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IMFC Statement by Olaf Scholz
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Germany

Statement by Mr. Olaf Scholz

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to the International Monetary and Financial Committee

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I. Global economy and financial markets

Global economy, Germany and Europe

The global recovery, especially in advanced economies, has gained momentum with progress in vaccination campaigns. In Germany and Europe the recovery has also gained traction with the easing of pandemic-related restrictions in the second and third quarter. The recovery is expected to continue in Germany over the course of this and the following year. Early indicators suggest a generally optimistic outlook by firms and consumers alike. Employees are returning from short-time to full-time work and employment is increasing again. At the same time, supply-side bottlenecks continue to weigh on the manufacturing sector, not only in Germany and Europe but globally, and the spread of the Delta variant underlines the pandemic-related risks.

Against this backdrop, economic divergences across countries pose a challenge for the global recovery. While uncertainty persists everywhere, pandemic-related risks are particularly acute in countries where vaccination coverage remains low. This increases the risk of economic setbacks. Inflation has significantly increased in many advanced economies. Central banks will continue to look through transitory inflation pressures but are monitoring developments closely and will act as needed to meet their mandates, including price stability. Effective communication from central banks remains critical in this phase.

Fiscal support remains important for some sectors and in general to boost the economic recovery. In Germany, we have extended the major support programmes until the end of the year with a view towards avoiding any cliff-effects. Meanwhile, utilisation of these programmes is declining, which demonstrates that the automatic (revenue-loss based) scaling back of support in the recovery phase is working as planned and the recovery is self-sustaining. So far, the main objective of Germany's support programmes to protect economic structures and preserve jobs (in particular the *Kurzarbeit* scheme) has been fully accomplished.

Looking ahead, while we must definitely avoid a premature withdrawal of support, we also envisage a gradual normalisation of fiscal policy while maintaining and accelerating extraordinarily high levels of transformative high-quality public investment to boost the transformation to a climate-friendly, digital and inclusive economy. As investing in the public capital stock in a targeted manner is expected to trigger substantial additional private investment, we simultaneously support the economic recovery and pave the way towards achieving our future climate goals. At the same time, we must make sure that inequalities exacerbated by this crisis are addressed, all the while taking into account demographic developments. The ongoing efforts to tackle the tax challenges arising from the digitalisation of the economy have taken a significant step forward as the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (IF) has reached a historic agreement on the two-pillar-project. The overwhelming global support for fair taxation is a remarkable achievement of multilateralism. It is now our goal to work on a swift and coordinated implementation of the agreement, which will also support our recovery efforts. The recovery must also go hand in hand with our efforts to tackle climate change. That should also be a lesson we have learned from the pandemic: we cannot afford to sleepwalk into the next looming crisis.

At the European level, finance ministers have acted in unprecedented solidarity, with a strong commitment to the close coordination of fiscal policies. While fiscal support is definitely still needed, it is entering a new phase, focusing in particular on more targeted forms of support. Our policy focus can increasingly shift towards supporting a sustainable recovery and increasing potential growth in member states by boosting targeted investments in climate-friendly and digital transition and implementing growth-enhancing structural reforms. Recovery and Resilience Facility grants help to strongly support these purposes. Once the recovery is firmly underway, we need to implement credible medium-term fiscal strategies that avoid cliff effects and ensure the sustainability of public finances.

At the global level, besides not scaling back policy support too early and remaining steadfast in supporting low-income countries, one other crucial policy to mitigate global divergences is to ensure rapid equitable access to vaccines across the globe. Given the success of the vaccines, it remains critical to ensure global access to vaccines through funding the ACT-Accelerator, donations and expanding global production in order to rapidly close the gap between different regions of the world.

Financial sector

The German financial sector has weathered the pandemic well. Germany's swift and substantial support measures have successfully mitigated the economic impact of the pandemic. In addition to a wide range of fiscal measures, Germany has taken several macroprudential, regulatory and supervisory measures (for example the release of the countercyclical capital buffer) to ensure financial stability and dampen the negative economic effects of the pandemic. These measures have helped to prevent the crisis from spreading to the banking sector and have bolstered financial stability. On top of that, the regulatory reforms that we adopted after the global financial crisis and the macroprudential policy tools that we are using have made the financial sector more resilient. Now it is important to strike a balance when withdrawing government support: avoiding the cliff effects of withdrawing support too early on the one hand, and supporting the necessary structural change in the real economy on the other.

Global financial stability is affected by the economic outlook. An improving economic environment contributes to a decline in near-term vulnerabilities for corporates and banks. However, vulnerabilities exist, not least as the pandemic leaves a legacy of higher corporate debt. A reassessment of the inflation outlook may pose financial stability risks by triggering an increase in interest rates and a tightening of global financial conditions, aggravating existing vulnerabilities. We must continue to closely monitor the stability of the banking sector and the financial system as a whole, at the national, European and global level.

II. International financial architecture and IMF policies

The IMF has reacted quickly and effectively to the challenges posed by the COVID-19 pandemic. Its toolkit has proved to be adequately broad and flexible to cope even with an unprecedented crisis like this. With the recovery gaining further ground, policy priorities are shifting towards promoting structural change and resolving long-standing balance-of-payments problems.

The large-scale general SDR allocation provided supplementary global reserves to help countries mitigate the impact of the crisis and thus strengthening their resilience. As the use of SDRs in an accountable and transparent manner is critical to achieve this aim, we welcome IMF staff's guidance note on the treatment and use of SDRs. Newly allocated SDRs should thus not be seen as a substitute for necessary macroeconomic adjustments and structural reforms that are supported through regular Fund arrangements. Germany is committed to facilitating SDR exchanges in accordance with its Voluntary Trading Arrangement (VTA) and encourages other IMF members with a strong reserve position to consider also signing a VTA to ensure a smooth functioning of SDR exchanges and adequate burden sharing across the membership.

We take note of the Fund's efforts to explore ways for member countries to voluntarily channel SDRs for the benefit of vulnerable and poor countries. We consider it essential that any IMF proposals on SDR channelling fully respect the national legal frameworks and policy considerations of member countries and do not undermine the IMF's financial and institutional integrity. The need to preserve the reserve asset character of channelled SDRs is of paramount importance in this regard. A possible new trust fund, such as the contemplated Resilience and Sustainability Trust (RST), would need to be carefully designed to avoid unintended consequences and drawbacks. For instance, it should neither induce facility shopping nor should it endanger members' capacity to repay on regular Fund programmes. We ask the Fund to explore options to support members financially through the RST also to leverage the financial engagement of multilateral development banks also in those areas of climate change and pandemic preparedness which lie predominantly in the remit of MDBs.

The IMF's Catastrophe Containment and Relief Trust (CCRT) and the IMF's Capacity Development (CD) are essential pillars in providing support for vulnerable countries. It is for this reason that Germany has committed considerable resources to the IMF's CD offerings and the CCRT and encourages others to provide the necessary resources to secure the full fourth and final tranche of debt relief. Germany is strongly committed to supporting low-income countries (LICs) and has contributed considerable resources to the Poverty Reduction and Growth Trust (PRGT) through its federal budget. LICs have been hit especially hard by the pandemic, and the Fund has reacted to this by reviewing access limits under the PRGT and increasing the potential for higher concessional lending. However, the capacity for additional borrowing on a sustainable basis is severely constrained in many LICs. Countries with an already high risk of debt distress can be quickly overburdened, especially if the additional debt is owed to a senior creditor. Their financing needs are best addressed by providing grants or highly concessional loans. This is why it is essential to ensure a clear delineation of tasks as well as close cooperation between the IMF, in its catalytic role, and institutions tasked with providing development assistance and financing like the World Bank and other MDB/IFIs. In cases where debt is unsustainable, swift progress on debt operations is needed.

These considerations should also guide the IMF's approach towards fragile and conflict-affected states (FCS), which is currently under review. We welcome the initiative and see scope for the Fund to provide better-targeted policy advice and enhanced support for capacity development. The scope for higher Fund lending, by contrast, is often constrained by the particular characteristics and vulnerabilities displayed by FCS. These include severe capacity constraints and high debt burdens, limiting the ability to implement a Fund-supported programme with sufficient confidence to ensure that repaying the Fund will not overburden the country.

Concerning international initiatives to address debt vulnerabilities, we welcome the G20/Paris Club Debt Service Suspension Initiative (DSSI) as a highly helpful instrument for low-income countries to cushion the impact of the crisis and increase health and social protection spending. The G20 Common Framework for Debt Treatments beyond the DSSI is a promising approach. We support the IMF in exploring ways to improve the efficiency of the Common Framework, including IMF Capacity Development to help strengthen economic institutions, and thus to achieve necessary debt treatments. We also continue to encourage eligible countries, where appropriate, to request debt treatment under the Common Framework supported by an upper credit tranche-quality IMF-supported programme.

We welcome the IMF's efforts to develop a Fund-wide strategy to integrate macro-critical aspects of climate change into its work. We support the Fund's aim to strengthen its analytical work on the global challenges of mitigating climate change and addressing transition risks and climate-change related financial stability risks. It is important that the IMF, in its bilateral surveillance, provides granular and tailored policy advice to help integrate climate change mitigation, transition and adaptation into economic policy. In particular, climate change mitigation should be systematically covered in Article IV consultations with large emitters. Furthermore, we support the Fund offering policy guidance on an appropriate international carbon price floor. We encourage the Fund in its work on macro-critical aspects of climate change and its close collaboration with other relevant organisations to leverage their expertise and to avoid overlaps.

We look forward to considering the budget resources needed for the IMF to continue delivering on its mandate, and discussing a range of options. We support the Fund's work on diversity and inclusion and promote gender diversity on the IMF Executive Board.