

Economic conditions in Germany

Underlying trends

Despite discernible pressures, the German economy continued to grow during the summer months. According to the Bundesbank's initial estimates, real gross domestic product (GDP) in the third quarter – adjusted for seasonal and working-day variations – may have exceeded the level recorded in spring by just over ½%. Adjusted for working-day variations, this signifies a year-on-year rise in overall economic output of almost 3½%, which was not much less than in the previous three-month period. In calendar-month terms, the rate of increase stood at 2¾%. Overall capacity utilisation is likely to have risen again markedly, which – like the further increase in employment – indicates a sustained favourable process of growth.

*Further growth
in overall
output*

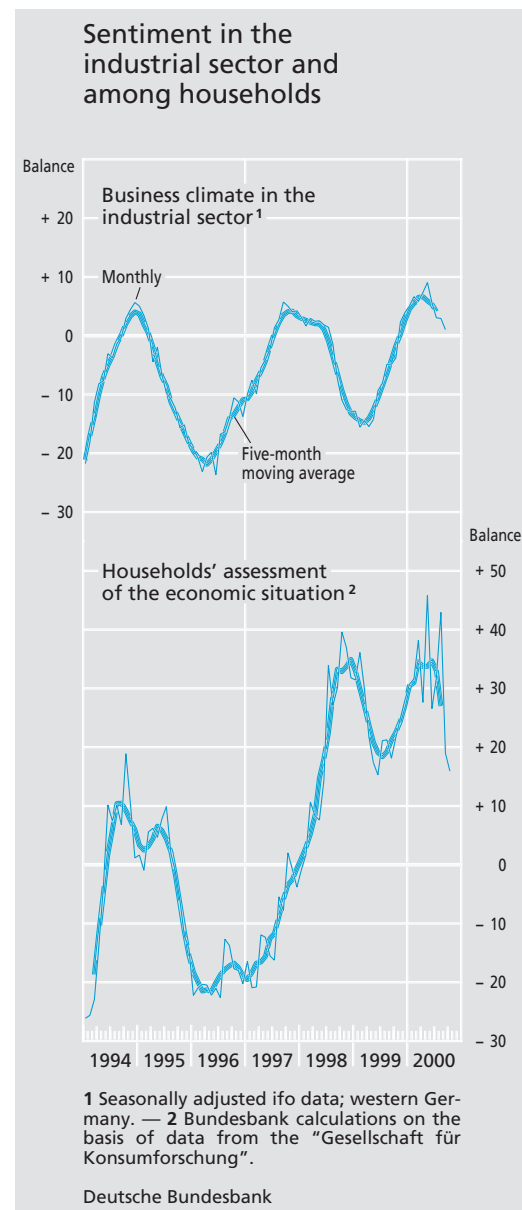
The underlying cyclical trend and the available advance indications do not provide any grounds for a pessimistic outlook at present. This is also true if – as expected – the statistical year-on-year rates of growth in real GDP for the second half of the year are no longer as high as before in calendar-month terms. Firstly, it has to be borne in mind that – once the slowdown in growth had been overcome – the cyclical recovery was quite strong in the second half of 1999. Secondly, there are significantly fewer working days available during the remaining part of the current year. However, one should not overlook the fact that “sand has been thrown in the wheels of the economy” – mainly on account of high oil prices. As the ifo institute survey of the business climate in the commercial sector shows, expectations for the immediate fu-

ture, in particular, were latterly not as high as they had been in spring. However, the resulting strains are likely to remain limited – as the economic research institutes and the Council of Experts for the Assessment of Overall Economic Trends have also pointed out in their latest surveys. The German economy appears to be in quite robust shape.

That is true even taking into account the fact that the shift to domestic demand as a driving force of the economy – as far as it is possible to discern – has not progressed as rapidly as had generally been expected previously. The unexpectedly sharp oil-price-induced deterioration in the terms of trade has put a damper, above all, on domestic demand. Domestic real incomes have been considerably reduced as a result of more expensive imports. On the other hand, the sustained growth of foreign markets and German enterprises' high level of competitiveness have generated additional stimuli to exports. Furthermore, German foreign trade is also likely to benefit from the fact that the oil-producing countries use at least part of their additional receipts for purchases from abroad. Foreign demand was the most important mainstay of economic activity up to end of the period under review.

Sectors' contributions to growth

From the sectoral point of view, industry again made a significant contribution to the sustained growth recorded in the period under review. Buoyant demand led to a further sharp expansion in output. Many new orders were again placed by foreign customers, in particular. The main reason for this was that global growth is now being supported by all the major economic regions, and that



the relative strengths of the German range of exports and a high degree of price competitiveness were able to make a full impact. Domestic enterprises have probably continued to gain market shares in their main sales markets. The commercial service providers also recorded strong stimuli to growth. According to surveys undertaken by the Centre for European Economic Research, commercial service providers were again able to boost their turn-

over significantly, albeit not quite as sharply as before. IT services and the transport industry, which benefited from the continuing cyclical upswing, continued to be at the forefront. The performance of architects and offices for technical consultancy and planning remained far below average, however. This was due, not least, to the fact that the construction sector was unable to pull itself out of the cyclical trough in summer either. Needs for structural adjustment in eastern Germany, which have not yet been fully implemented, as well as weak demand for new dwellings in western Germany, which is probably due in part to cutbacks in government assistance, prevented an improvement of the situation.

Households' sentiment less favourable

According to surveys, households' sentiment has recently become gloomier. In particular, the propensity to purchase consumer durables has diminished, according to the consumer research institution, *Gesellschaft für Konsumforschung*. This may have contributed to the fact that retail sales in summer were down on their level in spring. New car registrations were also at a low level over the past few months, despite some indications of the level having stabilised; on an average of the third quarter, their number was around one-fifth lower than in the same period last year. The dramatic rise in mineral oil prices, which was largely due to the international surge in the cost of oil and, to a lesser extent, to additional tax burdens, is likely to have played a part in this. Furthermore, the increase in energy prices was more noticeable than before owing to the approaching heating period. The loss in real income resulting from the persistent deterioration in the terms

of trade reduced the scope for consumer purchases both domestically and – as is shown by the perceptible decrease in expenditure on travel – abroad. The steady improvement in the situation on the labour market, mirrored by a sharp increase in employment and a reduction in unemployment, only partly offset these draining effects.

Output and labour market

In the third quarter, seasonally adjusted manufacturing output grew by 1¾% compared with the previous quarter, which had already brought a rise of more than 3%. Over the past six months as a whole, output rose at an annual rate of around 10½%. This means that growth, which amounted to 7¾% year-on-year, has gained momentum. Similarly sharp increases in output have not been recorded since the early nineties.

Industrial activity running flat out

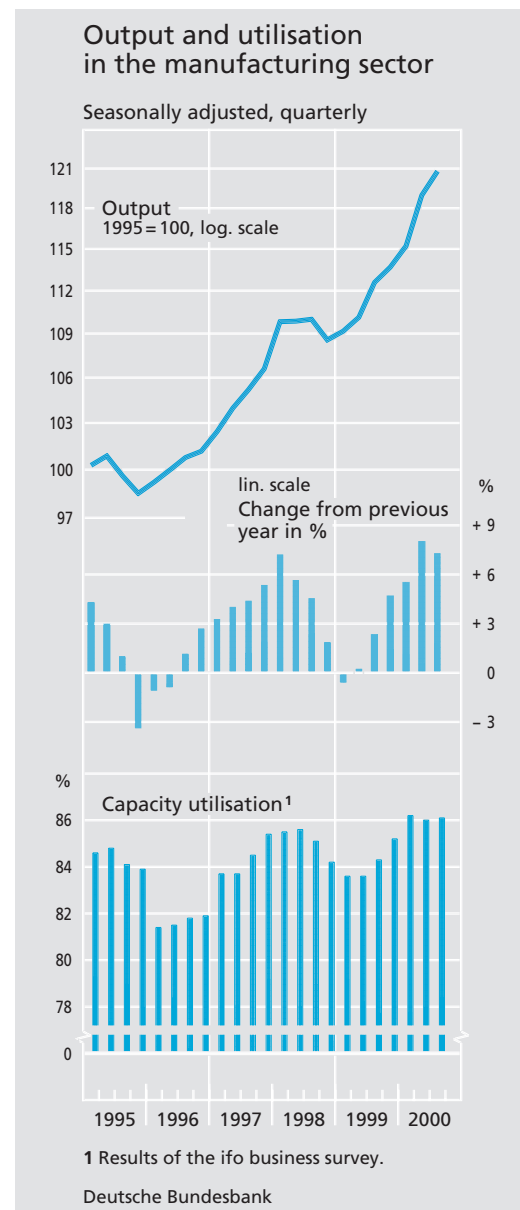
Producers of consumer durables performed especially well. In the past six months, their output rose by almost one-fifth in seasonally adjusted and annualised terms. Like the manufacturers of motor vehicles, who offset sluggish domestic business by increasing deliveries abroad, manufacturers of consumer electronics were also able to step up their output significantly – something which was undoubtedly associated with the special sports events in summer. While the capital goods sector also reported a marked expansion in production, the development in intermediate goods and non-durable goods was clearly below average.

*High level
of capacity
utilisation*

Utilisation of industrial capacity remained at a high level according to ifo institute data. At the end of September, it exceeded the level in the same period last year by 1¾ percentage points. In western Germany alone (for which there are data which go back further), the degree of utilisation was the highest since the unification boom in 1989/1990. At the same time, the forward reach of the orders on hand in the manufacturing sector as a whole increased somewhat. This suggests that production in some sectors is already close to the limit of capacity.

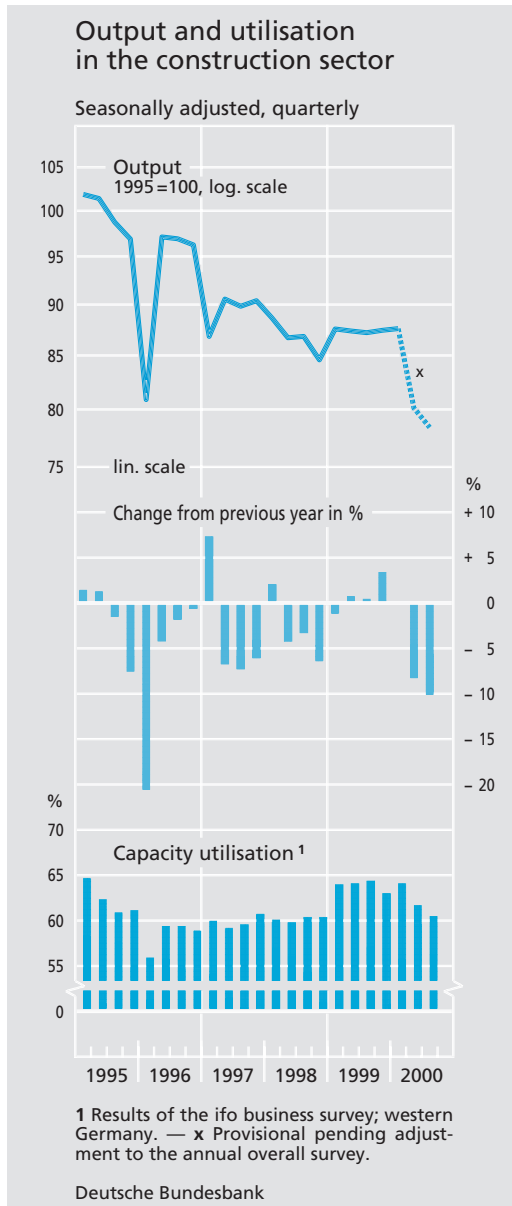
*Further decline
in construction
output*

By contrast, construction is far from having a good degree of capacity utilisation. In the summer months, seasonally adjusted construction output was down again on the spring, when it had fallen well below the level recorded at the turn of 1999-2000. According to the figures that are available at present, the level in the third quarter was almost one-tenth down on the same period last year. Judging by past experience, there will be an upward revision as a result of the overall survey, but this will probably be nowhere near sharp enough to make a significant change to the picture presented by the negative trend in output. The situation in the housing sector was particularly unfavourable. Turnover in the summer months was almost one-fifth below the level recorded 12 months previously, whereas the losses in both industrial and public sector construction remained in single figures. The turnover of housing sector firms in eastern Germany at the end of the period under review was, in fact, almost one-third lower than in 1999.



Given that unfavourable situation, there was a further reduction in employment in construction. According to the information available at present, the number of persons working in the construction sector in September was almost one-tenth lower again than a year before, even though employment has been steadily reduced since the mid-nineties. For quite some time now, however, the shedding of jobs in the construction sector has

*Sustained
increase in
employment*



been far more than offset by an expansion of employment in other sectors. According to the calculations of the Federal Statistical Office, the number of persons in work has shown a sharp increase since 1997. In August of this year, seasonally adjusted employment amounted to roughly 38.6 million, i.e. 550,000 or almost 1½% more than 12 months previously. The highest rates of growth are again likely to have been recorded

in the commercial services sector. Employment is also likely to have been increased in other private sector services as well as in distribution, the catering trade, and transportation. Even industry, which had been cutting back its staff up to the end of 1999, needed additional labour in the light of the sharp increases in output.

Many of the persons now in work were previously registered at the Federal Labour Office. The number of jobless has therefore been declining well into the past few months. In seasonally adjusted terms, it fell to 3.82 million at the end of October. This was roughly 80,000 below the level in mid-year and 270,000 lower than 12 months previously. The unemployment rate stood at 9.4%.

Further reduction in unemployment

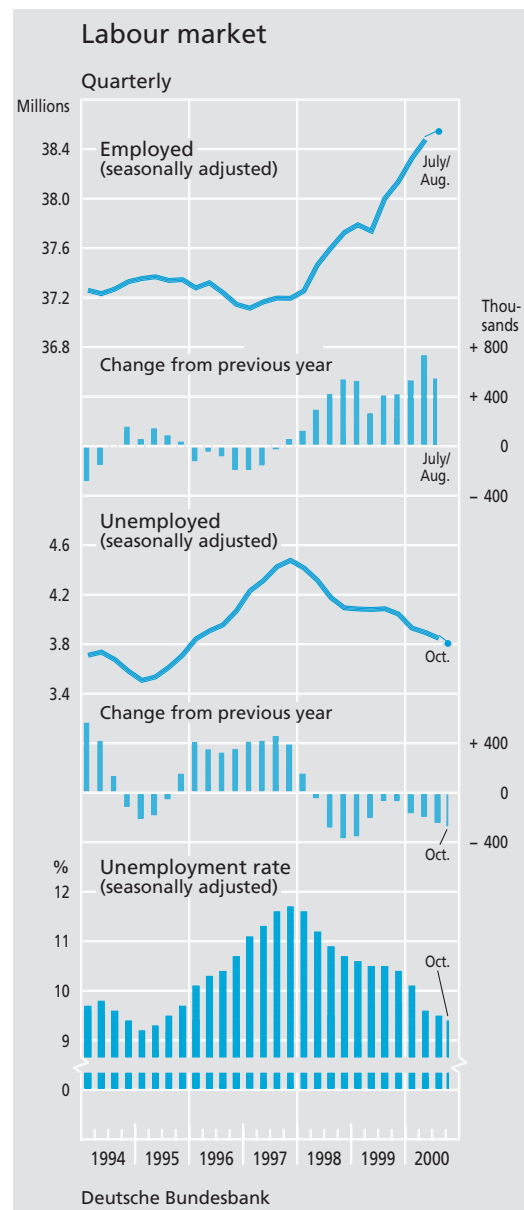
However, the reduction in unemployment is confined almost entirely to the western part of Germany. In eastern Germany the number of unemployed persons has been largely stagnating since spring at around 1.35 million in seasonally adjusted terms. At the end of the period under review, the year-on-year fall in the number of jobless persons amounted to just under 25,000. At the end of October, the seasonally adjusted unemployment rate stood at roughly 17½%.

The persistently high level of unemployment in eastern Germany was also due to the fact that the deployment of labour-market-policy instruments tended to be more restrictive. The number of persons participating in job-creation schemes, including structural adjustment measures, was roughly 55,000 down on the level recorded 12 months earlier. As-

Cutbacks in labour market policy

sistance provided by the Federal Labour Office in addition to the regulated programmes has also been cut back. It was not possible to offset the decline recorded in both above-mentioned areas by an expansion of, say, vocational training measures or assistance for re-integration into the active labour force. After adjustment for movements on the secondary, subsidised labour market, the situation is likely to have improved, because the number of "real" competitive jobs has probably increased.

The fact that the year-on-year rise in employment, up to the end of the period under review, was roughly twice as high as the concurrent reduction in unemployment signifies, firstly, that many persons who entered the (statistically recorded) labour market had been part of the "hidden reserve", which comprises all those who are fundamentally willing to work but who do not register themselves at the labour exchange. Secondly, persons working no more than 15 hours a week may continue to register themselves as unemployed. It is likely that many part-time low-income workers, in particular, who are employed in a job with a monthly remuneration of DM 630 or less, remain within that time limit. Irrespective of such double counting, there are notably sharp increases in such employment relationships out of the hidden reserve. This indicates a high degree of flexibility in terms of the labour supply. However, a positive assessment is sustainable only to the extent that "normal" work relationships, which are fully subject to the tax and levy provisions, are not simultaneously reduced.



Orders

Orders received by the industrial sector continued to rise during the summer months. In the third quarter, seasonally adjusted orders surpassed the level of the previous quarter, which – partly owing to special factors – had produced strong growth of more than ½ %. Orders received exceeded the level recorded in the same period last year by almost one-

Large-scale orders to industry

Revision of employment figures

Over the past one and a half years, the data provided by the Federal Statistical Office on employment in Germany have been revised sharply upwards in two stages. In March 1999 the total number of employed persons in Germany on an annual average of 1998 had been estimated at just under 34 million, whereas a figure of 37½ million is now reported in the national accounts. In 1999, the number of persons in work rose to almost 38 million.

| Year | Employed (thousands) | | Change | |
|------|----------------------|--------|-----------|------|
| | Old | New | Thousands | % |
| 1991 | 36,510 | 38,454 | 1,944 | 5.3 |
| 1998 | 33,970 | 37,540 | 3,570 | 10.5 |

The revisions proved to be necessary because the group of part-time low-income workers, which was derived from the results of the annual microcensus, had been underestimated for quite some time. Statistical recording has been improved, in particular, by the reporting requirement introduced in connection with the act revising the arrangements for part-time workers earning DM 630 a month or less. Following the first stage of adjustment in April 1999, the "principal occupation of around 2½ million persons" was, according to the Federal Statistical Office, "part-time low-income work". Incorporating the August 2000 revision, this figure is now likely to be around four million. Measured in terms of the total number of persons in employment, this is just over 10% compared with an estimated 6% at the beginning of the nineties. The new calculations were carried back to 1991, which is currently the first relevant year for the national

accounts on the basis of ESA 95; in all cases, they reflect a higher participation rate and, consequently, a larger potential labour force than previously assumed.

The increased inclusion of part-time low-income workers also entailed a downward revision of the average number of working hours per employee, since they work significantly fewer hours a year than those in full-time employment.

| Year | Working hours per employee | | | Volume of work (million hours) | | |
|------|----------------------------|-------|------|--------------------------------|-------|-----|
| | Old | New | % | Old | New | % |
| 1991 | 1,573 | 1,545 | -1.8 | 57.42 | 59.41 | 3.5 |
| 1997 | 1,570 | 1,506 | -4.1 | 53.34 | 56.03 | 5.0 |

According to the new calculations, the annual number of hours worked on an average of the total working population in 1997 was roughly 4% lower than shown by the earlier figures. As a consequence, the same-year increase in the volume of work, i.e. the total number of hours worked by all employed persons, at 5%, was only half as high as the increase in the number of persons in work. Thus, the contribution of labour in the production process has increased, but far less than is suggested by an analysis of the "per capita figure" alone. According to the calculations of the Federal Statistical Office, higher labour input is, however, not accompanied by a correspondingly higher output; as a result, productivity by hour and, in particular, productivity per employee are much lower than before the revision.

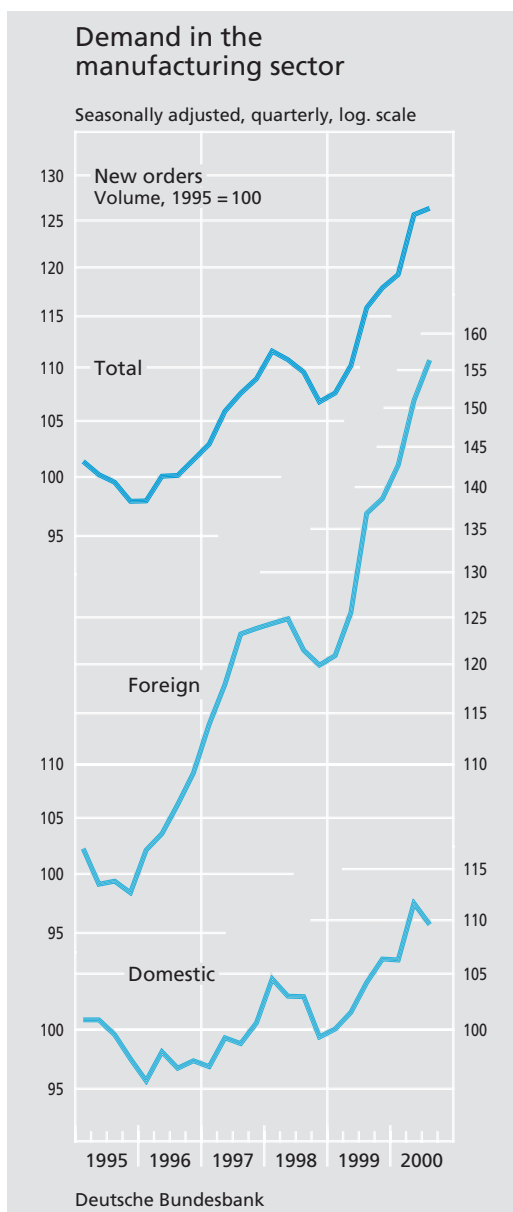
As part of the changeover in the national accounts to ESA 95, the Federal Statistical Office, for the first time, also published data on jobless persons in accordance with the definition of the International Labour Organisation (ILO). In this definition, an unemployed person is someone who is older than 15 years of age and without work (including low-paid part-time work), and who has actively been seeking work during the past four weeks and is able to take up work within the following two weeks. In 1999, these criteria were fulfilled by almost 3½ million persons, i.e. roughly 670,000 fewer than were registered at the Federal Labour Office during the same period.

| Year | Federal Statistical Office | | | Federal Labour Office | | |
|------|----------------------------|-------------|------|-----------------------|-------------|------|
| | Labour force | Un-employed | Rate | Labour force | Un-employed | Rate |
| | Thousands | | % | Thousands | | % |
| 1992 | 40,449 | 2,564 | 6.3 | 38,835 | 2,979 | 7.7 |
| 1999 | 41,307 | 3,428 | 8.3 | 38,964 | 4,099 | 10.5 |

By contrast, the labour exchanges record all persons between 15 and 65 years of age who are without work or working only part-time – at present, 15 hours a week or less – and who are seeking a job that is subject to compulsory insurance, comprising work of at least 15 hours a week and of more than seven days' duration; registration in person at the competent Labour Office is required. The number of persons meeting these broader criteria amounted to just over four million in 1999.

When calculating the unemployment rate – the percentage of unemployed or jobless persons in

the overall (statistically recorded) labour force – due account also has to be taken of the fact that the number of employed persons, estimated at 41.3 million in 1999 by the Federal Statistical Office, is 2¼ million higher than the figure provided by the Federal Labour Office. In accordance with the definition used by the labour exchanges, their calculations are based on the total number of civilian employed persons as well as the number of persons out of work; in the national accounts the Federal Statistical Office, by contrast, uses the total number of employed persons plus the number of unemployed persons. Apart from the slight methodological differences, the discrepancies in the statistical data are also due to the fact that the Federal Labour Office does not revise its calculations retroactively. The number of persons earning DM 630 a month or less recorded by the labour exchanges for June 1999 has been incorporated into the rate calculated by the Federal Labour Office from April 2000 onwards. In 1999, the annual average rate of unemployment as calculated by the Federal Statistical Office amounted to 8.3%; the figure provided by the Federal Labour Office was 10.5%. In Germany, the general public generally uses the data provided by the Federal Labour Office which, in contrast to the quarterly calculations of the Federal Statistical Office, are available on a monthly basis. The Bundesbank publishes figures according to both concepts in its Statistical Supplement to the Monthly Report 4 "Seasonally adjusted business statistics".



tenth. As had been the case for quite some while, foreign business continued to be the mainstay of this development. On an average of the period from July to September, seasonally adjusted orders were 3¾% up on the average level of April to June. The year-on-year-increase was 14½%. Manufacturers of durables and non-durables performed best, followed by the producers of intermediate goods. By comparison, the capital goods sec-

tor lagged behind somewhat, but – taken in isolation – still registered a sharp increase in orders.

Domestic demand, however, did not generate any expansionary impulses in summer. Domestic orders did not match the high level of the spring months, which – not least due to a number of large-scale orders – had brought a strong positive upsurge in demand. The year-on-year increase amounted to 5½%. While orders of intermediate goods remained largely stable, those placed in the capital goods sector, in particular, did not match their previous level.

Demand for construction work showed a further decline over the past few months. On an average of the third quarter, seasonally adjusted construction orders were roughly 7% lower than on an average of the period from April to June. Year-on-year, orders fell by 12½%. Since 1994, when there was a cyclical peak, the transaction volume has decreased – albeit with fluctuations – by roughly one-fifth overall.

Renewed decline in demand for construction

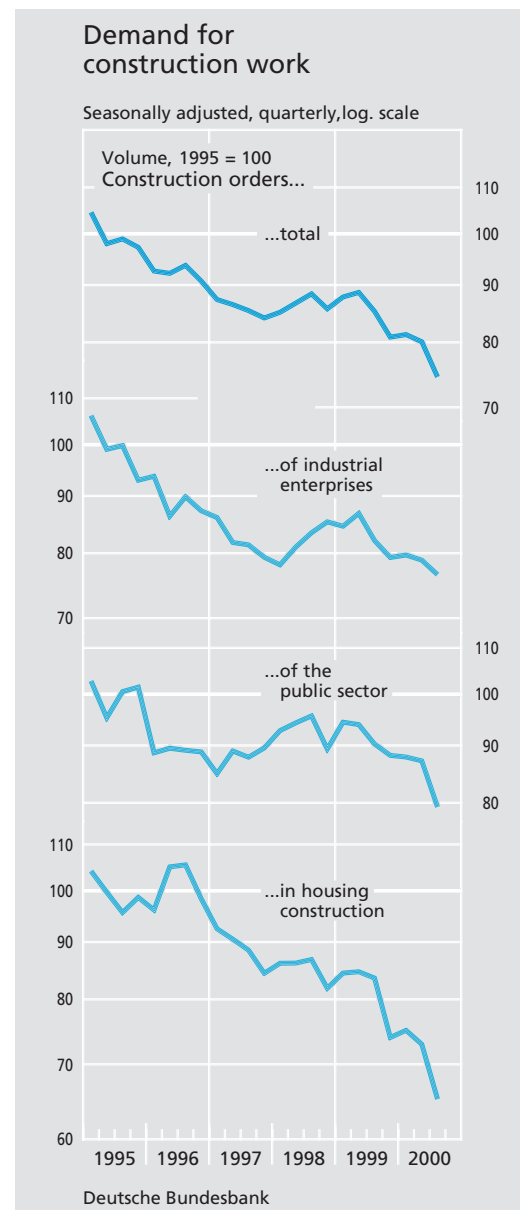
All the major construction subsectors – commercial, public and residential construction – were affected by this decline. With a year-on-year decrease in orders of roughly 7%, the development in industrial construction was not nearly as unfavourable as in the housing sector, where orders were latterly down again. Taking construction permits as a yardstick, the number of planned dwellings in July and August was around one-fifth down on the year. Compared with the mid-nineties, when housing construction activity was still

quite buoyant, the decline is roughly twice as high. A likely reason for the reduced propensity to build new dwellings, especially in rented housing construction, might have been the fact that, for some time now, there has been limited scope for raising rents. This situation has arisen – despite the sustained trend towards smaller households – owing to only small population growth and the fact that buoyant new construction activity during the first half of the nineties means that there is now an adequate supply of dwellings in many regions. In addition, tenancy legislation is being revised, and it appears likely that some aspects of this revision will place those who rent out properties in a less favourable position. Furthermore, the income limits for government assistance to private housing were lowered at the beginning of 2000. Finally, financial markets offer attractive investment alternatives, which is affecting privately financed housing, in particular.

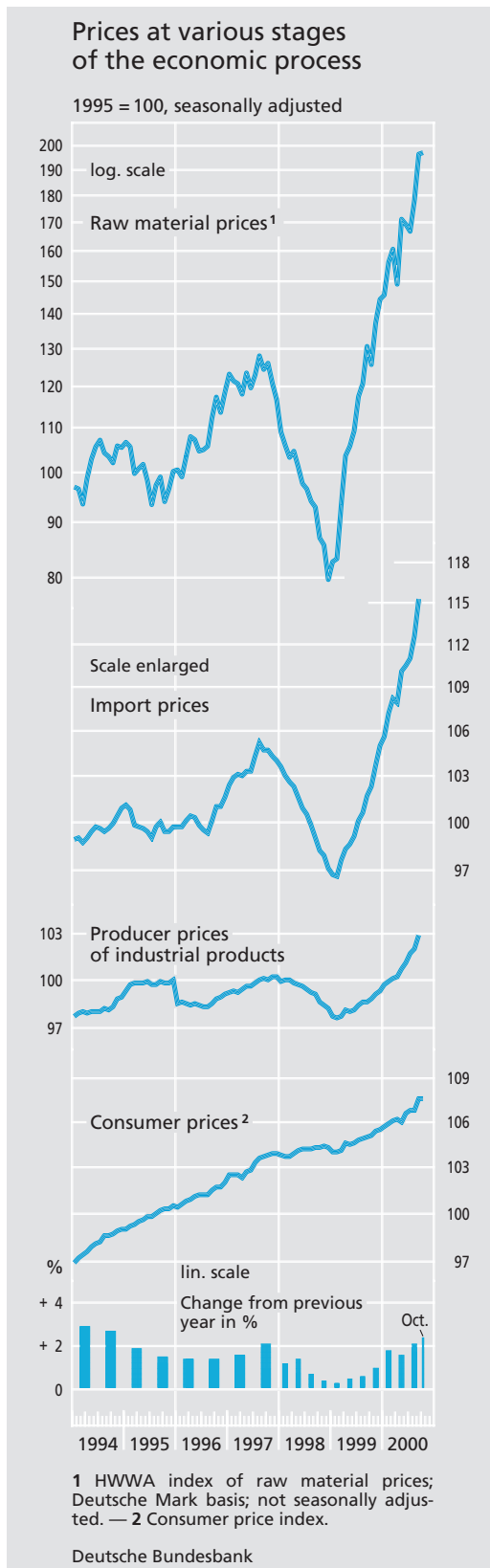
Prices

*Slower increase
in consumer
prices*

The sharp rise in consumer prices during the summer months did not continue in October in seasonally adjusted terms. According to the calculations of the Federal Statistical Office, the year-on-year rate of increase in the consumer price index was down to 2.4% at the end of the period under review, having previously reached a peak of 2.5% in the current trade cycle. This calming of prices was mainly due to significant reductions in prices for refined petroleum products. Although gas, contributions towards the cost of hot



water, and electricity became more expensive, overall energy prices fell somewhat for the first time since spring. This also affected overall consumer prices, since the prices for goods and services continued to remain moderate. The year-on-year increase in industrial products was no higher than ½% at the end of the period under review. Services and house rents were still roughly 1½% higher than 12 months previously; food prices were



around $\frac{3}{4}\%$ up on the year. Taking these goods together, the year-on-year rate of price increase stood at 1 % in October, too. A similar result is revealed by the core rates, which are calculated by the Bundesbank using various methods and which attempt to characterise the current price trend in isolation from short-term fluctuations.

As usual, consumer prices for refined petroleum products responded very rapidly to the calming of prices on the international oil markets. In mid-October, prices for Brent North Sea Oil had been moving around the US\$ 31½ per barrel mark. This was still much more than in the second half of the eighties or in the early nineties, for example, but markedly less than at the beginning of September, when international prices shot up at times to US\$ 37½. Spot market prices for petrol and heating oil eased, too, accompanied by sharp fluctuations. However, oil prices have been moving upwards again since then.

International oil prices somewhat lower

Import prices in September – more recent data are unavailable – reveal clear signs of the rise in oil prices at that time. Seasonally adjusted, they increased again noticeably, with the year-on-year rate of increase going up to +13.4 %. Excluding energy, there was a year-on-year price increase of 6.6 %. This development was a result of the persistent fall in the external value of the euro. At a year-on-year rate of 4.5 %, the rise in prices for finished goods remained comparatively limited.

Further rise in import prices ...

Price trend indicators for Germany

Change from previous year in %

| Item | 2000 | | | |
|--|---------|---------|---------|------|
| | 1st qtr | 2nd qtr | 3rd qtr | Oct. |
| Headline rate of inflation | | | | |
| Consumer prices | 1.7 | 1.6 | 2.0 | 2.4 |
| Statistical core rates ¹ | | | | |
| Consumer prices excluding seasonal food and energy | 0.7 | 0.8 | 0.9 | 0.9 |
| Consumer prices with modified weights ² | 0.8 | 0.8 | 0.8 | 1.0 |
| 5 % trimmed mean ³ | 0.8 | 1.0 | 1.2 | 1.3 |
| Weighted median ⁴ | 1.0 | 0.9 | 1.1 | 1.0 |
| Mean of the core rates | 0.8 | 0.8 | 1.0 | 1.1 |

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

The upsurge in industrial producer prices continued in September, too, not least owing to the movements in oil prices. The year-on-year rate of price increase amounted to 4.3%, which was the highest level since the early eighties. Excluding energy sources, year-on-year price rises amounted to just under 2½%.

... as well as in industrial producer prices

Construction prices also remained largely stable during the third quarter. Apart from road building, where input prices rose more sharply owing to a comparatively high level of dependency on oil prices, there were hardly any price movements in the other sectors. Overall, year-on-year price rises in the construction sector did not exceed ¾% during the summer months.

Construction prices largely stable