

Economic conditions in Germany

Basic trends

So far, during the first few months of this year, the German economy has not emerged from the slowdown which set in during the autumn of 1998. Although there was no further reduction in output following the marked slackening of growth during the latter part of 1998, the information available at present (which is still far from complete) indicates that the overall production of goods and services, according to the new ESA concept, was scarcely higher at the start of 1999 – in seasonally adjusted terms – than it had been in the final quarter of 1998. Admittedly, the impact of the unusual weather conditions has to be taken into account: the cold weather in the autumn of last year had led to hold-ups in production in the case of outdoor occupations – a situation which was alleviated by the sudden change to comparatively mild temperatures. This special factor is likely to have played a considerable part in the development in output at the beginning of the year. After adjustment for working-day variations and on the basis of 1995 ESA (see the next page for explanatory notes on the revised ESA figures), the year-on-year increase in gross domestic product (GDP) had amounted to around 1¼% in the fourth quarter of 1998. Much of that increase has probably faded, although this is also due to the fact that output went up very sharply at the start of 1998.

*Developments
in the economy
as a whole*

The underlying momentum in the German economy thus remained very subdued, mainly on account of the difficult international conditions. It is true that, as outlined above, a

*External and
domestic
factors*

Initial results of the introduction of the new European System of National and Regional Accounts 1995 (1995 ESA)

At the end of April 1999, the Federal Statistical Office presented quarterly national and regional accounts for the period from 1991 to 1998 in accordance with the rules of 1995 ESA for the first time. Simultaneously, supplementing this, the Bundesbank made available corresponding figures adjusted for seasonal and working-day variations. The revised figures, which do not yet include the sectoral distribution account and relate to Germany as a whole, reflect not only changes due to the new concept but also the incorporation of new, previously unavailable bases on which calculations are made, an updating of the price basis from 1991 to 1995 and, not least, a new method of calculating the number of employed.¹ The following changes are significant in analytical terms:

- As expected, the recorded level of the German gross domestic product (GDP) is consistently higher than before in both nominal and real terms.² At current prices, the adjustments range between 3.0% in 1991 and 1.1% in 1998. According to information supplied by the Federal Statistical Office, the changes due to the methodology used are on roughly the same scale in all the years.
- The main reason for the higher level of GDP is the extended definition of investment. Unlike before, this includes intangible assets such as computer software that has either been acquired, or produced in-house as well as copyright. Furthermore, fixed capital formation now includes military installations, such as buildings, which can be used for civilian purposes.
- The trend growth of the German economy is much flatter than previously recorded. According to the revised data, real gross value added increased by an annual average of 1.4% between

1991 and 1998, compared with 1.6% per year according to the old method of calculation. According to the revised figures, the underlying momentum of the economy for the last three years, in particular, was in each case ½ percentage point weaker than shown in the previously published data.

- Several factors have contributed to the slacker economic growth since 1995. Firstly, the results of the 1993 housing sample survey show that the previous method of extrapolation led to overstated estimates. Secondly, according to the last cost structure survey, there were higher intermediate goods ratios for the transport sector. Finally, the fact that the services sectors (which tend to have lower productivity) now have a higher weighting has slowed down the expansion of the economy as a whole.
- By contrast, the number of employed has been sharply revised upwards as a result of the (in any case impending) new calculation of part-time workers below a certain earnings level. This meant an increase of 1.25 million persons for 1991 and of 2.03 million persons for 1998. Hence, a total of 2.6 million persons in part-time work below a certain earnings level were recorded in the statistics for 1998. The original decline of 7% in the number of employed between 1991 and 1998 has been revised to a figure of –4.7% as a result of the new calculation.
- In mathematical terms, the contrary adjustment of growth and employment implies a weaker increase in statistically recorded labour productivity. Measured by real GDP per employed person, over the entire revision period it went up by 4.2 percentage points, or an annual 0.6 percentage point, less than shown previously.

Gross domestic product at constant prices

Change from previous year in %

Item	1992	1993	1994	1995	1996	1997	1998
1995 ESA							
Price basis 1995 (=100)	+ 2.2	– 1.1	+ 2.3	+ 1.7	+ 0.8	+ 1.8	+ 2.3
1979 ESA							
Price basis 1991 (=100)	+ 2.2	– 1.2	+ 2.7	+ 1.2	+ 1.3	+ 2.2	+ 2.8
Difference revised less previous figure in percentage points	0	+ 0.1	– 0.4	+ 0.5	– 0.5	– 0.4	– 0.5

¹ See also the explanatory notes on the methodology in Deutsche Bundesbank, Monthly Report, February 1999, page 57. — ² According to Article 8 of the ESA Regulation, however, the own resources of the EU will continue to be calculated using the national accounts data according to

the old 1979 ESA, which may be derived from the revised figures by allowing for the methodological changes. Up to September 1, 1999, this also applies to the calculation of the fiscal convergence criteria.

certain amount of progress in adjustment and encouraging signs of an improvement can be identified more clearly than before. Nevertheless, despite relief in terms of the exchange rate, the "second-round" and third-market effects of the negative demand shock have had a severely adverse impact on German exports and have depressed the propensity to invest within Germany. What is also significant, however, is the fact that the domestic stimuli to economic activity, which had become stronger last year, have so far failed to develop adequate momentum.

Still-unsettled issues in the areas of taxation and social policies, as well as in connection with the labour market, may have been among the factors which have had a retarding impact. These and uncertainties about how individual market positions will be affected by increasing competition in the euro area are probably exerting a restraining influence at present. The tax relief measures which came into force at the start of the year and the raising of child benefit have boosted private consumption somewhat. Besides higher energy taxes, there has recently also been a price reversal in the international energy markets which, viewed in isolation, and in contrast to the effects of falling import prices during the past eighteen months, now reduces incomes' purchasing power. Moreover, enterprises are likely to have been afforded less relief than before with regard to imported intermediate goods. Also, there are likely to be significant burdens in terms of wage costs following this year's pay round.

Against that background, the enterprises were rating their situation and prospects for the immediate future either cautiously and/or predominantly pessimistically up to the end of the period under review. In terms of the business climate as surveyed by the ifo Institute, a persistently large number of manufacturing firms gave a negative assessment. The fact that expectations have become somewhat more optimistic recently is probably due mainly to the improved opportunities for exporting, which derive to some extent from the depreciation of the euro against the US dollar. Even so, the balance of positive and negative assessments was recently more unfavourable than at any time since spring 1996.

According to the surveys conducted on behalf of the European Commission by the Nuremberg-based consumer research institution, *Gesellschaft für Konsumforschung*, the majority of households were, until a short while ago, quite optimistic about the outlook for the future. Recently, however, there has been a downturn here, too. Whereas the regularly surveyed propensity to make major acquisitions continued to indicate a basic optimism, households' assessments of their own income trend and, quite especially, consumers' general expectations regarding economic growth have become gloomier. Consumer sentiment, which reflects the responses to the individual questions, was thus characterised by less optimism than at any time in about 2 ½ years.

Sentiment in industry...

... and in the case of households

Output and labour market

Manufacturing output

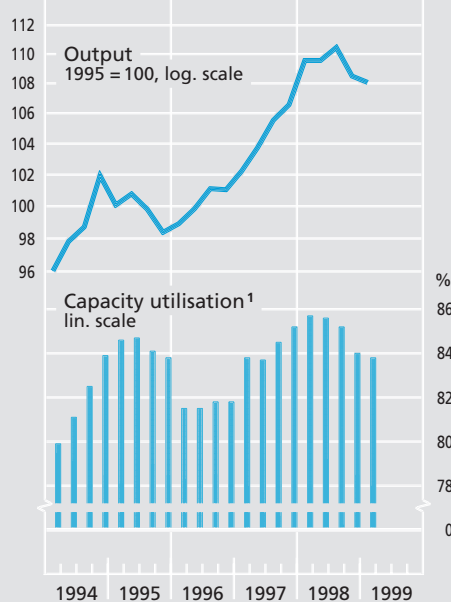
Seasonally adjusted manufacturing output in the first quarter of 1999 was somewhat lower than in the autumn of last year. Although there was a buoyant start to the year, this was due to a large extent to the favourable weather conditions and the backlog effect of the subdued ending to 1998. Subsequently, there was a noticeable slackening of momentum. This resulted in output being 1¼% down on the year before, following a year-on-year rise of nearly 2% in the final quarter of 1998.

Individual sectors

Output in the capital goods sector was perceptibly lower than in autumn last year. In particular, motor vehicle manufactures (who had achieved a sharp expansion in 1998) cut back their production. Additionally, there was a further reduction in the production of machinery and equipment, which had already undergone a downturn towards the end of last year. Year-on-year, there was a fall in this area of around 4½% on an average of the first three months of 1999. In terms of sales, domestic business in the capital goods sector as a whole has done less well than exports. That suggests that the propensity to install new machinery and equipment is quite subdued in Germany. In the case of manufacturers of intermediate goods, production was higher in the first few months of this year than it had been at the end of 1998, but it was still a long way from matching its level of twelve months previously. By contrast, the trend in durable and non-durable consumer goods was much more favourable, with a

Output and utilisation in the manufacturing sector

Seasonally adjusted, quarterly



1 Results of the ifo business survey.

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sharp increase both in comparison with autumn 1998 and with the previous year.

Given the fact that output was slack overall in the winter months, there was a further slight reduction in the utilisation of tangible fixed assets in industry in seasonally adjusted terms. According to the surveys of the ifo Institute, output in the manufacturing sector as a whole in March 1999 was also around 2 percentage points lower than a year before, when it had attained its last peak. At the same time, an increasingly large number of firms described their reserves of orders as too small and their stocks of finished products as too large.

Capacity utilisation

In the construction industry (the second major sector of the economy for which the official

Construction output

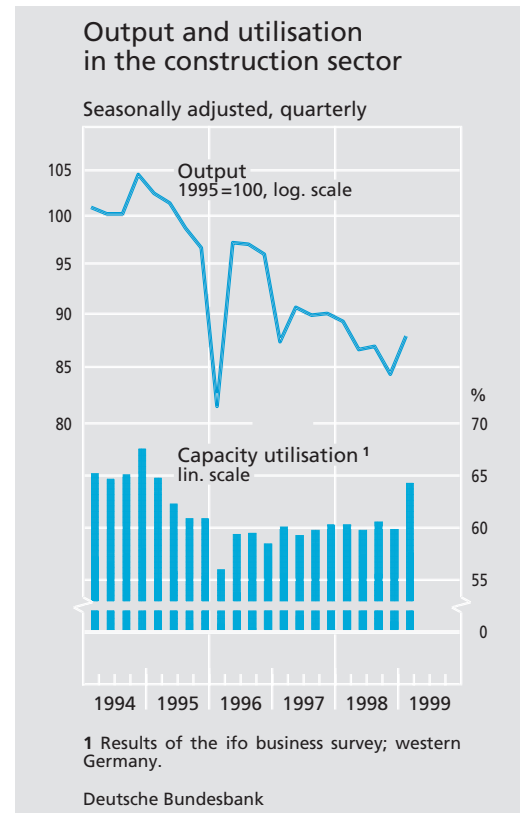
statistics supply figures in the short-term), the weather conditions had a positive impact on output in the first few months of the current year. Especially in January, the comparatively mild temperatures meant that construction work was held up far less than usual. After eliminating seasonal fluctuations, there was therefore a sharp rise compared with the fourth quarter of 1998, which had been quite cold. Subsequently, production returned to normal. During the whole period from January to March, seasonally adjusted output increased by 4½% compared with the final quarter of 1998. Although this figure was still 1¼% down on the year, the year-on-year decline in autumn of last year, at 6½%, had been much larger.

*Building
construction
and civil
engineering*

In particular, production in civil engineering (which is directly affected by weather conditions) showed a sharp seasonally adjusted expansion in the first few months of the year. In eastern Germany, this mainly benefited road construction, whereas a greater number of projects for the railways were being tackled in western Germany. By contrast, building construction activity was no higher than its depressed level at the end of 1998.

*Other sectors of
the economy*

Scarcely any up-to-date figures on developments in other areas are available at present. There are some indications that the providers of services to enterprises are finding it increasingly difficult to escape from the subdued development in industry. Experience has shown that the transportation sector, too, does not remain unaffected for long by a trend of this kind. By contrast, providers of financial services and services to households



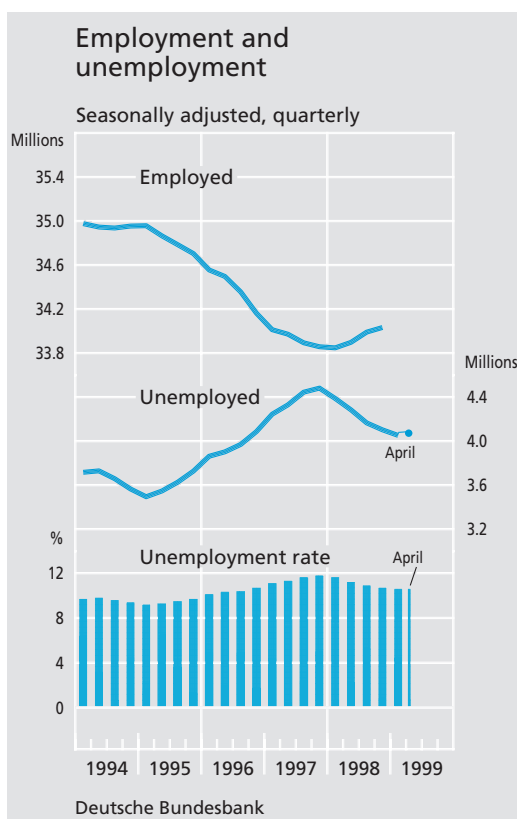
have continued to perform comparatively well.

The situation on the labour market showed scarcely any further improvement during the first few months of 1999. Although there was a positive reaction at the start of the year due to the relatively mild weather, the decline in unemployment since then – excluding seasonal fluctuations – has largely come to a standstill. The cyclical slowdown in manufacturing has undoubtedly played a major role in this.

Labour market

At the end of April, the seasonally adjusted number of unemployed was 4.09 million. Two-thirds of this figure were accounted for by the old Länder, i.e. one in three unemployed persons lived in eastern Germany.

Unemployment



It is there, in particular, that unemployment has been persisting at an almost unchanged high level for some time. Nevertheless, this stock variable conceals significant movements on the east German labour market, which may be taken as an indication of the continuing process of structural adjustment in the east German economy. Firstly, for example, in a year-on-year comparison, many persons who were not working previously have continued to register as unemployed. Secondly, however, there were also frequently lay-offs from a prior employment. At the same time, in addition to instances of newly engaged employees (not least in connection with active labour market policy measures), there were also departures from the labour market as a result of persons taking an early pension. In western Germany, by contrast, the im-

provement in weather conditions has resulted in a further drop in the number of persons previously in work who have become unemployed.

In April, the seasonally adjusted unemployment rate in Germany as a whole amounted to 10.6%. This meant that it was just as high as on an average of the first quarter, but $\frac{3}{4}$ percentage point lower than the previous year's level. Although there was a disproportionately sharp year-on-year fall in eastern Germany, the east German rate of 17.2% was latterly almost twice as high as in western Germany, which showed a seasonally adjusted figure of 9.0% in April.

Unemployment rate

In April, around 465,000 persons were taking part in job-creation schemes and 375,000 persons were attending vocational training courses. There has been scarcely any change from the preceding months in the number of participants; taken together, the comparable level last year was exceeded by almost 215,000. Whereas the emphasis in eastern Germany was on employment measures, further training was more to the fore in western Germany.

Labour market policy measures

The employment figures for the period 1991 to 1998 were revised appreciably by the Federal Statistical Office in April. To a far greater extent than hitherto, persons employed in a job with a monthly remuneration of up to DM 630 are now included in the calculation. According to the latest figures, the number of persons in work on an annual average in 1998 was put at around two million higher than before and, in seasonally adjusted

Employment

terms, was around 36 million at the end of 1998. This was 0.8 % more than a year previously. No information is available at present on the trend in employment during the first few months of the current year as the statistics of the wage and salary earners who are liable to social security contributions (which are prepared under the direction of the Federal Labour Office) have so far not supplied any more recent data owing to a reorganisation of the statistics.

Orders

Manufacturing orders received

In the first few months of this year, the demand for German industrial products had not yet recovered from the slump at the end of 1998. On an average of the first quarter, manufacturing orders received persisted, in seasonally adjusted terms and at constant prices, at the same level as in the final quarter of 1998. Since they had increased sharply twelve months previously, however, the year-on-year decline grew to 4¼%, compared with 2¼% in the period from October to December.

Domestic demand

The slackening in domestic demand against the comparable period last year (in which major contracts had been a factor) was, in fact, even somewhat more marked. There was a decline of 5% on an average of the first three months. Seasonally adjusted orders during the same period were likewise largely at the same level as at the end of 1998. Ordering had been buoyant at the start of the year, benefiting not only the producers of intermediate and capital goods but also the

Demand in the manufacturing sector

Seasonally adjusted, quarterly, log. scale



1 Not fully comparable owing to the reorganisation of the statistics.

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manufacturers of durable and non-durable consumer goods. However, there were no similarly favourable follow-up contracts. At the end of the first quarter, the flow of orders was, in fact, lower than in autumn 1998.

Foreign demand

The development of orders from abroad was somewhat more favourable. In the first quarter as a whole, these orders were, in fact, just over ¼ % higher in seasonally adjusted terms than they had been in the previous three-month period. The year-on-year decline (– 3 ½ %) was only slightly larger than in the fourth quarter of 1998 (– 3 ¼ %). The suppliers of intermediate goods and of durable and non-durable consumer goods performed comparatively well with growth rates of 1½ % and 1¼ %, respectively, in a seasonally adjusted quarterly comparison. By contrast, capital goods producers again suffered major losses, even though the lower valuation of the euro against the US dollar has improved price competitiveness during the past few months. In real terms, orders for capital goods are now around 6½ % down on their level in the comparable period last year. In addition to orders for machinery and equipment, it is mainly orders for the manufacture of road vehicles which have fallen following last year's favourable figure.

Construction orders received

By contrast, a sizeable volume of orders has been reported by the construction industry since the start of 1999. Taking January and February together and after eliminating seasonal fluctuations, the construction sector received 5 % higher orders than in the preceding three-month period. This was around 5½ % higher than the comparable figure for

early 1998, compared with an increase of no more than 1¼ % in the fourth quarter.

Housing had a major share in this development. On an average of January and February, orders for residential construction increased by a seasonally adjusted 8½ % compared with the preceding three-month period. This sharp rise should not obscure the fact that, despite continued low interest rates and stable construction prices, the basic trend in demand for housing is moderate and ultimately benefited mainly from the catching-up effects of the particular situation in winter. This becomes clear in a year-on-year comparison, for example. At around ½ %, the level of orders in January and February was further undershot. Orders have clearly fallen compared with the increased level in summer 1998, too. It may be assumed that – as has been the case for some time – apartment house construction, in particular, has been affected by cut-backs in demand. In many cases, investment appears unprofitable in the light of the fact that the high level of supply has been taken up only gradually by the market and that there are only limited prospects of rent increases.

Housing

Following perceptible restraint towards the end of 1998, an increased number of public sector construction projects were started in the first two months of the year. The year-on-year fall was thus reduced from 1½ % in the final quarter of 1998 to ½ % at the beginning of the current year. It was for road construction, in particular, that major orders were placed at the start of 1999.

Public sector construction

*Industrial
construction*

Industrial construction orders received in the two-month period of January and February were likewise higher, seasonally adjusted, than in the fourth quarter of 1998, although the increase was much less than in the other construction subsectors. In seasonally adjusted terms, the growth was no more than around 1¾%. However, the year-on-year rise of over one-tenth clearly shows that there had been a steady increase in construction sector activity for some time. Large-scale orders awarded by the German railways for the expansion of the rail network also contributed to the sharp rise.

*Private
consumption*

Judging by the few indicators that are available so far, there was evidently a marked rise in private consumer demand in the first quarter of this year. At all events, in the first three months of 1999 households' purchases from specialised retailers were just over 1½% up on the quite high level of the preceding quarter in seasonally adjusted terms. Admittedly, it should be borne in mind that special factors and the fact that Easter fell early this year contributed to that positive result. Durable consumer goods, such as motor vehicles, were less in demand, however. Taking the months of January to March together, new registrations of private vehicles were a seasonally adjusted 1½% down on their level in autumn last year. By contrast, holiday travel abroad was favoured highly by consumers, with significantly more being spent for that purpose. Additionally, stocks of heating oil were increased sharply, obviously in anticipation of the raising of energy taxes. The tax relief measures which came into force at the beginning of the year and the increase



in child benefit may have been used for increased expenditure in some cases. By contrast, the higher pay settlements this year and the lowering of the contribution rate to the statutory pension insurance scheme will not have an impact on income until later on in the year.

Prices and wages

Consumer prices

Price movements, which – not least owing to a large measure of imported price stability – had remained very subdued in the first two months of the year, have been showing a certain upward trend since March. This implies that the trend has now turned after having reached its lowest point; the price climate nevertheless continued to remain favourable. In April 1999, consumer prices overshot the low in February by a seasonally adjusted 0.6%; the year-on-year rate increased to 0.7%, compared with 0.2% in both January and February. The main reason for this was a marked rise in the cost of energy. Firstly, international spot market prices for crude oil and mineral oil products have risen dramatically during the last few weeks. Secondly, this development has been reinforced by tax increases for all energy sources (with the exception of coal) on April 1 as part of the ecological tax reform. In purely mathematical terms, the tax component has the effect of increasing consumer prices by around ½%. In actual fact, energy prices in April were up 6% on the preceding month. It may be inferred from this that both the additional fiscal burden and the increased international costs have in most cases been passed on to consumer prices. Above and beyond that, in the services sector there were price increases in the cases of local public transport, railways and insurance enterprises, whereas there were further reductions in telephone charges.

Industrial goods

By contrast, price movements in the case of industrial goods remained extremely moderate. Even though the depreciation of the euro

Consumer price index

Change from previous year in %

Item	1997	1998	1999	
			1st qtr	April
Manufactured products	0.9	1.0	0.7	0.4
Energy sources	2.8	-3.2	-3.6	3.1
of which Mineral oil products	2.9	-7.1	-5.5	4.8
Services	2.5	1.9	0.4	0.3
Rents	2.8	1.6	1.2	1.1
Food	1.2	0.9	-0.2	-0.2
Total	1.9	1.0	0.3	0.7

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is tending to make third-country imports more expensive and although the pressure of labour costs is rising, persistently intense competition is evidently leaving scarcely any room for further upward price adjustments. The year-on-year fall in April amounted to no more than 0.4%. A baseline effect, too, might have a dampening impact in the ensuing period. This is because the passing-on of the increase in value added tax was not felt so much in April but – with a time lag – more in May, which means that it will take correspondingly longer for it to be excluded from the calculation of the year-on-year rate.

The pace of rises in housing rents was becoming slower up to the end of the period under review. Furthermore, the year-on-year increase of around 1% was due not so much to

Housing rents

the expenditure on rents themselves but to sharper rises in incidental costs including public or semi-public services such as water, sewerage, and refuse disposal.

Harmonised price index

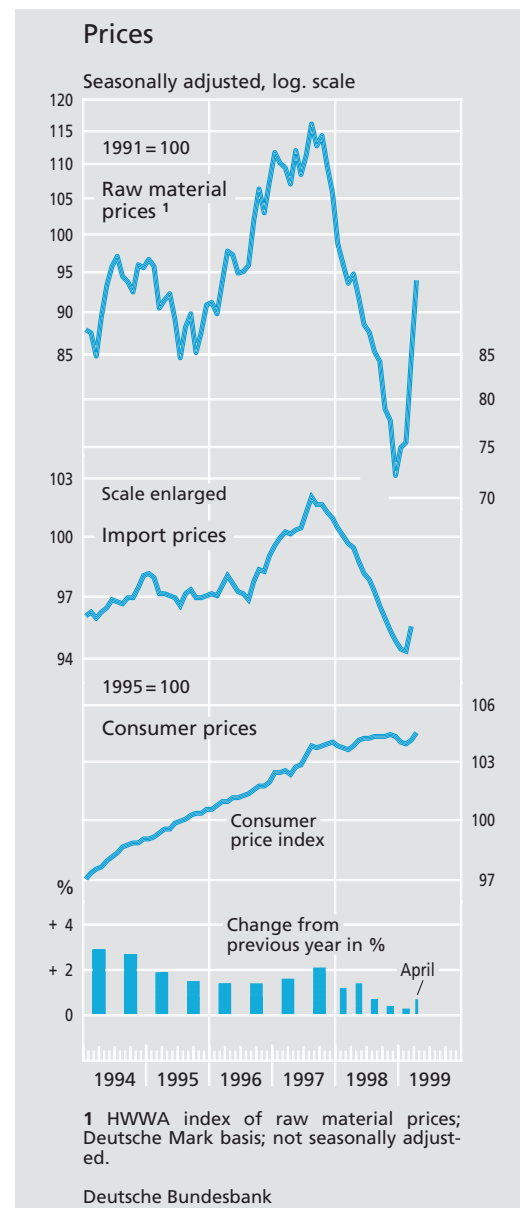
Despite the slight acceleration in price rises at the consumer level, price stability was maintained for the Federal Republic of Germany as part of the European monetary union. Price stability is defined by the European Central Bank as a year-on-year increase of below 2%. For better comparability in the euro area, the reference variable used for this purpose is the Harmonised Index of Consumer Prices (HICP). For Germany, movements in the HICP are largely similar to those of the national consumer price index; in April the HICP was 0.8% above its level in the comparable period last year.

Import prices

The pressure on prices emanating from external trade and payments is reflected most clearly by import prices, which were a seasonally adjusted 1¼% higher in March (more recent data are not available at present) than in the preceding month. This was due predominantly to energy becoming more expensive in the international markets, although the depreciation of the euro also had a significant impact. The 1998 price level continued to be undershot by 4.2%, although the year-on-year decline had still been as much as around 6% at the turn of 1998-9.

Producer prices

The downward trend in industrial selling prices, which was identifiable well into the first two months of the year, was also halted in March. The year-on-year decline did not accelerate further and amounted latterly to



2¼%. At the same time, manufacturing products on their own (which include neither energy sources nor mining and quarrying products) were 1½% cheaper than in the reference period for 1998. Prices for construction work remained largely stable during the past few months. In seasonally adjusted terms, the overall construction price level in February was more or less exactly as high as it

had been in November; there was likewise no change against the previous year.

1999 pay round

The pay agreements in this year's pay round were considerably higher than in years before. They thus departed from the basic strategy of moderate rises in negotiated pay rates that was being pursued in the past three years. Not only had that been an important prerequisite for the favourable price climate, it was also a major factor contributing to employment increasing in 1998 for the first time since German unification. In some cases, the new pay agreements significantly exceed the scope for increasing wages that is neutral in terms of its impact on employment during a phase that is difficult for the German economy. Moreover, the 1999 pay round brought no further progress in terms of structural improvements and greater flexibility. The fact that the majority of pay agreements will run for quite a long period does not make up for that failing.

Agreement in the metal-working and electrical engineering industry

The major factor in the 1999 pay round was the pay settlement in the west German metal-working and electrical engineering industry. Management and labour agreed on a 3.2 % increase in negotiated rates of pay from March 1, 1999. Including the lump-sum payment for the first two months of this year and the one-off payment amounting to 1% of the annual basic negotiated remuneration, the volume of the agreement, with an agreed duration of 14 months, amounts to 4.3 %, and to 3.6 % expressed on a 12-month basis. Compared with 1998, when the previous pay rise came into force in April, negotiated rates of pay will increase by 5 % on an annual aver-

age this year. The agreement was extended to the east German wage-bargaining areas of the metal-working and electrical engineering industry with a time lag of one month.

The rate agreed in the metal-working and electrical engineering industry set an example which was also followed in other negotiations. Following a lump-sum payment of DM 300 and DM 260 in western and eastern Germany, respectively, the negotiated rates of pay for salaried and waged staff in both the west and east German public sector, for example, were increased by 3.1% from April 1, 1999. The level of the Christmas bonus has remained unchanged, however.¹ The pay settlement is to be extended to the remuneration of civil servants with a delay of two months.²

Public sector

Monthly negotiated pay rates in the west German construction industry were increased by 2.9 % from April 1, 1999. Taking into account the lowering of the Christmas bonus by 22 percentage points and the increase in the holiday bonus by 5 percentage points, the volume of the agreement in the construction industry, which is still suffering from a severe crisis of adjustment, amounts to 1.6 %, with a duration of 12 months.³ For the east German construction industry, the pay agree-

Construction industry

¹ At the beginning of the year, however, a share of 1.25% to contributions to the supplementary pension funds for government employees was introduced for waged and salaried staff.

² The improvement in civil servants' remuneration will be 0.2 percentage point lower owing to the formation of a pension reserve.

³ What also has to be taken into consideration is the increase in incidental labour costs due to the reintroduction of full continued payment of wages and salaries during illness.

ments which had been terminated by employers were put back into force on April 1, 1999 for a 12-month period, which is equivalent to a one-year "pay freeze".

Management and labour in the construction sector additionally agreed on a sharp increase in minimum wages in the building trade. These were raised by 15½% to DM 18.50 per hour in western Germany and by 7½%

to DM 16.28 per hour in eastern Germany. If these new minimum hourly rates are declared to be generally binding, all construction firms operating in Germany must pay their employees at these or higher rates. Since this affects domestic construction workers subject to official negotiated rates only to a very slight extent, this measure is primarily designed to discourage "cheap" labour from Europe and/or firms that are not bound by pay agreements.