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Statement by Mr. Wolfgang Schäuble
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On behalf of the Federal Republic of Germany

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to the International Monetary and Financial Committee

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I. Global Economy and Financial Markets

Global Economy and Euro Area

Global growth in the first half of 2014 was weaker than expected. However, more dynamic growth can be expected for the second half of this year and for 2015. For 2015, the IMF still expects global growth to exceed the long-term average since the year 2000. Financial conditions, helped by highly accommodative monetary policy, are supportive for economic growth. But those favorable financial conditions have not yet led to strong growth of private investment in advanced economies.

Downside risks to the global economic outlook have risen in recent months. Geopolitical tensions have the potential to become a major threat to the expected strengthening of the global economic recovery. Highly accommodative monetary policies in advanced economies have supported demand and risk-taking. Against this background, financial market risks have increased in recent months. As asset prices are elevated, risk spreads in bond markets are compressed and volatility is low. This situation bears the danger of mispricing of risks and could lead to a sudden reversal in asset prices and capital flows. If downside risks materialized, the policy response would be complicated by the high level of private and public debt in many countries and the zero-lower bound of nominal interest rates in advanced economies. In advanced countries public debt in relation to GDP is at a historically high level. High debt levels hold back a stronger global recovery, limit options for economic policy and pose a risk for the outlook. In exceptional cases, expansionary fiscal and monetary policies can increase demand in the short term. But they cannot increase growth sustainably over the medium to long term. Instead, they can cause significant costs and risks with regard to sustainability of public debt, financial stability, and reform effort.

The increased risks make it even more urgent to pursue reliable policies and strengthen confidence. Maintaining a solid and stability-oriented fiscal policy is all the more important today to crowd-in private investment. More generally, we should strengthen confidence by abiding by the rules we agreed to and fulfill our commitments. The “G20 Brisbane Action Plan” will contain many structural reform commitments including labour and product market reforms but also the fiscal strategies of G20 members. We have to implement these reforms and our fiscal strategies rigorously. In particular, advanced economies should stick to their commitments to bring debt levels on sustainable paths. This will support confidence, demand, investment, and growth.

The euro area has made important progress in overcoming the crisis. Tensions in sovereign bond markets have abated, confidence has returned, and the economic situation has improved. Several peripheral countries have come out of their recessions. Determined policy action in several fields has laid the ground for the observed progress. Over the past years, significant progress has been achieved in fiscal consolidation. From 2009 to 2013, euro area countries, in aggregate, reduced the deficit-to-GDP ratio by 3.3 percentage points. Furthermore, progress in restoring competitiveness has been made. Unit labor costs and current account balances have improved substantially, in particular in countries that have been strongly affected by the crisis. The initiated structural reform processes start to yield tangible results. Moreover, substantial steps have been taken on the EU and euro area levels to strengthen the institutional setup of the Monetary Union.

At the same time, there is no room for complacency. Some large euro area countries are afflicted with persistent weak growth and the economic recovery in the euro area is still modest and uneven. Moreover, high debt levels and elevated deficits in many countries imply that continuing growth-friendly consolidation is required. Continuing on the path of growth-friendly fiscal consolidation, combined with structural reforms, will not only further foster confidence and improve the economic situation, but will also lead to higher investment and increase the euro area's long-term growth perspectives. This process will make the European economy more robust and shock-resistant and thus contribute to improving global financial and economic stability.

Germany

Germany's economy is overall in good shape. After strong GDP growth in the first quarter by 0.7 per cent (price, seasonally and calendar adjusted compared to the previous quarter) which was positively affected by mild winter weather, real GDP declined by 0.2 per cent in the second quarter, mainly because of the reverse effect in the construction sector. While the underlying momentum remains positive, firms have revised down their expectations on future business in recent months, and geopolitical tensions could impair economic activity through different channels, suggesting that GDP growth in 2014 and 2015 will be presumably lower than expected in spring.

Domestic demand remains to be the main driver of economic growth. In particular, consumption of households is going to expand steadily. This is underpinned by the elevated level of consumer sentiment as a result of the favorable development of real disposable income which is supported by low inflation and increasing levels of wages and employment; non-wage income is also going to expand. Housing investment may also continue its upward trend, although at a slower pace than in the recent past. In the absence of major adverse shocks business investment is expected to continue its modest recovery.

Germany's favorable economic situation is supported by a sound, trust building, and growth-friendly fiscal policy. The general government budget was slightly in surplus in 2013 and is expected to be balanced in 2014 and 2015. The budget of the federal government will be structurally balanced this year, and from 2015 onwards net borrowing will be brought down to zero.

Due to past consolidation efforts, the trend of rising debt-to-GDP ratios was reversed and fiscal space was created which is used for growth-enhancing measures such as additional investment in infrastructure and education as well as for addressing social equality issues.

Financial Sector

The balance between economic and financial risk taking is becoming increasingly skewed. Prices have risen and volatility has fallen in a highly correlated manner over a broad universe of assets. The high-yield segment in particular has seen unprecedented issuance volumes, spurred by high investor demand, and price and non-price indicators show a tendency of exuberance in some corners of the market. It is only reasonable to assume that a correction will eventually take place. If this happens abruptly, it could lead to considerable losses for market participants and have broader effects on the economy. Notably the less well-regulated segments of the financial sector may be a source of vulnerability and deserve heightened scrutiny. Overall, the current financial market environment poses an increasingly important challenge for policymakers, and we will remain alert with regard to emerging risks.

After the financial crisis in 2008, we have made important progress to build a stronger and more resilient financial system. In particular, we have improved the soundness of the banking sector. However, our job is not finished. Going forward, priorities are to continue to address the too big to fail problem on a global level by defining the terms and conditions for additional loss absorbing capacity of systemically important institutions. Also, we need to advance our efforts to appropriately monitor and supervise the shadow banking sector, and reforming the over the counter (OTC) derivatives market will help to reduce systemic risk and increase transparency. Full and consistent implementation of internationally agreed reforms will be crucial to further strengthen the financial system. Beyond that, we see merit in further exploring links between financial institutions and sovereigns and possible implications.

Bond and CDS spreads have declined markedly in the euro area, but we will be careful and there is no reason for complacency. The process of reform and repair is far from finished. Private and public balance sheets are still weak in many member states and could cause renewed uncertainty. In this context, we underscore that we are on track to implement the Banking Union, one of the most ambitious recent projects in the European Union. The results of the comprehensive assessment will be published soon and, once completed, the ECB will take up its supervisory role. In the wake of the comprehensive assessment, we have already witnessed efforts by banks to strengthen their resilience. In case the comprehensive assessment identifies additional needs, it will be important to react swiftly. Finally, we would like to emphasize that the new regulatory framework in the European Union is an important step to move away from bail-outs by taxpayers to bail-ins involving shareholders.

International tax system/ BEPS

The prevention of Base Erosion and Profit Shifting (BEPS) is one of the issues which is on top of Germany's international tax agenda. Accordingly, there is a strong support for the G20/OECD-BEPS project from Germany. Given the short time-line, it is remarkable that it was possible to agree in the OECD and G20 on a first set of proposals to fight BEPS. However, there is still work ahead of us to achieve all aims of the BEPS project. The successful cooperation between OECD states and G20-non-OECD-states has to be continued as "post BEPS". Germany encourages the IMF to continue to play its role in this regard and further examine important issues of international taxation as part of its bilateral and multilateral surveillance.

In order to support international tax cooperation, Germany will host the 2014 annual meeting of the Global Forum on Transparency and Exchange of Information for Tax Purposes on 28 – 29 October 2014. This meeting will contribute significantly to the further enhancement of tax transparency.

II. International Financial Architecture and IMF Policies

IMF Surveillance

Germany is supportive of efforts to strengthen surveillance as a core function of the IMF and the primary tool of the Fund for crisis prevention. We welcome the results of the 2014 Triennial Surveillance Review (TSR) and concur with the finding that on the whole the Fund has made good progress through implementing the recommendations from the 2011 TSR. Nevertheless, looking ahead further efforts will be needed, including in the areas of integrating bilateral and multilateral surveillance activities and better understanding macro-financial linkages. On the former, our understanding of both inward and outward spillovers can be deepened further without prejudice to domestic responsibilities of policy-makers. A deeper and broader external balance assessment, mindful of the limitations of quantitative methods, would be beneficial in this regard.

On macro-financial linkages, we support efforts to utilize an adapted version of the balance sheet approach and to develop a global flow of funds analysis in order to obtain a more complete picture of spillovers. A stronger emphasis on macro-financial surveillance will be a challenging but important undertaking when considering how to best conduct surveillance in the period ahead. Critical will be a firmer understanding of how to utilize macroprudential policy tools most effectively and to be able to apply this consistently and even-handed within the surveillance process.

Germany also welcomes the aspiration to increase the traction of the Fund's policy advice, which crucially hinges on its perceived quality and relevance, by providing more concrete and applicable advice based on domestic conditions. These endeavors will be essential for preserving the Fund's role as a trusted advisor to its membership.

Building on the Communiqué of the last meeting of the IMFC, we emphasize the importance of regular consultations between the Fund and all its members, which are part of the obligations of IMF membership. These consultations are necessary for a comprehensive assessment of risks to the global economy stemming from possible imbalances domestically which call for policy adjustments and to give other members the opportunity to gauge and discuss the country's economic situation and policies and potential spillovers. Excessive delays undermine the integrity of the surveillance process. Against this background, we welcome that the Executive Board of the Fund will explore more meaningful action that could be taken to address these delays and uphold the responsibilities of IMF membership.

IMF Quotas and Governance

The swift implementation of the 2010 Reforms is crucial for the Fund's credibility and legitimacy. Moreover, letting the 14th General Review enter into force would help to preserve the Fund's quota based financing principle. We encourage all members which have not yet accepted the Fourteenth General Review of Quotas and the 2010 Governance Reform to complete their ratifications quickly. We welcome the approach that if the 2010 reforms are not ratified by year-end, the IMFC will call on the IMF to build on its existing work and develop options for next steps.

As the recent data update has shown again, the current quota formula captures economic dynamism well, works as expected, and adequately reflects the role and the mandate of the Fund. Against this backdrop, a need for substantial reform of the formula seems not evident. Germany remains committed to continue constructive discussions on all elements of the Fifteenth General Review of Quotas. We reiterate our view that these discussions form an integrated package and no decisions are to be taken in isolation. With a view to the legitimacy of the Fund we consider it essential that the discussions and decisions on the quota formula and the quota review are fully anchored in the relevant IMF bodies where all members are represented. By the same token, the outcome must be in line with the interests of the wider IMF membership from all regions.

Sovereign Debt Restructuring

Germany welcomes the Fund's ongoing work to draw lessons from recent developments in sovereign debt restructuring and their implications for its legal and policy framework. We strongly support 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, we welcome the IMF proposals to address collective action problems in sovereign debt restructurings - including a modified Pari Passu Clause and enhanced collective action clauses. The Fund can play an important role in advancing this discussion, which should also pay due regard to inter-creditor equity, broad-based political acceptance, the preservation of rule of law principles, and respecting contractual obligations. We also look forward to the continuation of the discussions and forthcoming IMF analyses on the other areas as identified in the May 2013 Board discussions. With regard to further considerations on modifications to the Fund's lending framework we see it as crucial that the Fund's mandate as well as its catalytic role and financial integrity are fully respected, when the IMF has to step in with its financial resources. Overall, as work on sovereign debt restructuring issues is complex, a thorough analysis and further discussions that include key stakeholders are needed.

IMF Resources

The Fund continues to remain well-equipped with financial resources. The volume of commitments under the Fund's current financial arrangements is decreasing from their peak in mid-2011 and so does the level of IMF outstanding credit since March 2012. However, it is disappointing that the agreed quota increase which would provide the Fund with a comfortable and sufficient level of *regular* quota resources is still pending, and the associated rebalancing of quota and emergency resources is further blocked. However, we remain hopeful that the 2010 quota reform will be implemented soon. For the time being, with a renewed activation of the New Arrangements to Borrow in place, the Fund is in the position to cover actual and potential demand for financial resources and would be prepared even in a worst-case scenario which seems highly unlikely to occur.

While some pledges made by IMF members have not been translated into Borrowing Agreements, we are pleased by the broad-based response to the Fund's request and that almost all of the 2012 pledged bilateral credit arrangements have eventually been finalized and approved by the Board. With the recent extension of the arrangements, they continue to represent important temporary "second line of defence" of the IMF's resources. Since these credit arrangements were established for a special period of exceptional uncertainties, we do not consider them a "bridge" or a relevant measure for discussions on a possible general quota increase under the 15th General Review of Quotas.

IMF in Low-Income Countries

Highlighting the importance to reach out to all stakeholders and members, we encourage the Fund to continue its engagement with low-income countries and welcome the Fund's engagement with states in a fragile situation in line with its mandate.

Debt Limits in Fund-Supported Programs are a key part of the Fund's conditionality toolkit. We highly appreciate staff's ongoing efforts to propose a reform that is acceptable for the broader membership. While the Fund's policy should not unduly constrain member countries' ability to secure adequate external financing to support their development needs, a robust ex-ante mechanism is necessary to prevent a build-up of unsustainable debt. This seems of particular importance in light of the expanded range of financing options for countries, including for those which heavily rely on concessional finance and face significant debt vulnerabilities, and in some cases also have weak debt monitoring capacities.

Furthermore, the reform of the Debt Limits Policy needs to be closely aligned with the World Bank's Non-concessional Borrowing Policy which is also undergoing a review. Close coordination of both institutions is paramount to ensure the effectiveness of the policy. In view of these challenges, we welcome the reform initiative underway that is aimed at establishing a unified debt limits framework encompassing both concessional and non-concessional borrowings since both components may worsen a country's debt situation.