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**Statement by Mr. Klingbeil
Germany**

Statement by Mr Lars Klingbeil
Finance Minister of the Federal Republic of Germany
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I. Global Economy and Financial Markets

Global Economy, Europe and Germany

Russia's ongoing war against Ukraine continues to be a fundamental disruption of the international rules-based order and a heavy weight on the global economy. Germany condemns this aggression in the strongest possible terms and reiterates its clear, unequivocal call on Russia to immediately end its war and withdraw its forces.

Without a sustainable peaceful solution in the Middle East, strains on the global economy continue, by injecting system-wide uncertainty, disrupting international trade flows and putting persistent upward pressure on commodity prices. Germany calls on all involved parties to urgently de-escalate and reach a lasting peace.

An open, rules-based global trading system, flanked by deeper and broader partnerships among countries, remains critical to addressing global challenges. Unilateral trade restrictions, including tariffs and other market-distorting policies, depress global growth prospects and trigger negative spillovers across interconnected economies.

Global growth has so far shown remarkable resilience, yet the balance of risks remains firmly tilted to the downside. Alongside ongoing conflicts and geopolitical tensions, the economic impacts of climate change are becoming increasingly visible. While the rapid proliferation of artificial intelligence (AI) may act as a powerful structural driver for long-term productivity, it introduces new vulnerabilities, for example in the areas of cybersecurity, financial markets and labour markets.

Additional downside risks to the global economy stem from a continuous rise in bond yields, which have just now returned to long term averages. Against the backdrop of already elevated public debt levels, rising debt-servicing costs are severely restricting fiscal space and intensifying global fiscal sustainability concerns. Fiscal policies must therefore be carefully calibrated. Ensuring and preserving debt sustainability must remain an immediate priority.

The global disinflation process has come to a halt. Headline inflation has resurged in several major economies, driven by elevated energy prices. In this challenging environment, safeguarding the independence of central banks remains vital to anchoring inflation expectations and ensuring price stability.

The European economy continues to face considerable and increasing headwinds, but it has shown remarkable resilience in the first half of 2026. Growth has so far remained solid and labour markets have continued to be robust. At the same time, inflation this year has substantially increased and is well above medium-term inflation targets. Ongoing wars and conflicts continue to exert upward pressure on energy prices and will weigh on our economies for quite some time. Geopolitical risks and economic uncertainties significantly cloud the outlook. In light of these risks, Europe remains committed to promoting global economic stability and sustainable growth. Europe continues to champion free trade and a rules-based global trade order.

While rising bond yields have put additional pressure on already tight fiscal spaces, the European fiscal framework remains essential in order to preserve fiscal sustainability and maintain sufficient room to respond to possible future shocks.

To increase its resilience and improve its economic prospects, the European Union aims to enhance the attractiveness and competitiveness of the Single Market. Removing internal barriers, reducing red tape, strengthening entrepreneurship and innovative activities, and mobilising more private capital for investments are key to European competitiveness. In light of geopolitical challenges, Europe also aims to secure supply chains and deepen and diversify trade partnerships.

Structural reforms that focus on improvements in productivity growth are also crucial. The European Union has recognised the importance of national structural reforms and supports their implementation via country-specific recommendations and the reformed economic governance framework.

Economic activity in Germany has stabilised recently, with real GDP increasing over the first half of 2026. Exports have performed better than expected and the negative impact of higher energy prices appears to have been less pronounced than initially expected. However, the economic environment remains challenging, with further energy price increases since July due to the conflict in the Middle East. In addition, climate change, exemplified by extraordinary heat waves and exceptionally low water levels in key waterways significantly affecting the transport of industrial goods, is adding to other existing challenges related to demographic change, competitiveness and trade policy. At the same time, the government's sizeable fiscal package and broader reform efforts are starting to support activity and strengthen the medium-term economic outlook.

We published a new economic forecast with increased growth rates at the beginning of October. We expect real GDP to increase by 1.3% in 2026, by 1.1% in 2027 and by 0.6% in 2028. Inflation is expected to stay elevated in the short term due to the impact and pass-through of higher energy prices with rates of 2.7% in 2026, 3.0% in 2027 and 2.2% in 2028.

To strengthen the growth potential of the German economy, the federal government is pursuing a three-pronged strategy of investment, structural reforms and fiscal sustainability.

We have already implemented a broad range of measures to strengthen public and private investment. The Special Fund for Infrastructure and Climate Neutrality is boosting public investment, backed by consistent progress and performance monitoring. By applying performance-budgeting principles to public investment management, the federal government is promoting an efficient and effective use of these funds. This will ensure that investment expenditure from the Special Fund translates as swiftly and successfully as possible into noticeable improvements in public infrastructure, as well as greater innovation and improved growth prospects. We have launched a broad range of measures to accelerate planning and approval procedures, for instance for infrastructure investments financed through the Special Fund, as well as in areas such as housing construction and geothermal energy. These reforms aim to reduce bureaucracy and will enable public and private investment to be realised more swiftly and efficiently. At the same time, we are mobilising additional private investment through tax incentives and the Germany Fund.

The fiscal scope created by the Special Fund for Infrastructure and Climate Neutrality is being used by the federal government to invest in the modernisation and targeted expansion of the public capital stock. Key areas of investment include transport infrastructure, digitalisation, energy infrastructure and research and development. Against the backdrop of the current geopolitical situation, the introduction of the exemption from the debt brake for security- and defence-related expenditure enables a significant increase in spending to strengthen Germany's defence capabilities.

Addressing labour shortages and mobilising untapped labour potential are also key priorities. Our reforms will strengthen incentives for longer working lives, the take-up of employment and increased working hours, while supporting the integration of jobseekers into the labour market. Measures to improve the reconciliation of work and family life, including the gradual expansion of all-day childcare, can help mobilise additional labour supply. Further measures aim to facilitate job transitions, promote skills development and training, and reduce disincentives to increase working hours.

In addition, we are strengthening the long-term sustainability of our social security systems. Our health and long-term care reforms aim to ensure sustainable financing and contribute to stabilising non-wage labour costs. At the same time, we are reforming our pension system across its three pillars. We are strengthening occupational and funded private pension provision, improving access to capital markets and opportunities for long-term investment, while pursuing broader reforms to ensure a sustainable and intergenerationally balanced pension system.

Furthermore, given the significant burden posed by the current high fuel prices on the German economy, the federal government will introduce a temporary reduction in the energy tax on petrol and diesel from October 2026, providing rapid relief to both households and businesses. The federal government will continue to closely monitor fuel price developments and is assessing further measures to mitigate the impact of high energy prices.

Finally, we are prioritising spending to ensure fiscal sustainability and efficiency. This is a central task for the coming years. The key approach to the structural consolidation of the federal budget focuses on boosting growth through investments, reforms and growth-oriented prioritisation of spending. In addition, revenue-side measures – including, for example, various reforms to excise duties – have been agreed to strengthen government revenues, while a systematic review of government tasks and spending aims to increase the efficiency of public expenditure. We will continue to pursue this course vigorously and decisively.

Global financial markets face a period of heightened uncertainty due to the ongoing conflict in the Middle East and pressures on sovereign debt markets. Risks to financial stability remain tilted to the downside. Additional risk factors include high market valuations, uncertain AI growth prospects and the ongoing growth of the global non-banking financial institution (NBFI) sector, which harbours the risk of contagion in a financial markets downturn. The risk of cyberattacks is high in the current environment, not least due to the rapidly advancing capabilities of frontier AI models. It is important that the global financial system is and continues to be resilient, given the wide range of risks and underlying vulnerabilities.

The financial system in Germany continues to be resilient despite the different stress periods. The German banking sector shows stable profitability and asset quality. It also remains well capitalised and liquid. Still, close monitoring and constant vigilance is paramount.

Amid growing geopolitical tensions and increasing pressure on multilateralism, stronger partnerships across the Global South and North are more important than ever. Through the independent high-level South-North Commission on Development Policy, co-chaired by former Chancellor Olaf Scholz and former President of Costa Rica Laura Chinchilla, Germany is working with its partners to develop innovative responses to shared global challenges and to strengthen international cooperation.

II. International Financial Architecture and IMF Policies

As the central pillar of global monetary cooperation, the IMF continues to demonstrate the high value of multilateralism. It provides an important counterweight to growing inward-looking tendencies and geoeconomic fragmentation. Germany commends the IMF for being a

trusted partner of and candid advisor to its membership in times of repeated shocks and major structural transformations of the global economy.

We strongly support the Fund's efforts to sharpen its focus on the core pillars of macroeconomic resilience and balance of payments stability. This is of particular importance in the face of elevated uncertainties regarding trade and supply chains, growth and inflation. At the same time, the Fund should keep sight of the relevant macroeconomic implications and risks resulting from emerging macro-critical issues such as climate change and AI. Regarding surveillance, the Fund should continue to place particular emphasis on flagging material macroeconomic and financial stability risks at an early stage and provide specific and well-tailored policy advice. With regard to IMF lending, programmes need to deliver durable change through meaningful reforms and policy adjustments. In doing so, prudent lending standards must safeguard the revolving character of the Fund's resources. We applaud the IMF for setting an adequately high bar in these areas, as reflected in the recently completed reviews of its major policy frameworks, including those covering surveillance, programme design and conditionality, and financial sector assessments.

We welcome the completion of the Comprehensive Surveillance Review (CSR). Its implementation should improve surveillance in the realms of economic resilience, provide more comprehensive external assessments and ensure a more risk-based approach. This is especially pertinent amid exceptionally high uncertainty, which is driven by the transformative trends of digitalisation, AI, geoeconomic fragmentation, trade restrictions, climate change and demographic transitions. We see scope for further strengthening candour in surveillance, i.e. to promote crisis prevention and timely programme engagement with the IMF, where appropriate.

We also look forward to the operationalisation of the important concept of macro-criticality, guiding decisions on how to calibrate institutional engagement in non-traditional policy areas. In this context, we maintain our support for Fund coverage of the macroeconomic implications of climate change. We continue to advocate for the presumption of climate mitigation coverage in bilateral surveillance with the largest emitters.

External imbalances warrant close attention where they point to underlying vulnerabilities, unsustainable policies or structural distortions. The Fund's analytical framework should combine multilaterally consistent diagnostics with a forward-looking and risk-based assessment of current account flows, external balance sheets and potential spillovers. Where deficits reflect unsustainable fiscal or other domestic imbalances, these should be addressed; where surpluses are driven by distortive policies, non-market practices or structural impediments to domestic demand, these distortions should be removed and domestic sources of growth strengthened. Policy recommendations should ultimately be anchored in identified distortions and prospective risks, rather than inferred mechanically from the size or persistence of past external outcomes.

We continue to have significant reservations regarding the proposed net foreign assets (NFA) benchmarking within the External Balance Assessment (EBA) framework. The derivation of NFA benchmarks lacks analytical robustness and can be politically misleading. Including NFA benchmarking based on past current account assessments would mean a structural break in how EBA gaps can be interpreted, as any normative view in the future would be increasingly based on the past.

We welcome the completion of the Financial Sector Assessment Program (FSAP) Review and its focus on enhancing traction, focus, and effectiveness. Going forward, implementation of its recommendations should sharpen the prioritisation and risk-based scoping of FSAPs and streamline processes to make the best use of IMF staff and national authorities' resources.

We strongly support further strengthening conditionality in Fund-supported programmes, as agreed in the context of the recently completed Review of Program Design and Conditionality. This includes streamlining and refocusing structural conditionality on a few highest-quality reform measures, subject to close monitoring; frontloading fiscal adjustments where necessary to address balance of payments problems; and fostering candid stocktaking of programme success and lessons learnt when programmes end. The catalytic effect of Fund financing should be strengthened by paying closer attention to the risks of excess senior debt crowding out private-sector credit. We see scope for further enhancing programme design for high-risk cases. In particular, this should be grounded in realistic macroeconomic assumptions, complemented by scenario analysis and contingency planning. Against this backdrop, we are also looking forward to the upcoming review of the Fund's Exceptional Access Policy. We attach high importance to addressing the material shortcomings that have become apparent in its application.

We welcome that many IMF members have already consented to their quota increase under the 16th General Review of Quotas (GRQ) and call on all others to complete their national procedures quickly. We remain committed to a strong, quota-based and adequately resourced IMF at the centre of the Global Financial Safety Net. The agreed Diriyah Principles for Quota and Governance reforms provide a basis for further discussions of the challenging topics at hand under the 17th GRQ. We remain ready to discuss these issues constructively, including how to better reflect members' positions in the world economy, based on fair and broad burden-sharing. In this respect, we continue to believe that the current quota formula performs well and therefore does not need a major overhaul. We reiterate our view that openness should continue to play a significant role in the quota formula, in line with the IMF's mandate to promote international monetary cooperation and the expansion of international trade.

We welcome the strengthening of the Fund's risk management framework, including continued work to further embed a strong risk culture across the institution and to enhance forward-looking risk reporting. Against the backdrop of heightened uncertainty and debt-related challenges, maintaining a strong focus on the Fund's financial and credit risks is

particularly important. Accordingly, the ongoing efforts to strengthen programme conditionality are also a central pillar of the Fund's safeguards against credit risk. We also underline the importance of strong precautionary balances in the General Resources Account and adequate reserves and buffers in IMF-administered trusts. The Fund must remain vigilant to the risk of overdue financial obligations and stand ready to apply its arrears strategy, if needed.

We continue to attach high priority to strengthening the international debt architecture and ensuring that debt-related risks are flagged and addressed early. We commend the completion of the review of the Debt Sustainability Framework for Low Income Countries. We appreciate the increased debt data transparency through the newly introduced data confidence flag and the enhanced analytical rigor, including the new mechanical signal for debt sustainability as well as additional indicators to inform staff judgement. Staff's candid judgement, including in situations where model-based signals do not fully capture underlying solvency concerns, remains crucial in order to flag unsustainable debt early on and avoid the "too little, too late" problem in debt restructurings. In this context, we continue to caution that liquidity pressures can be difficult to distinguish from solvency problems.

We appreciate the Fund's active contributions to discussions on the international debt architecture, while preserving its neutral role. We welcome progress in the implementation of the G20 Common Framework for Debt Treatments, including through discussions at the Global Sovereign Debt Roundtable, and see merit in expanding the framework to a broader set of countries, as appropriate. For countries with sustainable debt and ambitious reform agendas, we support continued efforts to advance the IMF-World Bank three-pillar approach, which helps these countries strengthen economic resilience, mobilise sustainable financing, and restore fiscal space for sustainable and inclusive growth. In this context, we welcome close World Bank-IMF cooperation on public financial management and domestic revenue mobilisation.

In addition, more needs to be done to address significant gaps in debt data, including on collateralised instruments such as total return swaps. Used by a small but growing number of sovereign borrowers, these instruments often come with undisclosed terms that make it difficult to capture the resulting contingent liabilities and procyclicality risks in debt sustainability assessments. We appreciate efforts by the IMF and World Bank to enhance transparency and to fully reflect the respective risks in debt sustainability assessments.

Lastly, we see the rising share of countries' debt owed to the IMF and the World Bank as an important risk signal and a cause for concern. We encourage IMF staff to provide an analysis of the respective trends and associated risks, as well as implications for the design of Fund-supported programmes.