

## Economic conditions in Germany

### Macroeconomic situation

*Subdued GDP growth in 2012 Q2*

Despite the difficult economic situation in some euro-area countries and the dip in global economic activity, the German economy continued to expand in the second quarter of 2012, albeit at a slower pace. The Federal Statistical Office's flash estimate recorded quarter-on-quarter GDP growth of 0.3% in the second quarter of 2012 (after seasonal and calendar adjustment), compared with 0.5% in the first quarter.<sup>1</sup> Enterprises' average capacity utilisation remained around normal. Although the external demand stimuli were less pronounced in the first half of 2012, they were still strong enough, *in tandem* with expanding domestic activity, to enable output to grow in line with its potential. The uncertainty triggered by the euro-area sovereign debt crisis continued to dampen investment in machinery and equipment, but was also reflected in more cautious recruitment plans of late. By contrast, construction and consumer demand have hardly been affected by the confidence effects so far and have even benefited from them in some cases.

*Exports to euro area flat, ...*

Germany's exports may have risen almost as steeply in the second quarter of 2012 as during the first three months of the year. While export growth to non-euro-area countries continued virtually unabated, exports to euro-area countries stagnated. As the sizeable falls in demand in the latter part of 2011 were barely recouped in the first quarter of 2012, this sideways motion means that Germany's overall euro-area business was dominated by contractionary dynamics. Since the current business cycle peak in the third quarter of 2011, which, in terms of value, came close to matching the level at the end of the previous upswing, dampening effects have predominated, emanating mainly from Italy and Spain. The value of goods exported to France stagnated. The underlying upward trend in exports to the Netherlands and

Austria remained on an upward course, however.

Business with customers in non-euro-area countries was barely touched by the global economic downturn. The pace of growth varied considerably across countries, however. Growth in exports to the USA, for example, slowed down fairly abruptly after regaining momentum in late 2011 and early 2012. This also applies to the majority of German enterprises' key trading partners in South and East Asia. Exports to United Kingdom remained buoyant, however, despite recessionary tendencies. Significant export gains were generated in Russia again. Exports to central and eastern European countries also posted a further increase.

*... but exports to non-euro-area countries still rising*

The growth in exports was driven primarily by manufacturers of capital goods, as opposed to producers of intermediate goods who had been the main driving force in the first quarter. Exports of information and communication technology (ICT) products, as well as electrical equipment received a significant boost. Furthermore, foreign customers once again purchased a greater number of German motor vehicles, especially in the premium car segment. Exports of machinery and equipment were rather sluggish. In the intermediate goods sector, there was a further expansion of exports in the chemicals industry, whereas manufacturers of metals and metal products suffered a setback in the international markets. Exports of consumer goods likewise rose.

*Above-average growth in capital goods exports*

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<sup>1</sup> During the regular revision of the German national accounts, which is carried out every year in the summer months, GDP growth for the year 2010 was raised by 0.5 percentage point to 4.2%. This would indicate that the German economy recovered faster from the steep drop in output than has been documented in the GDP results to date. The new data are more consistent with the overall macroeconomic picture of an ongoing upturn, which was characterised from the outset by a jump in employment and a very buoyant business climate among enterprises.

*Strong growth in construction investment, not just due to catch-up effects*

Construction investment is likely to have expanded in the second quarter. This owed something to the rebound following the sharp weather-related reduction in activity in February but also to building firms' very buoyant order situation. Towards the end of last year, an extremely large number of building permits were granted for new residential and commercial properties. In addition, public sector demand surged after the turn of the year.

*Investment in machinery and equipment still sluggish*

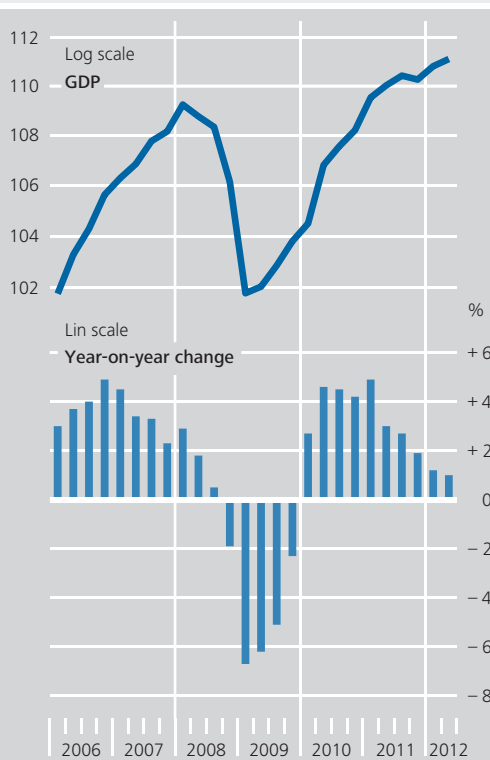
By contrast, purchases of moveable fixed assets continued to stagnate in the second quarter of 2012. Investment in machinery and equipment has been subdued now for the past three quarters. This is because few companies are looking to expand production capacities at the moment. Capacity utilisation in manufacturing has fallen since autumn 2011 and is now back within the longer-term average range. Furthermore, German firms' economic outlook was dampened by the escalation of the euro debt crisis, from which they have not yet fully recovered despite the temporary easing at the end of last year, and the heightened uncertainty is causing them to adopt a "wait-and-see" approach. This is above all the case for purchases of new machinery. By contrast, vehicle fleets continued to be modernised on a large scale. This is shown by the number of registrations for commercial vehicles, which between April and June were up on the previous quarter in seasonally adjusted terms.

*Moderate upturn in private consumption continuing*

Private consumption showed a further seasonally adjusted rise in the second quarter of 2012. Consumer demand benefited from the favourable labour market situation and the substantial wage increases. Moreover, the slowing rate of inflation is likely to have boosted consumer confidence. The decline in petrol and heating oil prices undoubtedly increased households' real spending capacity. This benefited the retail trade sector, the turnover of which saw a marked recovery in the reporting period in seasonally adjusted terms. A large number of homeowners took advantage of the lower energy prices to replenish their heating oil tanks.

### Overall output

2005 = 100, price and seasonally adjusted



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By contrast, expenditure on automobile purchases was scaled back. One indication of this is that the number of new private passenger car registrations in the second quarter was significantly lower than in the preceding quarters.

Following zero growth in the first quarter of 2012, imports saw a marked quarter-on-quarter increase in the second quarter (after seasonal adjustment). However, imports have not kept pace with export growth since the beginning of 2012. This is partly because of an underlying trend in which construction activity, with its relatively low import content, has increasingly become the main driver of domestic economic activity, whereas investment in machinery and equipment has lacked momentum of late and private consumption has been developing at a steady moderate pace. Domestic enterprises purchased fewer intermediate goods from foreign manufacturers between April and June, whereas they had been keen buyers of inputs in the first quarter. By contrast, demand for

*Distinct rise in imports*

### Underlying trends in foreign trade

Seasonally adjusted, quarterly



1 Adjusted for the price indices for foreign trade.  
 Deutsche Bundesbank

foreign-manufactured computers, electronic and optical products as well as electrical equipment surged. Demand for imported machinery was also somewhat greater.

*Imports from Europe stronger*

Deliveries from euro-area countries and EU member states in central and eastern Europe went up in the second quarter of 2012. The value of imports from other parts of the world (apart from China) largely decreased. It should be borne in mind, however, that the reduction in nominal imports from Russia and the OPEC countries is probably due to declining energy prices, while the growing rise in the effective price of US-produced goods caused by ex-

change rate movements may have additionally dulled import dynamics from the United States.

### Sectoral trends

Industrial output in the second quarter of 2012 was down slightly by a seasonally adjusted ½% on the previous three months. This was attributable primarily to the steep decline in capital goods production (-1½%). The 2½% decline in the mechanical engineering sector owed much, however, to a statistical effect, as the index level in the first quarter was greatly inflated by post-bookings. The automotive industry cut back its output significantly in the second quarter (-3%) due to high stockpiles. This, however, presumably affected mass-market vehicle manufacturers most as they struggled with weaker demand, especially from the euro area. By contrast, production of top-range models still appears to be very strong. Manufacturers of intermediate goods marginally increased their output (+¼%), while consumer goods production declined somewhat in seasonally adjusted terms (-¼%).

*Slight fall in industrial output*

The lack of momentum in industrial activity seen over the past three quarters is reflected in the fact that capacity utilisation of fixed assets has been progressively scaled back. According to surveys carried out by the Ifo Institute, manufacturing capacity utilisation in July, at 83% of the normal take-up rate, fell below the longer-term average for the first time in almost two years. The level of utilisation in the capital goods sector was more clearly below the multi-year average than in the case of intermediate goods.

*Manufacturing capacity utilisation slightly below normal*

Construction output picked up considerably in the second quarter of 2012 (+4½%) compared with the previous three months. Weather-related catch-up effects played an important role in this, as is attested in the individual sub-sectors of the construction industry. Civil engineering activity, which is generally more strongly affected by the cold weather, expanded some-

*Clear rise in construction, but energy production a little lower*

what more substantially than in the case of building construction. This runs counter to the current underlying trend in which, owing to the robust demand for residential and commercial properties, buildings are developing more dynamically than infrastructure projects, which are largely reliant on public sector spending. Energy output in the second quarter was cut back slightly (-1/2%) in seasonally adjusted terms, compared with the period from January to March.

*Service sector up on balance*

Economic activity in the services sectors is likely to have been more buoyant overall than in industry. This is suggested by Ifo Institute data, according to which firms' optimistic assessments of the business situation have been adjusted downwards only fairly marginally. Nevertheless, there are signs that the downturn in industrial output affected industry-related service providers, in particular. This is borne out, for example, by the fact that the mileage of domestic heavy goods vehicles on toll roads rose only slightly on the first quarter in seasonally adjusted terms. Declines were also recorded in the wholesale trade. Consumption-related service providers performed better only in certain areas. While the retail trade fared well overall, motor vehicle sales dipped discernibly. The turnover of hotels and restaurants also failed to reach the level of the first three months. Conversely, construction-related service providers benefited from the upturn in the building trade.

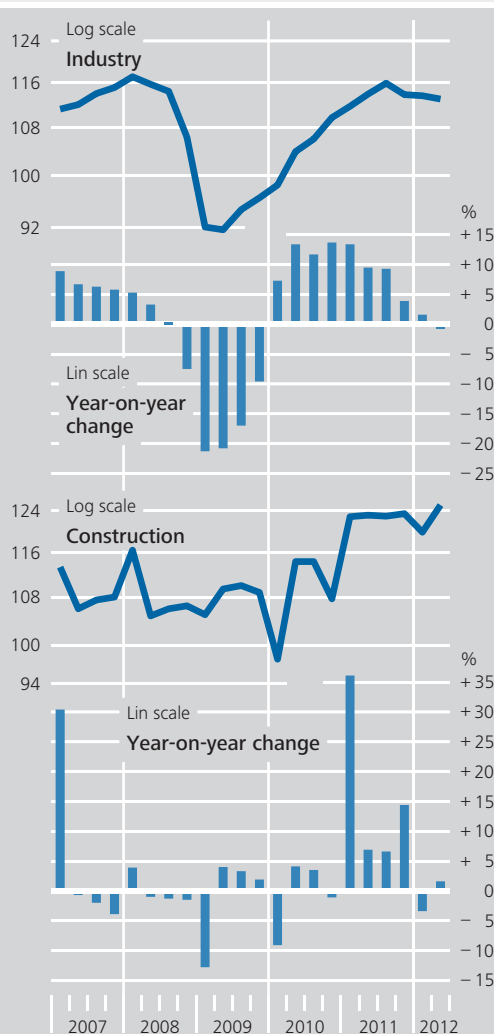
## Employment and labour market

*More cautious recruitment plans*

Although the positive trend on the labour market was confirmed in the second quarter by the continued rise in employment, the slower pace of economic activity made itself felt. Employed persons, for instance, were working fewer hours towards the end of the period under review and, after seasonal adjustment, the number of unemployed persons rose somewhat quarter on quarter for the first time since the

### Output in industry and in construction

2005 = 100, seasonally adjusted, quarterly



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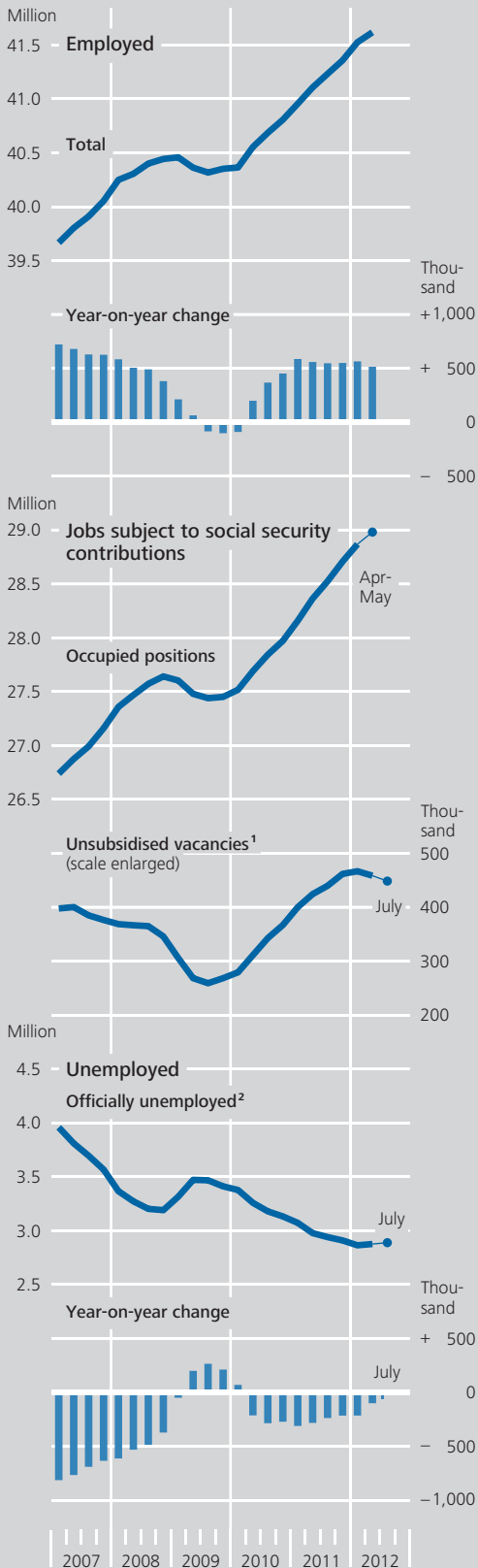
cyclical upturn began. This suggests that, despite an expansionary underlying trend, the growing concerns about the economy are now being reflected in more cautious recruitment plans.

According to estimates by the Federal Statistical Office, the seasonally adjusted number of persons in work in Germany went up by 92,000, or 0.2%, compared with the first quarter of 2012. Job growth was consequently weaker than in previous quarters. The majority of newly created positions were again regular jobs subject to social security contributions. By contrast, there was a further decline in the

*Slower rise in employment*

## Labour market

Seasonally adjusted, quarterly



<sup>1</sup> Excluding seasonal jobs and jobs located abroad. <sup>2</sup> From May 2009, unemployed excluding persons newly registered on the books of private employment agencies.

number of persons working exclusively in low-paid part-time employment and in the number of government-sponsored workfare arrangements ("one-euro jobs"), whereas there was little change in the number of self-employed persons.

According to initial estimates by the Federal Employment Agency, employment fully subject to social security contributions rose considerably in April and May. Nevertheless, with a seasonally adjusted increase of 98,000 persons, or 0.3%, vis-à-vis the first-quarter average, the rise failed to match the particularly robust growth figures recorded in the preceding quarters. This was due, among other factors, to slower growth in employment in the cyclically sensitive manufacturing industry as well as in the closely related trade and logistics sectors. There was a further reduction in agency-hired temporary staff. Their number was down by around 1% compared with the peak level reached one year previously. Employment in the health and education sectors as well as in business-related services (excluding temporary agency hirings) continued to grow substantially. Considerable increases were likewise recorded in other services sectors, such as hotels and restaurants, information and communication as well as in education and training.

*More regular jobs especially in services sector*

Given the subdued economic growth, the further increase in employment was accompanied by a reduced number of effective working hours. The adjustment was made primarily through working time accounts. According to information provided by the Institute for Employment Research (IAB), the first six months of 2012 represented the first net reduction in working time accounts since the beginning of 2010.

*Reduced working hours*

The number of persons officially registered as unemployed in the second quarter went up slightly by a seasonally adjusted 12,000 on the first three months to 2.88 million. The unemployment rate remained unchanged at 6.8%. The customary spring pick-up in eco-

*No further fall in official unemployment*

conomic activity was relatively muted this year following the largely mild winter weather. The previous downward trend in unemployment did, however, level off to some extent. This was due in part to the fact that, given the dramatic decline by over two million in the number of unemployed persons since 2005, the jobless pool has been reduced so much that firms are now finding it quite hard to recruit new staff. Hence, the ongoing upturn in employment is now primarily drawing on previously non-employed members of the resident population and on immigrants.

*Rise in short-term unemployment*

It is precisely the short-term unemployed, who have a relatively good chance of finding new work, that have been in short supply on the labour market for quite some time now. The seasonally adjusted number of recently unemployed workers claiming insurance benefits stood at around 880,000 and thus matched the prior-year figure. Normal labour market turnover, together with necessary adjustments in terms of retraining and relocating, produces a certain core level of short-term unemployment that remains stubbornly entrenched even in a boom. At the current end, the moderate rise in unemployment is translating directly into an increase in the number of short-term jobless workers claiming unemployment insurance. In addition to this recent rise, the exceptionally favourable economic climate a year ago means that relatively few unemployed persons are transferring at present from the short-term insurance scheme to the longer-term welfare benefits scheme. This was the main reason for the further slight seasonally adjusted decline in the number of unemployed persons receiving the basic welfare allowance in the period under review by around 9,000 persons. By contrast, fewer people dropped out of the basic welfare system to take up gainful employment. Registered unemployment in July 2012 rose again slightly on the month by 7,000 persons.

*Dwindling momentum set to continue*

The available leading indicators suggest that the labour market could continue to lose momentum in the coming months. The BA-X job

index saw a marked decline in the second quarter for the first time since the beginning of the recovery three years ago. Besides a repeated reduction in new vacancies, the existing number of reported (unassisted) vacancies also declined perceptibly. Vacancies for regular jobs fully subject to social security contributions fell by around 7,000 to 460,000 in seasonally adjusted terms, which is more or less equal to the level recorded in the fourth quarter of 2011. The Ifo employment barometer, which provides information about planned staffing levels in trade and industry over the next three months, fell again in the second quarter of 2012. Despite the ongoing decline over the past five quarters, however, the indicator is still at a high level.

## ■ Wages and prices

Employers and employees negotiated considerable wage rises in the pay negotiations that were concluded in the second quarter of 2012, as was the case at the beginning of this year's pay round. While the services segments principally agreed incremental wage increases spanning fairly long contractual periods, negotiators in industry tended to go for strong rises with a fairly short duration. The wage increases were, for the most part, agreed in the form of permanent percentage increases, whereas one-off lump sum payments played only a negligible role.

*Sizeable wage increases in this year's pay round*

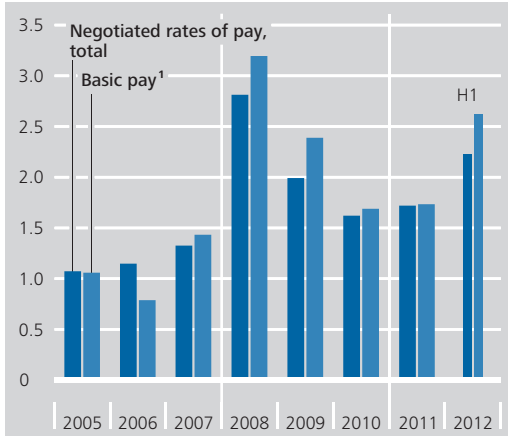
In addition to the collective agreements for core staff, negotiators in the metal-working and electrical engineering sector and the chemical industry agreed on phased sectoral wage add-ons for temporarily hired workers.<sup>2</sup> The agreed incremental wage add-ons, which will come into effect in the first two sectors on 1 November 2012, should help to reduce the income gap of temporary workers compared

*Graduated rise in earnings of agency hirings*

<sup>2</sup> Graduated wage add-ons were also recently agreed for agency-hired temporary workers involved in the manufacture of rubber and plastic products and in the rail transport sector.

### Negotiated rates of pay

Year-on-year percentage change, on monthly basis



<sup>1</sup> Excluding additional benefits and lump-sum payments.  
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with permanent salaried employees in relation to the length of their contracts. This collective improvement for temporary hirings also satisfies the need for action called for by some politicians. This new deal will not excessively burden company payrolls as it primarily affects the lower pay groups. However, the employment opportunities *per se*, especially for low-skilled workers, will be squeezed owing to the rising cost of their labour.

*Wage growth remains at a high level*

The underlying momentum of wage growth is still very much pointing upwards. According to the Bundesbank's pay rate statistics, basic rates of pay in the second quarter went up by 2.7% on the year, after increasing by 2.6% in the first quarter of 2012.<sup>3</sup> For negotiated rates of pay including all ancillary agreements, the rate of growth, at 2.6%, was perceptibly higher than in the first quarter (1.9%). Given that generous bonus payments were also paid out to employees of large industrial enterprises, growth in actual earnings is likely to have been similarly high.

*Spread of sector-wide minimum wages*

On 1 August of this year, in the absence of a clear vote by the labour ministry's collective bargaining committee, the German government introduced – by way of a federal regulation – a new generally binding minimum wage for staff working in education and training. The

binding minimum wage has been set at a high level considering that, in western Germany, only skilled construction workers receive a higher sector-specific minimum wage and that, in eastern Germany, the new minimum wage is higher than in any other sector.

The deterioration of the global economic outlook was reflected in falling commodity prices in the second quarter of 2012. In terms of import prices, this was partly neutralised by the euro's depreciation. Nevertheless, import prices declined by a seasonally adjusted 1.6% compared with the previous quarter. The fall was particularly pronounced in the case of energy prices. By contrast, the upward trend in the prices of capital goods and consumer goods continued virtually unabated. The year-on-year rate of increase in import prices eased further to 2.0%.

*Import prices falling, ...*

Domestic sales prices remained unchanged on a quarterly average, although they declined gradually during the course of the quarter, as was the case with imports. The year-on-year rate of increase narrowed to 2.1%. Export prices held up at the level of the first quarter. As a result, the terms of trade picked up slightly after falling in the first three months of 2012 to the lowest level recorded since the first half of the 1980s.

*... as are industrial sales prices*

The construction industry, by contrast, was able to push through marked price increases in the second quarter as a result of the buoyant business activity in that sector. Construction prices rose 2.8% on the year. The price of residential real estate also continued to accelerate. According to calculations by the Association of German Pfandbrief Banks (*Verband deutscher Pfandbriefbanken*), property prices rose quite

*Construction and property prices still rising*

<sup>3</sup> The Federal Statistical Office, whose index excludes government employees with civil servant status, reports an increase of 2.2% in negotiated rates of basic pay in the second quarter, compared with 2.0% in the first quarter. Differences compared with the Bundesbank's pay index also result from the fact that the Federal Statistical Office only reports the April figure for the second quarter.

steeply by 1.3% on the first quarter of 2012 and by 3.5% on the year.

*No further rise in consumer prices*

Although consumer prices did not increase further in the course of the second quarter, they nonetheless rose by a seasonally adjusted 0.2% on a quarterly average, after going up by 0.7% in the first quarter. Consequently, the price increase in the first half of 2012, at +1.1% on the previous period, was even somewhat sharper than in the second half of 2011. In the months from April to June, price developments were influenced primarily by the drop in crude oil prices. As a result, the prices of refined petroleum products declined by 3.9%; this was still not enough to fully offset the sharp rise in late 2011 and early 2012, however. Heating oil and fuel were 2.5% more expensive in June than one year earlier. Fairly significant reductions were also evident in the case of dairy products. By contrast, some other food products became considerably dearer, which was partly attributable to the weather. The upward trend in prices continued in the case of other goods (excluding energy and food), which was probably also due to the stable domestic demand and the relatively weak euro. A further marked rise occurred in the price of services owing, not least, to the cost of travel and holiday services. The increase in rents remained very subdued. On balance, the annual Consumer Price Index (CPI) fell from 2.1% on a quarterly average to 1.9%, while the Harmonised Index of Consumer Prices (HICP) declined from 2.4% to 2.1%.

Consumer prices edged up in July by a seasonally adjusted 0.1%. A distinct rise was also recorded in the price of petroleum products owing to the reversal in crude oil prices. Food prices eased, however. The prices of other goods and services remained largely unchanged. The year-on-year increase in the CPI stood at 1.7%, as in the previous month, while the HICP measure went down from 2.0% to 1.9%.

**Import, export, producer and consumer prices**

2005 = 100, seasonally adjusted, monthly

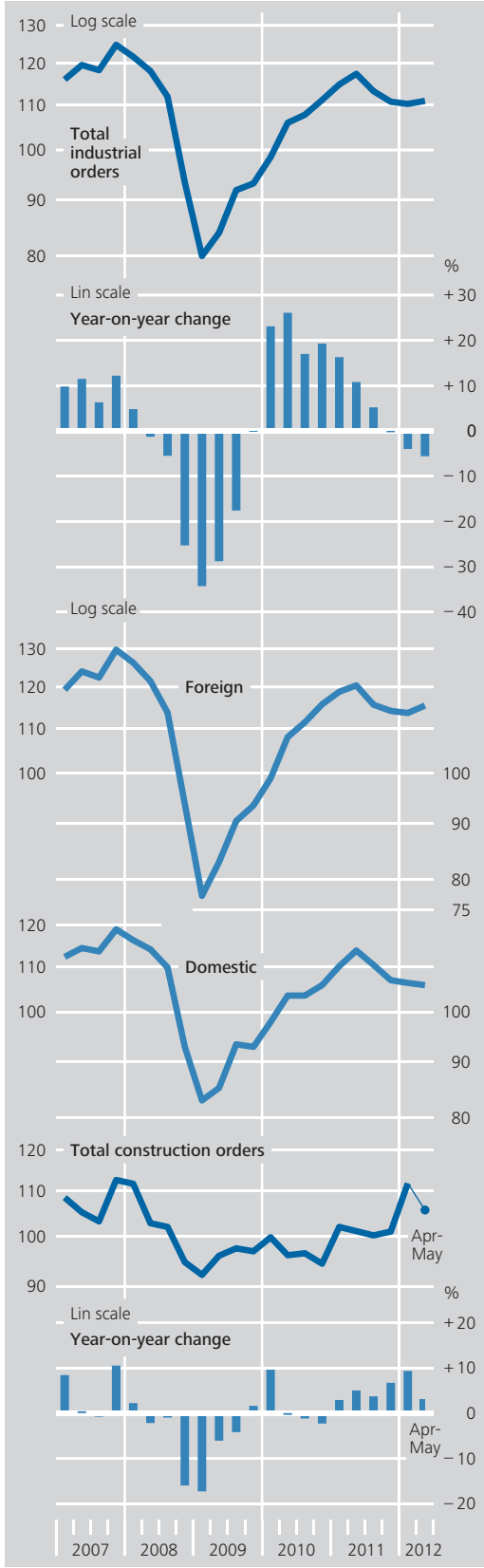


**1** Producer price index for industrial products in domestic sales. **2** Not seasonally adjusted, quarterly. **3** National consumer price index.



### Demand for industrial goods and construction work

Volume, 2005 = 100, seasonally adjusted, quarterly



### Orders received and outlook

In the second half of the year, the further intensification of the sovereign debt crisis in the euro area and the resulting uncertainty could have a greater negative impact on economic activity in Germany. Alongside the impact of waning confidence in the euro area on investment activity, this notably relates to the direct effects transmitted via foreign trade. This is because the adjustment crises in the countries on the euro-area periphery are no longer exerting substantial downward pressure solely on their domestic economy but are now also spilling over to the rest of the euro area via a number of transmission channels which have been opened up by the single currency area. However, as long as demand for German products from non-euro-area countries remains essentially intact despite the deteriorating expectations, a reversal of the underlying cyclical trend in Germany is highly unlikely, especially as under this constellation, key components of domestic demand should remain buoyant.

*Marked increase in economic risks for the second half of 2012*

According to the Ifo surveys, the business outlook for trade and industry deteriorated significantly in the second quarter. Industrial enterprises, in particular, scaled back their expectations in light of the economic risks on major foreign markets. The generally more domestically oriented service providers were much more optimistic about their future business activities, however. Service providers outside the trade sector, for example, downgraded their expectations only marginally. The optimistic underlying sentiment in the retail trade sector is holding up, whereas it deteriorated significantly in the wholesale trade owing to its dependency on industrial activity. It is noteworthy that the construction industry scaled back its business expectations significantly in the course of the first six months, although the starting level at the beginning of the year was exceptionally high.

*Marked deterioration in business expectations in industry*

Industrial orders in the second quarter of 2012 rose slightly by a seasonally adjusted ¾% quar-

*Low inflow of orders on the whole*

ter on quarter. A dampening effect was generated by orders of intermediate goods (-¼%). By contrast, producers of consumer goods recorded a considerable 1½% increase, and orders from manufacturers of capital goods picked up again for the first time since the summer of 2011 (+1%). However, the relative weakness of this sector in the current economic cycle is reflected by the fact that orders were still down 6½% on the year.

*Weaker demand from non-euro-area countries, but rise in orders from Germany and other euro-area states*

The regional breakdown of orders also shows that in the second quarter, those geographical areas that had previously declined were able to make up some ground. Thus the seasonally adjusted rise in orders from euro-area countries, at 1½%, was equally as strong as the growth in orders from non-euro-area countries, whereas domestic orders fell by ½%. It should be noted, however, that subcontracts for aircraft production that are passed on within the euro area as part of the European production network are statistically assigned to the euro area, even if – as was the case on numerous occasions in the reporting period – the original order originated from outside the euro area. The year-on-year comparison, which this time also reflects the fall-off from the peak order level in the current cycle, shows a significant decline in orders from the euro area.<sup>4</sup> The drop in domestic orders was only half as big, while orders from countries outside the euro area even recorded slight growth.

*Construction demand more moderate*

The flow of construction orders was more moderate in April and May – more recent statistical data are unavailable at present – following a considerable boost across all subsectors at the beginning of the year. The drop in construction orders is consistent with the fact that significantly fewer building permits were granted in the first three months of this year than at the end of 2011, when, however, orders had surged. Growth in new building permits was extremely brisk during the reporting period. Measured in terms of the estimated costs, permits for both residential and commercial construction were up by around one sev-

### Economic and income expectations of consumers



Source: GfK. 1 Balance of the positive and negative data as a percentage of all responses; deviation from the multi-year average.  
 Deutsche Bundesbank

enth on the average of the first quarter. Taking both the weaker performance at the beginning of the year and the wave of permits granted in the second quarter together, it becomes evident in the case of residential construction, in particular, that the dynamic pace of expansion witnessed last year has not been matched so far this year.

Despite growing concerns about the economy, households' propensity to consume is expected to remain at a high level in the coming months. The main reason for this is that, to date, income expectations have been entirely decoupled from the perceived downward drift in the economic outlook, which is clearly discernible in the household surveys conducted by the German consumer research institution (GfK). This is presumably attributable to the fact that

*Propensity to consume still high*

<sup>4</sup> The size of the year-on-year change was also affected by the fact that an exceptionally number of large orders were placed in the second quarter of 2011.

an increasing number of workers are now seeing the significant wage increases for the first half of the year on their wage slips, as well as additional sizeable bonus payments in some cases, and are now assessing the risk to their personal job security as limited in view of the very favourable employment situation. Added to this is the fact that work and income oppor-

tunities are considered to be comparatively good in Germany, also from a longer-term perspective, notwithstanding the changing cyclical conditions. The phase during which structurally induced wage restraints had a dampening effect on income expectations, even during boom periods, now seems to be over.