

Economic conditions in Germany

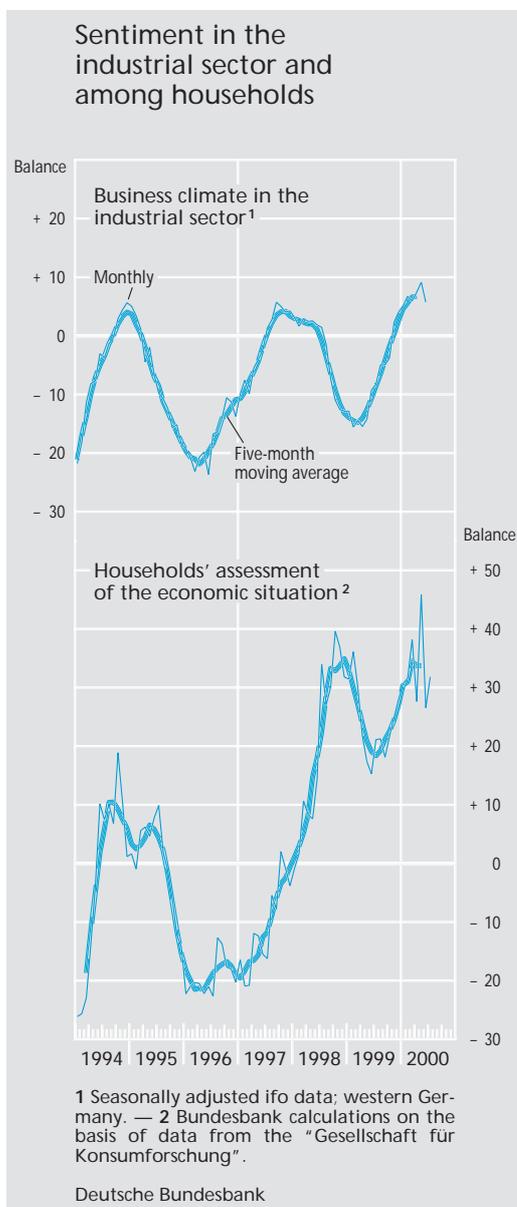
Underlying trends

The consolidation of the upswing has continued in Germany: growth accelerated in spring 2000. According to the Bundesbank's initial calculations, overall output in the second quarter – adjusted for seasonal and working-day variations – could have risen by slightly more than 1 % compared with the preceding three-month period, when it had already increased quite sharply at around $\frac{3}{4}$ %. The year-on-year increase in (real) gross domestic product (GDP) – adjusted for working-day variations – is likely to have gone up to $3\frac{1}{4}$ %, having been $2\frac{1}{4}$ % in the first quarter of 2000. In calendar-month terms, this signifies a growth of 3 %.

*Sharp growth
in GDP*

The stimuli generated by global trade remained strong, although the high propensity to import meant that the contribution to growth made by foreign trade was not as pronounced, on balance, as export activity indicates. Furthermore, there has been a further shift in foreign trade prices to the disadvantage of the German economy – mainly as a result of the increase in oil prices and the strength of the US dollar. The accompanying losses in real income, taken by themselves, represent a notable contractionary factor. Nevertheless, the deterioration in the terms of trade has not been as great so far as in the first half of the seventies and in the early eighties – the two previous comparable periods of a sharp surge in oil prices. Although the DM price of imported crude oil has tripled within a short space of time, the German economy's low degree of structural dependence on oil means that the amount it

*External
influences*



pays for oil has not had such a severe impact as in the two previous cases. Whereas net imports of crude oil and oil products accounted for around 3 % of GDP in 1974, and as much as 4 ¼ % in 1981, the figure for this year is estimated to be no more than 1 ¼ %. Added to this was the fact that prices for other raw materials and finished goods showed only a moderate rise. A further major factor was that the negative terms-of-trade effect, at

least in most cases, did not have an adverse impact on enterprises' profitability and propensity to invest. Indeed, moderate pay settlements ensured that these influences were offset to a large extent, with surges in external prices being accompanied by domestic cost discipline. Overall, the way in which the terms-of-trade effect was distributed internally was not so detrimental to the continued expansion of economic activity as it had been earlier.

The rise in output in the first half of 2000, which – at an annualised rate – can be put at around 3 ¼ %, was considerably sharper than the concurrent rise in the overall production potential; there has thus been a noticeable increase in capacity utilisation. The available indicators suggest that the propensity to invest has become much greater. According to the surveys of the ifo institute, there are more plans than before to increase capacity. This is likely to result in more jobs and rising employment. This is undoubtedly due in part to the fact that there has been a perceptible overall improvement in enterprises' profitability – albeit to markedly differing degrees in individual cases – since its deterioration last year. This is suggested by the fact that labour costs per unit of turnover have also had an alleviating effect under the impact of a sharp rise in productivity. Capital market rates are not as low as they were at the start of 1999, although this also reflects the strength of the current global upswing. Furthermore, the relevant real rate of interest for long-term corporate loans can by no means be rated as high – the opposite is more likely to be the case. Not least, what should be considered

Increasing capacity utilisation and rising propensity to invest

more than ever is the fact that, for many enterprises, access to equity capital has become easier and more attractive. That applies to the stock market in general and to the *Neuer Markt* in particular as well as to the venture capital segment, which is now very dynamic. The financing base of the economy has thus become broader and more consistent with demand.

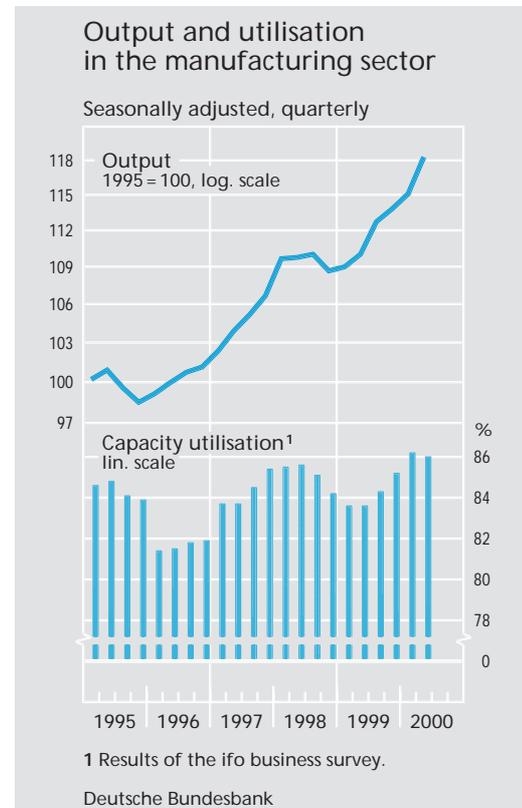
Consumer spending more buoyant

Consumer spending picked up in the spring months, although the oil-price increase was an adverse factor. According to the surveys undertaken by the consumer research institution, *Gesellschaft für Konsumforschung*, households felt that the outlook for the economy in general was quite positive; nevertheless, the propensity to make major purchases still tended to be subdued. This was reflected, not least, by the comparatively small numbers of new motor vehicle registrations. Other retail sales, however, showed a sharp seasonally adjusted rise in the months from April to June.

Output and labour market

Manufacturing as an engine of the economy

Manufacturing output has been further expanded during the past few months. On an average of the period from April to June¹, it was nearly 3% up on the preceding winter months in seasonally adjusted terms²; year-on-year, the increase went up to just under 7½%, compared with 6½% previously. Owing to the sharp rise, utilisation of existing production capacity remained high. According to the surveys of the ifo institute, utilisation in June remained around 2 percentage

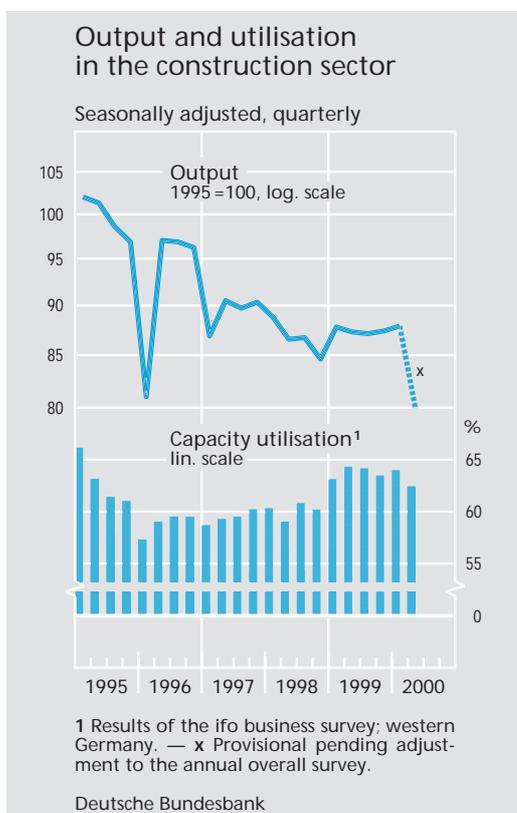


points up on the previous year's level. Taking turnover as a yardstick, there were again a very large number of deliveries to foreign customers. Year-on-year growth increased to just over one-sixth. However, more deliveries are now being made to domestic customers as well: for the first time in a long while, the year-on-year rates of increase came near to being in double figures.

In particular, producers of capital goods achieved year-on-year increases in output of more than 10%, with the manufacturers of

¹ One of the reasons why it is advisable to combine the period from April to June in the analysis is the unusual way the holidays fell this year.

² Output in the first three months of 2000, for which factors from last year were used in an initial provisional adjustment of the monthly figures to the quarterly survey, has been revised downwards by 0.5 index points in line with the results of the current quarterly survey.



telecommunications equipment and installations as well as of office and computer equipment continuing – as for some while – to be the pace-setters in this area. In the field of consumer durables, the production of radio, television and video equipment was at a high level.

Development also positive in the case of service providers

The positive development in manufacturing also had an impact on commercial service providers. According to surveys, in the second quarter they reported that the outlook for business had shown a marked improvement following a somewhat more subdued development at the turn of 1999-2000. This applies particularly to computer companies and management consultancy firms, although car and plant hire firms, as well as the advertising industry, also rated the situation and outlook

as favourable. According to the reports by their associations, much the same applies to many skilled trades.

In spring, the construction sector was, by contrast, still unable to extricate itself from the adjustment pressure under which it has been for some time, especially in eastern Germany. In the second quarter, in fact, it showed a further sharp decline, following the first few months of the year which had benefited from the comparatively mild weather conditions. At around 8%, the year-on-year figure also shows a sharp fall. The development in building construction was especially unfavourable, with all construction subsectors – residential, commercial and public construction – being affected. Civil engineering fared better by comparison, but still suffered cutbacks in output of 4½%.

Construction, by contrast, remains weak

The sharp growth in overall output has led not only to a rise in the average number of working hours but also to an increase in demand for labour. There was a further slight reduction in unemployment. According to the calculations of the Federal Statistical Office, the seasonally adjusted number of persons in work rose to 36.27 million up to May (more recent data are unavailable at present), which was 45,000 more than at the end of the first quarter, and 145,000, or 0.4%, more than a year before. The largest increase was in the labour-intensive services sector. For industry, the indicators suggest that the long-prevailing reduction in employment has now probably come to an end, although it is unlikely that new employees have been recruited on a significant scale so far.

Rise in employment

The trend in the construction sector was still pointing downwards at the end of the period under review.

*Higher number
of vacancies*

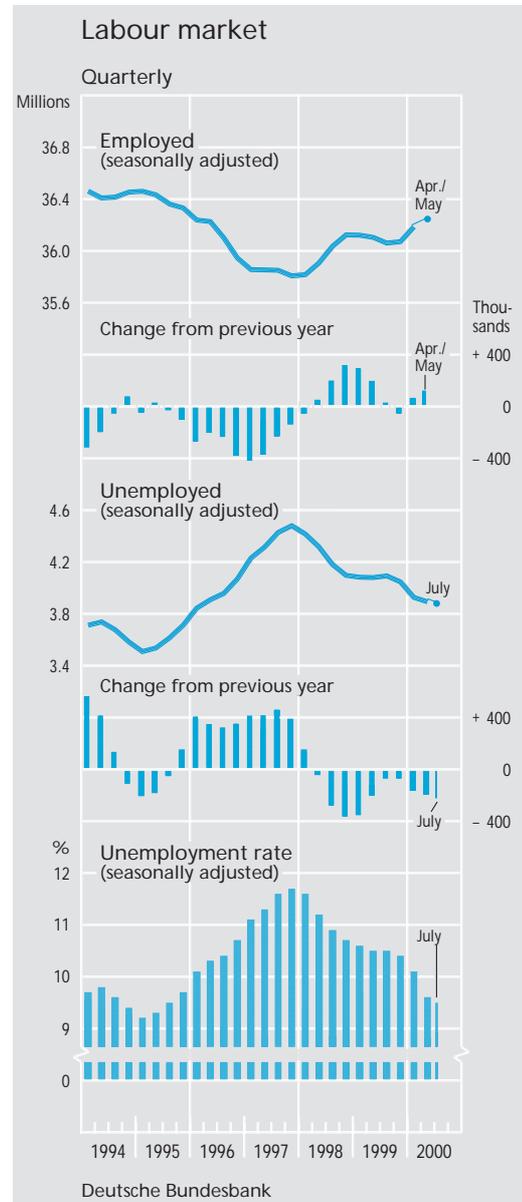
An overall increase in demand for labour is indicated by the development in vacancies reported to the labour exchanges. Although this indicator comprises only part of total demand, it is likely that it is largely an accurate reflection of the economy's needs. After adjustment for seasonal variations, the number of vacancies had increased to just over 520,000 by the end of July. This is the highest figure recorded in Germany since the early nineties, and signifies a rise of around 40,000 compared with the end of 1999: the year-on-year increase is almost twice as high.

*Reduction in
unemployment*

Rising employment was accompanied by a reduction in joblessness. Although the pace of the reduction has slowed down recently, this is likely to have been partly due to special factors, such as the start of the summer holiday period. Falling unemployment is the underlying trend. Seasonally adjusted, 3.89 million persons were registered as unemployed at the Federal Labour Office at the end of July, i.e. 25,000 fewer than on an average of the second quarter. Compared with 12 months before, this was a reduction of roughly 225,000.

*Labour-
market-policy
instruments*

This development was accompanied by a marked cut-back in the deployment of labour-market-policy instruments in comparison with 1999. At just over 650,000 at the end of July, the number of persons attending vocational training courses and taking part in job-creation schemes, which still represents



the largest single item of government assistance, was roughly 115,000 down on its earlier level.

At the end of July, the seasonally adjusted share of registered unemployed persons in the total (civilian) labour force was 9.5%. In western Germany, the unemployment rate was 7.7%, compared with 17.4% in eastern Germany. This illustrates the fact that the la-

*High
unemployment
in eastern
Germany*



bour market situation in eastern Germany remains much less favourable than in the western part of the country. Not only are more persons affected by unemployment in eastern Germany, developments over the past few months, if anything, still tended to be negative. There has been scarcely any decline in unemployment of late, for example, and the number of persons registered as unemployed persisted at 1.37 million.

A quantitative comparison of the increase in employment in Germany as a whole and the concurrent fall in unemployment reveals a clear discrepancy. Whereas the number of persons in work on an average of the months April and May was around 120,000 higher than 12 months previously, unemployment during the same period fell by almost 185,000. The declining number of members of the workforce shows once again that the labour market is not a closed system. A major role in the current context is played by demographic factors which are bringing about a decline in the potential workforce. The *Institut für Arbeitsmarkt- und Berufsforschung* (Institute for Employment Research) estimates this effect to be as much as 175,000 on an annual average of 2000 compared with 1999.

Decline in the potential workforce

Orders

There has been a further perceptible rise in the volume of new manufacturing orders, indicating a speedy continuation of the upswing. On an average of the second quarter, seasonally adjusted orders were around 5½% up on the level reached in the winter months. The year-on-year increase, which had already been in double figures, went up to 14½%. At 20½% year-on-year, the rise in foreign orders was sharper still. The increase in domestic orders was, by contrast, below-average, although a rate of around 10¼% likewise testifies to a notable pace of growth. Furthermore, the seasonally adjusted increase in business on the domestic sales market over the past few months was not

Large volume of orders received by industry

much less than the increase in new orders from abroad. A number of particularly large-scale orders played a part in this.

Sectoral focal points

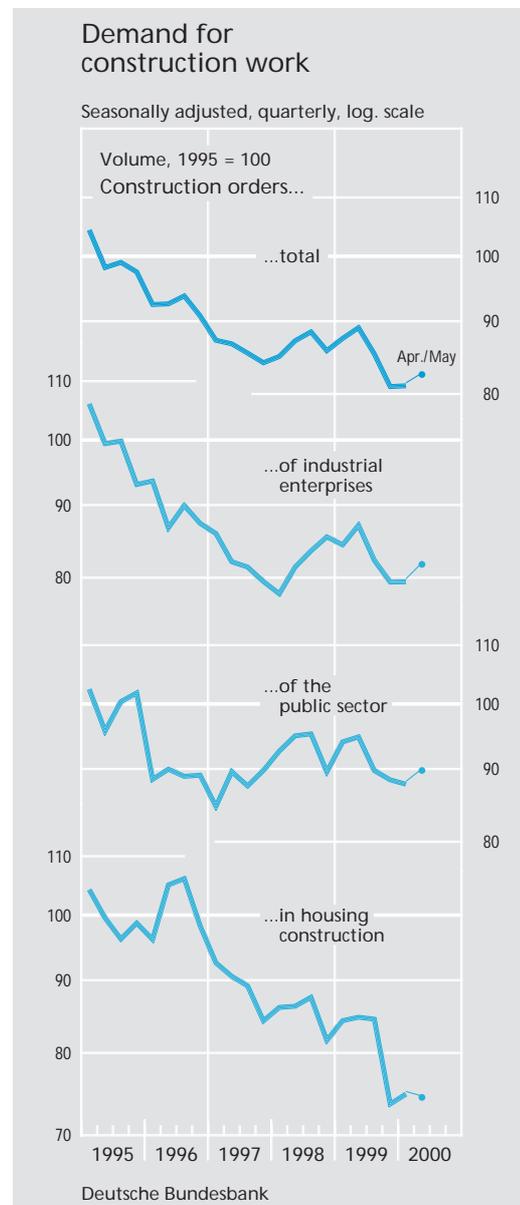
In contrast to the first quarter, demand was centred on the capital goods sector. Demand for intermediate and consumer goods did not attain the same level but likewise achieved sharp rates of growth. With a growth in orders reaching nearly 20%, capital goods were also in the lead when measured in terms of the development in the previous 12 months. The figure for orders placed with manufacturers of other transport equipment (which includes aeroplanes, ships and railways) was even considerably higher. Furthermore, the situation remained positive in the case of office and communications equipment, whereas the manufacturers of motor vehicles and structural metal products lagged behind.

Construction demand remained subdued

In contrast to manufacturing, demand for construction work was still subdued in spring. Nevertheless, recent incoming construction orders point to a stabilisation at a low level. On an average of the months April and May, the seasonally adjusted level was slightly up on the first quarter, which had been as high as at the end of 1999. At around 8%, compared with just over 7% previously, the decline over 12 months became larger, however.

Commercial and public non-residential building

The commercial construction sector, in particular, provides some indications that the situation has bottomed out. Seasonally adjusted, commercial construction orders received in the two-month period of April and



May were around 2½% up on the winter months in terms of volume. Although this figure was still significantly (5½%) down on the previous year's level, the year-on-year fall was no longer significantly greater than in the first quarter. Over the past few months, the volume of orders placed by public sector contractors was likewise somewhat higher than in the winter quarter: at slightly less than 7%, there was no more than a lower-

Price trend indicators for Germany

Change from previous year in %

| Item | 1999 | 2000 | | |
|--|---------|---------|---------|------|
| | 4th qtr | 1st qtr | 2nd qtr | July |
| Headline rate of inflation | | | | |
| Consumer prices | 1.0 | 1.7 | 1.6 | 1.9 |
| Statistical core rates 1 | | | | |
| Consumer prices excluding seasonal food and energy | 0.2 | 0.7 | 0.8 | 0.8 |
| Consumer prices with modified weights 2 | 0.5 | 0.8 | 0.8 | 0.8 |
| 5 % trimmed mean 3 | 0.6 | 0.8 | 1.0 | 1.2 |
| Weighted median 4 | 0.7 | 1.0 | 0.9 | 1.2 |

1 Bundesbank calculations. — 2 Reduction of the weights of volatile components. — 3 5% exclusion of components showing a high/low degree of volatility. — 4 Price change for the component at which the cumulative individual weights reach 50%.

Deutsche Bundesbank

than-average decline compared with the previous year.

Residential construction

By contrast, the situation in residential construction remained quite unfavourable. The slight improvement in incoming orders during the first few months of the year was not maintained. Seasonally adjusted, there was a further decline in new orders. The year-on-year fall, which had amounted to around 11% in the first quarter, increased to 13 ½ %.

Construction permits for dwellings

Construction permits for dwellings do not point to a turnaround in the near future either. Although a reorganisation of the statistics has meant that the relevant data have been incomplete since the start of the year, the information that is available (which does not contain some of the Länder) shows a con-

tinuing year-on-year fall in the number of dwelling units for which a permit has been granted. In the spring months of April and May, in fact, the negative rates slipped down well into double figures. This does not apply just to the construction of rented housing, i.e. apartments in buildings with three or more dwelling units. Recently, there has also been a noticeable decline in the number of permits for the construction of houses with one or two dwellings. This is also the case in western Germany, where the situation had hitherto been comparatively favourable.

Prices

According to the calculations of the Federal Statistical Office, consumer prices in Germany were 1.9% up on the year in July. This was the same rate as in June and again significantly more than in April and May, when the year-on-year figure had been no more than 1.5%.

Rise in year-on-year rate of consumer price increase

The recent increase in inflation was mainly due to sharp price rises for energy sources – especially in the case of petrol and light heating oil, which also had an impact on gas prices and on contributions for hot water and heating. Consumer prices were thus following the dictates of the international markets. Including the “ecological” tax increases on January 1, prices for energy sources reached a new peak.

Sharp price increases for sources of energy...

Excluding energy, the year-on-year rate of inflation in July amounted to 0.9%, which was not much more than on an average of the

... albeit at a moderate underlying rate

second quarter. The rise was evident both in services, at a year-on-year rate of latterly 1.5%, and in rents, at 1.3%. Industrial goods and food exerted stabilising influences, however. In the industrial goods sector, severe competitive pressure – further intensified by the advancing use of modern information media and the concomitant increase in market transparency – means that suppliers can make only modest increases to their prices. In the food product markets, competition among major discount chains continued. As a result, consumers did not have to pay more at the end of the period under review than they did in July 1999.

The core inflation rate, which seeks to capture the trend rise in annual consumer price inflation excluding short-term fluctuations and special factors, amounted to around 1% recently. This was only slightly more than in the first few months of this year. This means that inflationary pressures, in terms of the underlying trend, have not increased significantly so far despite the heavy impact of oil prices. Future developments will have to be watched carefully, however.

Volatile oil markets

That is not least the case because prices on the international oil markets are fluctuating sharply at present and no easing is identifiable in terms of the exchange rate. Brent North Sea Oil, for example, was quoted at around US\$ 30 in mid-August, which was almost back up to its end-June level, having fallen to US\$ 26½ in the interim. At the end of the period under review, the spot market prices for heating oil in Rotterdam – which act as a signal for supplies in Europe – even



went above their previous mid-year peak, although petrol prices continued to be well down on their previous levels.

Further deterioration in the terms of trade

Overall, there has been scarcely any let-up so far in external price pressure. The year-on-year rate of increase in import prices fell back only slightly, from 11.7 % in May to 11.5 % in June. The seasonally adjusted monthly rate of inflation, which had been almost 1 % on an average of the period from January to May, did decelerate at the end of the period under review, although it still amounted to around ½ %. This was also the main reason for the terms of trade, after adjustment for seasonal variations, again becoming less favourable in June and for the year-on-year deterioration remaining unchanged at just over 7 %. Seasonally adjusted, the rise in export prices did not continue of late: the year-on-year increase went down from 3.8 % in May to 3.6 % in June. Nevertheless, given a favourable market situation and competitive position as well as the fact that depreciation made it possible to use some leeway in pricing, selling prices in foreign business – calculated in D-Mark – had been raised quite steadily up to May.

Domestic prices for industrial products continued to rise slightly up to June in seasonally adjusted terms. The increase over 12 months went up to 2.9 %, having been 2.4 % at the end of the first quarter. Excluding energy, the year-on-year rate of price increase went down somewhat to 1.9 % in June, compared with 2.0 % in May.

Further rise in industrial producer prices

Seasonally adjusted, construction work was hardly any more expensive in the second quarter of 2000 than it had been in the first quarter. Even so, the difference when compared with the price level in the same period of 1999 increased to 0.8 %, having been 0.4 % at the start of this year owing to falls in prices a year before. There was a significantly higher-than-average rate of price increase in road building, the input costs of which rose comparatively sharply as a result of the oil-price increase. Year-on-year price rises in this sector amounted to 2.3 %. By contrast, price rises in residential construction were not as pronounced, the year-on-year rate of increase being no more than half as high as the overall average.

Construction prices largely stable