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Germany**

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I. Global Economy and Financial Markets

Global Economy, Europe and Germany

While global economic growth is stabilizing and inflation continues to moderate, the prospects for medium-term global growth remain subdued with rates below historical trends. Structural challenges related to population aging, weak investment, and low productivity growth persist. These challenges are coupled with downside risks and add to the adverse impacts of climate change, geo-economic and financial fragmentation, as well as intensifying wars and conflicts. The ongoing repercussions of Russia's war of aggression against Ukraine remain a significant drag on the global economy.

All countries need to set the stage for better future growth now. This includes well-calibrated fiscal and monetary policies to keep inflation in check, ensure debt sustainability, and rebuild fiscal buffers. In addition, it is crucial to facilitate growth-enhancing investment and implement ambitious structural reforms in order to make labor markets and social safety nets more efficient, improve the investment climate, and cut red tape. A level playing field between economies is needed to protect open trade, which in turn will help boost global economic prosperity.

The implementation of the revised EU economic governance framework that was adopted in April 2024, with its new fiscal rules, will enhance fiscal sustainability and reduce deficits and debt levels, which are still too high in some member states. A prudent and sustainable fiscal policy should also support the ongoing disinflationary process. To accelerate growth and achieve urgently needed progress towards green and digital transformations, both public and private investment are needed. To this end, we are reducing unnecessary bureaucracy and cutting red tape to improve the business environment for European companies, thereby substantially enhancing productivity and potential growth. Further strengthening the EU capital markets union in the years to come will contribute to deepening European financial markets while helping to channel EU savings and international investment towards shared priorities.

The German economy, due to its high degree of trade openness, the importance of its industrial sector and its former dependence on Russian energy supplies, was hit hard by the sharp rise in energy prices following the outset of Russia's war of aggression against Ukraine. Despite the severity of the crisis, the economy proved more resilient than initially expected, thanks among other things to extensive, targeted and temporary relief measures for companies

and citizens. Nevertheless, real GDP growth has remained subdued since 2022, as the effects of high inflation rates and the necessary rise in interest rates have weighed on growth. Also, ongoing uncertainty has led to an elevated rate of household savings and a more hesitant approach towards investment. Growth is expected to pick up again in the coming years, driven by increasing private consumption. Consumer spending should benefit from a recovery in real wages, as inflation has come down and nominal wage growth has been strong. The labor market has overall been relatively robust in spite of the economic stagnation. With interest rates further decreasing and world trade expanding, investment and exports should also increase going forward. However, downside risks remain with respect to geopolitical tensions and elevated uncertainty.

German growth is, however, currently not only being weighed down by cyclical factors, but potential output growth is also estimated to be markedly lower than in the past due to demographic trends, low productivity growth, and structural shifts in the economy. To bolster Germany's growth potential, the Federal Government has agreed on a Growth Initiative that contains 49 supply-side measures to enhance the framework conditions for doing business and to strengthen the economy's competitiveness. The measures aim to incentivize private investment and innovation, cut red tape, create incentives for labor supply and improve the availability of capital, especially for start-ups and SMEs. Also, Germany's WIN Initiative will provide 12 billion euros to promote start-ups, innovation and venture capital in Germany. The Growth Initiative will deepen the financial sector and expand energy market capacity. Other supply-side measures such as the Growth Opportunities Act, the Future Financing Act and the Skilled Workers Strategy have already been implemented by the Federal Government.

Financial Sector

With inflation slowing down and major central banks lowering their policy rates, debt servicing pressures have started to ease. However, vulnerabilities persist due to elevated debt levels, high asset price valuations, the leverage of non-bank financial institutions, and fragilities in the commercial real estate market. Geopolitical tensions and high uncertainty also increase the risk of sharp asset price corrections and surges in market volatility.

The financial sector in the EU and in Germany has remained resilient in the face of these challenges. The banking system is well capitalized and liquid, and bank profitability continues to be high. However, it is important for both public authorities as well as market participants to remain vigilant and monitor risks closely. Given the cross-border nature of many risks to financial stability, international cooperation and consistent standards are important. We strongly value the IMF's contribution in this respect and appreciate the Fund's analysis of global financial risks.

II. International Financial Architecture and IMF Policies

The IMF plays a unique role in the world economy, as a facilitator of global monetary cooperation, as a trusted advisor on the adoption and implementation of sound economic and

financial policies, and as a provider of financial support to help members address their short-term balance-of-payments problems. As we have seen time and again in recent years, the IMF plays a crucial role to safeguard the stability of the international monetary system. It has served its purpose exceptionally well, its mandate remains highly relevant and its governance structure has lived up to the task. During all recent crises, the Fund has met challenges swiftly and decisively and has provided ample support, be it advice, be it technical assistance, or be it financially, for its members, as evidenced during the COVID-19 pandemic and during the global economic turbulence triggered by Russia's invasion of Ukraine. It is thus important to safeguard and strengthen the IMF's unique role in the international financial architecture. As we commemorate the 80th anniversary of the Bretton Woods conference and the ensuing establishment of the IMF and the World Bank, Germany remains strongly committed to multilateral cooperation to enhance global prosperity and address common challenges.

In this spirit, Germany welcomes the conclusion of the 16th General Review of Quotas, which ensures the adequacy of the Fund's lending capacity. The implementation of the quota increase is key to maintaining the Fund's current resource envelope and strengthening its quota-based nature. In summer 2024, Germany consented to its quota increase, the rollback of the New Arrangements to Borrow and the option to extend the Bilateral Borrowing Agreement. We call on all members to finalize their domestic procedures in due time. Regarding the 17th General Review of Quotas, Germany will continue to participate constructively in discussions, including with regard to a limited realignment of quota shares in favor of the most underrepresented member countries. The current quota formula appropriately reflects the weight and role of countries in the world economy and delivers on quota realignment objectives. Any realignment must be based on fair burden-sharing, while protecting the voice and representation of the Fund's poorest members. We welcome the creation of a 25th Chair in the Executive Board in favor of Sub-Saharan Africa, which strengthens the voice and representation of emerging and developing countries in the IMF. We further welcome Liechtenstein as the Fund's 191st member.

The past four years have seen a surge in demand for IMF lending arrangements in the context of the mentioned global challenges. During this time, the Fund has frequently reviewed and adjusted its lending policies to better support its membership and to provide more resources more flexibly and at more favorable terms. Germany has been supportive of these policy changes. At the same time, the expansion of the IMF's lending role has brought challenges in terms of preserving debt sustainability of borrowing members, managing credit risks, adhering to its role as an impartial advisor, ensuring successful adjustment programs and fulfilling its core mandate as a monetary institution. Moreover, while IMF lending can help countries address short-term macroeconomic imbalances, it is the policies and structural/institutional reforms and their implementation by program countries that determine the ultimate success of IMF programs. This requires sound program design by the IMF and strong ownership and domestic policy efforts on the part of national authorities, including domestic resource mobilization to help close financing gaps and, where necessary, the

initiation of debt operations. There is room – and indeed a need – for improvement in this area. The upcoming Review of Conditionality will provide an opportunity to thoroughly examine the factors that drive the success of IMF engagements and to distil valuable lessons for appropriately strengthening program design and conditionality for the long-term benefit of member countries. Looking ahead, it is essential that countries succeed in managing a durable exit from Fund support in order to avoid protracted dependence on IMF financial assistance. Germany continues to attach great importance to reforms that support good governance, transparency in public policy, and the fight against corruption within Fund-supported programs. The Fund's communication needs to be prudent and nimble, and we look forward to the comprehensive Review of its Communication Strategy.

The recent changes of the Fund's charges and surcharges policy will provide helpful support by lowering the cost of credit for borrowers while maintaining the incentive function of the policies and allowing continued, though reduced income generation and reserve accumulation. This is an important achievement and demonstrates the Fund's ability to react to global developments and to the needs of its members.

Germany welcomes the progress in debt restructurings under the G20 Common Framework, although more work needs to be done. Debt challenges persist in many low- and middle-income countries, thus impairing macroeconomic stability and sustainable development. It is important not to mistake debt sustainability concerns for mere liquidity pressures. The Fund has a key role to play in providing prudent debt sustainability assessments. In this regard, we look forward to the Review of the Debt Sustainability Framework for Low-Income Countries (LICs). To enhance debt transparency, the IMF should make good use of program conditionality. To build resilience and ensure that debt remains sustainable in the future, domestic resource mobilization in LICs remains important.

Germany welcomes last week's conclusion of the Review of the Poverty Reduction and Growth Trust (PRGT) which provides necessary concessional financial support to LICs to help them address their balance-of-payments problems. Germany has supported the PRGT repeatedly through significant budgetary grants and loans over the years. Given high demand for concessional support, increasing the PRGT's efficiency and effectiveness and ensuring its long-term financial self-sustainability are truly necessary. This requires prudent lending practices, including a consistent application of access norms and high-quality program design. Meanwhile, the financing situation of the PRGT needs to be monitored closely. The recent decision on PRGT financing is momentous and marks a significant contribution by the IMF in an environment of elevated risks and related own reserve needs. It should be considered as a one-off measure and must not set a precedent for the future. The placements of GRA resources into the Interim Placement Administered Account in the coming years will require an adequate level of the Fund's reserves and income. If the PRGT financing situation deteriorates again, the necessary adjustments will need to be made on the lending side.

With regard to ensuring the Fund's financial integrity, the increase in Precautionary Balances in recent years is welcome and marks an important development in the right direction. Amidst

persistent global risks and specific risks to the Fund's balance sheet, particularly credit and investment risks, we advocate continued vigilance and sound risk management, including the continued accumulation of risk buffers.

Germany welcomes the implementation of the IMF Climate Strategy and the appropriate mainstreaming of climate-related considerations across all areas of the Fund's work. However, we also consider it necessary to make the reform measures in IMF-supported programs under the Resilience and Sustainability Trust more ambitious and to ensure their commensurability with access levels.

Finally, Germany commends the Fund's ongoing efforts to enhance diversity, gender equality and inclusion. We acknowledge that this work needs to continue, and we urge Management to persist in advancing these objectives. In this context, we fully support the medium-term voluntary objectives on gender diversity at the IMF Executive Board.