

Economic conditions in Germany

Underlying trends

The cyclical stagnation in the German economy persisted after mid-year. After ceasing to expand in the spring months, overall output remained largely at its previously attained level in the summer. According to the Bundesbank's initial calculations, the figure for the second quarter is likely to have been just about maintained in seasonally adjusted terms. Even after adjustment for working-day variations, output was thus no more than around $\frac{1}{4}\%$ up on the year. In the period from April to June, the year-on-year figure had been just over $+\frac{1}{2}\%$. Taking the first three quarters together gives a year-on-year growth rate of $\frac{3}{4}\%$.

*Stagnation of
GDP in the
third quarter*

The tendency to sluggishness in the economy as a whole has become stronger recently. As is revealed by various surveys, there has been a further clear deterioration in sentiment both in the business sector and among households. This is likely to be due, above all, to the general feeling of uncertainty in the wake of the terrorist attacks in the United States. There was a sharp fall in manufacturing orders in September, suggesting that, in many cases, spending decisions have been put on hold for the time being. On the labour market, the cyclical strains have remained limited. The fact that the rate of price increase has gone back down significantly again is to be rated positively.

*Acute
uncertainty as
a result of
terrorist attacks*

It was essentially services that were a mainstay of output in the summer months. Within the services sector, it was probably more consumption-oriented service providers that

*Services have
stabilising
effect*

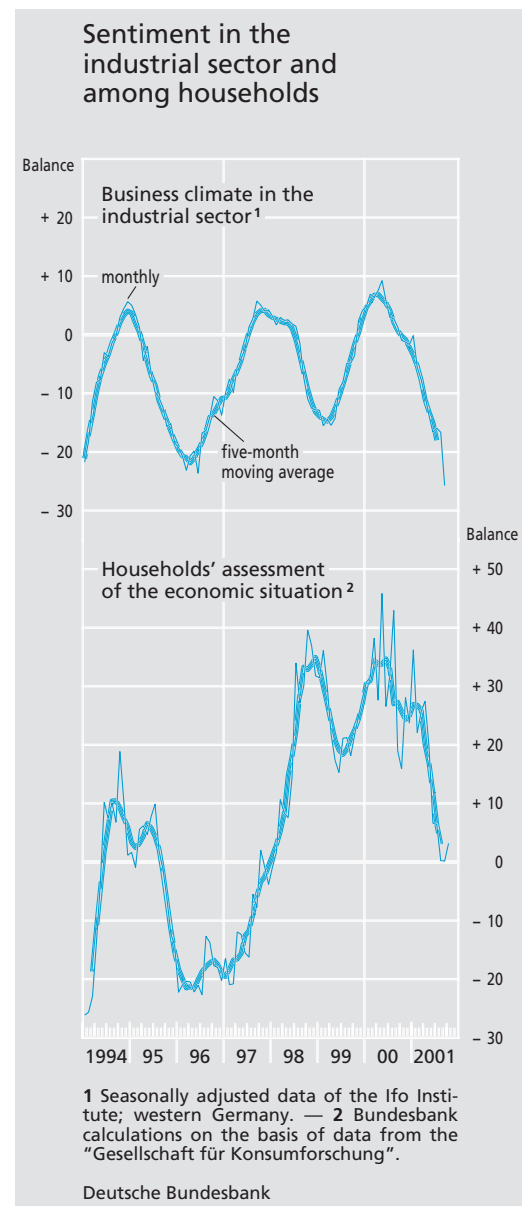
achieved positive results rather than the business services sector, where the slowdown in manufacturing and the continuing difficult situation in construction had a dampening impact on business activity. This is also confirmed by the surveys of the Centre for European Economic Research (ZEW), which indicate a worsening of the situation for the advertising industry and for firms of architects and planners, in particular.

High level of exports, and destocking

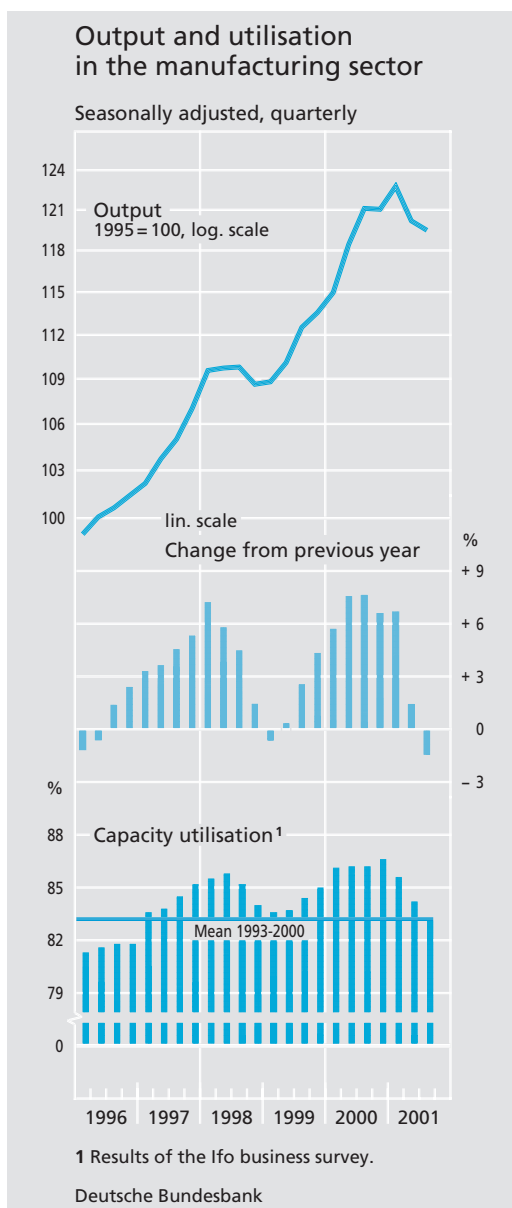
As far as it is possible to tell, exports have held up at a fairly high level. In fact, there is likely to have been a significant increase in real net exports in the third quarter. Although manufacturing activity was still tending to weakness, this was also due to the fact that many enterprises were endeavouring to reduce their high inventory positions. Moreover, the business sector was also hesitant to engage in new investment projects owing to the depressed level of demand for industrial products caused by uncertainties about the future development of international trade. Restraint was exercised, in particular, in terms of orders in the telecommunications and IT sectors.

Consumer confidence and consumption behaviour

Sentiment among households has become considerably gloomier over the past few months, not least on account of the unpredictable political situation. Above all, the economic outlook was rated as unfavourable. Income expectations, too, tended to be less positive, although current information on the level of incomes, by itself, hardly gives cause for a negative assessment. Rather, households' income in the summer months probably remained at roughly the same level as in



the second quarter. Actual earnings in manufacturing (excluding construction and energy) are likely to have fallen by ¼%, seasonally adjusted, in July and August in comparison with the average of the second quarter. However, the remuneration of wage and salary earners in the public sector was raised by 2.4% as of 1 September. Nevertheless, in order to strengthen savings, households have cut back their consumption expenditure



somewhat when compared with the preceding months, when the lowering of income tax had been having a stimulating impact.

Output and labour market

Slight decline in manufacturing output

Seasonally adjusted manufacturing output in summer was somewhat lower than in the second quarter. While it was initially possible

to make up for most of the shortfalls in production that had occurred in July owing to the increased number of works holidays, the level of output was not quite maintained in September. Seasonally adjusted, the volume of production in the third quarter was more than ½ % down on the average of the preceding three months, in which there had already been perceptible cutbacks. In summer, output was down over 12 months for the first time since early 1999 (by around 1½ %).

The decline in manufacturing output was accompanied by a fall in the level of capacity utilisation. According to the surveys of the ifo institute, seasonally adjusted capacity utilisation was around 1 percentage point lower in September than it had been three months earlier, and roughly 3 percentage points down on the year. The degree of capacity utilisation was thus nearly corresponding again to the medium-term average, which is an approximate reflection of neutral standard utilisation.

Lower capacity utilisation

According to information on manufacturing turnover, business with foreign customers was holding up comparatively well up to the end of the period under review. Even though the third quarter no longer showed a quarter-on-quarter rise in seasonally adjusted terms, year-on-year growth was still around 1%. The increase in turnover over 12 months was much sharper in the case of producers of consumer goods. Capital goods producers, too, reported a higher-than-average increase in deliveries. By contrast, the result for the basic goods sector was significantly down on the year. This was likewise the case for domestic sales in that sector. Since the other sectors

Turnover only slightly weaker

also failed to achieve quite the same levels as one year earlier, domestic deliveries were, on the whole, noticeably down in the summer months.

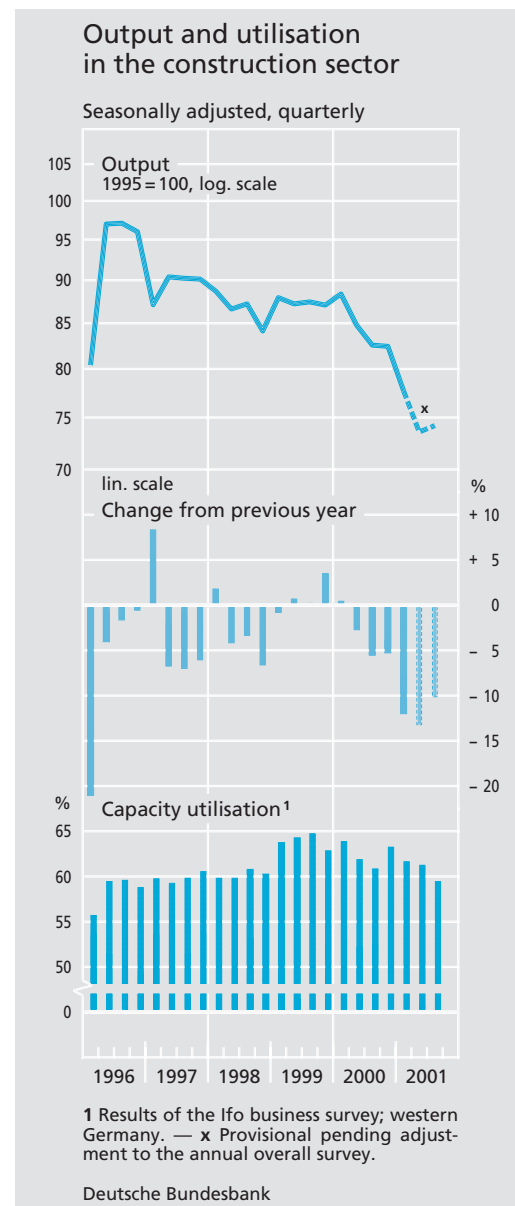
*Slight recovery
in construction
output*

Output in the construction sector – and probably in the ancillary sectors, too – remained at a low level in summer. This means that the downward trend, which had begun in the mid-nineties and had intensified further at the turn of 1999-2000, was at least interrupted. Whether a turn for the better is in the offing must still remain an open question, however. At all events, seasonally adjusted output on an average of the third quarter was around $\frac{3}{4}$ % higher than in the spring quarter. However, it was still considerably lower ($-9\frac{1}{2}$ %) than the level in the comparable period of 2000. In the period of April to June, however, the decline had been as much as $12\frac{1}{4}$ %, and in the first few months of the year even as large as $14\frac{1}{4}$ %.

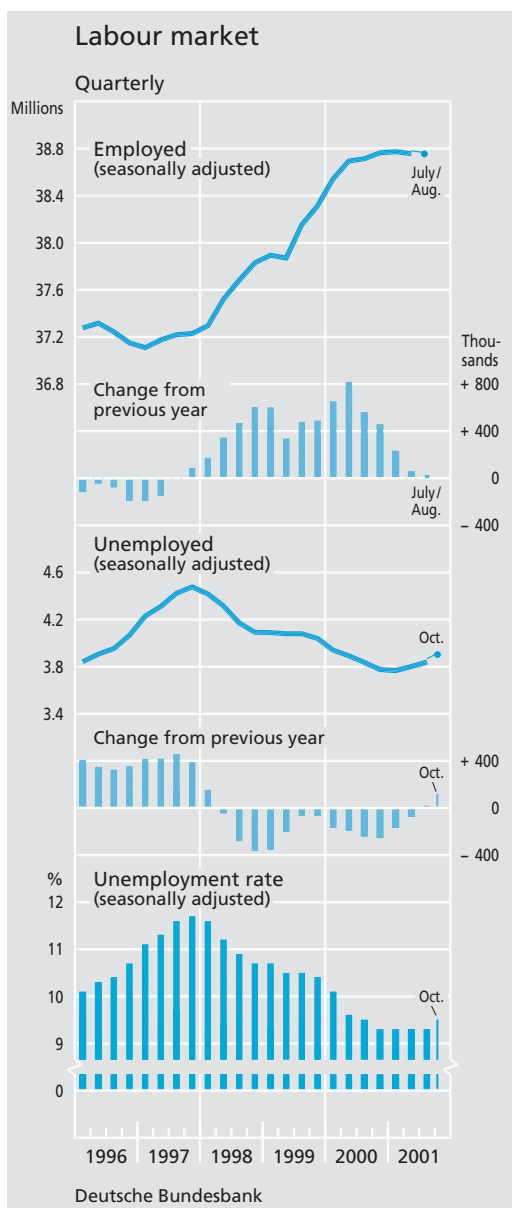
The year-on-year fall was especially large in building construction. This was due, in particular, to the sharp cut-back in business activity in residential construction, which – measured by turnover – was almost one-fifth lower at the end of the period under review. The slight increase in output in industrial building, by contrast, had scarcely any impact. The situation in civil engineering was much more favourable, the comparable turnover figures for 2000 being largely matched in both the industrial and public sectors.

*Subdued
reaction of
employment*

So far, the labour market's reaction to the continuing stagnation of overall output has tended to be subdued. In particular, employ-



ment has been cut back only slightly. By August (more recent information from the Federal Statistical Office is unavailable at present), the seasonally adjusted number of persons in work had fallen to 38.76 million. Since the start of the present cyclical slow-down on the labour market, which set in at the turn of 2000-01, employment has been reduced in seasonally adjusted terms by a total of 35,000 persons, or 0.1 %. Besides the



construction sector, which continued to show a need for labour-employment adjustment, industry has recently also cut back its manpower levels slightly. In the services sector, staffing arrangements have likewise become more cautious. All in all, the year-on-year increase in employment was still just under 30,000 in July/August, compared with around 60,000 in spring.

The number of persons registered as unemployed rose between the most recent low in December 2000 and the end of October by 140,000 to a seasonally adjusted 3.92 million. The level in October was 115,000 up on the year. The seasonally adjusted unemployment rate, as defined by the Federal Labour Office, amounted to 9.5 % at the end of the period under review; according to the International Labour Office (ILO) definition, the figure was 8.0 %.

Unemployment on an upward trend

The deployment of labour-market-policy measures has been further reduced over the past few months. At 330,000 persons, around 60,000 fewer persons were attending vocational training courses than one year previously. Over the past 12 months, the number of persons employed on job creation schemes and in structural adjustment measures fell by 85,000 to 230,000. Even though this reduction especially affected eastern Germany, this part of the country still accounted for three-quarters of those employed by such measures. By contrast, the number of older unemployed persons (58 years and above), who no longer have to be available for a job placement and are also not counted as unemployed, has increased to 245,000 over the past few months. This was 55,000 more than 12 months previously.

Cut-back in labour-market policy

Orders

New orders received by German manufacturers showed a further decline in summer 2001. On an average of the period from July to September, they were 2¾ % lower, seasonally

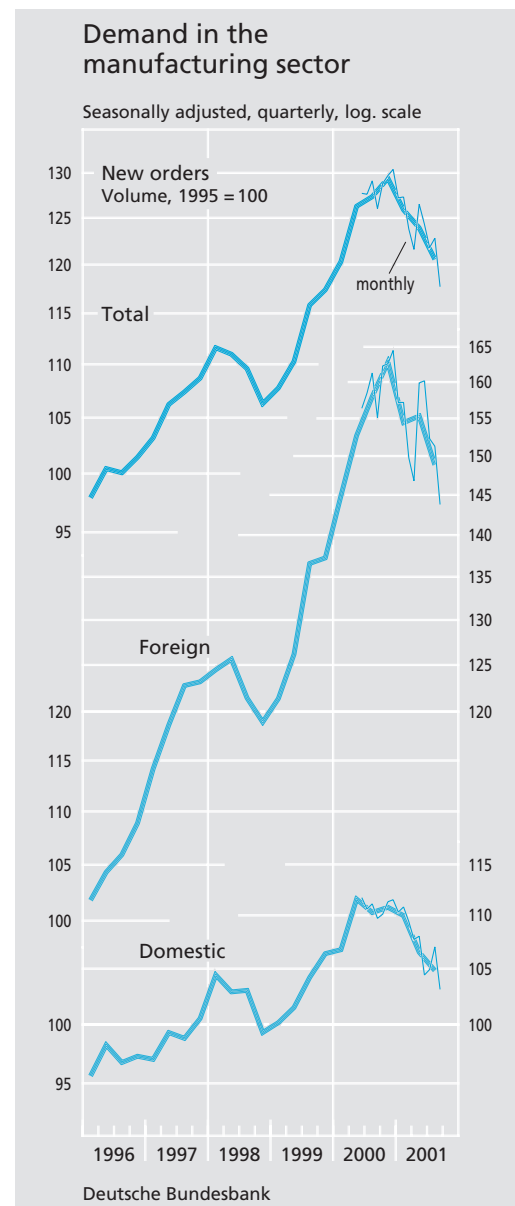
Perceptible decline in incoming orders

adjusted, than in the preceding three-month period. In September, especially, there were acute shortfalls – probably as an immediate reaction to the terrorist attacks in the United States. This means that the fall in demand, which had begun in autumn last year, has significantly intensified of late. The year-on-year figure turned from + 10 ½ % in the final quarter of 2000 to – 5 ½ % at the end of the period under review. This chiefly reflects the sharp rise in orders that persisted up to the end of 2000.

In particular, there have been fewer orders from abroad recently. This followed an intermittent recovery in spring, which was due, not least, to a number of large-scale orders. During the past three months, orders were, on average, a seasonally adjusted 4 ¼ % lower than in the second quarter and 6 % down on the year. Since autumn 2000, export orders have declined by almost 10 % in seasonally adjusted terms, and were thus no higher at the end of the period under review than they were 18 months ago. By contrast, orders received from domestic customers have been cut back somewhat less. Above all recently, they have held up better. This has played a crucial role in their decline since autumn of last year being less marked, at a seasonally adjusted 5 ½ %, than that of export orders.

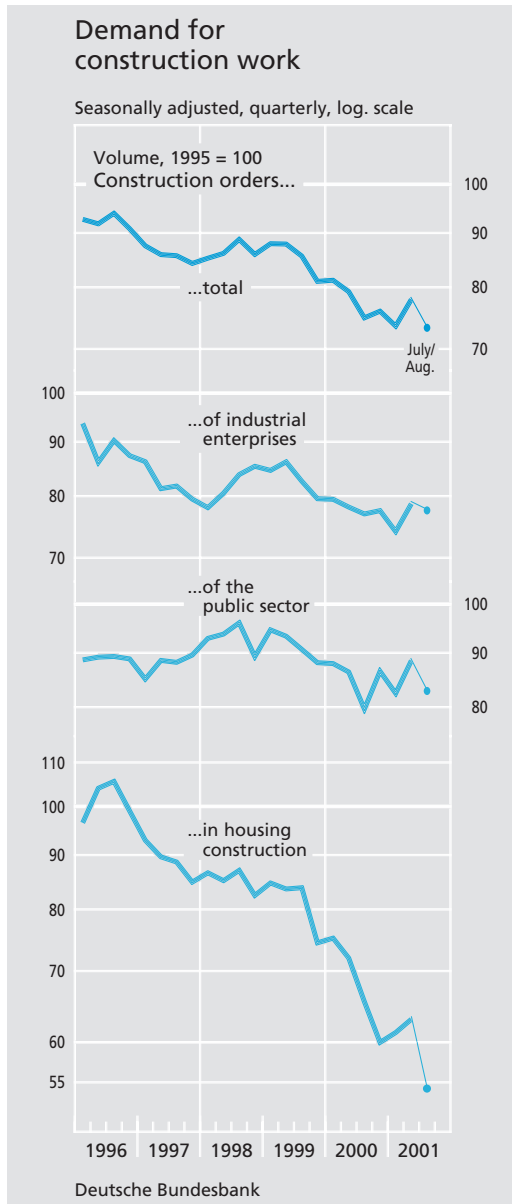
*Declining
construction
demand*

Demand for construction work fell again significantly in the summer months. In seasonally adjusted terms, new construction orders on an average of July and August were 6 ¼ % down on the spring, when demand had temporarily picked up. At all events, incoming



orders were at roughly the same level as at the beginning of the year, which meant that no new low was produced. The figure was 2 ½ % down on the year, compared with 1 ¼ % in the second quarter.

In residential construction, in particular, the situation with regard to demand has deteriorated significantly. The year-on-year shortfall in orders latterly increased to nearly one-fifth



again, having intermittently gone down to 12 ½ %. The main reason for this was the fact that demand in western Germany – which had been more or less stable for some time – witnessed a further dramatic fall. In seasonally adjusted terms, it decreased in July/August by nearly 15 % compared with the preceding months. Taking construction permits as a yardstick, construction work is likely to have been

started on a smaller number of both single-family houses and rental apartments.

The level of orders placed by public sector and industrial customers in July and August was also no longer as high as it had been before. Specifically, the decline compared with the second quarter in the public sector, at a seasonally adjusted 6¾ %, was much sharper than that in industry, where demand fell by only 1¾ %. Although this meant that there was no continuation of the upturn observed in both sectors in the spring months, the level of early 2001 was, at all events, at least not undershot and, in fact, continued to be exceeded in the industrial sector. Even at the end of the period under review, orders were still up on the year, i. e. by 1½ % in the case of public sector contractors, and by 3¼ % in the case of industrial customers.

Prices

The price climate in Germany was continuing to improve up to the end of the period under review. By October, the year-on-year rate of increase in the consumer price index had gone down to 2.0 %, having been 3.2 % in the second quarter of 2001. For the first time in some while, the current rate of price increase matched the rise reflected by the statistical core rates. This means that price developments, measured year-on-year, are, on balance, scarcely influenced at present by larger-scale special movements.

Price developments more favourable again

In seasonally adjusted terms, consumer prices from the middle of the year onwards were

largely stable, whereas they had risen more than 1½% between January and June. This was mainly due to the fall in energy prices, where lower prices for mineral oil products, in particular, have more than made up for the persistent price increases in tenants' costs for hot water and heating.

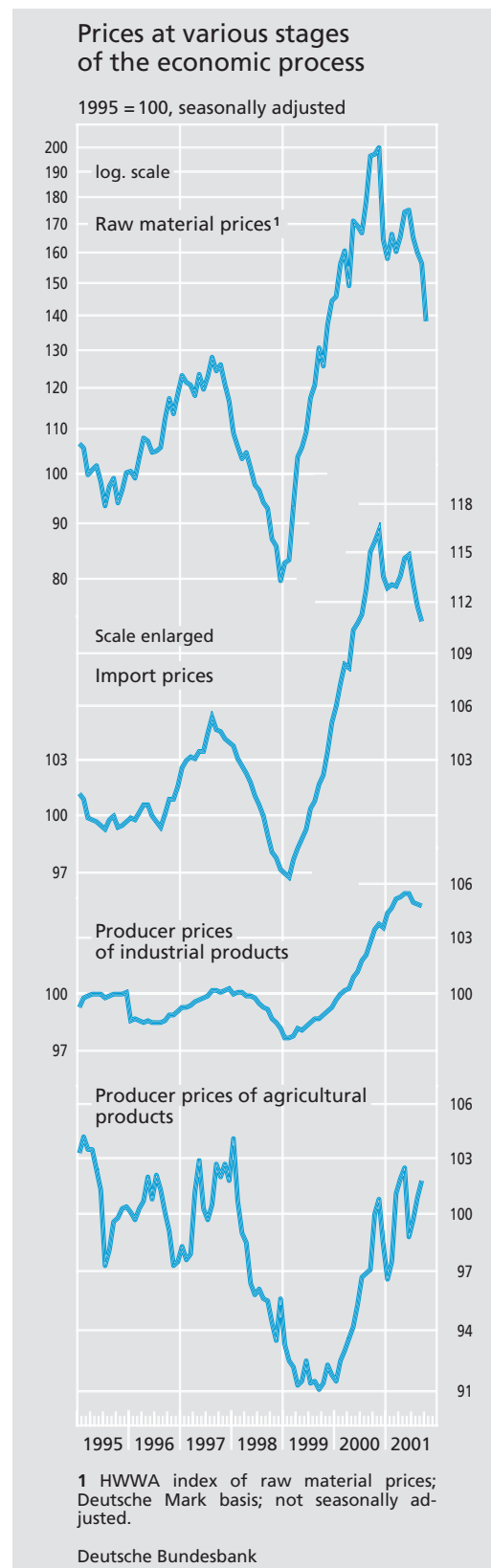
Price movements for major groups of goods

Furthermore, the rate of price increase for food has been tending to slow down, since the significantly price-boosting effects of the BSE and foot-and-mouth disease crises have abated, as has the impact of the intermittently unfavourable weather conditions. In the period from January to June, food prices went up by around 4½% in seasonally adjusted terms, but by no more than 0.7% in the months that followed. Nevertheless, the year-on-year rise in October still amounted to 6.6%.

Price rises for manufactured goods were much lower than this, with a year-on-year rate increase of no more than 1.1% even at the end of the period under review. Seasonally adjusted, prices had risen by less than 0.1% per month since mid-year. Rents rises were likewise very subdued, with the year-on-year increase having been less than 1¼% for some time. Inflation was much more pronounced in the case of services. This was not, however, due to current developments, but rather, for the most part, to increases in administered prices at the start of the year, which continue to affect the year-on-year rate.

Lower oil prices and import prices

International oil prices during the past few weeks were in the order of roughly US\$ 21 per barrel of Brent Oil. They were thus around



Consumer price index

2001; Changes from previous year in %

Item	1st qtr	2nd qtr	3rd qtr	Oct.
Energy sources	11.2	12.3	4.8	-0.4
of which				
Mineral oil products	5.2	9.3	-3.4	-9.8
Food	2.7	6.2	6.4	6.6
of which				
Seasonal products	2.9	9.6	7.5	8.4
Meat and fish products	4.6	8.4	8.8	8.3
Manufactured goods	0.5	0.9	1.0	1.1
Services	3.0	2.9	3.0	3.2
Rents	1.2	1.2	1.2	1.2
Total	2.5	3.2	2.5	2.0

Deutsche Bundesbank

one-third cheaper than one year previously, when upward price fluctuations had been especially large. Much the same applies to spot market prices for petrol and light heating oil. This was clearly reflected in German import prices and was a main factor in imports being 3.6% cheaper overall in September than 12 months earlier. Furthermore, iron and steel

products as well as units for producing and distributing electricity were much less expensive to buy than in 2000.

In September, domestic selling prices for German industrial products were 1.9% up on the year. This was much lower than in April, when the most recent peak had been reached (5%). In addition to cheaper energy, lower prices were charged by producers of intermediate goods. In summer, construction work cost scarcely more than 12 months previously. In seasonally adjusted terms, the construction price level even went down slightly compared with the spring. By contrast, agricultural prices at the producer level have recently started to rise again somewhat. The year-on-year rate of increase, which had fallen to 3.2% in July, went back up to 4.8% in September. This was due, firstly, to strong upward price pressure in the case of potatoes, owing to the fact that this year's harvest was not as good as in previous years. Secondly, the fall in pig prices since the end of the winter has not continued. Following a slump in prices in the wake of the BSE crisis, beef cattle, too, have been becoming slightly more expensive again since February.

Price developments at the producer level