

## Economic conditions in Germany

### Underlying trends

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In Germany, there have recently been growing signs of a cyclical revival. Positive signals have been generated particularly by industry, which continues to play a key role in developments in the economy as a whole. The flow of industrial orders has become perceptibly broader during the past few months. It was especially from abroad that German enterprises received more orders – including major contracts. According to the surveys of firms conducted by the ifo institute, assessments of future export business (which had become negative in the past year) have now shown a marked improvement. The main factor behind this was undoubtedly the above-mentioned marked brightening of the outlook in an international context. Additionally, the indicator determined by the Bundesbank showed a significant increase in price competitiveness during the first half of 1999 compared with 38 countries which, together, have a share of more than nine-tenths in German foreign trade.

*Signs of a  
cyclical revival*

Nevertheless, foreign markets have not yet recovered their old dynamism. As is also shown by the German Industrial and Trade Association's traditional spring survey of the foreign chambers of commerce, the weakness in exports does appear to have been overcome, although the recovery has so far been quite moderate overall. This, as well as political uncertainties, may have contributed to the business climate in industry being rather subdued of late. In particular, there was no change in the cautious appraisal of the current situation, and negative assessments

continued to have the upper hand. Although there was a recovery in the propensity to invest, by and large it still failed to impart a stimulus. The burgeoning optimism about the economy is scarcely likely to have been dented by the interest-rate rise in the capital market, especially as this is to be regarded largely as return to normal and the expected real rate of interest may still be regarded as low. What will be crucial is the extent to which there will soon also be an improvement in longer-term expectations of sales and earnings, which had been severely dampened in the wake of both the international financial and economic crises and political uncertainties.

*Stabilisation of  
the construc-  
tion sector...*

In terms of the domestic economy, cyclical developments are now also being bolstered by the emerging stabilisation of the construction sector. As in industry, demand in the construction sector has picked up in the past few months. The terms of financing and the stable prices for construction work continued to have a positive impact. By contrast, households' consumer spending was again quite restrained recently, which might also have something to do with the standstill in the labour market. According to the surveys of the consumer research institution, *Gesellschaft für Konsumforschung*, consumer sentiment – which for a long time was on the upside, in contrast to the basic trend in business sentiment – has become noticeably gloomier since spring. Households, according to the information they provided themselves, assessed their income prospects less favourably.

*... but restraint  
on the part of  
consumers*

This was against the background of a sharp rise in negotiated wage rates following the last pay round, a fall in social contributions, and an increase in government transfers to households. This applies not only in nominal terms but also – in the light of the fact that the general price trend remains favourable – with regard to the purchasing power of disposable incomes, which is likely to have risen significantly. On the other hand, further energy tax increases have been announced as part of the ecological tax reform and the debate on the future of the pension system is in full sway. Even though the fiscal and budgetary policy course has now started to take shape, the regulations concerning employees earning DM 630 a month or less and quasi-self-employed persons are still causing considerable uncertainty.

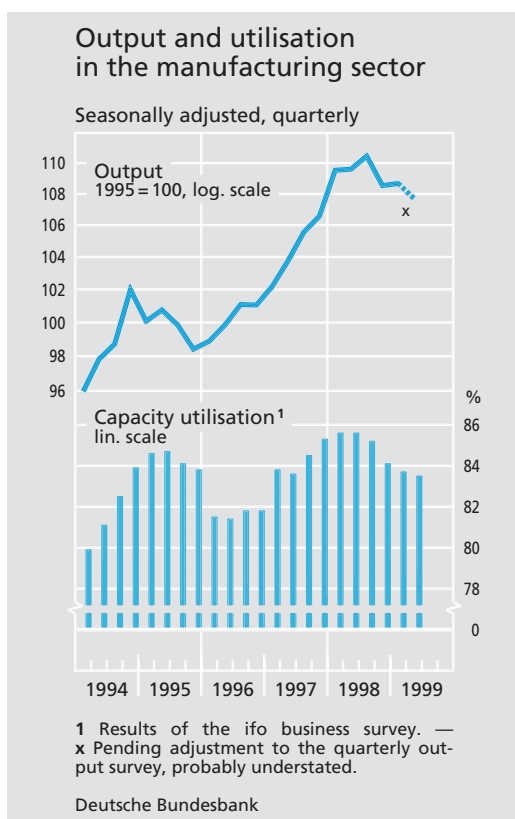
*Differing policy  
signals*

## Output and labour market

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So far, the response of manufacturing output (which includes, in particular, industry and the construction sector) to the improvement in the orders situation has been quite muted. Furthermore, providers of services to enterprises, too, are anticipating no more than a subdued development in sales; much the same applies to service-oriented craft firms. There is therefore much to suggest that there was still no rise in overall output in the spring months. Instead, real GDP in the second quarter may have been roughly just as high, after adjustment for seasonal and working-day variations, as it had been in the preceding three-month period. This would mean that

*Subdued  
underlying  
momentum of  
the economy as  
a whole*



the comparable figure for 1998 was exceeded, as before, by slightly more than ½ %.

In assessing the second quarter, however, the special factors in the first three months of the year also have to be taken into account. Thus, taking the first and second quarters of 1999 together to smooth out special factors – such as Easter falling early this year – overall output grew at a seasonally and working-day adjusted annual rate of approximately ½ % compared with the second half of 1998. This was somewhat less than in the second half of last year, when there had been a perceptible slowdown in growth in comparison with the first six months of 1998. Although activity in the economy as a whole has now become recognisably more stable, the basic cyclical

momentum is likely to become stronger only later on in the year.

One of the reasons why manufacturing output<sup>1</sup> was probably no higher than in the first three months of this year (despite the favourable development in orders in the second quarter) was undoubtedly the fact that, in some cases, major contracts have been awarded which are only gradually being reflected in output. Another factor was the early start to the summer holidays in some of the larger Länder. Overall, the volume of industrial production was no higher than in the corresponding period of 1998, which also applies to the first half of 1999 as a whole. According to the surveys of the ifo institute, there was a further slight decline in capacity utilisation during the past few months. In June, the preceding peak, which had been reached in spring 1998, was undershot by just over 2 percentage points. At the same time, however, the lead over the last low in 1996 was also 2 percentage points. The level of current utilisation may therefore probably be described as average. According to the enterprises' assessment, there has not been any further decrease in orders on hand latterly, and the stocks of finished products are not rated as any worse than before.

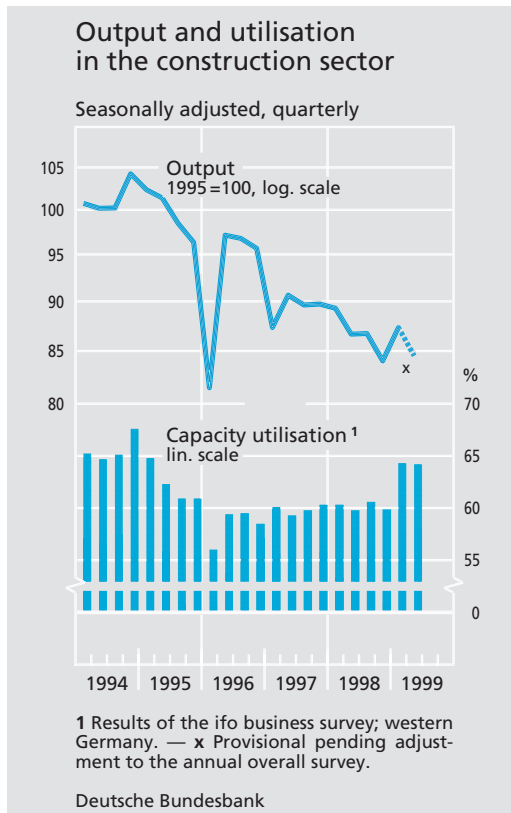
According to the available information in the official statistics, seasonally adjusted construction output in the second quarter, at

<sup>1</sup> An assessment of developments in manufacturing output is currently being made more difficult by the fact that, although the data for the first three months have been adjusted to the figures of the quarterly survey of output (resulting in a correction upwards by ¾ index points), the figures for April to June have not yet been revised.

*Manufacturing output ...*

*... and capacity utilisation*

*Construction output*



– 3 %, was significantly down on the figure for the winter months. However, it has to be borne in mind that the comparatively mild winter held up construction work less than is usual in that quarter. Secondly, it is very probable that these figures will be revised upward in line with the overall survey. In fact, the seasonally adjusted decline in output still shown in the statistics at present might be revised to such an extent that there is no longer a year-on-year fall. Even then, however, there is scarcely any prospect of a significant positive contribution to overall economic growth.

*No stimuli on the labour market*

There is unlikely to have been much change in the situation on the labour market over the past few months. There has been a slight rise in the number of unemployed persons during the year so far. According to the data of the

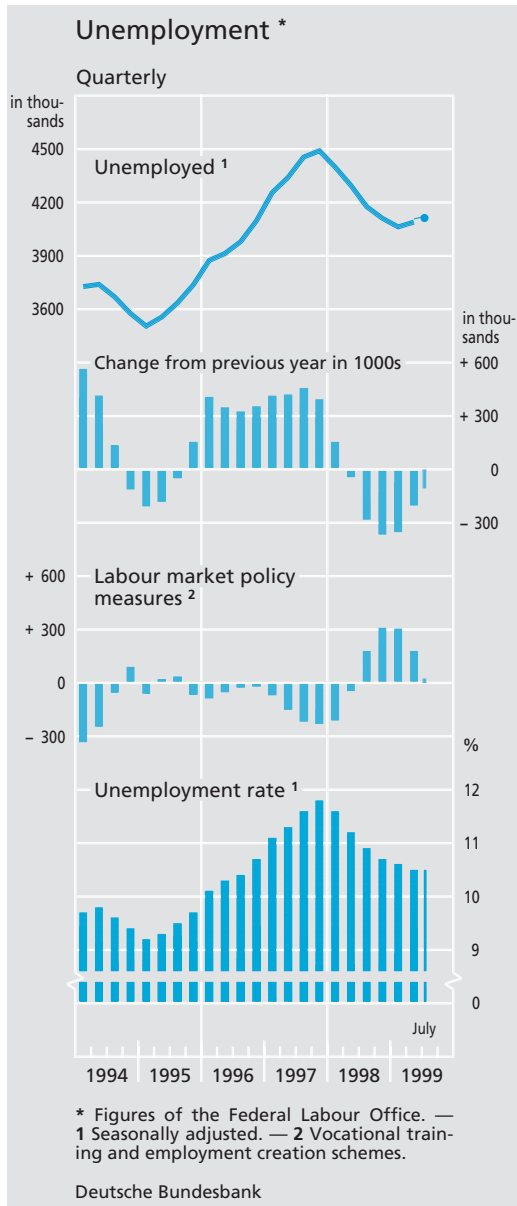
Federal Labour Office, 4.12 million persons, seasonally adjusted, were registered as unemployed at the end of July. This meant the level in the comparable period last year was undershot by no more than just under 110,000, compared with around 350,000 on an average of the first three months of the year. The seasonally adjusted unemployment rate at the end of the period under review was 10.5 %, i.e. just under ½ percentage point less than 12 months previously. It should be borne in mind, however, that the decrease is due in part to a statistical adjustment of the working population owing to a higher estimated figure for DM 630 jobs.

One factor contributing to the rise in the numbers out of work is the reduction in the Federal Labour Office's employment creation schemes. At the end of July, 420,000 employees were taking part in these programmes. Although this was still more or less as many as last year, it was 45,000 fewer than at the end of the winter. Vocational training courses, too, were deployed less extensively than before, with 345,000 attending them at the end of July – around 35,000 fewer than four months previously. By contrast, youth unemployment has been reduced so far by around 20,000 to 25,000 with the assistance of the Federal Government's immediate employment creation programme.

*Cut-back in labour market policy*

The cut-back in labour market policy measures, taken in isolation, signifies a reduction in the statistically recorded numbers in work on the secondary, government-assisted labour market. Furthermore, jobs are likely to have been lost at the same time in some

*Employment stagnating*



areas of the primary labour market as well. That is the case, at any rate, in industry and the construction sector. Craft firms reported a reduced deployment of labour not only in the construction and finishing trades but also in the services sectors. Even though there are still no official statistical data available on the total number of persons in work, the rise in employment recorded during 1998 is unlikely to have continued in the first half of 1999.

Redundancies affecting persons earning DM 630 a month or less have had much less of an impact on the number of persons in work than might be supposed on the basis of the reports about this which have recently been accumulating. According to the official statistics, for example, the number of such part-time workers in the retail and wholesale trades, and in hotels and restaurants, in April of this year (when the new regulation came into force) was slightly more than 105,000, or nearly 6% lower than in March. Newspaper publishers report 20,000 persons no longer delivering newspapers. However, a considerable number of such persons who work only a small number of hours also have another (main) occupation, which they continue to pursue. They therefore do not become unemployed but, instead, remain gainfully employed and are recorded in the statistics as before. Furthermore, it should be borne in mind that the members of the labour force who have been made redundant are possibly being replaced in some cases by new labour from the "hidden reserve", i.e. that part of the population which is not registered as unemployed and is looking for work. This is suggested, at least, by the fact that labour exchanges are reporting a marked rise in vacancies in house and office-cleaning occupations, in hotels and restaurants, and in delivery services. Another factor has been the greater use of subcontracting firms. In terms of the number of employed persons, the changes might therefore be comparatively slight overall. On balance, however, there is likely to be a significant fall in the total number of hours worked.

DM 630 jobs

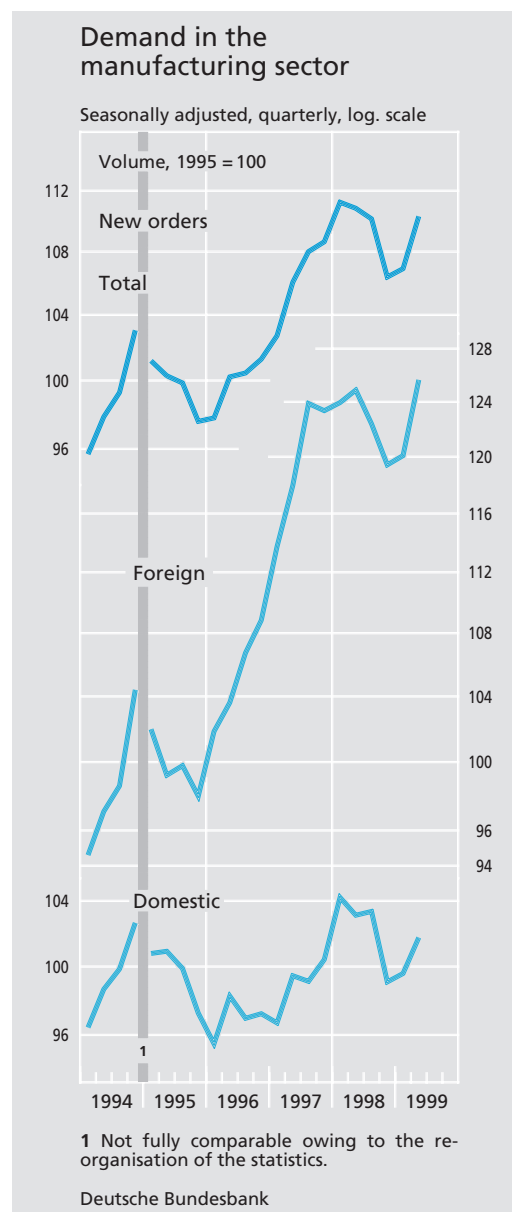
*Structure of  
unemployment*

The persistently high unemployment figure ought not to conceal the fact that, behind the assumed fixed level, substantial changes are continuing to take place on the labour market. Processes of this kind are captured, in particular, by the recently published results of the movement analysis and last year's structural analysis. For example, just over three-quarters of the approximately 7½ million persons who ended their unemployment during 1998 were without work for no longer than one year. Among those aged below 55, the relevant figure was around 80%. The rate for young persons finding work is especially high at over 90% on average. The rates fall markedly with increasing age, but the rate was still almost two-thirds in the 50 to 55 age group. Long-term unemployment, generally defined as being without work for more than one year, is therefore concentrated in the 55 to 65 age group. Measured by the level of unemployment, two-fifths of those who were without work for one year or longer were aged over 55. It is difficult to estimate how many of these older persons, who account for a major part of the structural core of unemployment, are still actually available to the labour market.

**Orders**

*Manufacturing*

The expectation that the economy will pick up is based, in particular, on the marked improvement in the orders situation in German industry. After eliminating price changes and seasonal fluctuations, orders received by the manufacturing sector in the second quarter were just under 3½% higher than in the pre-



ceding three-month period, which itself had brought a slight increase. Compared with the last low in autumn 1998, this represents a rise in orders of more than 3½%. Although this was still slightly down on the level of orders in the corresponding period last year, in the first quarter the shortfall had been almost 4%. According to the results of the ifo surveys, the flow of orders has become broader, bringing back up the forward reach

### Orders received in the manufacturing sector by main industrial grouping \*

Change from previous year in %

Item	1998			1999	
	Year	3rd qtr	4th qtr	1st qtr	2nd qtr
Foreign demand	2.6	-0.9	-3.3	-3.2	1.1
Intermediate goods	-1.6	-4.4	-8.4	-3.0	2.1
Capital goods	5.2	-0.9	-2.4	-6.2	-1.5
Consumer goods	7.1	8.3	8.3	4.0	5.8
Domestic demand	3.6	4.3	-1.3	-4.4	-1.3
Intermediate goods	3.0	2.0	-2.3	-3.2	-1.2
Capital goods	6.8	10.0	0.6	-6.7	0.1
Consumer goods	-0.3	1.0	-2.0	-3.9	-4.0

\* Volume, adjusted for working-day variations.

Deutsche Bundesbank

of orders on hand, which in winter had fallen to their lowest level in the past two years.

There has been an especially sharp rise in orders from abroad. Seasonally adjusted, on an average of the spring months they were 5% higher than in winter and were nearly 5½% up on the level of autumn 1998. This meant that there was an increase again in the level over 12 months, which was increasingly being undershot towards the end of last year.

The increased demand affected all major areas of industrial production in Germany. Even though the capital goods sector was in the lead, with a 6% growth in demand in the quarter, the producers of intermediate goods and of durable and non-durable consumer goods were not very far behind. At almost

6%, the largest year-on-year increase was in durables. Although the intermediate goods industry was unable to keep pace with this, latterly new orders were again higher than the comparable figures for 1998. Only the capital goods sector remained below last year's order level, although the gap at the end of the period under review was no longer as large as it had been at the start of this year. Developments are marked by extreme differences between individual subsectors. Whereas manufacturers of communications equipment achieved growth rates of up to 50% on the year, orders for 'other transport equipment' (which primarily includes the manufacture of aircraft and of rolling stock as well as the building and repairing of ships and boats) declined at a double-digit rate. In machinery and equipment manufacturing, the most important sector of the capital goods industry, the year-on-year fall decreased from around 13½% in the first quarter to roughly 8% in spring.

In the second quarter, seasonally adjusted domestic orders rose by around 2% compared with the average of the months January to March, which was an increase of 2½% in comparison with the low in the fourth quarter of 1998. This was again down on the level in the corresponding period last year, the figure being roughly -1½% following as much as -4½% in the first quarter.

There has been an improvement in the orders situation particularly in the case of capital goods producers, although significant growth was also achieved in the intermediate goods sector. The capital goods sector was able to

Foreign demand

Domestic demand

match the previous year's level of orders. The shortfall in intermediate goods went down to just over 1%. By contrast, domestic orders placed with the durable and non-durable consumer goods industries were scarcely higher in spring than they had been in winter. The year-on-year decline, at 4%, remained far higher than average. But for greater purchases of motor vehicles in anticipation of price increases in June, the trend would have been even more unfavourable.

*Subdued  
investment*

Even though there has been an increase in domestic orders of capital goods in the past few months – in the second quarter they were 4% up, seasonally adjusted, on their low of autumn 1998 – it seems premature to infer a sustained and broad capital formation from that fact alone. So far, demand has been concentrated on the communications and transport equipment segments, whereas major areas such as machinery and equipment, and data processing have remained largely unaffected. Furthermore, as mentioned above, the utilisation of existing capacity was declining up to the middle of the year; in many places a need for expansion therefore does not appear to be urgent. Despite the fact that terms of financing continue to be favourable, it seems likely that there will be only a moderate rise in spending on investment in the current year. This is also indicated by the surveys of the ifo institute, according to which west German enterprises are budgeting an increase in expenditure on plant and buildings of no more than just over 4%, compared with almost 12% in 1998.

Despite the subdued plans for investment, it is not only in industry that there are currently signs of the economy picking up; as mentioned, positive developments in contracts awarded in the construction sector are pointing to a gradual improvement in the situation. Compared with the last low in autumn 1998, for example, there has been a marked rise in new construction orders since the start of the year. In the second quarter, they were around 6% higher than in autumn 1998 in seasonally adjusted terms, with somewhat more than one-half of that figure being accounted for by the winter months and just over two-fifths by the spring. The level in the corresponding period of 1998 was overshoot by slightly more than 2%.

*Construction*

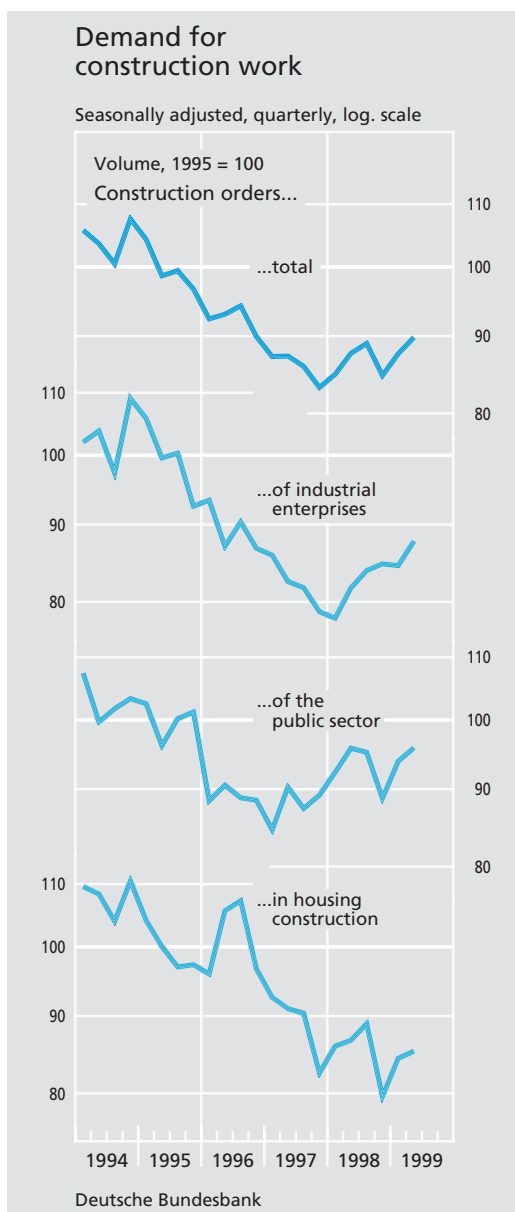
The situation in eastern Germany, where the construction industry has already been undergoing a hard process of structural adjustment for some time, seems to be gradually easing. At least, incoming orders in the months from April to June were significantly higher in seasonally adjusted terms than they had been before, and the comparable figure for 1998 was overshoot on average by 2½%.

*New Länder*

The sharpest growth in demand in Germany as a whole was in trade and industry. Incoming orders came to a standstill in winter after showing a continuous slight increase since the middle of 1998, but now rose again by just under 4% in seasonally adjusted terms. Taking permits as a yardstick, work is likely to have started not only on office and administrative buildings but also on several factory and workshop buildings for which building permission had been requested earlier. The

*Industrial  
construction*





railways as well as postal and telecommunication services likewise began major construction projects.

*Public sector construction*

The positive development in public sector construction continued in the spring months. On an average of the second quarter, orders placed were a seasonally adjusted 2 % higher than in the first three months of the year. Ordering in public building was especially buoy-

ant, the volume of orders being 8½ % up on the year. By contrast, road construction, which is largely under the auspices of public sector institutions, was around 1% below its level in the comparable period of 1998. This resulted in public sector construction orders being somewhat lower overall than one year before.

*Housing*

Finally, there was a slight increase in orders received for residential construction during the April to June period, which reduced the year-on-year fall to 2 %. It appears doubtful, however, whether this means that the slowdown in residential construction may be regarded as having been overcome. At any rate, construction permits do not yet indicate a radical improvement. The number of dwellings for which a permit has been granted in Germany as a whole was latterly even further down on the year. This was mainly due to the development in western Germany, where the decline compared with 1998 was – for the first time in some while and much as in eastern Germany – in double-digit figures. In seasonally adjusted terms, the already-low level of the first quarter was scarcely exceeded even in the period April to June. Single-family house construction no longer imparted sufficient momentum to offset the persistent deterioration in rented housing construction. It remains to be seen whether this was no more than a temporary period of weakness. Important underlying conditions for construction, at least, may still be described as quite favourable. For example, mortgage rates remain at a comparatively low level, even though they have now edged up somewhat, and the prices for new construction work fell

again slightly in spring. Despite the increase in value added tax last year, up to the end of the period under review the overall price index for residential buildings remained below its 1995 level.

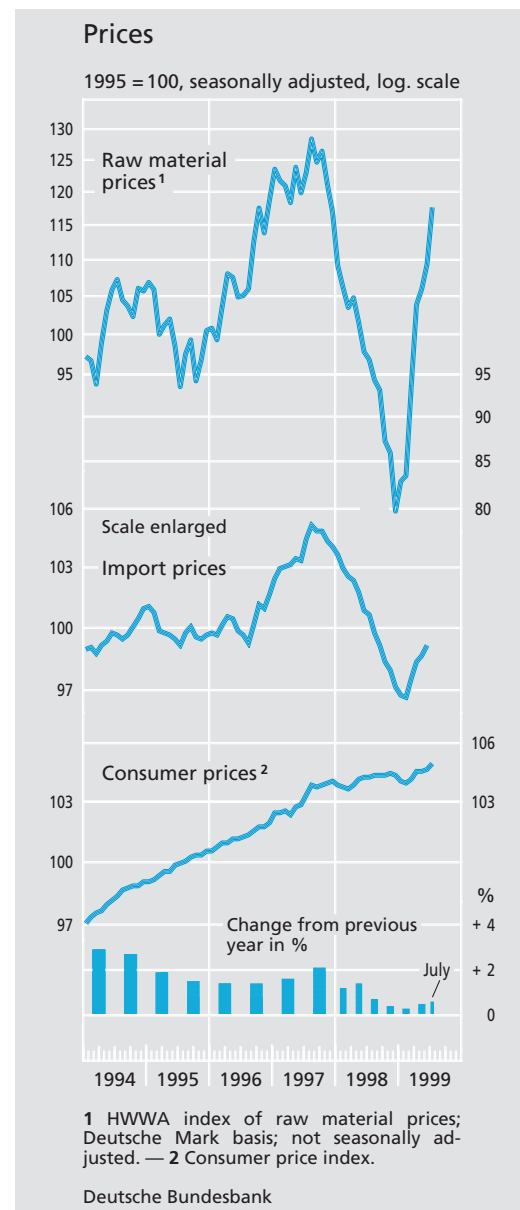
## Prices

*Price climate  
still favourable*

Even though the lowest point in general price movements now seems to have been passed, inflation still remains within narrow bounds. Measured by the annual rate of the consumer price index, it amounted to no more than 0.6 % in July. In January and February, which mark the lowest level, year-on-year inflation had been measured at 0.2 %. After eliminating seasonal fluctuations, consumer prices went up by just under ½ % in the months May to July, which corresponds to an annualised rate of about 1 ½ %. In accordance with the usual definitions, which also take account of inaccuracies in measurement, this means that price stability has been maintained.

*Energy more  
expensive*

The slight acceleration in inflation during the past few months was due almost exclusively to energy sources. The perceptible increase in the cost of crude oil on the international markets – a development that, from a German perspective, was intermittently intensified by the euro's depreciation against the US dollar – led to an upward adjustment of consumer prices for mineral oil products, in particular. In July, energy sources as a whole (including electricity and gas for household consumption) were therefore around 2 ½ % dearer, seasonally adjusted, than they had been in April, when there had already been a jump-



rise in prices of 5 ½ % due to the increase in energy taxes. Overall, this means that energy prices have risen for the consumer by around 9 %, seasonally adjusted, since the start of the year. The year-on-year figure, which had been clearly negative in January at – 4 %, went up to + 5 ½ % in July.

Excluding sources of energy, the level of consumer prices at the end of the period under

*Other  
categories of  
consumption*

review was scarcely higher than it had been at the start of the year; the year-on-year rate fell from 0.6% in January to 0.1% in July. This was mainly due to price movements in industrial goods being very moderate in comparison with 1998. For the first time in the nineties, in mid-year their prices showed a year-on-year decline. Furthermore, food was markedly cheaper in July than it had been 12 months earlier. Favourable supplies of seasonal goods as well as a general intensification of competition in the retail trade meant that food products fell in seasonally adjusted terms as well. In the area of services, the lowering of charges for telephone calls, especially, has had a price-dampening impact. The year-on-year rise in housing rents slowed down to around 1%.

*Import prices*

The sharp rise in international oil prices played a crucial role in determining German import prices. The anti-inflationary effect of external factors came to an end in February of this year and gave way to developments

which tended to increase prices. In seasonally adjusted terms, import prices calculated in Deutsche Mark rose by 2½% between February and June (more recent statistical information is unavailable at present). The level 12 months earlier had been undershot by around 6½% at the turn of 1998-99, but the year-on-year fall was no more than 1¾% at the end of the period under review. However, the trend in prices for imported goods has changed in areas apart from energy, too. If energy sources are excluded from the analysis, an increase in the cost of the other imports is likewise apparent. Although this rise has so far not been very pronounced, the year-on-year decline of 4½% at the beginning of the year decreased to 2½% in June, and a price rise is identifiable in seasonally adjusted terms. This affected not only some raw materials and semi-finished goods – much the same applies to imports of finished products, too. This may be an indication that such products will sooner or later become dearer for the private consumer.