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**Statement by Mr. Scholz**
**Germany**

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**to the International Monetary and Financial Committee**

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## I. Global Economy and Financial Markets

### Global Economy

The global economic recovery is continuing and increasingly broad-based. Growth has been driven by trade and investment. Output gaps have already been closed in many economies and are closing in many more. Unemployment is further decreasing and several economies feature full employment.

But there is no time for complacency. While risks in the short term seem broadly balanced, uncertainties remain, including policy uncertainties in several major economies. Medium-term risks to global economic growth are substantial. The analysis of financial vulnerabilities shows: The negative side-effects of very expansionary fiscal and monetary policies are becoming more obvious. Many asset markets show high valuations and there is a rising risk that market based finance could play a prominent role in a potential next crisis. High private and public debt and very low monetary policy interest rates mean that buffers are not at the level they should be.

There is a strong need to increase resilience to be able to weather the next storm. Fiscal consolidation, stronger financial sectors and monetary policy normalization are part of the necessity to strengthen resilience. In the longer term, the challenges of weak productivity growth and ageing populations remain.

The turn towards inward-looking policies and against free trade threatens our common economic prospects. Trade has lifted millions of people out of poverty and has encouraged and advanced global cooperation and international dialogue. Protectionist measures will harm trade and growth. Germany is therefore committed to resisting all forms of protectionism. We are committed to a rules-based international system with close international cooperation in multilateral institutions and fora. That is the only way to effectively address the challenges and risks we face.

Although we do not know when the next economic or financial crisis will happen and where it will start, we can prepare for it. The time for enhancing resilience is now, given the favorable economic conditions. We need to “repair the roof while the sun is shining”, as the IMF Managing Director has put it and implement the resilience principles agreed during Germany’s G20 Presidency in March 2017. We need to pursue structural reforms more vigorously to boost potential growth. Public spending should be sustainable and growth

friendly. We need to build buffers that help to withstand and overcome future crises. We must bring debt onto a downward path. Sustainable public finances are also contributing to equal opportunities across generations and to stability.

**Euro Area Developments**

The economic expansion in the euro area has gained additional momentum last year. The euro area GDP is estimated to have grown by 2.3 % in 2017. According to the latest European Commission forecast it is expected to continue growing at broadly the same pace in 2018, before growth is expected to somewhat moderate to 2.0 % in 2019. Economic sentiments have slightly weakened of late, but are still close to pre-crisis highs. The main driver of economic growth over the last years has been domestic demand, supported by steady employment growth, increasing confidence of consumers and firms, improving investment conditions and a very accommodative monetary policy. In the last quarters, the strengthening of the world economy has also contributed significantly to the increase in GDP growth. Headline inflation markedly increased at the start of 2017, mainly driven by base effects due to food and energy price developments. With base effects fading, euro area inflation remained subdued in the fourth quarter of 2017. Headline inflation stood at 1.4 % in March. The ongoing economic expansion is the result of the ambitious reform efforts of the past years. These efforts should not be curtailed. Potential growth is still rather low, growth differences between member states, albeit narrowing, still remain and unemployment rates are still above pre-crisis levels in many countries. Continuing with structural reforms in product and labor markets that boost productivity and help to further reduce unemployment and improve social coherence is essential. Public and private debt in many member states is still high, constituting a potential source of vulnerability. It is thus important to use the current economic environment as a window of opportunity to bring down elevated debt levels, also against the background of financing costs expected to increase. Ambitious structural reforms, a growth friendly composition of public expenditure and adherence to fiscal rules are necessary to secure the sustainability of public finances which in turn will strengthen the resilience of the euro area economy.

**Germany**

The growth forecasts for the German economy are positive: Expectations for real GDP growth have been revised upwards in the IMF spring projection: +2.5 % for 2018 (after +2.3 % in interim projection from January 2018). The autumn 2017 World Economic Outlook projected a real GDP growth rate of 1.8 %. For 2019 the IMF expects a growth rate of 2.0 %, in line with the January interim forecast. The German economy is demonstrating steady growth on a broad base: wages and employment are increasing appreciably and low interest rates, relatively high corporate profits and positive trends in the production of investment goods and orders speak in favor of a sustained ongoing upward dynamic of investment.

The German economy is in a state of slightly over-utilised capacity; capacity bottlenecks and skills shortages are already limiting economic momentum in some sectors such as construction. Fiscal policy should avoid further exacerbating economic constraints and to help guard the economy against overheating.

On the back of continued favourable conditions for public finances, the German fiscal position remains sound. Since 2012 budgets are close-to-balance or in surplus. A favorable cyclical development and falling interest rates contributed to this development. Public investment increased significantly in recent years. With 4.0 % on average per year since 2005 the increase of public investment was higher than the increase of total public expenditure (+2.5 %) or GDP (+3.0 %). In 2017, public investment increased by 5.1 %, hence stronger than total expenditure (+3.6 %) or nominal GDP (+3.8 %).

According to our current projection, public investment will continue to increase strongly, by 5 % per year on average. The budget balance of the general government (encompassing Federation, Länder, municipalities and social security funds) will continue to be in surplus.

This projection does not yet include the new draft for the 2018 budget and the key figures for the medium-term fiscal plan up to 2022. They will be adopted by the federal government in May. The measureable volume of new initiative will also contribute to further push public investment, e.g. in digital infrastructure and child care, while safeguarding our solid fiscal situation.

The federal government is committed to sound public finances, with the goal of a balanced budget. This is in line with the objective to avoid pro-cyclical fiscal policies as mandated by European and national rules. One important reason for balanced budgets is that the German population is ageing steadily, which makes a sound and sustainable fiscal policy essential. Also, a future normalization of interest rates and financing costs requires prudent fiscal policies.

Germany will tackle the multiple challenges ahead in order to safeguard its current strong economic growth and retain Germany's international competitiveness, also through suitable tax policies.

First, the federal government will use additional expected financial leeway of €46bn in the years up to the end of 2021, the current legislative term. This corresponds to approximately 1 1/2 percentage points of GDP. The federal government wants to use these resources to increase investment and provide tax relief, to strengthen potential growth. This amount is appropriate given the strong performance of the German economy, which has record levels of employment, is growing above its potential rate, and is running at slight excess capacity.
Second, it will provide tax relief to taxpayers, particularly by abolishing the solidarity surcharge for 90 % of the working population. The solidarity surcharge is a 5.5 % surcharge on income taxes that was initially levied to finance the costs of German reunification.

Third, it will work actively at the international level towards fair taxation of multinational enterprises. Germany will also continue to fight tax evasion, base erosion and profit shifting.

The German government remains committed to the ongoing discussion about a further strengthening of the European Monetary Union. The European Head of States gave a mandate to primarily focus the debate on the strengthening of the Banking Union and a possible further development of the European Stability Mechanism (ESM). In the upcoming months Germany will work towards taking these issues forward together with the European partners.

**Financial Sector**

The low level of short term risks to global financial stability reflects the advanced regulatory framework becoming operative as well as the aforementioned rather positive economic developments. However, this cyclical upswing and the associated low level of market volatility mask elevated threats to financial stability in the medium term. These threats may materialize if risks are systematically and collectively underestimated. The consequences of such reversal of risk perception in markets might be particularly severe in the current environment. As private and public debt have risen to high levels in an environment of prolonged loose monetary policies, this may come along with significant vulnerabilities once interest rates will rise on a broader front.

The combination of low interest rates and search-for-yield behavior has pushed asset prices to extraordinary levels, not necessarily supported by economic fundamentals. If these stretched valuations are subject to reversal, the growing importance of passive investment management, most prominently via exchange-traded-funds, may be a factor that could amplify downside movements of asset prices. A potential coexistence of search for yield and increased risk-taking, by loosening of credit standards or shifts in credit supply to relatively risky borrowers, may undermine financial stability notably if unexpected events occur. To prevent this appropriate macroprudential and financial sector policies and supervision are necessary and the full implementation of the G20 financial regulation agenda remains essential.

At the same time, the market environment for financial institutions remains challenging. Despite the recently increasing profitability of financial institutions, many banks and insurance companies will have to adapt their business models in the medium term. In this regard, the use of financial technology may help financial institutions lower operational costs – at least in the medium term – and thereby raise profitability. Within this new digital environment, cyber risk appears as a major risk, which has to be addressed internationally.

In Europe, despite remarkable progress, non-performing loans need to be continuously reduced to sustainable levels in a decisive manner and in full respect of the existing rulebook. Besides solving these legacy problems, there are a number of remaining challenges to be addressed and risks to be reduced on the final stretch towards a strong and sustainable Banking Union. We should improve insolvency regimes where needed and must ensure a strong regulatory and supervisory framework to prevent future crisis. In order to re-establish the fundamental economic link between risk and return and to protect taxpayers' money the build-up of adequate and credible bail-in buffers is key. Finally, we need to break up the

contagious link from sovereigns to banks by means of a risk-adequate regulation of sovereign exposures.

At the global level, only a well-monitored and responsibly regulated financial sector will be resilient enough to provide a sound basis for sustainable growth. Therefore, we should remain committed to support the timely, full and consistent implementation of the agreed financial sector reforms and prevent a rollback of regulatory standards.

**International Tax Issues**

We welcome the ongoing growth of support for the OECD/G20 Base Erosion and Profit Shifting (BEPS) recommendations. We are pleased to see an increasingly broad regional diversity among the membership of the Inclusive Framework on BEPS, now comprising 113 countries and jurisdictions and illustrating the truly global dimension of this project. A united approach for the development of a fair international tax system and the fight against aggressive tax planning strategies is indispensable for the establishment of a global growth-friendly level playing field.

Under Germany's G20 presidency in 2017 and with substantial support by the OECD, tax transparency has tremendously been enhanced. The automatic exchange of information on financial accounts under the Common Reporting Standard (CRS), which commenced among the first 49 jurisdictions in September 2017, marks a milestone in the common efforts for more transparency around the world. In this context, it is all the more important that remaining jurisdictions begin with exchanging information by September 2018 at the latest. As regards the implementation of the agreed international standards on tax transparency, there is only one country on the OECD/Global Forum list with the overall rating "Non Compliant". Again, this shows the progress in improving tax transparency. Nevertheless, there is still work to be done in this field. In this context, we welcome the Financial Action Task Force's (FATF) progress report on improving transparency and availability of beneficial ownership information. Finance Ministers agreed in March 2017 in Baden-Baden to enhance tax certainty. Therefore, OECD and IMF have proposed a set of practical tools to be implemented and were asked to review progress in 2018.

Concerning the challenges to tax the digital economy, a discussion at G20 level was initiated under Germany's G20 Presidency in order to meet the growing pressure to do further work in this area. In that respect, the OECD has been asked to deliver an interim report. This report was presented to the G20 Finance Ministers and Central Bank Governors in Buenos Aires at their meeting of 19$^{th}$ March 2018. The report contains an economic analysis of the value creation process in highly digitalized business models, a description of advantages and disadvantages of a so called "Equalisation Tax" as interim measure, underlining key points of such a tax for those countries that urge to act and it also gives guidance for the work on a long-term solution. An common approach towards agreeing on a long-term solution will be subject to another report in 2020. This is key for a fair and global international tax system to

avoid further uncoordinated unilateral actions and to prevent increasing fragmentation of the international tax rules.

### Digital Finance

The effects of digitalization are particularly visible in the financial industry. It is speeding up the globalization of markets and presents both potentially enormous opportunities as well as unprecedented challenges. This is why we should monitor and actively shape the digitalization of financial markets. Our main goal must be a level-playing-field for all market participants. To this end, the regulatory framework for the digital transformation of financial services should have financial stability and consumer protection at its core. It should enable digitization and not hinder innovation. It should furthermore address possible emerging risks due to technological innovation effectively.

Digital instruments issued through a distributed ledger technology, referred to as “crypto-assets” or “tokens”, illustrate the effects of digitalization und underpin our approach to monitor and actively shape the digitalization of financial market. Tokens constitute a new, innovative and fast evolving tool. However, tokens could pose substantial risks for investors and market integrity. Without appropriate measures, they could also be vulnerable to financial crime. In the longer run, potential risks in the field of financial stability may emerge as well.

Therefore, we call on the IMF to keep a close watch on current and future developments in this area and ensure that global financial stability is not compromised.

## II. International Financial Architecture and IMF Policies

Germany supports discussions at the IMF on issues relating to the international financial architecture in line with the Fund’s mandate to promote the stability of the international monetary system. We consider it important for supporting stability in a sustainable way that policies are guided by the appropriate incentives. To strengthen resilience of economies, the IMF plays a crucial role under its surveillance mandate. Benefiting from its broad experience and expertise, the Fund is well placed to support countries as a trusted advisor in identifying economic and financial risks and unsustainable developments and recommending appropriate policies to address challenges. We are looking forward to the upcoming comprehensive surveillance review which should look in depth into developments of high private and public debt and evaluate the effectiveness of the Fund’s surveillance policy advice as regards to strengthening the resilience of its member countries.

### 15th General Review of Quotas

We confirm our commitment to work constructively within a well-sequenced, integrated package approach towards completing the 15th General Review of Quotas by the IMF Spring Meetings 2019 and no later than the IMF Annual Meetings 2019. Germany reaffirms its commitment to a strong, quota-based and adequately resourced IMF. We remain committed to

discuss plausible scenarios for the adequacy of the Fund resources, including options for a moderate quota increase. In this respect we stress the importance of fostering the quota-based character of the Fund. Any discussions and decisions on the elements of the quota review should continue to be fully anchored in the relevant IMF bodies and respect the interests of the whole membership.

We take note of the recent discussion in the IMF on the adequate size of the Fund and look forward to staff presenting plausible scenarios based on sound and realistic assumptions taking into account the actual level of requested financial assistance in the last decade as well as the Fund's catalytic financing role. It will be important that Fund financing will crowd-in the private sector and is not be seen as crowding-out or disincentivising private sector engagement.

We believe that any realignment of quota shares should result in an increase in the share of dynamic economies in line with their relative positions in the world economy, thus further increasing the Fund's representativeness. However, a credible perspective for a quota increase would be needed at the current juncture for a fruitful continuation of the discussions on the quota review and quota formula. Data updates have demonstrated that the current quota formula already delivers well on the aims of the current quota review, thus no fundamental change to the formula seems warranted. The main variables of the quota formula should remain both GDP and openness. These are the measures most suited to capture the mandate of the IMF to promote trade and the openness of economies.

**Capital Flows**

Germany supports the ongoing efforts by the IMF to further expand our analytical understanding of the drivers and consequences of capital flows and to reflect this understanding in its bilateral and multilateral surveillance activities. While it is important to remember that the Fund does not exert an arbiter function in the international monetary system regarding capital flows, it still plays an important role by being able to advise its members on how to reap the benefits that free movement of capital can bring while being able to shield themselves with appropriate policies from disruptive effects of volatile capital flows. We also support the ongoing efforts to better understand the interconnections between capital flow measures and macro-prudential measures, also within the context of the Fund's advice on its Institutional View, and look forward to further analysis of possible policy responses regarding the deployment of both types of measures by the member states. We encourage the Fund to collaborate closely with the OECD on capital flow issues. Lastly, we would like to point out, that stable and resilient economies with sustainable public and private debt levels as well as a sound regulatory framework for the use of capital flow management and macro-prudential instruments, not only face a lower probability of experiencing severe capital flow volatility, but will also be more able to cope with any such occurrence.

**GFSN and Regional Financing Arrangements**

The Global Financial Safety Net (GFSN), which complements domestic policy measures to prevent and address crisis situations, has been considerably strengthened over recent years and is financially stronger than ever. It has evolved in a diversified fashion, allowing for tailored

responses to countries' needs, their systemic relevance and for flexibility in case of future crises. By offering its members a uniform and non-discriminatory access to its financial resources in case of a balance of payments need, the IMF is the *truly global* financial safety net and plays a key role in crisis prevention and resolution. Central banks and regional financing arrangements (RFAs) as independent actors also contribute to the stability of the international monetary system in line with their specific mandates. Further efforts to enhance IMF-RFA cooperation based on broadly accepted principles, where feasible, are welcome. When discussing challenges for the GFSN in an evolving global economy, the responsibilities of sovereign countries for the prosperity and resilience of their economies need to be duly acknowledged, as they cannot be replaced by any kind of external financial safety net.

**Improving Debt Sustainability**

Germany considers ensuring debt sustainability as fundamental for sustained growth and economic resilience for all countries. We look forward to the upcoming Board review of the Fund's Debt Sustainability Analysis for Market Access Countries. Further rising public debt, particularly in low-income countries (LIC), is a cause of concern. To prevent debt from becoming unsustainable, the Fund can and should play a key role in monitoring debt developments and providing advice and technical assistance to member countries on prudent debt policies and sound public financial management.

To prevent unsustainable debt developments in LICs, Germany attaches great importance to improved debt transparency and fully supports the work by the Fund and the World Bank as well as by the Paris Club on this topic. One step towards more debt transparency could be debt registries, improving the available information on loans made to LICs. This would also contribute to implementing the G20 Operational Guidelines for Sustainable Financing as endorsed in March 2017.

**Compact with Africa (CWA)**

The G20 Compact with Africa initiative aims to contribute to economic development through improved framework conditions for private investment in reform-minded African countries. At the margins of the IMF and World Bank spring meetings, Togo has joined the initiative as a new member, increasing participation to eleven African countries.

Via the CWA, the participating African countries, the IMF, the World Bank Group (WBG) and the African Development Bank (AfDB) as the responsible international organizations, as well as bilateral partners from the G20 and other interested countries, coordinate their actions towards improving the macroeconomic, business, and financing frameworks in the compact countries. Germany remains fully committed to advancing the initiative as co-chair of the Africa Advisory Group.

Compact Teams, consisting of representatives from government authorities, international organizations and bilateral partners, are the key driver of implementation of CWA reform agendas and commitments and private sector mobilization on the ground. The first Monitoring Report to G20 Finance Ministers and Central Bank Governors has taken stock of

the progress already achieved and has underlined the strong commitment and dedicated efforts of all the partners involved in the initiative.

We highly appreciate the IMF's contribution to the CWA initiative, including the integration of the CWA's objectives into its regular surveillance and program work in these countries and the efficient coordination with the WBG and the AfDB. To live up to the ambition of the G20 to serve as a catalyst for more private investment in CWA countries, all G20 members are encouraged to reinforce their efforts to mobilize the private sector in their home countries. We invite further interested partners from the G20 and beyond to put existing and new support measures for CWA countries into the context of the Compact initiative. The private sector is invited to seize the economic opportunities that reform-minded African countries offer.

**Sustainable Development and Financing for Development**

The Fund should continue to contribute to the 2030 Development Agenda through its surveillance, lending, and capacity development in line with its mandate. Building resilience should be the priority of these endeavors; the work of the Fund to support countries in fostering domestic resource mobilization is crucial. As remittances continue to be a very substantial part of some developing countries' and emerging economies' own resources, Germany had put the improvement of the environment for remittances on the international agenda during its G20 Presidency in 2017. The IMF and the World Bank have, through technical assistance, played an important role in our efforts to improve the environment for remittances. With regard to remittance providers' access to banking services the Financial Stability Board (FSB) submitted a report with recommendations to the G20 Finance Ministers and Central Bank Governors in March 2018 that should now be implemented. The FSB will also, together with the FATF, the IMF, the World Bank and the Global Partnership for Financial Inclusion, coordinate to monitor the take-up of these recommendations and report back to the G20 in July 2019.