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

Statement by the Hon. Jens Weidmann,
Governor of the Fund for Germany

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

I.

First of all, I would like to thank the Japanese authorities for their outstanding hospitality and excellent organization of these Annual Meetings here in Tokyo. We cordially welcome South Sudan as a new IMF member.

II.

The global recovery is progressing at a moderate pace and risks to the outlook are considerable. Our main task at the current juncture is to rebuild confidence. Fiscal consolidation and the deleveraging process of banks, firms, and households continue to dampen growth in the short-term. However, delaying necessary adjustments will further aggravate risks for the prospects of a lasting, fundamentally sound global recovery. Fiscal and financial sector adjustments are crucial to regain lost credibility and strengthen confidence. While international cooperation is important, decisive commitment and policy implementation at the level of individual countries is the most powerful lever. Growth-oriented fiscal consolidation with ambitious structural reforms will restore market confidence and improve the conditions for growth. In Europe, we will implement the stronger fiscal framework as agreed. But other major advanced countries must also implement sustainable fiscal consolidation plans rapidly.

For the euro area the growth outlook for 2013 appears weaker than previously expected. However, significant progress has been achieved in fiscal consolidation over recent years, thereby fostering the foundation of growth. From 2009 to 2011, euro area countries, on average, reduced the deficit-to-GDP ratio by 2.3 percentage points. Fiscal adjustment in the euro area is continuing in 2012, and it is indeed crucial that efforts are maintained to restore sound fiscal positions. Some progress in restoring international competitiveness has already been made. Unit labor costs and current account balances have started to undergo a correction process in most of the countries that have been strongly affected by the crisis. The initiated structural reform processes in the labor market and other areas start to yield tangible results. Further structural reforms are essential for euro area countries to strengthen competitiveness, increase the flexibility of their economies and enhance longer-term growth potential.

III.

In 2012, the German economy remains one of the growth drivers of the euro area. Domestic demand – driven by increasing employment and wages - made the largest growth contribution in the last two years. Thus, Germany further contributes to a gradual, market-driven unwinding of global economic imbalances. The labor market situation in Germany is projected to remain favorable, although the upward trend in employment has been flattening recently. Unemployment is likely to stay below the three-million mark on average, both in 2012 and 2013. Altogether, Germany's economic upturn is expected to continue, but at a more moderate pace, with growth perspectives dampened by the European debt crisis and an overall global slowdown. Therefore, resolving this crisis remains of utmost importance. Regaining sound and sustainable public finances is key to restore confidence and growth in Europe and the global economy.

Germany remains firmly committed to a growth-friendly consolidation strategy contributing to restore trust in the euro area. We have successfully met the requirements of our constitutional "debt brake" as well as the requirements at the European and international level – and we will continue to do so in the future. In the 2012 budget and the financial plan until 2016, the Federal Government's net borrowing falls well below the maximum permissible net borrowing. We aim at a general government deficit of about ½% of GDP in 2012 and a nearly balanced budget by the year 2014.

IV.

Stress in financial markets has receded following the ECB decision on Outright Monetary Transactions (OMT). Recent signs of stabilisation are welcome, but remain fragile. It is now of the utmost importance that those members of the euro area which are still vulnerable demonstrate an unwavering commitment to economic reform. Indeed, it is a pre-condition of the ECB's OMT program that reforms are on track. Significantly decreased sovereign risk premia over the last year for Ireland and Portugal indicate that markets acknowledge fundamental progress.

Another indicator of the need for further adjustment is the market valuation of banks: Price-to-book ratios of European banks have been declining substantially and are far below 1 now (0.5 as opposed to around 2 before the crisis). Markets apparently are cautious about the earnings prospects of the sector signaling, among other challenges, that the repair of the banking sector is far from complete. Losses have to be absorbed, deleveraging has to take place, further bank restructuring lies ahead. And, as banks search for profitable business, new risks are likely to emerge.

A strong, convincing single supervisor in Europe will be important both in this respect and also to counter recent fragmentation tendencies. The retrenchment to core businesses and national markets is a normal reaction to financial crises. Some of this is structural, as banks are adapting strategic priorities and business models. And some of it is driven by uncertainty and risk aversion. This underlines the importance to regain confidence in the banking sectors of particular euro area countries by cleaning-up the balance sheets. This should be accompanied by the establishment of an effective European supervisor in order to foster a sustainable return to financial market integration.

V.

Since the last Annual Meeting, important decisions were taken with a view to ensure that the IMF has the necessary resources to fulfill its systemic role. Germany has committed to contribute €41.5 billion to a new round of bilateral credit lines to temporarily increase resources in the IMF's General Resources Account as part of a broad international effort. Several countries and central banks, including the Deutsche Bundesbank, are signing their borrowing agreements with the IMF on the occasion of this Annual Meeting. We call on other countries and central banks that have also made pledges to the IMF to finalize their bilateral financial agreements with the IMF soon in order to ensure that all financial commitments made at the Los Cabos G20 Summit become operational. Our understanding is that any bilateral borrowing will be temporary and only a second line of defense after quota and NAB resources.

Three aspects are worth emphasizing in this regard. First, the IMF is and should remain a quota-based institution. The envisaged doubling of quotas in the context of the implementation of the 2010 decision on quota and governance reforms will contribute to a rebalancing of borrowed resources in relation to quota resources. This will strengthen consistency between the Fund's financing and governance structure and will thus enhance its legitimacy. Second, prudent financial policies and effective risk mitigation measures, in particular access, conditionality and adequate program design are key for preserving the Fund's financial integrity. IMF-supported programs must be appropriately geared towards restoring a sustainable balance of payments position with a view to ensure the temporary use and revolving nature of Fund resources in line with the statutory provisions and to facilitate a timely graduation of countries from official-sector support. In this context, we welcome the recent review of the Fund's conditionality which needs to be applied strictly to ensure the intended positive signaling effect of Fund programs. Third, strengthening the Fund's precautionary balances must be given high priority so as to increase the buffers in a timely manner commensurate with its risks in order to safeguard the Fund's resources.

VI.

Surveillance is the primary tool for the International Monetary Fund to fulfill its important crisis prevention function and remains the core competence of the IMF. Germany welcomes the steps taken to enhance both bilateral and multilateral surveillance and the adoption of the new surveillance decision. While maintaining the primary focus on domestic stability as the key contribution for global stability, the Fund's surveillance will benefit from sharpening its international dimension through an enhanced analysis of the interconnectedness of countries and associated potentials for spillover effects. By the same token, for those countries facing inward spill-overs, it is all the more important to consistently reduce home-grown vulnerabilities. Also, the implementation of the 2011 IEO recommendations for strengthening the Fund's surveillance will further improve the Fund's advisory capabilities in this area. Furthermore, we support the implementation of the recently agreed Financial Surveillance Strategy which complements the traditional surveillance function and provides valuable steps to enhance the scope and the analytical depth of the Fund's surveillance of financial sector related vulnerabilities and associated macro-financial linkages. Taken together, these steps will also contribute to improve traction, which crucially depends on the perceived relevance and quality of the Fund's analysis and advice.

VII.

Germany has notified the Fund of its acceptance of the 2010 quota and governance reform in spring, well ahead of the deadline. Thus Germany has contributed its share for a timely implementation of the reform and a subsequent strengthening of the Fund's legitimacy and effectiveness.

With regard to the forthcoming review of the quota formula we believe that the four principles which underpinned the 2008 reform of the quota formula continue to provide the appropriate basis for the current review. Furthermore, the formula should be based on verifiable and clear economic criteria. It should have a close link to the Fund's mandate which is closely related to the countries' openness to the world economy. Against this background, Germany believes that GDP and openness remain the main variables in the formula, and considers that openness should carry an increased weight.

VIII.

Low-income countries (LICs) have become more open and integrated into the global economy. The global financial crisis has had a significant impact on LICs, with many facing a significant deterioration in their external positions. In response to the new situation, the IMF reformed its concessional lending facilities in 2009 to make them more flexible and to meet the increasing demand for financial assistance. The recent review of IMF facilities for LICs showed however that there is room for better tailoring of these facilities according to the Fund´s mandate and with appropriate conditionality attached. Given the scarcity of PRGT resources Germany supported the use of SDR 2.45 billion SDR in windfall gold sales profits in order to increase the lending capacity of the PRGT. Germany deems the agreed underlying three pillar strategy essential to secure the self-sustainability of the PRGT over the long term. Potential modifications to the IMF facilities for LICs would need to be mindful of this objective.