

Economic conditions in Germany

Macroeconomic situation

Unexpected drop in economic output in 2014 Q2

According to the Federal Statistical Office's flash estimate, aggregate output in Germany in the second quarter of 2014 was down 0.2% on the level of the previous quarter after seasonal and calendar adjustment. This was attributable in part to a significantly stronger rise in output in a number of weather-dependent economic sectors in the first quarter than is usual for that time of year, owing to the exceptionally mild temperatures. In statistical terms, this dented the quarter-on-quarter growth rate in the reporting period.¹ But it was compounded by the fact that cyclical developments fell short of expectations. For one thing, the ongoing slow pace of recovery in the euro area and the continued muted growth in non-euro-area markets had a dampening effect on the German economy. For another, the escalating geopolitical tensions proved to be an increasing burden. While these did not yet have a noticeable direct impact on the real economy via the trade channel in the second quarter, business sentiment was, however, undoubtedly depressed by heightened tensions in the crisis-stricken regions. This is likely to have prompted firms to plan and operate more cautiously.

Growth potential not quite realised in H1

Looking at the course of economic development over the first six months of the year so as to eliminate weather-related effects, the growth of gross domestic product (GDP) averaged ¼% per quarter. This means that actual output expanded more slowly than in the second half of 2013, and potential output was not quite fully realised either. Overall produc-

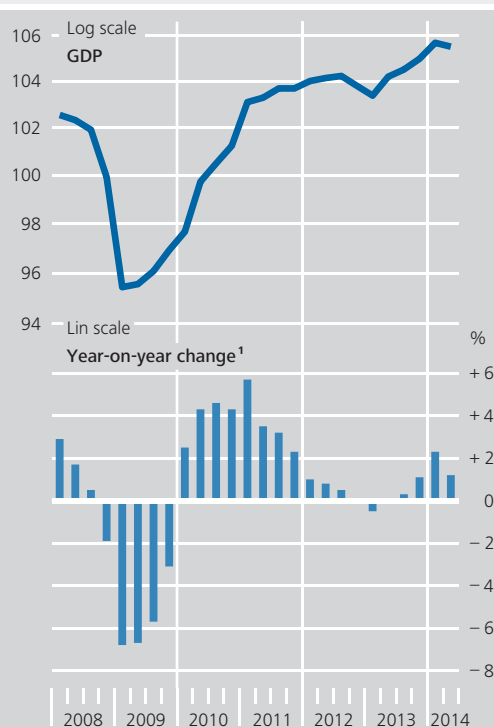
tion capacity utilisation therefore declined somewhat from its level at the turn of 2013-14, but remained within the range of normal capacity utilisation. This is because the domestic expansionary forces have essentially remained intact.

A major revision of the national accounts data was carried out prior to the publication of this *Monthly Report*. The most striking adjustment concerns the upward revision of nominal GDP over the entire recalculation period (see the box on pages 58 and 59). This has an impact on key macroeconomic ratios which are also of economic policy relevance, for instance in the context of surveillance procedures. The balance of payment statistics were likewise comprehensively revised around mid-year.² As a result of the conceptual changes in the two statistical accounting systems, the German economy's

Marked fall in current account surplus relative to GDP following major revision of statistics

Overall output

2010 = 100, price- and seasonally adjusted



Source of unadjusted figures: Federal Statistical Office. ¹ Only calendar-adjusted.
 Deutsche Bundesbank

¹ This effect is estimated at around 0.3 percentage point. See Deutsche Bundesbank, The impact of weather conditions on gross domestic product in the latter part of 2013 and early part of 2014, *Monthly Report*, May 2014, pp 54-55.

² See Deutsche Bundesbank, Changes in the methodology and classifications of the balance of payments and the international investment position, *Monthly Report*, June 2014, pp 57-68.

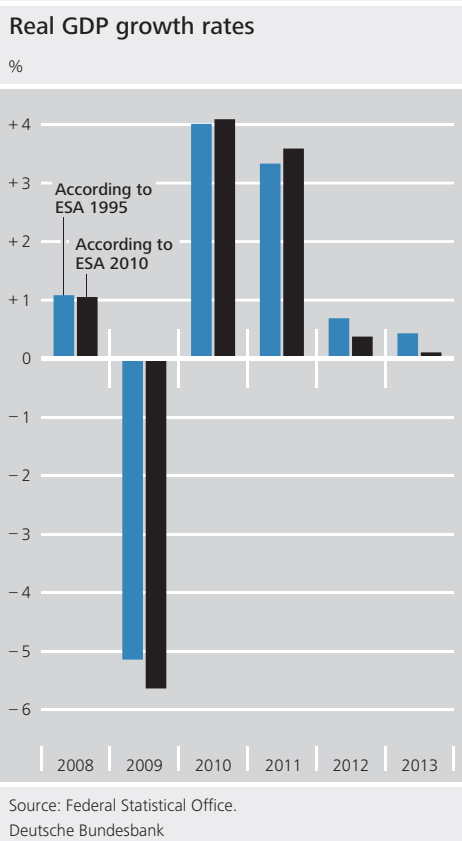
Impact on GDP of the 2014 major revision of national accounts

In its flash estimate of gross domestic product (GDP) for the second quarter of 2014, the Federal Statistical Office released the first national accounts figures computed on the basis of the European System of National and Regional Accounts 2010 (ESA 2010). The new accounting rules are based on the currently valid internationally agreed standards for macroeconomic accounting set out in the System of National Accounts 2008 (SNA 2008). ESA 1995, which was derived from SNA 1993, has thereby been superseded. The Federal Statistical Office plans to completely recalculate the national accounts right back to 1991.¹ Over and above these methodological changes, the usual mid-year revisions were made to the national accounts data of the past three and a half years. These revisions factored in

information from lagged base statistics, in particular from the annual surveys for 2012.

With regard to GDP, the most significant methodological change in quantitative terms is the recording of research and development (R&D) and expenditure on military weapon systems as capital formation.² Hitherto, spending on research and development was treated as intermediate consumption, which is deducted from output when determining gross value added. The reclassification of firms' R&D spending as gross fixed capital formation results in a direct increase in GDP. By contrast, the reclassification of government R&D spending does not result *per se* in any increase in GDP, as in the old national accounts it was assigned to (government) consumption expenditure via intermediate consumption. However, the value added in the public sector is largely calculated via the cost side, so that the depreciation on R&D investment that has to be additionally recognised does push up GDP indirectly. The same effect occurs in spending on military weapon systems, which until now was included under (government) consumption and, under ESA 2010, is likewise recorded as capital formation.

The major revision of the annual accounts mainly results in an upward shift in the level of (nominal) GDP. On an average of the period 1991 to 2013, it increased by just



¹ The Federal Statistical Office will publish detailed results of the 2014 major revision of national accounts on 1 September 2014.

² See A Braakmann, Revidierte Konzepte für Volkswirtschaftliche Gesamtrechnungen, *Wirtschaft und Statistik*, August 2013, pp 521-527; and Federal Statistical Office, Major revision of national accounts in 2014: First results and background, background paper on the press release of 14 August 2014.

over 3% compared with the previous ESA 1995 calculation and is thus in line with expectations. By contrast, the German economy's growth momentum is virtually unchanged following the recalculation. The annual average rate of change of real GDP remains unchanged at 1.3% in the period 1991-2013. There is likewise basically nothing new to be discerned in the cyclical pattern, although cyclical movements are somewhat more pronounced than in the previous calculation. In particular, the severe slump in economic activity in 2009 (-5.6%) is even greater than before the revision (-5.1%). This also applies to the upturn in 2010 and 2011, which is just over 0.3 percentage point stronger in cumulative terms. Aggregate growth weakened significantly in the course of 2012 according to the recalculation, while the downturn in the fourth quarter of 2012 and first quarter of 2013 was somewhat steeper. The finding

that the German economy returned to a growth path in the further course of 2013 remains robust. However, GDP growth for the past two years is weaker than previously reported. When interpreting the revisions for the past two years, it should be noted that the usual data revisions at the current end have probably played a significantly greater role than the methodological changes.

current account surplus has, since 2006, exceeded the threshold value of 6% of GDP only in around half of these years on balance and not virtually every year, as was previously reported.³ In the first half of 2014, the current account surplus stood at a seasonally adjusted 6.9%.

barely showed any increase on balance. Exports to the United States and China picked up momentum, whereas foreign sales to Japan suffered a further significant setback. Sales of goods to central and eastern European EU countries and to the United Kingdom weak-

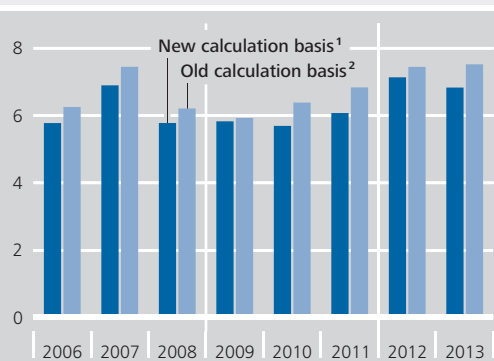
Goods exports showing renewed moderate rise

German enterprises' foreign business rose only moderately again in the second quarter of 2014. Exports of goods rose ¾% in price- and seasonally adjusted terms on the previous quarter, when growth had stood at ½%. In the reporting quarter, exports to euro-area partner countries fared better than average, while exports to countries outside the euro area

³ The threshold value is of relevance within the context of the European Union's Macroeconomic Imbalance Procedure (MIP). See, for example, Deutsche Bundesbank, The German economy's current account surplus, Annual Report 2013, pp 39-60, and Deutsche Bundesbank, Germany's external position against the background of increasing economic policy surveillance, Monthly Report, October 2011, pp 41-58.

Current account surplus

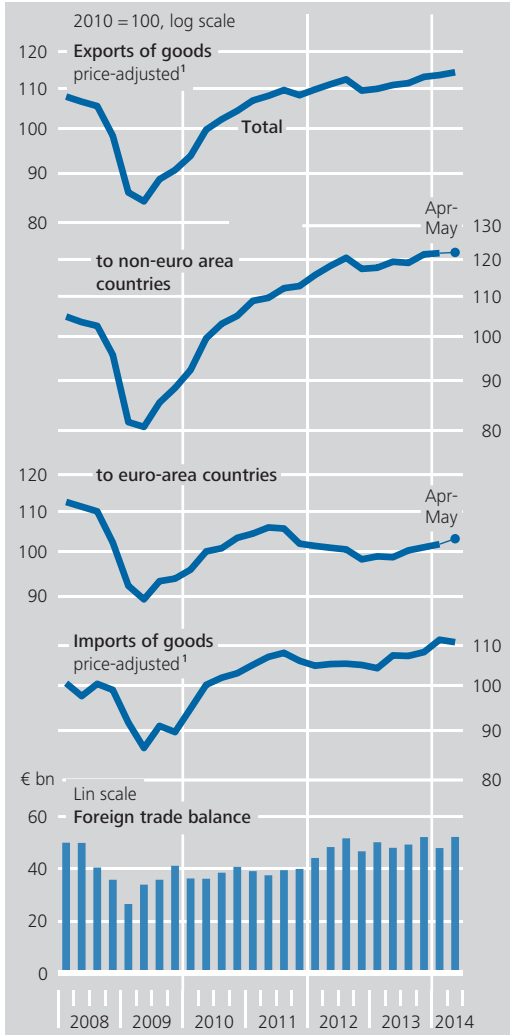
As a percentage of GDP



¹ Current account balance according to Balance of Payments and International Investment Position Manual, Sixth Edition (BPM6), GDP according to European System of Accounts (ESA) 2010. ² Current account balance according to BPM5, GDP according to ESA 1995.

Underlying trends in foreign trade

Seasonally adjusted, quarterly



Source of unadjusted figures: Federal Statistical Office. 1 Adjusted using the price indices for foreign trade.
 Deutsche Bundesbank

ened slightly in the first two months of the second quarter, after the demand for German products in these countries had expanded considerably since the second half of 2013. Germany's trade with Russia has been trending downwards since the beginning of 2013. By May 2014, the overall value of goods had fallen by almost one-fifth. Clearly, the trading environment vis-à-vis Russia had already begun to worsen some time before the Ukraine crisis escalated.

Motor vehicles once again proved to be the mainstay of Germany's export business in the second quarter. Furthermore, there was a slight

Motor vehicle exports still mainstay of export business

price-adjusted increase in exports of other capital goods, such as computers, electronic and optical products as well as electrical equipment, following a sharp rise in the first quarter. By contrast, exports of machinery and intermediate goods were up only marginally on the prior-quarter level. Exports of consumer goods increased slightly.

The upswing in goods imports that had been apparent since the beginning of 2013 abated in the second quarter of 2014. At ½%, real imports of goods were down slightly on the quarter after adjustment for seasonal variations. The weaker demand for foreign products affected suppliers from the euro area to a somewhat greater extent than those from non-euro-area countries. Capital goods purchases fell particularly strongly. This was primarily attributable to a marked decline in imports of other transport equipment, which is to be seen in connection with the slacker demand for products of the European aviation industry. This contrasted with a perceptible rise in imports of motor vehicles, trailers and semi-trailers. Moreover, imports of ICT products and electrical equipment went up again. Purchases of machinery from other countries declined markedly in line with the subdued domestic investment dynamics after increasing significantly in the preceding quarter. The fact that imports of intermediate goods decreased appreciably, after imports of inputs and intermediate goods had shown strong growth in the first quarter, could be due to growing cautiousness in the corporate sector. Consumer goods imports also declined, whereas energy imports remained largely unchanged in price-adjusted terms.

Moderate fall in imports

Investment in machinery and equipment faltering

Seasonally adjusted corporate investment in new machinery and equipment in the second quarter probably did not quite match the level recorded in the first three months of the year. This means that the recovery in investment that had started to take hold one year ago faltered. Up to the middle of the year, high capacity utilisation levels in many industries pointed to an at least satisfactory sales outlook and to con-

tainable geopolitical risks. In the meantime, however, there is reason to fear that the investment climate might suffer collateral damage as a result of the growing tensions in a number of crisis-stricken regions.

Construction investment very volatile in H1 owing to weather effect

Seasonally adjusted construction investment in the second quarter fell well below the figure of the first quarter. This sharp drop is due primarily to a technical countermovement to the highly elevated production levels in the first quarter owing to the mild winter weather. Aggregating the figures for the first two quarters so as to largely neutralise the weather effects yields a slight increase vis-à-vis the second half of 2013.

Private consumption still pointing upwards

Private consumption is likely to have registered a further increase in the reporting period. This is suggested by the surveys conducted by the consumer research institution, Gesellschaft für Konsumforschung (GfK), which indicate that consumer confidence has improved further. Households' very buoyant mood was partly fuelled by the positive labour market situation plus significant wage increases. Their propensity to purchase consequently remained at an exceptionally high level. Retailers assessed their business situation in the reporting period equally as favourably as in the first quarter. This sector was, however, not quite able to match the turnover level achieved in the first quarter following a steep jump. Households took advantage of the relatively low heating oil prices, which have been favourable for quite some time now, to stock up their reserves. By contrast, fewer new passenger cars were registered between April and June for personal use.

orders and production expectations were pointing upwards into the second quarter, and no reductions in capacity utilisation were reported.

The production of capital goods outperformed that of inputs and intermediate goods in the reporting period. This can be seen in the seasonally adjusted quarter-on-quarter data (-3¼% and -1½%, respectively) published in the production statistics. Moreover, if it is assumed that bridge day and holiday effects play a relatively significant role in the capital goods-producing sectors owing to the way in which the production processes are organised, the cyclical trend remained relatively stable. The automotive industry managed to maintain the output level, which had surged in the first quarter, in seasonally adjusted terms. This was also the case for the manufacture of computer, electronic and optical products. Manufacturers of machinery and equipment cut back their production again despite an abundant inflow of new orders. Output in the chemicals industry also decreased for the second quarter in succession, shrinking by a steep 4¾%. The production of consumer goods between April and June fell only marginally on the previous three-month period.

Production of intermediate goods worse affected than that of capital goods

Manufacturing firms reported that their plant was operating at 84% of capacity in July. Capacity utilisation has therefore held up at the level of its longer-term average since the beginning of 2014, which can be interpreted as being at a normal level. Capacity utilisation in the intermediate goods industry contracted

Industrial capacity utilisation largely normal

■ Sectoral trends

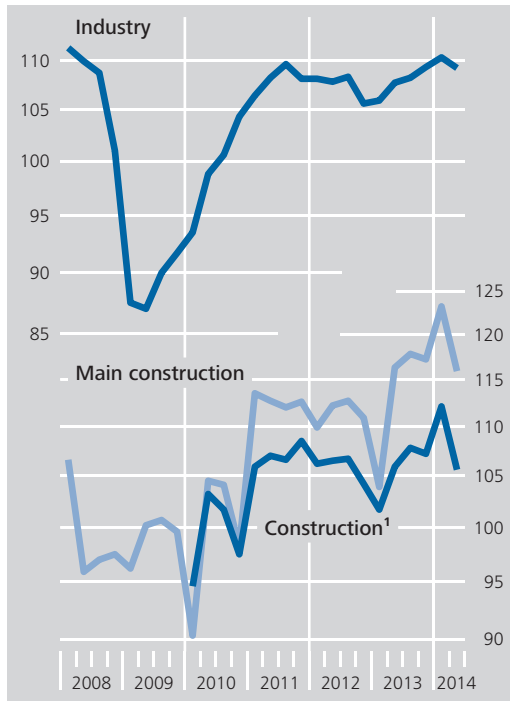
Unexpected drop in industrial output

In the second quarter of 2014, industrial output contracted by a seasonally adjusted 1% compared with the previous quarter. Half of this marked decline can be attributed to bridge day and holiday effects.⁴ The remaining decline in output does not, however, match the picture painted by the current indicators. Both new

⁴ First, the fact that the May Day public holiday fell on a Thursday this year meant that many employees made use of the change to take off the Friday, too. This is likely to have dampened output in the second quarter. Second, the very late occurrence of Easter this year meant that there were fewer public holidays in the first three months of the year than in any other first quarter since 1991. As a result, output was at a comparatively high level between January and March 2014. As the public holiday calendar in the second quarter corresponded to the seasonal norm, the seasonally adjusted quarter-on-quarter rate of change was depressed accordingly. Aggregating the two effects gives a decline of almost ½ percentage point in the quarter-on-quarter change in industrial output.

Output in industry and in construction

2010 = 100, seasonally adjusted, quarterly, log scale



Source of unadjusted figures: Federal Statistical Office. ¹ Main construction and finishing trades.
 Deutsche Bundesbank

slightly in keeping with the lower output, but remained above the long-term sectoral average. By contrast, the degree of capacity utilisation in the capital goods sector reached the normal sector-specific level.

Sharp contraction in seasonally adjusted construction output owing to weather effect, slight increase in energy production

The substantial 5¾% quarter-on-quarter decline in seasonally adjusted construction output can be attributed largely to weather effects. The exceptionally mild weather during the winter months resulted in a well below-average decline in output in the first quarter, which, statistically, drove up construction output in seasonally adjusted terms. As in the industrial sector, bridge day and holiday effects are also likely to have played a part in this. Output in the main construction subsector, which is generally susceptible to substantial weather-related fluctuations, fell by a seasonally adjusted 6% in the reporting period compared with the previous quarter. Within this subsector, the decline in building construction was somewhat more pronounced than in civil engineering. Output in

the finishing trades fell by 5¾%, although the reported figures should be regarded as very provisional. Energy production went up slightly in the second quarter by ¼%.

The rising trend in the services sector appears to have continued in the reporting period. According to surveys conducted by the Ifo Institute, the business situation in major industry and consumption-related sectors remained very positive or even improved slightly on the first quarter. Nevertheless, some service industries felt the effects of the fact that the producing sector was showing signs of flagging in the second quarter following the positive start to the year. The drop in the mileage of domestic heavy goods vehicles passing through motorway tolls suggests that the transport sector was one of those affected. Furthermore, wholesalers' turnover weakened following a substantial rise in sales in the first quarter. Motor vehicle traders suffered losses in sales after posting a good start to the year. This, however, was due to a decline in trade with households, whereas sales to commercial customers picked up again slightly. Consumption-related service providers benefited from the favourable consumer climate. Retail sales in the second quarter were down only marginally on the high level of the previous quarter. The hotel and restaurant sector recorded a decline in turnover.

Positive cyclical trend in the services sector

Employment and labour market

Job growth continued in the second quarter of 2014. Given that the usual spring rebound in employment was weaker this year, mainly on account of the mild winter, the seasonally adjusted number of persons in work in Germany went up less sharply than in the first quarter (+126,000), expanding by 89,000, or 0.2%. The rise in the number of people in employment was once again chiefly attributable to additional jobs subject to social security contributions. In the first two months of the second

As anticipated, weaker growth in employment after mild winter

quarter alone – more recent data are not yet available – the number of additional regular jobs exceeded the average level of the first quarter by 112,000 (+0.4%). At the same time, there was a further fall in the number of self-employed persons, although not quite to the same degree as in the previous quarter. One possible reason for this is that some of the immigrant workers from Romania and Bulgaria might have switched to employee status after full labour mobility within the EU was introduced for this group of persons at the beginning of this year.

Job growth focused on some services sectors

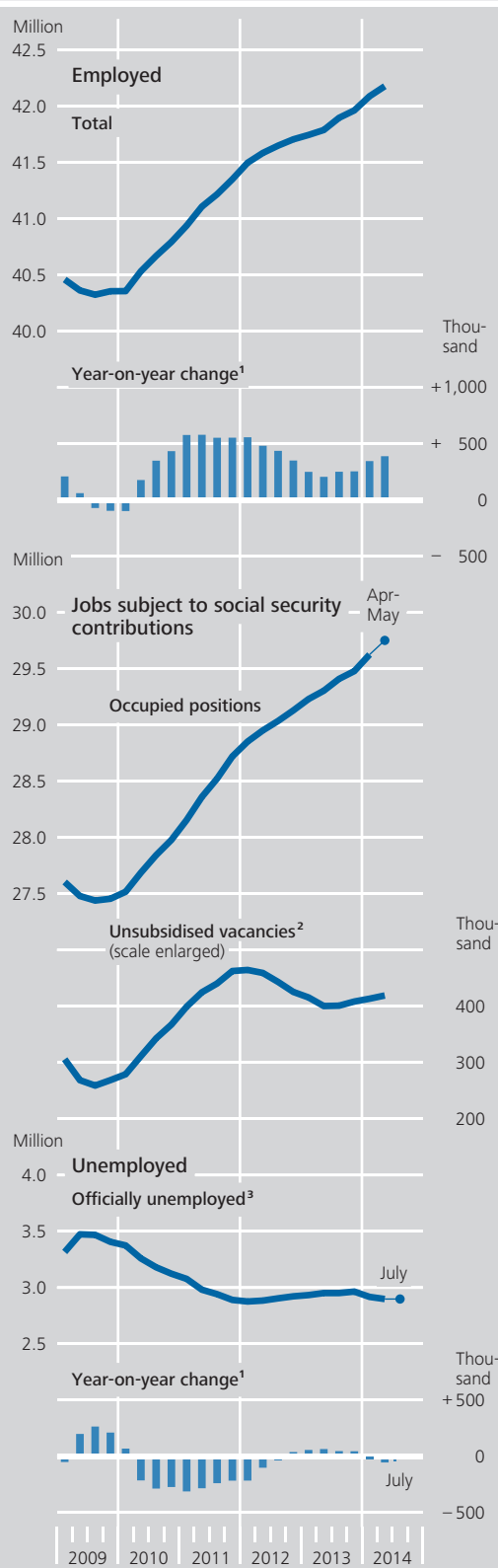
Following increased recruitment in the industrial sector at the beginning of the year, only a small number of additional regular jobs subject to social security contributions were filled in the sector in April and May on a seasonally adjusted basis. This pattern was even more pronounced in the construction sector owing to its high sensitivity to weather conditions. The greatest increase in employment, at +1%, was recorded in business-related services (excluding temporary agency employment), a sector which has been strongly expanding for quite some time, as well as in hotels and restaurants and in the health and social work sector (+¾% in each case). Moreover, continued above-average growth in employment was recorded in the transport and storage sector as well as in education, with both sectors posting an increase of ½%.

Modest fall in unemployment

On an average of the second quarter, the seasonally adjusted official number of unemployed persons fell by 19,000, after declining by 47,000 in the first quarter owing, not least, to the mild winter temperatures. The unemployment total stood at 2.90 million in the period under review. The unemployment rate fell by 0.1 percentage point to 6.7%. The fact that there was a temporary rise in seasonally adjusted unemployment in May and June is presumably due to a normalisation following the weather-related low level of unemployment in the preceding months. In any case, the seasonally adjusted jobless total declined again slightly

Labour market

Seasonally adjusted, quarterly



Source of unadjusted figures: Federal Statistical Office and Federal Employment Agency. **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.

in July. Unlike official unemployment, total underemployment (including persons taking part in labour market policy measures, but excluding short-time work) did not increase during the second quarter. This was due mainly to the fact that fewer job creation schemes were made available and fewer people took advantage of early-retirement schemes.

Slight rise in vacant positions

Only a small number of additional unsubsidised vacancies subject to social security contributions were reported during the period under review. There was no further quarter-on-quarter rise in the number of vacant positions in the manufacturing sector, whereas the number of construction sector vacancies declined again on the quarter. This contrasted with a rise in the number of vacant positions in several services sectors, such as health and social work, trade, as well as professional, scientific and technical activities. Job growth was also recorded in other business-related services (which include temporary agency employment) following a decline over the past two years.⁵

More cautious recruitment approach expected from firms in coming months

On balance, enterprises are likely to take a more cautious approach to recruitment in the coming months. This was indicated by the Ifo Institute's employment barometer, which already includes the results of the July surveys. This is likely to have only a limited impact on the official unemployment level as there have long been only few reserves in this area that can be mobilised in the short term. The likelihood that unemployment will continue moving sideways over the next few months is supported by the fact that the IAB's labour market barometer, which is based on surveys of the managers of all the regional employment agencies, has now fallen just below the neutral threshold.

■ Wages and prices

Growth in negotiated pay rates peaked in Q2

At +3.4%, the year-on-year increase in negotiated rates of pay in the second quarter of 2014 was virtually as high as in the first quarter

(+3.3%). Whereas the increase in the first quarter was mainly attributable to the considerable back payments in the retail sector, while growth in basic rates of pay was lower (+2.8%), pay growth in the reporting period was chiefly driven by the substantial increases in scheduled rates of pay under the first agreements in this year's pay round. The +3.5% year-on-year increase in collective wages, excluding one-off payments and fringe benefits, in the second quarter, is likely to have marked a peak. One reason for this is that the follow-up pay increment that forms part of many current wage settlements is lower than the initial rise. Another reason is that the most recently agreed increases were smaller than those negotiated in the agreements concluded at the beginning of the year. For salaried employees in the private and public banking sector as well as in the steel industry, for example, the latest wage agreements foresee a pay increase of 2¼% based on a notional duration of 12 months. In the wage agreements concluded prior to that (eg for the chemical industry and for central and local government) the wage increase had amounted to 3%.

At the beginning of July 2014, the Bundestag and the Bundesrat adopted the Act Reinforcing Collective Bargaining Autonomy (*Tarifautonomiestärkungsgesetz*) which *inter alia* provides for the introduction of a general statutory minimum wage of normally €8.50 per hour from January 2015. In addition to the transition periods and exceptions already contained in the Federal Government's draft legislation, it was decided that in the newspaper industry the minimum wage is to be introduced gradually

Minimum wage law adopted

⁵ The statistics on vacancies reported to the Federal Labour Agency were extended in July (retroactively from January 2013) to include vacancies from an automated cooperation procedure of participating employers. These data show a leap in the level in January 2013. Secondly, the comparison between the new and old time series shows that increasing use has been made of the newly integrated procedure for the automatic transmission of vacancies, especially in the area of temporary agency employment. It is not possible to tell, however, whether this resulted in shifts within the reporting types or whether there were a greater number of reports to the Federal Labour Agency.

between 2015 and 2017. It was further clarified that the minimum wage of €8.50 per hour will also apply to seasonal workers from 2015 onwards; however, the number of days for which they are exempt from making social security contributions will be increased from 50 to 70 (limited to four years), and board and lodgings may be counted towards the minimum wage. Moreover, contrary to the original timeframe set forth in the Federal Government's draft legislation, the independent Minimum Wage Commission will now review the minimum wage rate as early as mid-2016. On the basis of the Commission's recommendation, the minimum wage level could be adjusted for the first time in January 2017 and after that every two years.



More sectors making use of the transitional minimum wage provisions

Transitional periods up until the end of 2017 apply to sector-specific minimum wage levels, although a minimum wage of at least €8.50 will also have to be paid in these sectors from January 2017. Thus, the industrial trade union IG BAU and the representatives of the employers' associations for workers in agriculture and forestry as well as in horticulture recently came to an agreement on a collective minimum wage, which aims, not least, to stagger the higher payroll costs resulting from the introduction of a minimum wage over a longer period of time. The agreement foresees a minimum wage of €7.40 per hour in western Germany and €7.20 in eastern Germany from January 2015 along with a phased increase to €9.10 per hour Germany-wide from November 2017. By contrast, the social partners in the hotel and restaurant sector have been unable to reach an agreement so far. Discussions regarding a similar ruling for taxi firms are still ongoing.

Further fall in prices at upstream stages of the economy

In the second quarter, prices at the upstream stages of the German economy eased further in seasonally adjusted terms. This was due mainly to a decline in energy prices, especially sharp reductions in prices for gas and electricity, while petroleum products became dearer in line with quotations in the international markets. Other industrial goods prices, too, moder-

ated somewhat at both the import and the domestic producer level. The fall in import prices came to a halt over the course of the quarter, probably owing in part to the euro's depreciation against major partner currencies. Despite the further price reductions, the year-on-year decline in prices narrowed slightly to -0.8% in the case of domestic sales and perceptibly in the case of imports to -1.9%. Foreign sales prices declined at a more moderate rate over 12 months, which led to an improvement in the terms of trade.

Despite the continued high level of utilisation of equipment in the main construction sector, the increase in construction prices eased during the second quarter. The year-on-year rate of price inflation went down from 2.0% to 1.7%. The weaker price dynamics are probably due primarily to the favourable development in material costs, which rose at a much slower rate in the second quarter. According to vdp, house prices rose again moderately in the second quarter by an annual rate of 2.5%.

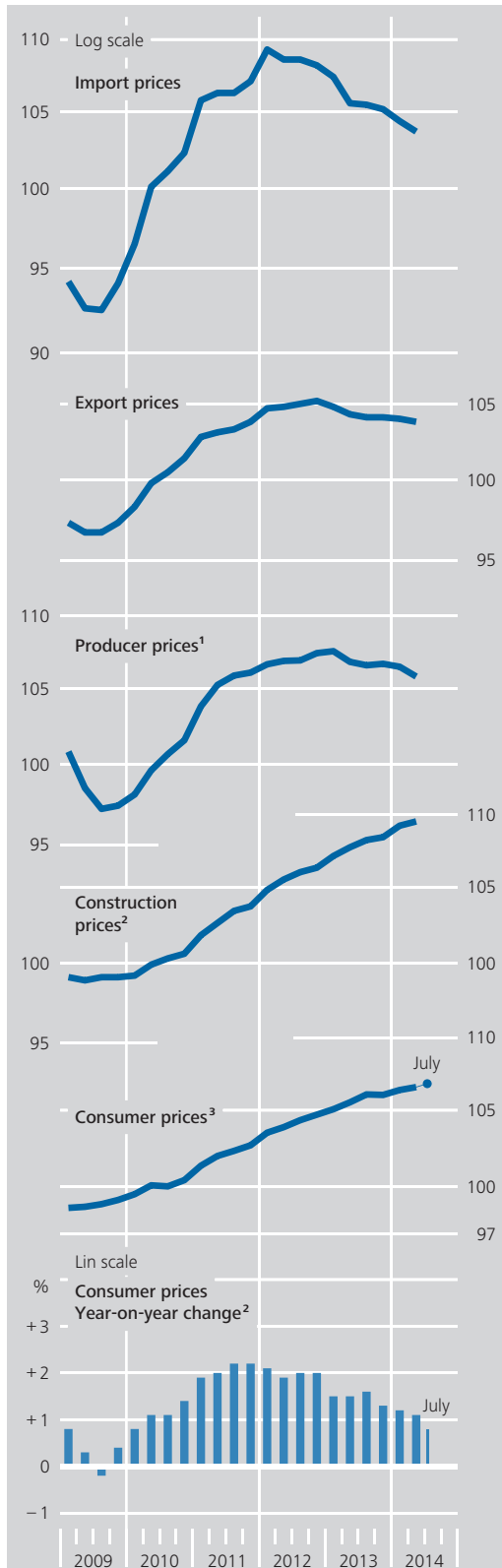
Slower rise in construction prices

Consumer price inflation slowed somewhat in the second quarter. Seasonally adjusted prices went up by a mere 0.2% on the quarter, after rising by as much as 0.4% in the first quarter. The slightly weaker upward trend was due, in particular, to a clear drop in prices for fruit and

Muted rate of consumer price increases

Import, export, producer, construction and consumer prices

2010 = 100, seasonally adjusted, quarterly



Source of unadjusted figures: Federal Statistical Office. **1** Producer price index for industrial products in domestic sales. **2** Not seasonally adjusted. **3** National consumer price index.
 Deutsche Bundesbank

vegetables, which had risen considerably in 2013 as a result of weather-related factors. Price inflation in the case of industrial goods largely came to a standstill, which is probably connected partly with the euro's earlier appreciation. The slowdown in price inflation for services related primarily to package holidays. With the seasonal changeover to summer destinations in the shopping basket for package holidays, price reductions for vacations in a number of southern European countries also became effective in the German consumer price index. By contrast, the prices of other services and housing rents continued to rise. In the case of energy prices, fuel became significantly more expensive on the back of rising crude oil prices. Hardly any of the sharp corrections in the prices of gas and electricity at the producer and import level have, to date, been passed on to consumers. On balance, the annual rate of inflation as measured by the national consumer price index (CPI) fell slightly to 1.0%. The Harmonised Index of Consumer Prices (HICP) held steady at 1.0%.

Consumer price inflation in Germany rose slightly in July. After seasonal adjustment, consumer prices were up 0.2% on the month, compared with 0.1% in June. Only in the case of energy was there a slight reduction in prices. The year-on-year CPI and HICP inflation measures both went down to 0.8% owing to a baseline effect.

Slight increase in inflation in July

Orders received and outlook

A flurry of unfavourable news reports relating to the international crisis regions have dulled Germany's economic outlook since the middle of the year. Current indicators cast doubt on the assumption on which the spring forecasts were based, namely that the underlying cyclical trend would strengthen further in the second half of 2014. The Ifo Institute's business climate index has dropped three times in a row of late, with the expectations component, in particular, falling. The perceptible decline in industrial

Duller economic outlook according to new indicators

firms' influx of orders over the course of the second quarter along with poorer export expectations suggest that the external shocks will harm industrial activity in particular. Added to this is the fact that the sharper sanctions imposed on Russia and the Russian government's countermeasures will impinge on foreign trade, which is likely to dampen sentiment not just in the heavily export-dependent industries. Domestically oriented sectors of the economy, such as construction and trade, and in July for the first time also services providers, are feeling the effects, too. It should be noted, however, that sentiment has deteriorated from a high level, which, together with the fundamental underlying upward trend in domestic demand, suggests that the course of economic momentum will not change direction.

Decline in industrial orders, ...

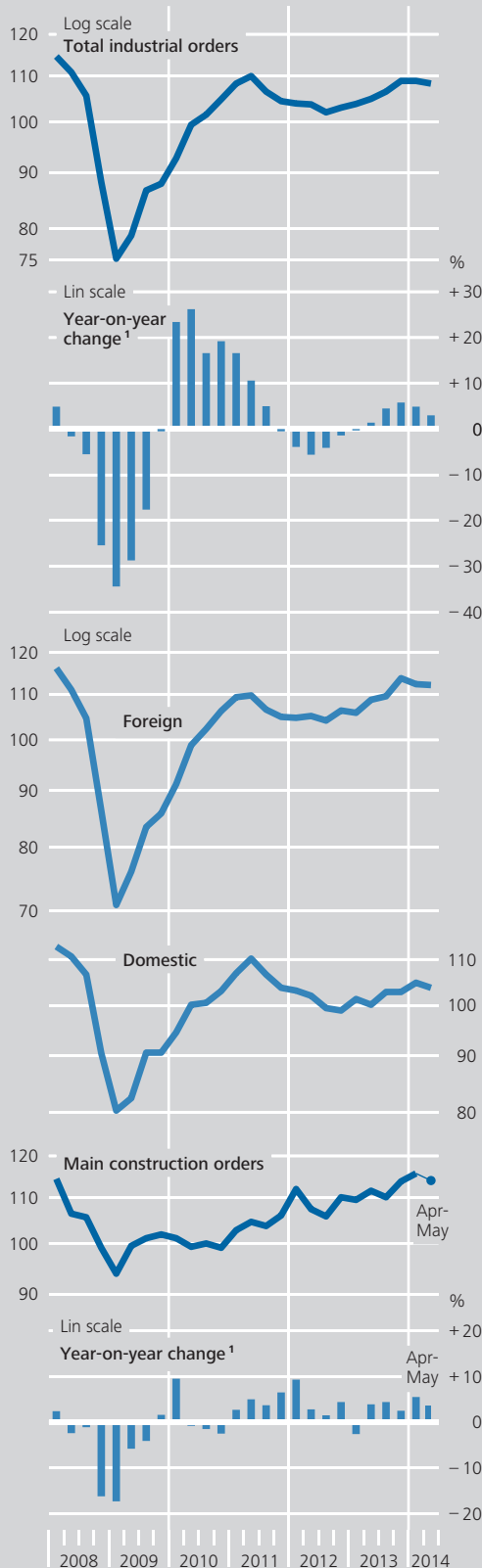
Industrial orders declined by a seasonally adjusted ½% on balance in the second quarter of 2014 compared with the first quarter. It should be borne in mind that, despite the extremely weak June result, the strong inflow of large-scale orders in April and May raised the quarter-on-quarter rate *per se* by just over 1 percentage point. The fact that this volatile component had a dampening impact in the first quarter underscores the interruption of the upward tendency in industrial goods orders since the beginning of the second quarter. Measured in terms of the order capacity index, the volume of new orders received up to June will nonetheless suffice to keep the rate of industrial capacity utilisation at a normal level.

... especially in the capital goods sector

Intermediate goods producers saw a ¾% quarter-on-quarter decline in orders in the reporting period, whereby the decrease in new domestic orders was less pronounced. Despite a slight rise in the number of orders from the euro area in the second quarter – just like in the first quarter – this was largely offset by a very marked drop in orders from non-euro-area countries. Orders of capital goods, including the large-scale orders, fell by a seasonally adjusted ½% on the first quarter, when the figure had likewise fallen short of the prior-quarter

Demand for industrial goods and construction work

Volume, 2010 = 100, seasonally adjusted, quarterly



Source of unadjusted figures: Federal Statistical Office. 1 Only calendar-adjusted.
 Deutsche Bundesbank

level. Excluding the manufacture of other transport equipment, in which large-scale orders feature prominently, the inflow of orders in the capital goods sector declined significantly (-2¼%). The downturn in domestic orders was not as pronounced as in the case of orders from abroad. The sharp increase in trade with non-euro-area countries in the first three months of the year was cancelled out in the second quarter. The corresponding volume of orders received from the euro area has been flagging since the beginning of the year, after picking up perceptibly from a very depressed level in 2013. The fact that overall capital goods orders from the euro area still managed to post a significant increase during the reporting period was due to orders for other transport equipment. After such orders, which largely relate to the joint European production of aircraft and spacecraft, dipped in the first three months of the year, new orders received in the second quarter reached a new record high, notwithstanding the poor outturn in June.

Favourable outlook for the construction sector

The outlook for the construction sector remains favourable. Housing construction was not the sole driving force behind this development, with new impetus also being generated by other divisions. A greater number of new public sector construction orders (on a seasonally adjusted basis) have been placed over the course of this year so far than in the second

half of 2013. While the volume of new industrial and commercial construction orders has sagged of late, this is due primarily to the fact that no major projects were received in April and May on a comparable scale with those placed in the preceding quarters. Housing construction remained the major driver behind the buoyant construction momentum. The estimated jump of 4¾% in the first half of 2014 in the volume of permits granted for the construction of new one-family and multiple-family houses – measured in terms of the gauged construction costs – matched the order surge recorded in the second half of 2013.

Along with housing construction, private consumption is the mainstay of economic activity at present, despite growing turbulence from the external setting. According to the surveys carried out by the consumer research institution GfK, consumer confidence brightened further going into the second half of the year. Households' income expectations are very optimistic, not least owing to the favourable outlook for employment and earnings. The low rate of inflation is also increasing real spending power. So far, the gloomier economic outlook has not yet depressed household sentiment. But even if the gloomier outlook were to spill over to household sentiment, the recent track record suggests that the propensity to purchase may well continue to prove to be robust.

Private consumption a mainstay of economic activity