2015 LIMA
ANNUAL MEETINGS
WORLD BANK GROUP
INTERNATIONAL MONETARY FUND

Governor's Statement No. 7

October 9, 2015

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

I.

First, I would like to thank the Peruvian authorities for their outstanding hospitality during this year's Annual Meetings here in Lima. I also would like to thank the IMF and World Bank management and staff for their dedicated work. Continued implementation of their mandates and the effective cooperation of the two institutions provide a key contribution for the global economy and their member countries to prosper. We look forward to welcoming Nauru as the 189th member of the IMF and World Bank in the near future.

II.

Over the current year global growth has only slightly picked up and the global growth outlook has weakened somewhat compared to earlier estimates. The economic development is expected, however, to be uneven across countries and regions. While growth is expected to hold up in advanced economies, emerging economies as a group are facing a weaker outlook, with a few countries experiencing a substantial deterioration in their growth perspectives. The increased pressure on some emerging markets in connection with the downward adjustment in commodity prices and increasingly volatile capital flows as well as the appropriate policy responses are expected to be at the center of this year's discussions at the Annual Meetings. Flexible exchange rates are conducive to successfully managing these challenges. Short-term macroeconomic stimulus measures, however, will be of limited use, not least given limited policy space and pre-existing vulnerabilities in a number of countries. Instead, the aim needs to be to promote sustainable growth through confidence building measures, including continued progress toward achieving sound public finances, and structural reforms that help spur investment and productivity. This applies both to advanced countries as well as emerging market and development countries.

III.

The German economy is overall in good shape. The robust upswing continued in the second and presumably the third quarter of 2015, with GDP growth outpacing potential output growth. Conditions are favorable for a continuation of the solid growth momentum in the remainder of the year, fuelled by both external and domestic demand. Consumption will benefit from very favorable consumer sentiment, fuelled by increasing employment, higher wages and low consumer price inflation. Business investment is expected to gain momentum as firms may soon be facing above-average capacity utilization and, thus, need to expand their production capacities. Although external demand currently faces downside risks stemming largely from emerging market economies, it will continue to support economic activity in Germany, as indicated in the recent strong rise in industrial orders from abroad. Buoyed by factors exogenous to the German economy - the decline in oil prices and the depreciation of the euro – the current account surplus widened further in the first half of 2015 to above 8 % of GDP, despite solid import growth on the back of robust domestic demand.

IV.

Highly accommodative monetary policies in advanced economies have supported demand but also risk-taking. This can give rise to an inefficient allocation of capital, pushing capital into illiquid or non-viable assets and investment. The heightened level of financial market risks associated with sudden reversals in capital flows and asset prices has become apparent during the recent episodes of turmoil in some emerging markets and in the context of the prospect of monetary policy normalization in the US. Increasing resilience and building buffers is a key task for policy makers in countries vulnerable to an increase in market volatility and risk aversion. Regardless, heightened market volatility by itself should not be a reason to postpone the normalization process if it is fundamentally warranted. In the Euro area meanwhile, financial stability has been strengthened as new institutions and sizeable backstops have been established. At the same time, however, the low interest rate environment and ample liquidity provision have incentivized banks to increase their sovereign exposures in search for yield. Reassessing the regulatory treatment of sovereign exposures is an urgent task in order to disentangle the sovereign-bank nexus.

V.

The IMF plays an important role in maintaining the stability of the international monetary system through its surveillance function by providing sound policy advice geared toward pursuing sustainable policies and strengthening resilience against shocks. It is our view that surveillance is the Fund's primary tool for crisis prevention. Against this backdrop, we welcome the continued implementation of the recommendations of the 2014 Triennial Surveillance Review, with a particular focus on integrating financial and real sector analyses and enhancing the analysis of risks and the transmission of shocks across sectors and borders. To be sure, the Fund's ability to act as a trusted advisor to its member countries hinges crucially on the perceived quality and relevance of its advice. In this context, we also welcome the Fund's ongoing work to draw lessons from recent sovereign debt restructuring cases and its advisory function in encouraging the use of the new bond clauses.

VI.

Discussions on the setup of the international financial architecture are again moving to the forefront of the policy agenda. We look forward to the upcoming assessment by the IMF of the global financial safety net architecture, but caution that many of the ideas that are being voiced yet in this context have been considered before and – following a thorough discussion – have been dismissed in the past, given the difficult trade-offs, legal and governance obstacles, potentially adverse incentives, and unforeseeable financial commitments they involve. We do consider the Fund's lending toolkit as sufficiently broad and flexible and have doubts regarding a redefinition of the role and purpose of the SDR and the establishment of a global stabilization mechanism. With regard to the Fund's lending framework, we look forward to future work by the IMF on the rules governing exceptional access, and its policies with respect to lending into arrears and official sector involvement. Any modifications of the Fund's lending framework should be fully in accordance with the Fund's mandate and the provision of the Articles of Agreement to make "the general resources of the Fund temporarily available to [members] under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity" (Article I(v)). In this context, ensuring the catalytic role of the Fund and its financial integrity is of the essence.

VII.

To be effective in fulfilling its mandate the Fund also needs to have a governance structure that adequately captures changes in its members' relative position in the global economy. In this context, it is deeply regrettable that the Fourteenth General Review of Quotas and the 2010 Governance Reform have not been implemented to date, given their pivotal importance for the Fund's credibility, legitimacy, and its character as quota-based institution. We strongly encourage all members that have not yet accepted the 2010 reforms to make every effort to complete their ratification as soon as possible. While the ratification of the 2010 reforms remains our highest priority, we are open to consider possible interim steps towards the numerical outcome of the Fourteenth Review. We also stand ready for discussions towards an integrated package solution for the Fifteenth General Review of Quotas.

VIII.

With respect to the resources available to the Fund, the New Arrangements to Borrow (NAB) have recently been activated for another six months' period and the bilateral credit arrangements have been extended for their fourth and final year. With the level of committed resources as well as IMF credit outstanding far below their historic peak, the Fund's Forward Commitment Capacity based on quota and NAB resources has risen substantially to around SDR 300 billion. In light of this development, we consider the Fund comfortably equipped to deal with actual and potential financing needs of its membership. Looking ahead, we consider that only a partial activation of the NAB might be appropriate next time, as needed. Given the establishment of new and the expansion of existing regional financing arrangements since 2012, the need for additional bilateral borrowing arrangements as a "second line of defense" for the Fund has lost its evidence. However, if in the future the Fund demonstrates a clear need for additional resources, a new financing round would be required. A key consideration in this regard for us is a globally broad and fair participation by member countries, also to ensure, for reasons of the Fund's legitimacy, that members' individual financing shares closely correspond to their voting shares in the Fund. At the same time, we consider that substantial Fund resources could be freed up by addressing the prolonged use and exit problem under the Fund's precautionary facilities.

These resources would boost the Fund's ability to support its members in case of need even further.

IX.

Finally, the upcoming review of the SDR basket is an important item on the Fund's policy agenda. We are open to consider an inclusion of the Renminbi in the basket, provided that the existing criteria and operational requirements for the Fund are met. We look forward to the analysis of the Fund, on the basis of which the Executive Board will take its decision.