International Monetary and Financial Committee

Twenty-Fifth Meeting
April 21, 2012

Statement by Wolfgang Schäuble
Federal Minister of Finance, Bundesministerium der Finanzen, Germany

On behalf of Germany

Statement by Mr. Wolfgang Schäuble

Minister of Finance of the Federal Republic of Germany

to the International Monetary and Financial Committee

Washington, April 21st, 2012

I. Global Economy and Financial Markets

Global Economy

Global GDP and world trade growth are set to recover at a moderate pace. Fiscal consolidation and the deleveraging process of banks, firms, and private households are dampening growth. But they are essential to restore lost confidence, and delaying these necessary adjustments would pose serious risks for recovery. As growth expectations in particular in advanced economies are subdued, considerable fiscal and financial sector adjustments are crucial to regain lost credibility and strengthen confidence. By underpinning a path of growth-oriented fiscal consolidation with ambitious structural reforms, market confidence can be restored and the conditions for growth improved. Competitiveness will be strengthened and longer-term growth potential enhanced.

The prospects for the Euro Area have improved relative to the situation at the end of last year. Recent data point to a further brightening of the outlook from the second quarter. There is no reason for excessive pessimism; the euro area is delivering on its internal and international commitments. Exaggerating downside risks from the euro area ignores upside risks at the current juncture. Despite considerable challenges in peripheral Europe, fundamentals have improved further in the Euro Area overall. As the crisis has also affected potential output, I believe it would be unwise to continue to orient policy at large output gaps based on past pre-crisis parameters.

Challenges for fiscal policy continue to be huge in the light of weak output growth and high unemployment in many advanced economies. Fiscal arrangements and frameworks in Europe have been strengthened and adjustment is on its way. Our strategy in Germany with sound public finances, targeted incentives for growth and timely structural reforms is a firm contribution to stronger domestic demand, balanced growth and low unemployment. In addition, it protects our credibility on financial markets which is indispensible for our ability to serve as an anchor for the monetary union. This is the best contribution for European and global growth and stability.

Germany

In 2011, the German economy expanded strongly for the second consecutive year. Growth was mainly driven by domestic demand, with investment in equipment and machinery and in construction expanding considerably. Private consumption further intensified its positive trend since 2010 supported by a buoyant labor market and substantial wage increases. As expected, economic activity cooled off towards the end of the last year, reflecting global developments. However, confidence indicators and robust employment growth suggest that the loss of momentum will only be temporary. As the global economy is about to pick up again, this should also raise the tempo of macroeconomic expansion in Germany.

The labour market benefited from the increase in economic activity in 2011. Unemployment fell below the three-million mark on average, while employment reached the highest level since 1991. The downward trend in unemployment and upward trend in employment will continue in 2012, albeit at a more moderate pace.

The risk profile is largely balanced. On the one hand the increase of commodity prices (especially for energy) is a burden on purchasing power. On the other hand the labour market situation in Germany – and thus disposable income of private households – is improving stronger than expected. On balance, the perspectives for domestic demand are still favourable. Investment and consumption are expected to be the main drivers of growth in 2012 and also in 2013. Accordingly, the ongoing decline in the current account balance will continue, slashing the surplus from 5.8% in 2010 to slightly above 4% in 2013.

Germany is committed to consolidate public finances. In 2011, Germany's budget deficit was reduced to 1.0 % of GDP. Accordingly, the deficit receded below the ceiling stipulated by the European Stability and Growth Pact two years earlier than required. In 2012 Germany will reach its medium term objective of a structural deficit of a maximum of 0.5 % of GDP. Germany will comply with this objective on a lasting basis; the debt ratio will decrease to 73 % of GDP in 2016.

The strengthening of bank's capital in Europe is progressing. The European Banking Authority expects that banks will reach the target capital ratio set for end-June 2012 with only limited recourse to deleveraging. Measures submitted so far address the shortfall in full and create an additional buffer of approximately 26% of the initial shortfall. So far, there is no evidence of an excessive deleveraging. We expect the German banks participating to reduce credit supply by about 2%. It is important to acknowledge that some degree of deleveraging in the financial sector is healthy. The repair of bank's balance sheets has not yet been completed. Deleveraging will go hand in hand with a deleveraging in non-financial corporates and a decrease in credit demand and ultimately contribute to stability in financial markets.

Financial Sector

Global financial stability has appreciably improved in recent months due to the stabilization of the Eurozone financial markets. European policymakers have taken important steps towards necessary reforms. However, the improved market conditions should not lead to complacency, rather the current calm is a window of opportunity to carry on with necessary reforms and balance sheet adjustments. Germany welcomes the IMF’s and FSB’s recent biannual Early Warning Exercise.

The continuing financial crisis underscores the necessity to further strengthen regulatory and supervisory policies in order to make financial systems more resilient and prevent future crises. All countries should support this process by bringing in the necessary legislation to ensure that the new global standards and policies are implemented, in particular with regard to strengthening the capital and liquidity regime. These new standards and policies will strengthen the resilience of banks, contribute to the stability of the entire financial system by submitting all financial products, institutions and markets to effective oversight and regulation, and improve incentives for better risk management. It will also be important to strengthen the framework and the data base for macro-prudential supervision.

Germany fully supports the FSB´s approach to and priorities for enhanced monitoring and detailed reporting on the implementation of financial regulatory reforms and, additionally to the Fund’s important role in financial sector surveillance, welcomes the Fund’s input and cooperation with other international fora on these issues.

The development and implementation of an effective monitoring framework as well as balanced and targeted regulatory measures with regard to the shadow banking system are of great importance. To effectively detect and reduce systemic risks stemming from the shadow banking system and address the problem of regulatory arbitrage, it is necessary to comprehensively cover all entities and activities directly or indirectly involved in credit intermediation outside the regular banking system, including hedge funds.

One of the most pressing challenges ahead is the finalization and implementation of an appropriate framework to deal with systemically important financial institutions to both bolster their resilience and reduce the moral hazard. Therefore, Germany continues to support the work on extending the agreed framework for global systemically important firms, especially banks, to all SIFIs, both bank and non-bank.

The experience of the crisis has also demonstrated the importance of a well-designed legal framework for effective bank resolution, and in this respect Germany welcomes efforts to implement the new international standard for resolution of financial institutions, the FSB’s

Key Attributes of Effective Resolution Regimes for Financial Institutions, in a full and consistent manner.

II. International Financial Architecture and IMF Policies

IMF Resources

It is generally agreed that the IMF should have the necessary resources to fulfill its systemic role. In this context, Germany is committed to contribute to a new round of bilateral credit lines to increase resources in the IMF's General Resources Account as part of a broad international effort. We regard any bilateral borrowing as a temporary supplement and a second line of defense after quota and NAB resources. The resources should be available to all members, subject to the traditional IMF lending policy and liability framework. It is our understanding that it is the joint responsibility of all financially strong IMF members to ensure that the Fund continues to have sufficient resources to play its catalytic role and meet an adequate share of global financing needs to the benefit of the whole membership.

With historically high volumes of outstanding credit and commitments as well as highly concentrated exposures, we emphasize the need for appropriate risk mitigation measures to safeguard the Fund's resources. We therefore stress the importance of the IMF's traditional risk mitigation measures, in particular conditionality, program design and access limits. Furthermore, as part of that strategy, the strengthening of the precautionary balances must be given high priority so as to increase the Fund's risk buffers and safeguard against rising credit risks.

IMF surveillance

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 ongoing effort to develop a comprehensive framework to analyze real and financial sector issues. We find the intention to pursue a more holistic approach to surveillance commendable. Better integrating macroeconomic and financial sector surveillance, fully taking into account the interconnections among countries, and enhanced risk assessments seem to us as particularly important. While we are of the view that the implementation of the recent IEO recommendations is a priority, Germany welcomes the discussion on the building blocks for a proposed integrated surveillance decision. Possible adaptations to Fund surveillance should include a better integration of bilateral, regional and multilateral surveillance, recognizing the need for robust assessments of spillovers. In this context it is also important that the IMF swiftly implements regular monitoring and assessment of cross-border capital flows and their transmission channels as well as capital flow management measures. The Fund, in its multilateral surveillance, should encourage members to take into account international spillovers by its power of persuasion and analytical skills. It may not legally require members to change their policies. Surveillance should also appropriately involve monetary unions, taking proper account of the policy-making framework, and internal and external interconnectedness.

Notwithstanding the welcome efforts to strengthen the multilateral dimension of surveillance, bilateral surveillance is and should remain the key pillar of the Fund's surveillance framework as preserving domestic stability is the indispensable precondition for and essential contribution to safeguarding global stability.

IMF Governance

The current governance structure and division of labor between the Executive Board, the IMF management, and the IMFC has proven to be conducive to timely and effective decision-making in the Fund and has enabled the IMF to react adequately to economic and financial crises. While Germany is open to discuss ways to further improve the Fund's governance structure, including strengthened ministerial involvement, we deem it indispensable that the roles, competences, and responsibilities of the Board of Governors and the Executive Board be preserved.

It is important to respect the agreed timetable for the implementation of the 2010 quota and governance reform, which is closely linked to the envisaged changes in Board representation. In Germany, the parliamentary process for the acceptance of the governance reform is well underway and is expected to be completed in time by summer 2012.

With regard to the forthcoming review of the quota formula we believe that the basic structure of the formula should be maintained and that the four principles that underpinned the 2008 reform – a simple, transparent, and mutually acceptable formula that is consistent with the multiple role of the quotas and feasible to implement statistically – continue to provide a good guideline. The formula should be based on verifiable and clear economic criteria and the variables used should have a close link to the Fund's mandate and its character as a monetary institution.