Governor's Statement No. 10

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Statement by the Hon. **JENS WEIDMANN,**
Governor of the Fund for **GERMANY**

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Governor of the Fund for Germany

Mr. Chairman,
Fellow Governors,
Ms. Lagarde,
Mr. Kim,
Ladies and Gentlemen,

I.

I would like to thank the management and staff of both the IMF and World Bank for the excellent organization of this year's annual meetings and their dedicated work throughout the year. I would also like to welcome Nauru, which joined the IMF and the World Bank earlier this year, as the 189th member country of the two Bretton Woods Institutions.

II.

The world economy continues to expand at a modest pace—this is the message of current economic projections. To many observers, however, such an outcome seems to be disappointing. But in my view the somewhat muted recovery should be seen in the context of the ongoing challenges which we are facing today. These challenges differ from one region to another. In advanced economies gains in productivity continue to be weak. And in some countries remaining crisis legacies—like high unemployment and high private and public debt—weigh on national growth perspectives. Other countries, like China for example, are undergoing a challenging structural transformation towards an economy that is less dependent on exports and investment. And last but not least: If the currently observable growing skepticism with regard to the benefits of economic integration and migration were to lead to more inward-looking economic policies this could imply weaker long-term global growth. In such a case, monetary policy would certainly be the wrong addressee to counter-act it. In any event, globally seen, monetary policy is already highly accommodative in many regions of the world. And fiscal policy is often constrained by high debt levels and limited fiscal space, too. Against this backdrop it is imperative that governments step up their structural reform efforts to raise potential output and enhance resilience to economic shocks.

III.

The German economy continues to be in a solid upswing. In the first half of the year, GDP growth exceeded potential output growth, driven by domestic as well as external demand. In general, favorable conditions suggest solid growth looking forward, as also evidenced by high levels of business and consumer sentiment. However, economic activity could expand at somewhat more muted rates on the back of less buoyant external demand. This holds especially for the remainder of the year as exports are expected to suffer a soft patch after exceptionally strong growth in the first two quarters of 2016. Domestic demand is expected to remain strong with sturdy housing investment activity and solid private consumption growth backed by increasing employment, higher wages, and low consumer price inflation. The demand impact related to refugee immigration is expected to peter out because of substantially lower numbers of

newly arriving persons. On the supply side, labor market integration of the refugees could prove to be slow, despite currently very favorable overall employment conditions. While the impact on the German economy of the UK's plan to leave the European Union is subject to considerable uncertainty, currently available information points to only a limited dampening effect in the short to medium term.

IV.

The current global macrofinancial environment of subdued economic growth and prolonged low interest rates could also entail significant (side) effects on global financial stability. It provides additional incentives for piling up debt and delaying fiscal consolidation, with private and public debt in several countries having already reached very high levels. However, the current easy financial conditions should not be expected to last forever. A significant change in funding conditions would undermine debt sustainability and lead to an increase in credit risk. Furthermore, higher financial risk-taking in the aforementioned macrofinancial environment raises the risks of a sudden re-pricing of financial assets. Not least, financial institutions, in particular in the euro area, need to further adapt their business models to the challenges posed by low interest rates and subdued growth. These challenges are accompanied by already existing structural strains in the financial sector, such as high levels of non-performing loans and overcapacity in several countries as well as increased competition. All of these strains are weighing on the banking sector's profitability. To the extent that regulatory reforms over the past few years, such as higher capital and liquidity requirements or the reduction of implicit state guarantees, have also affected institutions' profitability, this should be seen as an unavoidable by-product of enhancing the resilience of the banking sector. These reforms have contributed to a more stable and resilient banking system and reduced institutions' incentives for excessive risk-taking. They should not delude us into thinking that some of the regulatory reforms introduced in recent years need to be watered down.

V.

The IMF continues to play a key role for the stability of the international monetary system. Effective surveillance is—and remains—the IMF's most important tool for promoting stability and thus for crisis prevention. By identifying vulnerabilities to economic and financial stability and developing appropriate policy recommendations on macro-critical issues, the Fund can play a crucial role for enhancing policy efforts of member countries towards improving the resilience of their economies. In this context, I would like to emphasize the importance of regular consultations of the Fund with all its members as well as the provision of timely and accurate data by countries so as to enable high quality surveillance.

VI.

I welcome the entry into effect of the 2010 Quota and Governance Reforms in early 2016 which was an important milestone for strengthening the credibility, effectiveness, and legitimacy of the IMF, giving dynamic emerging economies a greater say in the institution and reaffirming the IMF's character as a quota-based institution. With this step being taken, the focus has now turned to the 15th General Review of Quotas. Germany is committed to work constructively towards an outcome that is agreeable for the broad membership. At the same time, the outlook for a successful completion of the review within the current deadline appears increasingly uncertain, given the complexity of the issues at hand and the need to garner the required support

for a quota increase that is both realistic and sufficient to result in increased shares for dynamic economies in line with their relative positions in the world economy. I would therefore deem it prudent to agree to a more manageable timeline to enable completion of the 15th Review with a meaningful result. Clear sequencing is needed, starting with an agreement on the adequate size of the Fund that would form a valid basis for ensuing discussions on the quota formula and quota realignments in order for quotas to properly reflect the position of member countries in the world economy.

VII.

With the 2012 bilateral borrowing arrangements beginning to expire from October this year, the IMF considers that elevated risks in the global economy call for maintaining its access to bilateral borrowing as a third line of defense after quota and NAB resources. Germany is committed to maintain an IMF fully equipped to fulfil its responsibilities. Subject to broad participation and an equitable burden sharing by the IMF membership, the Deutsche Bundesbank stands ready to conclude a new bilateral loan agreement with the IMF in an amount of up to EUR 41.5 billion, based on the agreed new governance structure which gives creditors a formal say in the activation of the agreements. As the IMF is a quota based institution—and should remain one—it is clear that the new 2016 credit arrangements are only a temporary addition to the Fund's regular resources; at the same time they should not be interpreted as an indication for a possible future general quota increase.

VIII.

There has for some time been an active debate on the adequacy of the Global Financial Safety Net (GFSN) and the role of the Fund as its key element at the global level for all of its member countries in an equitable way. Over the past years, responding to unprecedented turbulences in the international monetary and financial system, we have seen a substantial strengthening of the various elements that make up the GFSN, including a sizeable augmentation of the IMF's lending capacity and the creation and expansion of regional financing arrangements. With the IMF at the center as the truly global element supplemented on a regional and national level, the GFSN has evolved into a multilayered structure with new elements forming in response to specific needs. I consider the diversity and specialization of the safety net architecture to be a source of strength. It allows for flexibility in case of future crises which are hardly predictable. Going forward, I caution against undermining the trust in the very significant financial strength of the current GFSN and against creating expectations of ever expanding resources available under the GFSN. Instead, we should emphasize that sound and prudent domestic policies, including sufficiently strong levels of owned reserves, are the first and best instruments to reduce vulnerabilities and increase resilience against shocks.

IX.

As part of the debate on the GFSN, the IMF is currently reviewing its lending toolkit, with a particular focus on facilities for crisis prevention. This is welcome and allows for a review of its Flexible Credit Line and the Precautionary and Liquidity Line, which are currently in prolonged usage that was not originally envisaged. The proper design of such facilities is crucial to ensure efficiency of the instruments and an only temporary use of Fund resources. Moreover, attention needs to be given to the Fund's specific institutional setup and its financing mechanism, which firmly limits its ability to offer insurance-type facilities or to replicate other elements of the

GFSN such as swap lines by central banks. Since the IMF's financial resources are ample but always limited, insuring a large number of member countries against liquidity risks will overburden the Fund financially—while creating questionable incentives. Maintaining the financial integrity of the IMF requires an appropriate design of its lending instruments that includes a carefully targeted balance of financing and adjustment as well as appropriate access limits under its programs. Well-designed IMF programs, if fully implemented, have a good chance to be successful and to serve as a seal of approval for a country's policies and a positive signal to markets, thus counteracting some perceptions of a "stigma" of the IMF. Here, the IMF could in my view be more active in presenting its advice and support as a beneficial element for countries to the public.

X.

Much work has been done in the IWF in recent years on the subject of sovereign debt restructurings, taking account of past experiences in member countries and developments in the structure of sovereign debt. The Fund has drawn important lessons and adapted its policy framework accordingly, including its lending policies. I strongly support the efforts to strengthen the existing contractual market-based approach in order to facilitate efficient and effective sovereign debt restructuring measures in case of need. In this regard, I welcome the IMF's important contribution in its advisory function that encourages the broad use of modified pari passu and enhanced collective action clauses (CAC) in new international sovereign debt issuances and look forward to its analysis on possibly achieving progress in introducing these new clauses also in the outstanding stock of sovereign debt. I also look forward to the Fund's analysis of state-contingent financing instruments and their possible use and contribution to enhance the resilience of economies.

XI.

I welcome the inclusion of the Renminbi in the SDR basket as an important step towards a basket composition that better reflects the relative role of currencies in the global trading and financial system. Concerning the question of a possible broader use of the SDR, it is my opinion that a thorough analysis is needed. This includes a deeper understanding of why economic agents so far do not more widely use the SDR, eg as unit of account, denomination of debt instruments or to price international trade and commodities. Whether or not they eventually make use of it – or use other instruments for hedging exchange rate risks – should in my view be left to the discretion of those agents.