

Economic conditions in Germany

Macroeconomic situation

Sharp GDP growth in 2013 Q2

The German economy expanded sharply in the second quarter of 2013. According to the flash estimate by the Federal Statistical Office, second-quarter real GDP was up 0.7% on the quarter after seasonal and calendar adjustment. This high quarter-on-quarter growth is to be seen in connection with the stagnant economic output in the first quarter of 2013, when the incipient upturn was being held back by the very unfavourable weather. The strong expansion in activity in the second quarter is likely to have brought the German economy back to a normal level of capacity utilisation, following the temporary decline in the second half of 2012 due to the escalation of the euro-area debt crisis and the global dip in economic growth.

The weather-related losses in building activity, which had hampered growth in the winter, were largely recovered, contributing to the strong expansion in economic output in the second quarter. Private consumption also boosted demand. By contrast, there was still a lack of major impetus from export demand in the wake of the difficult adjustment processes in some euro-area countries and the slowdown in economic growth in various emerging markets. As a result, business investment remained subdued. This was reflected in the modest increase in employment.

Stronger demand from non-euro-area countries drives slight increase in exports

German enterprises' export business picked up again somewhat after the slump in the final quarter of 2012 and the first quarter of 2013, but failed to recover all of last autumn's losses and lagged the longer-term growth path. A positive factor is that exports of goods to the USA and to Japan showed a substantial rise. In addition, exports to the OPEC countries increased considerably. By contrast, exports to other euro-area countries exerted a dampening impact and, despite a certain stabilisation of

activity, German exports to central and east European EU accession countries tailed off distinctly. Sales in the United Kingdom likewise lacked upward momentum in spite of the stable economic recovery. There was only very little stimulus from trade with China and the other Asian industrial countries and emerging market economies as well as Russia. The moderating pace of growth and feeble macroeconomic development are reflected here.

Growth in foreign demand, although it covered broad areas of the range of products made by German exporters, remained quite moderate, which was due mainly to a considerable decline in exports of aircraft and ships. This should just be seen as a brief lull, however, since foreign sales of other transport equipment held up a high level even during the recent economic downturn. Exports of chemical and

Broad-based rise in exports

Overall output

2005 = 100, price and seasonally adjusted





pharmaceutical products only just matched the level of the first quarter. By contrast, exports of IT products, electronic and optical equipment as well as electrical equipment picked up sharply. It is notable that, after a lean period of almost one year, exports of machinery also went up significantly. Motor vehicles and motor vehicle parts were also in greater demand again from foreign customers. In addition, more metals and metal products were exported.

Enterprises' investment in new machinery and equipment, which had stabilised at a low level at the beginning of 2013 following the pro-

nounced decline in 2012, gathered little momentum in the spring despite the sharp increase in economic output. Capital formation in the domestic corporate sector remained subdued despite ample own funds and access to cheap sources of funding. This was probably mainly due to the persistently gloomy sales outlook, above all in the euro area, and ongoing economic policy uncertainty in connection with the debt crisis. Furthermore, capacity utilisation in industry had not yet regained a normal level, with procurement of new plants being largely confined to the need for replacement. Imports of machinery and equipment increased markedly in some subsectors and more commercial vehicles were being registered again. However, domestic sales of machinery and equipment failed to move away from the depressed level of the previous quarter.

Investment in machinery and equipment still lacking momentum

Construction investment rose steeply in the second quarter of 2013. Backlog and catch-up effects played a major role in this respect, given that construction activity shrank considerably in the first quarter due to adverse weather conditions. Added to this was momentum created by additional demand. A very large number of permits for residential construction have been issued since the beginning of the year. There was a clear rise in public sector construction projects and accompanying contracts in the first few months of the year. Even demand for commercial construction picked up somewhat recently.

Substantial growth in construction investment

Private consumption is likely to have increased significantly in the second quarter of 2013, supported by the favourable labour market conditions and the wage increases contained in the collective wage agreements, albeit with different points of emphasis compared with the first quarter. While retail sales showed no further increase according to the provisional statistical data, new private passenger car registrations increased distinctly. In addition, many households replenished their oil tanks after the persistently cold weather, with the fall in heating

Robust growth of private consumption

fuel costs arriving at an opportune time for them.

Pronounced growth in imports

Germany imported a much larger volume of goods in the second quarter than in the previous two quarters, with imports from other euro-area countries increasing much more sharply than those from countries outside the euro area. In particular demand were capital goods, mainly ICT products and electrical equipment. There were also more purchases of motor vehicles and motor vehicle parts. By contrast, imports of machinery declined again following a weak rebound in the previous quarter. Intermediate goods imports increased only slightly. Imports of consumer goods from other countries rose significantly in line with positive consumption activity. This also applies to imports of energy.

■ Sectoral trends

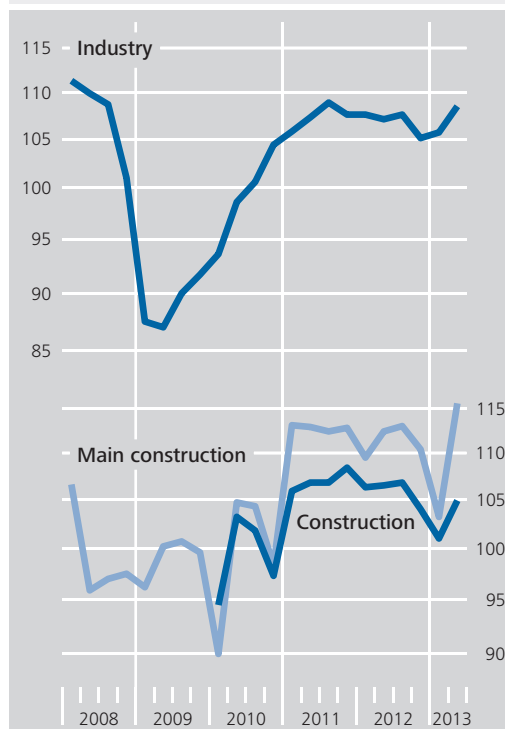
Clear rise in industrial output, capacity utilisation up considerably

German industry picked up momentum in the second quarter following weakness in the fourth quarter of 2012 and first quarter of 2013. According to the provisional data of the Federal Statistical Office, production increased by a seasonally adjusted 2½% on the first quarter. According to the Ifo business survey, capacity utilisation rose from just under 82% in April to 83% in July, which was only 1 percentage point below the multi-year average.

The steep rise in output was mainly driven by the manufacturers of capital goods, as the motor vehicle industry stepped up output again after the lull in late 2012 and early 2013. The Federal Statistical Office reports a seasonally adjusted 11% increase in output on the quarter. However, according to the motor vehicle industry association statistics, there was quarter-on-quarter growth of only 2¼% and 2% on the basis of sales statistics. Orders received did not show any strong increase in the past few months either. Usually, the different data collection methods indicate very similar rates of change. Output was also stepped up in other

Output in industry and in construction

2010 = 100, seasonally adjusted, quarterly, log scale



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segments of the capital goods sector, with the quarter-on-quarter increase in mechanical engineering turning out to be quite considerable at 2%. Furthermore, somewhat more intermediate goods were produced. Capacity utilisation also improved in this sector, without matching the multi-year average. In spite of the very positive consumer sentiment in Germany, output of consumer goods stagnated at a low level following a decline in the previous quarter, which meant that there was no increase in capacity utilisation in this sector. This shows that positive consumption activity does not necessarily have a direct impact on domestic industrial production owing to the high percentage of services in private consumption and the major significance of imported consumer goods.

Main construction industry output was increased far above the normal level of capacity utilisation following the end of the very persistent cold winter weather this year. Given the al-

Sharp surge in construction activity due to catch-up effects, energy output also higher

ready favourable situation with regard to order books, construction firms strove to catch up quickly with the processing backlog. As a result, output in the main construction industry rose by a seasonally adjusted 12% on the first quarter and, according to the Ifo survey, the utilisation of construction equipment reached a peak of 74% in June. The catch-up effects were most pronounced (+15%) in civil engineering, which generally suffers more from cold weather conditions than other construction subsectors. Building construction work in the main construction industry increased by just over one-tenth. After seasonal adjustment, the finishing trades saw a decline in output of 4% compared with the first quarter. This may have been caused by cutbacks in production in the main construction industry during the winter months. Nevertheless, when interpreting the figures, it has to be borne in mind that the information available for the finishing trades is subject to considerable uncertainty. Energy production showed a distinct seasonally adjusted rise of 2¼% in the period under review.

Growth in services but differences between the sectors

The available indicators suggest that the services sector grew again in the second quarter. Even so, the individual sectors present a mixed picture. The transport sector probably benefited from higher industrial output and the weather-related catch-up effects in the construction sector. This is signalled by the sharp increase in the mileage of domestic heavy goods vehicles on toll roads. Furthermore, according to the Ifo surveys, business-related service providers continued to view their business situation as positive in the second quarter. By contrast, the general tendency to stagnation in the wholesale trade continued. Trade in motor vehicles flourished, mainly due to demand for private passenger cars, whereas commercial sales declined. The retail trade, which benefited from strong consumer sentiment, maintained the elevated sales level of the preceding few months. Hotels and restaurants saw a decline in turnover, however, possibly as a result of the cold weather in early spring.

Employment and labour market

Employment continued to grow in the second quarter of 2013, albeit at a moderate pace, in line with the slight underutilisation of aggregate capacity for extended periods during the first half of the year and the subdued formation of fixed capital. According to estimates by the Federal Statistical Office, the seasonally adjusted number of persons in work in Germany went up by no more than 52,000, or 0.1%, in the second quarter of 2013 compared with the first quarter. Once again, the newly created positions were exclusively regular jobs subject to social security contributions. At the same time, there was no further decline in self-employed positions. Prior to this, self-employment is likely to have been substituted by employment contracts. This is implied at least by the sharp increase in employment subject to social security contributions amongst east European immigrants, who were subject to restrictions until spring 2011. At the same time, there were considerable cuts in incentives to move from unemployment to become self-employed. The number of persons working exclusively in low-paid part-time employment stagnated in spite of the raising of the wage ceiling to €450 per month at the beginning of the year.

Subdued increase in employment in second quarter

Employment subject to social security contributions went up by 60,000 persons, or 0.2%, in seasonally adjusted terms in April and May according to the Federal Employment Agency. Nevertheless, only a few branches of economic activity, all in the tertiary sector, recorded a marked increase in jobs. Employment increased primarily in the business-related services (excluding temporary agency employment), health and education, and the logistics sector. By contrast, job growth in manufacturing and construction virtually ground to a halt.

Jobs subject to social security contributions grow only in services sector

Temporary agency employment likewise saw a stagnation, although this can be viewed as an improvement following quite a considerable

Waning significance of temporary employment

decline in both employment and the number of reported job vacancies during 2012. This may have been related to the pick-up in industrial activity, especially as the adjustment in the level of temporary employment, which was linked to the introduction of a minimum wage and wage add-ons for increased length of contract in some industrial sectors, was likely to be largely complete in the interim. Data from the temporary employment agency statistics, now available up until the end of 2012, show a particularly sharp decline in production and manufacturing activities assigned to the manufacturing sector, where more than one in eight jobs was cut within the space of 12 months. By contrast, temporary employment in the area of health, welfare and education sectors continued to increase.

Strong immigration also at beginning of 2013

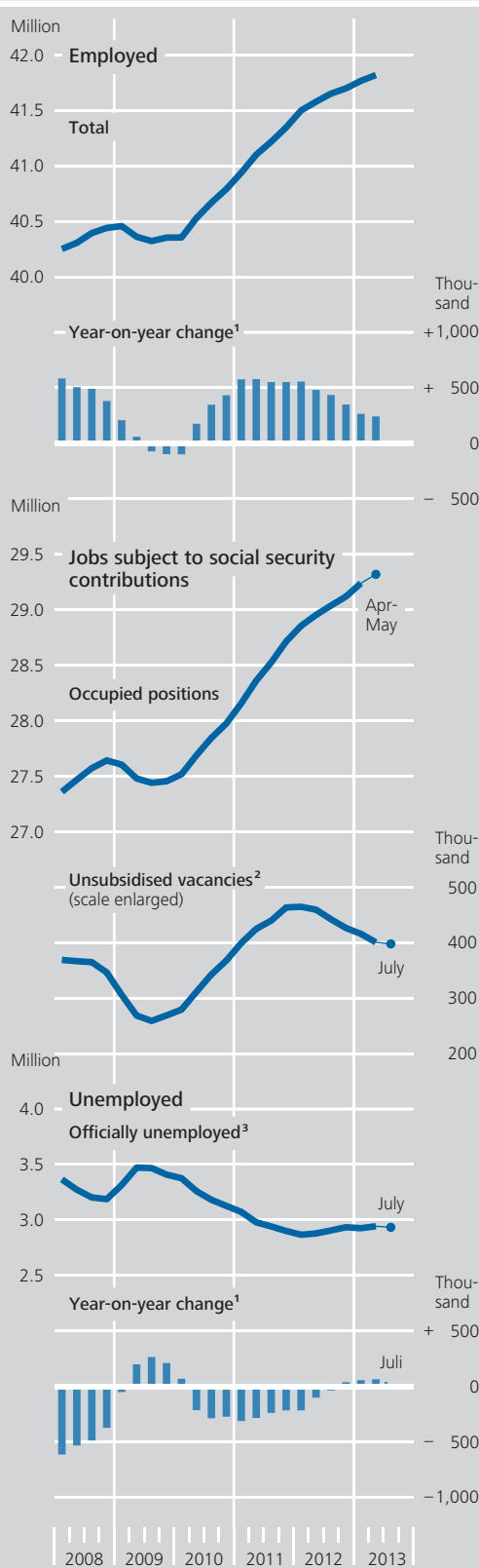
The supply of labour in Germany continues to be boosted by immigration, with workers increasingly originating from southern Europe. According to Federal Statistical Office data, 78,000 persons moved to Germany on balance in the first three months of 2013. The year-on-year increase of 4,500 can mainly be explained by increased immigration from Italy and Spain. This suggests that the effects stemming from the labour market differentials in the euro area are shaping net immigration to Germany in 2013 to a large extent.

Slight rise in registered unemployment

The after-effects of economic weakness are evident in the slight rise in underemployment. After seasonal adjustment, the number of registered unemployed rose by 18,000 persons to 2.94 million in the second quarter, after a marginal decline in the previous quarter. The official unemployment figure went up by 65,000 on the year. The unemployment rate remained almost unchanged at 6.8% over the past 12 months, as there was a proportional increase in the labour force. The rise in unemployment was concentrated mostly on the number of unemployed persons claiming insurance benefits. Unemployment went down somewhat in July, as it had done in June; the

Labour market

Seasonally adjusted, quarterly



1 Not seasonally adjusted. **2** Excluding seasonal jobs and jobs located abroad. **3** From May 2009, unemployed excluding persons newly registered on the books of private employment agencies.

unemployment rate remained unchanged at 6.8%.

Little momentum on the labour market to be expected over next few months

Leading indicators suggest that the labour market could remain calm in the coming months. The Ifo employment barometer, which provides information on the employment plans of trade and industry and business-related services over the coming three months, does point to a slight increase in employment, but shows greater caution in terms of firms' recruitment plans compared with the final quarter of 2012 and first quarter of 2013. The Federal Employment Agency's BA-X job index also showed a fairly sharp decline again in the second quarter, as both the level and intake of reported vacancies decreased more rapidly than in the winter. This is predominantly a result of the decline in temporary agency employment. Job vacancies in all other sectors decreased only slightly on the whole. A similar picture is also revealed by the quarterly Job Vacancy Survey of the IAB Institute for Employment Research.

■ Wages and prices

Temporary easing in growth of negotiated rates of pay

There was a temporary easing in negotiated wage increases in the second quarter of 2013. Basic rates of pay went up by no more than 2.2% year-on-year and thus considerably less sharply than in the first quarter (+3.0%). Including all one-off payments and ancillary agreements, the 2.2% increase in negotiated rates of pay was weaker than in the winter (+2.9%). This was because some of the newly agreed settlements involved pay increases only with a time lag and there is still no agreement in retail despite months of negotiations.

Balanced pay agreements continue to run for longer periods

The latest settlements in the insurance industry, in wholesale and foreign trade and at Volkswagen continued the tendency towards fairly balanced wage increases in this year's pay round. The pay agreements amounted to a volume of between 2% and 3% in annualised terms, with the increases mainly taking place on two dates. Overall, the contract periods of around 21

months on average are somewhat longer than last year.

The minimum wage system, which differs by sector, currently includes minimum wage levels for 13 sectors throughout Germany, of which 11 have been declared to be generally binding; most recently on 1 August 2013, €10 per hour was agreed for the first time for the scaffolding trade. The sector-specific minimum wages currently range from €7.50 in temporary employment and the security services industry of some federal states to €13.70 for skilled construction workers in the west German construction sector. The minimum wage agreement is potentially valid for around 3.6 million employees and thus 12% of employees subject to social security contributions overall.¹

Further minimum wage agreements

Given muted global economic activity and, especially, the gloomier economic outlook for emerging markets, prices at the upstream stages of the economy eased noticeably in seasonally adjusted terms in the second quarter. The decline was particularly pronounced in the case of energy prices, which are directly dependent on oil prices. However, prices of intermediate goods fell too. The prices of capital goods also declined somewhat. By contrast, consumer goods prices increased slightly. Due to the particularly high share of energy, the decline in the prices of imports overall, at a seasonally adjusted 1.9% on the quarter, clearly exceeded that for domestic products (-0.7%) and exports (-0.6%). Accordingly, the year-on-year decline in import prices widened to 2.8%. The terms of trade continued to improve on the back of the prices of export goods, only declining slightly in year-on-year terms at -0.4%. German manufacturers managed to achieve somewhat higher prices in domestic sales in fact compared with the previous year.

Declining prices in upstream branches

¹ As there is no reporting requirement for wage groupings, there is no official information on the percentage of those receiving minimum wages in each of the sectors.

Rise in property prices continues

Property prices continued to rise at an unchanged pace in the second quarter of 2013. According to the Association of German Pfandbrief Banks (*Verband deutscher Pfandbriefbanken*), the price index for owner-occupied housing went up by 1.2% on the quarter. In year-on-year terms, house prices rose by 3.3%. In spite of extremely buoyant demand, the increase in prices for construction work remained quite moderate at 2.1% on the year. The decline in the cost of building materials in the wake of the slump in commodity prices is likely to have played a part in this.

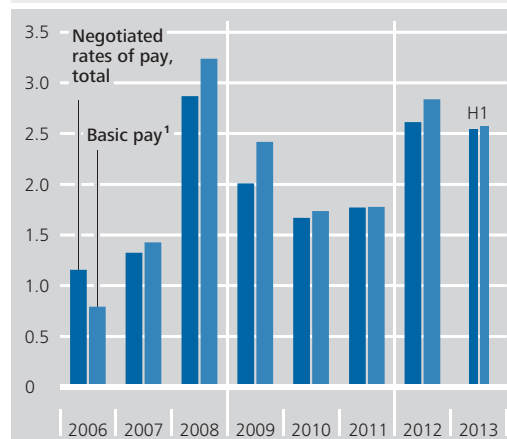
Consumer price inflation strengthens somewhat

Notwithstanding declining prices at the upstream stages of the economy, consumer prices showed a slight rise in the second quarter of 2013. The seasonally adjusted quarterly rate went up from 0.3% to 0.6%. This is noteworthy in that energy prices eased somewhat again after rising sharply at the start of the year. One key reason for the slightly accelerated price increase was the fact that food prices went up again perceptibly. This is true of fruit and vegetables in particular, with unfavourable weather conditions in some parts of Europe being a contributory factor. However, prices for dairy products also continued to rise steeply. Furthermore, the state lottery operators raised ticket prices dramatically; in purely mathematical terms, this contributed 0.2 percentage points to the overall rate. The prices of services therefore showed a substantial rise on the first quarter. The rate of inflation for industrial goods (excluding energy), by contrast, was within the normal range, as was the increase in housing rents.

As in the first quarter, the annual rate of the national consumer price index (CPI) remained unchanged at 1.5% due to the rise in lottery charges, and despite declining energy inflation and the Easter effect being shifted into the first quarter. By contrast, the annual rate of the Harmonised Index of Consumer Prices (HICP), whose basket of goods does not contain games of chance, fell from 1.9% to 1.5%. This continues to reflect the fact that the annual

Negotiated rates of pay

Year-on-year percentage change, on monthly basis



¹ Excluding additional benefits and lump-sum payments.

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rate is biased upwards due to chain-linking problems in the hotel services sub-index.² This effect amounted to 0.3 percentage point in the second quarter of this year. Over the course of the quarter, the inflation rate went up to 1.8% (CPI) and 1.9% (HICP) respectively. The annual rate of the Consumer Price Index (CPI) rose slightly to 1.9% in July, moving more closely into line with the HICP rate. The rise in consumer prices is likely to ease somewhat over the next few months. Food prices, which have also reached a very high level due to weather conditions, will not go on increasing at the same pace, and favourable price developments on the import side are likely to have a moderating effect on industrial goods.

■ Orders received and outlook

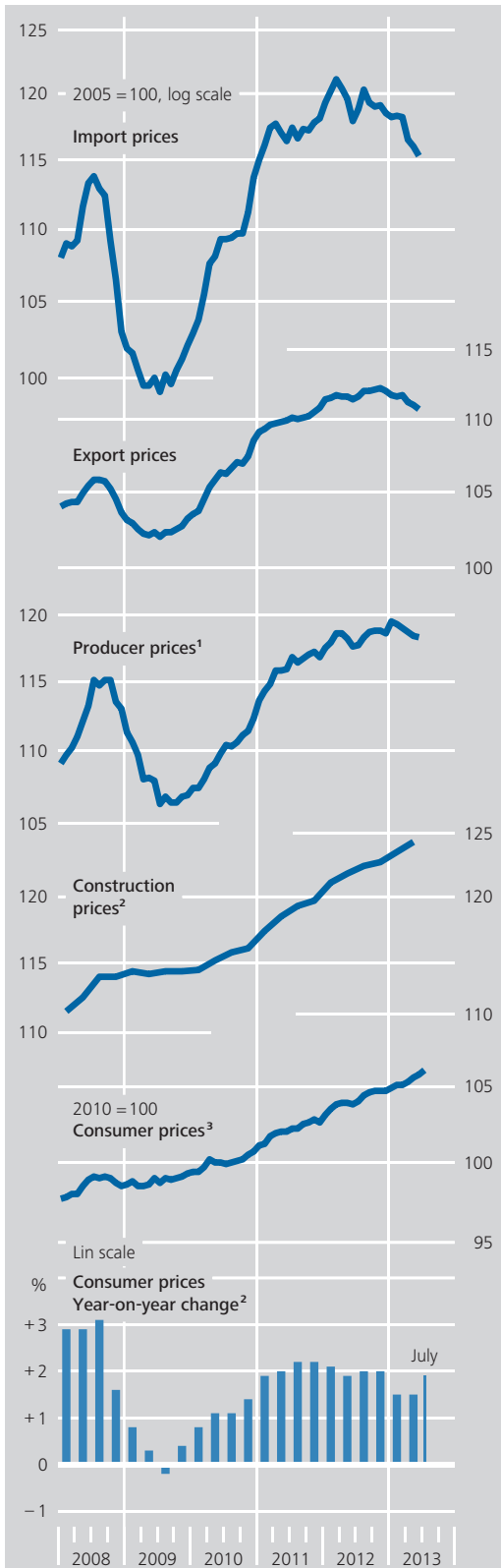
According to the Ifo surveys, business expectations in trade and industry continue to be characterised by cautious optimism. It should be borne in mind that most enterprises assess their current situation as good or at least satisfactory, which is consistent with the fact that normal aggregate capacity utilisation has now

Distinctly more foreign orders ...

² See Deutsche Bundesbank, The contribution of the hotel services sub-index to explaining the current deviations between CPI and HICP inflation measures, Monthly Report, April 2013, p 7.

Import, export, producer, construction and consumer prices

Seasonally adjusted, monthly



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

been achieved again. In manufacturing, optimism is mainly founded on firms' expectations of better business on the international markets. In the second quarter, industrial export orders were 3% up on the quarter in seasonally adjusted terms. Additional demand is mainly focused on capital goods. There was a clear increase in orders of intermediate goods from non-euro-area countries in the second quarter. There was little further rise in demand from other euro area countries. Whilst the increase in the volume of orders from the rest of the world can be viewed as the return to a moderate underlying upward trend, it remains to be seen whether the rise in demand from the euro area is already pointing to a trend reversal.

In the period under review, domestic orders fell 1¼% short of their prior-quarter level in seasonally adjusted terms, although they were higher than the average three-month volume of the weak second half of 2012. The picture presented by the first half of 2013 overall is thus that of no more than a moderate upward movement. This applies to domestic orders of both intermediate and capital goods, which suggests that German industry is taking a cautious view of the shorter and medium-term outlook. In terms of domestic industrial output, the larger volume of orders overall suggests a likely further increase in the third quarter. However, this will probably not be enough either to raise capacity utilisation above the long-term average or to give a marked boost to investment activity.

... but weaker domestic orders

The construction industry presents a brighter outlook. Housing demand is still providing powerful stimuli. A sizeable number of multiple-family dwellings was approved in the second quarter. Moreover, the number of one-family and two-family houses to be approved has shown a clear increase since the beginning of the year. In the period from January to June 2013, approvals for new housing rose by a seasonally adjusted 7½% compared with the second half of 2012. Households' continued positive earnings prospects, immigration and

Major stimuli from housing construction ...

highly favourable financing conditions fuelled the additional demand for homes and apartments. There was a pause in the placing of public sector construction orders in the second quarter. However, indicators continue to suggest an upturn in demand from this sector, as a large number of approvals for public sector construction projects was granted in the winter months, which is likely to be reflected in the construction firms' order books in the foreseeable future. By contrast, demand in commercial construction was subdued in line with firms' hesitance to invest in machinery and equipment.

Very good consumer climate

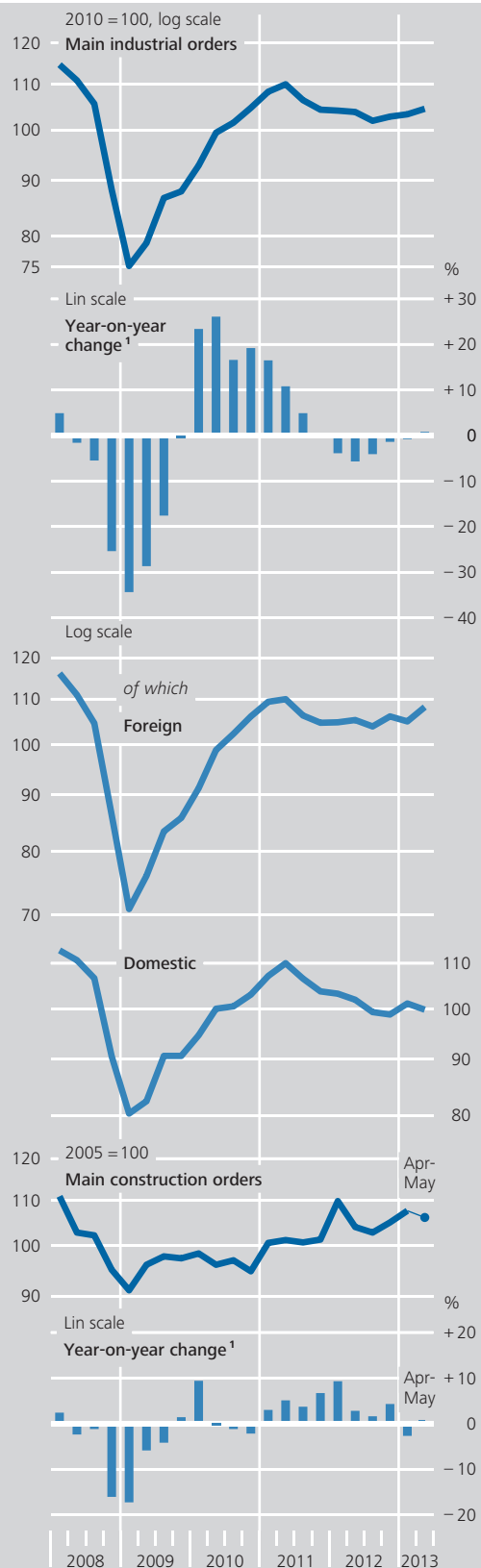
Private consumption is probably continuing to make a significant contribution to economic growth. This is suggested by the extremely favourable consumer climate, which has been steadily improving over the past few months. It is related to a steep rise in income expectations based on a positive earnings outlook and the continuing positive labour market. The extremely positive assessment of the prospects for earnings stands in contrast to a very cautious optimism with regard to the outlook for the economy. Consumers also seem to be aware that the times of excessive wage moderation are over. This is reflected in the continued exceptionally high propensity to purchase. The fall in deposit and mortgage rates possibly played a part both in reducing the incentive to build up financial assets and in boosting the incentive to buy residential property or to consume.

Economic expansion returns to normal pace in second half

Following the second quarter, which was characterised by catch-up and backlog effects, economic growth is likely to return to normal and stabilise again in the second half of the year. The expected increase in economic activity around the level of potential growth will ensure that capacity remains well utilised, though it is doubtful whether this will be enough for a marked revival in investment activity. Additional demand for German industrial products is coming predominantly from non-euro-area countries. German enterprises which have pos-

Demand for industrial goods and construction work

Volume, seasonally adjusted, quarterly



1 Only calendar-adjusted.
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itioned themselves internationally are therefore often expanding their production capacities locally. This limits domestic investment in tangible fixed assets and the growth of exports to non-euro-area countries. Domestic investment activity is unlikely to pick up sustainably until there is a long-term improvement in the economic prospects for the euro-area countries and uncertainty surrounding economic policy is further contained by suitable measures to combat the debt crisis in the euro area. Until then, economic activity in Germany will be sustained to a large extent by private consumption and housing construction. The necessary conditions

for this are in place by virtue of consumers' purchasing power and the very favourable financing conditions. Such a change of emphasis to the forces of domestic growth is desirable in terms of economic policy, as it will correct particular developments of the past decade and strikes a better balance between foreign and domestic economic activity. In terms of steady growth, the historical and successful patterns of specialisation developed by the Germany economy with its high degree of integration into the international division of labour also call for neighbouring countries to generate enough demand for German products, however.