RELEASE

Washington, DC – November 18, 2020: *An International Monetary Fund (IMF) mission, led by Mr. Shekhar Aiyar, conducted discussions virtually on the 2020 Article IV Consultation from November 4–18. At the end of the visit, the mission issued the following statement:*

Germany has navigated the first wave of the COVID-19 pandemic relatively well. While the pandemic has taken a grave toll on social life and economic activity, an early and vigorous public health and economic policy response has helped contain the economic contraction to a level well below other large European countries. While the economy began to rebound in the third quarter, the outlook has weakened in the face of a new wave of infections, and downside risks loom large. Policies should focus on setting 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 further, the emphasis should be on "building better for the future," focusing on ways to tackle Germany's long-term challenges, such as supporting productivity growth and external rebalancing, and decarbonizing the economy.

Economic Outlook

To date, Germany has been relatively successful at managing the pandemic. Early and widespread testing and contact tracing, and efficient use of ample hospital capacity have resulted in one of the lowest mortality rates in Europe. However, a new wave of infections, now well in excess of the Spring peak, has triggered a "lockdown light" for the month of November. Restaurants, bars, and cultural and entertainment venues are closed nationwide, while schools and daycares remain open.

The authorities swiftly launched unprecedented support measures to combat the economic fallout caused by the pandemic, taking advantage of ample fiscal space. The multi-pronged fiscal and guarantee packages announced in March and June—with a total envelope of over 30 percent of GDP—were among the largest in Europe. The initial set of measures in March included scaling-up medical expenditures, expanding the short-time work program (“Kurzarbeit”), extending the duration of unemployment benefits, providing emergency liquidity to firms, and expanding the public guarantee framework. The stimulus package agreed in June aimed to boost domestic demand through a temporary VAT cut, expanded support for small businesses, and greater public spending on green investment, digital infrastructure, and healthcare. In November, the government announced further measures to support the most affected businesses, and extended some existing support programs through mid-2021. While actual spending has been well below the initial envelope, these measures provide critical income and liquidity support to affected households and businesses, and bolster confidence.

The outlook is highly uncertain, and risks are tilted to the downside. An unprecedented economic contraction in the second quarter was followed by a stronger-than-expected rebound in the third quarter, helped by supportive policies. But the resurgence of infections—and the new lockdown—demonstrate the continuing challenge of reopening the economy while keeping the virus in check. Overall, the German economy is projected to contract by about 5½ percent in 2020, with only a partial recovery in 2021. Output is not expected to return to its pre-crisis level before 2022. Risks to the outlook are substantial. A failure to bring new infection waves under control could necessitate stricter and longer lasting lockdowns. Broader risks, such as a no-deal Brexit, a re-escalation of trade tensions, and other shocks to the global economy could also weigh on Germany’s open and trade-oriented economy. On the upside, quicker progress on a vaccine—as suggested by recent medical announcements—may allow a speedier resumption of economic activity.

Keeping Fiscal Policy Supportive

Fiscal policy should remain sufficiently accomodative until there is evidence of a sustained recovery. Although some stimulus measures are due to expire at the end of this year, the 2021 budget appropriately maintains considerable demand support, with the escape clause of the debt brake rule remaining activated to support this fiscal path. The authorities should remain vigilant for signs of balance-sheet distress and labor market scarring and stand ready to deploy additional measures if needed. Such measures could include additional grants to viable firms, reduced social security contributions from low-income earners, and expedited public investment and spending on climate change mitigation policies. While public debt will increase in the near term, it remains sustainable across multiple stress scenarios and should not pose an obstacle to vigorous fiscal policy action. Strong governance standards and transparent monitoring of implemented measures are crucial to ensure efficient resource allocation and maintain public trust.

Looking beyond the near term, fiscal policy should aim to “build better for the future.” Once the acute crisis abates, the focus should shift to addressing long-term challenges of structural transformation: potential growth should be boosted by investing in digital infrastructure, encouraging innovation, and bolstering labor supply. Policy should aim to make medium-term growth greener, by implementing the government’s ambitious climate investment plan, and more inclusive, by raising the disposable income of low-income households. These measures should also contribute to reducing long-standing external imbalances. The structural fiscal balance is expected to improve significantly from 2022 onwards, as the economy recovers and support measures expire, leaving ample fiscal resources for the necessary structural transformation, including challenges posed by demographic developments.

Preventing Labor Market Scarring and Growing Inequality

Labor market policies should remain protective to prevent scarring and widening inequalities. The COVID-19 crisis disproportionately affects contact-intensive services, with women bearing a particularly high burden due to their high employment shares in these sectors. To limit scarring and preserve valuable job matches, it is essential that crisis-induced changes to the parameters of Kurzarbeit—making the subsidy more generous and easier to access—remain in place until a sustained recovery is underway. Since marginal workers, many of them women, and the self-employed, are not eligible for Kurzarbeit, the extended basic income should also be maintained until their labor market prospects improve.

As the recovery gains momentum, labor market policies should shift to facilitating the necessary reallocation while protecting the most vulnerable. The pandemic is likely to bring long-term changes to the economy, such as a shift towards more remote working and online purchases. Strengthening incentives for job search should be accompanied by policies to reduce hiring costs for viable firms, for example through bolstering existing hiring subsidies and subsidies for apprenticeships. Further stepping-up investment in full-time quality care in kindergartens and schools could help reintegrate women into the labor market, while investments in digitalization and lifelong learning could enhance labor mobility.

Reinforcing Financial Stability

Financial policies should strike a careful balance between unwinding extraordinary support measures and ensuring banks' ability to lend. With the insolvency moratorium being phased out, corporate bankruptcies are likely to rise. At the same time, lending conditions could tighten as several exceptional borrower support measures expire and default risk increases. To safeguard financial stability, the government should ensure a smooth transition by continuing some direct support for firms, targeting those whose operations have been temporarily impaired by health risks or social distancing restrictions and firms that are crucial for the economy to function, while facilitating the exit of unviable companies. In this context, we welcome the planned implementation of the EU Directive on Preventive Restructuring, which will help distressed but viable firms avoid disruptive insolvencies, thereby preserving productive capital and supporting financial stability.

The German banking sector is likely to take a significant hit to profits and capital but remains broadly resilient under the baseline economic outlook. The COVID-19 recession exposes banks to rising default risk and lower revenues. However, existing capital buffers, the temporary relaxation of regulatory capital requirements, and a range of measures to mitigate borrowers' liquidity concerns and reduce credit risk, will help cushion the impact on bank solvency. Since it will take time for businesses and households to recover, bank capital buffers should be rebuilt gradually, minimizing disruptions to the supply of new loans. Bank supervisors should maintain guidance to banks to refrain from discretionary dividend distributions and share buy-backs until the full impact of the pandemic becomes clearer. They should also continue encouraging banks to tackle the long-standing issue of low profitability, through restructuring efforts to boost non-interest revenues and reduce administrative costs.

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The mission thanks the authorities and all our other counterparts for the constructive policy dialogue and productive collaboration.