

Economic conditions in Germany

Macroeconomic situation

German economy showing strong growth in Q1

The cyclical upturn in the German economy gained momentum at the beginning of the year. According to the Federal Statistical Office's flash estimate, real gross domestic product (GDP) in the first quarter of 2017 rose substantially by 0.6%, after seasonal and calendar adjustment, against the fourth quarter of 2016 in which the German economy had expanded by 0.4%. The pace of aggregate growth clearly exceeded the potential rate. As a result, overall capacity utilisation, which has been considerably above its longer-term average for quite some time, increased further. The very upbeat economic situation is also reflected in the extremely optimistic sentiment in the German economy and among households. This, together with the favourable order situation in industry and construction, suggests that the

strong gains are likely to continue in the second quarter.

The acceleration in aggregate growth was due mainly to a marked expansion in construction activity fuelled by high demand, especially for housing, but also to a recent high inflow of new orders in the industrial sector, which helped it to overcome its sluggish phase in the second half of 2016. Growth continued to be supported by buoyant business activity in the services sector.

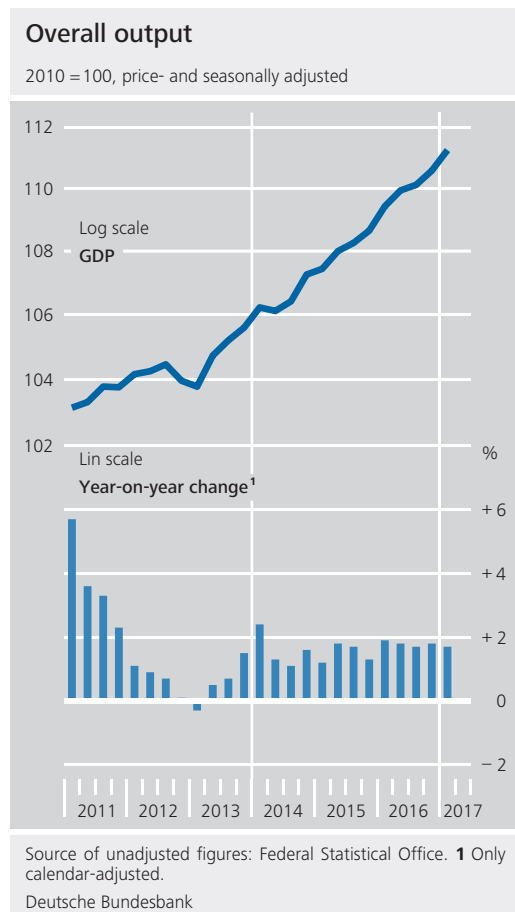
Acceleration in growth driven by industry and construction

A breakdown of the GDP expenditure components likewise suggests that the upswing became more broadly based recently. Investment in machinery and equipment also picked up again after the turn of the year in the wake of strong export growth, which continued the trend seen at the end of 2016, and the above-average level of capacity utilisation in industry. The boom in the housing market continued. Although the inflation hike at the start of the year eroded consumers' real disposable income, private consumption remained on an expansionary course owing to the ongoing very buoyant labour market situation.

Upswing more broadly based

German exports continued on their upward path in the first quarter of 2017 and recorded a substantial increase on the previous quarter in seasonally adjusted terms. According to the figures available up until February, the development in the value of exports remained broadly based in regional terms. Euro-area demand for German products rose considerably. Sales of German goods in non-euro-area markets grew even more dynamically, however, with very substantial growth being recorded in the United States. The value of goods exported to the United Kingdom likewise increased perceptibly after – in some cases, considerable – declines had been recorded in the preceding quarters. The depreciation of the pound sterling is likely to have played an important role in

Strong growth in German exports at beginning of year



this development, however. Furthermore, trade with Russia stood out in particular after posting a surge in growth. The recovery of the Russian economy from the persistent recession witnessed in recent years, combined with the marked appreciation of the rouble, are likely to have fuelled the demand for German exports. Exports of goods to China almost maintained the record level of the final quarter of 2016, when they had risen sharply. This contrasted with a sharp drop in exports to Japan and the other industrial economies in Asia. German enterprises also saw a substantial decline in their exports to the OPEC countries.

Upturn in investment in machinery and equipment

Investment in machinery and equipment overcame its sluggish phase of the previous year and picked up significantly in the first quarter of 2017. This is suggested by the strong growth in both the domestic sales and imports of capital goods. Furthermore, the number of registrations of commercially used vehicles went up considerably. The strong industrial demand and the ongoing buoyant export activity coupled with the greater utilisation of production capacity is likely to have contributed to the higher propensity of enterprises to invest.

Construction investment extremely dynamic

According to the current indicators, construction investment grew strongly in the first quarter of 2017. The main reason for this was likely due once again to the very high investment levels in residential construction. Investment in commercial construction probably also expanded appreciably, however. This is indicated in any case by the turnover figures for the main construction sector available up until February, which also show a clear upward trend in commercial construction.

Private consumption probably somewhat more moderate at beginning of year

Private consumption probably grew somewhat more moderately in the first quarter of 2017 than in the final quarter of 2016. The marginal decline in the propensity to consume is likely to have been due mainly to the sharper rise in prices at the beginning of the year, which reduced consumers' purchasing power. This had an impact on retail sales, which largely stag-

Foreign trade

Seasonally adjusted, quarterly



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

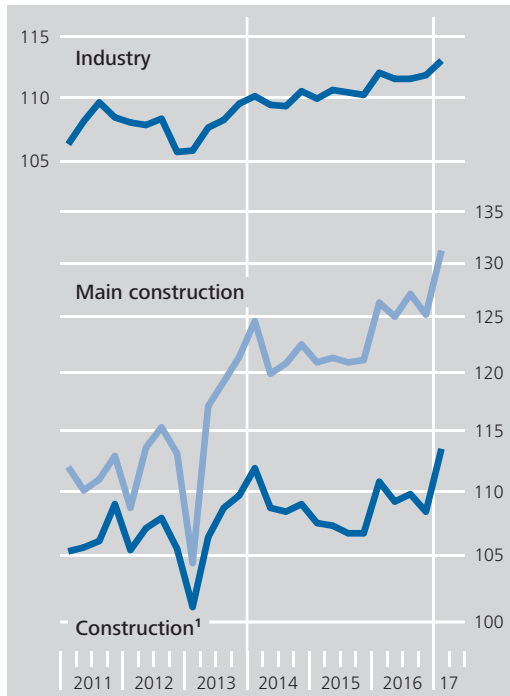
nated in real terms after posting fairly strong growth in the second half of 2016. Sales of textiles, clothing and shoes fell particularly steeply after recording exceptionally strong growth in the preceding quarter. By contrast, the buoyant consumer demand for information and communication technology (ICT) equipment continued unabated. There were also more purchases of motor vehicles, which is indicated, *inter alia*, by the renewed increase in the number of new registrations by households.

The value of imports increased sharply in the first quarter of 2017 after adjustment for seasonal variations. Impetus was provided by both

Import demand still robust

Output in industry and in construction

2010 = 100, seasonally adjusted, quarterly, log scale



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

the continuing robust domestic developments and the flourishing export activity of German enterprises. Import growth is likely to have been considerably weaker in real terms, ie after excluding the fairly strong price effects in the reporting period. In regional terms, the value of imports from the euro area went up particularly sharply. Substantial growth was also recorded in imports from non-euro-area countries, however. This benefited, *inter alia*, US and Japanese manufacturers, which were able to significantly step up their exports to Germany. German demand for products from the United Kingdom likewise grew. The strong increase in the value of imports from the OPEC countries and Russia, which, in the case of the latter, even recorded a perceptible two-digit growth figure, should probably be seen in connection with the surge in crude oil prices at the end of 2016. By contrast, imports from the People's Republic of China, which had risen perceptibly by one-tenth in the previous quarter, dropped considerably.

■ Sectoral trends

After a period of stagnation in the second half of 2016, industry started the new year off briskly. In the first quarter of 2017, seasonally adjusted output was substantially stronger than in the previous quarter (+1%). Driven by the exceptionally strong inflow of new orders, industrial enterprises had already begun procuring a greater volume of intermediate goods in the final quarter of 2016 both from within Germany and abroad in order to rapidly ramp up their output. Motor vehicle manufacturers stepped up their production particularly sharply after they had cut back their output at the end of the year. Considerable growth in output was also seen in the manufacture of basic metals as well as in the production of chemicals and pharmaceuticals. On the whole, the output of intermediate, capital and consumer goods all grew at fairly similar rates.

Industrial activity on growth path

According to Ifo Institute data, capacity utilisation of tangible fixed assets in manufacturing remained at its highest level since mid-2011 (86%) and thus well above its longer-term average. Manufacturers of intermediate and consumer goods reported a marked increase in capacity utilisation, whereas it declined quite perceptibly in the capital goods sector.

Industrial capacity utilisation still above average

According to statistics, the construction sector recorded exceptionally strong seasonally adjusted growth in the first quarter of 2017 compared with the final quarter of 2016 (+4¾%). Although output in the finishing trades also increased very strongly (+4½%), this was mainly attributable to a marked seasonally adjusted rise of 4¾% in the production index for the main construction sector. According to Federal Statistical Office data, this increase is due, in part, to a sharp increase in the number of con-

Construction activity very dynamic

struction firms required to report.¹ This does, however, limit the economic explanatory value of the growth rate for the first quarter, as part of this increase is likely to reflect the increased levels of activity in the previous periods. On the other hand, the main construction sector is now presenting a more coherent economic picture which is more in line with the available data on output, new orders, equipment utilisation and sentiment indicators.

Services sector painting a positive picture overall

The services sector was painting a predominantly positive picture in the first quarter of 2017. Wholesale trade posted a marked increase in sales spurred by the favourable industrial activity and the brisk import activity. This is consistent with the assessment of the business situation in the sector, which, according to the Ifo Institute, is at its highest level since 1991. By contrast, real retail sales (excluding cars) grew relatively moderately and remained broadly unchanged at the prior-quarter level. Motor vehicle sales – statistical information is available up to February – performed very well, however. This is also indicated by the rise in the number of newly registered motor vehicles. Other services, excluding trade, probably also started the new year on an upbeat note. Amongst other things, this is suggested by the business expectations of enterprises, which remained well above the long-term average.

favourable development will continue in the months to come.

The seasonally adjusted number of persons in work in Germany in the first quarter of 2017 went up by 203,000, or 0.5%, after rising by an almost equal amount in the final quarter of 2016. Jobs subject to social security contributions continued to be the main driver of this positive development. According to initial estimates by the Federal Employment Agency for January and February, employment subject to social security contributions went up in all economic sectors with the exception of the finance and insurance industries. This applies in particular to business-related services (including temporary agency employment, which grew again recently), logistics, the information and communication sector as well as education and training. The construction sector continued to hire new staff on a considerable scale in keeping with the vigorous growth in construction activity. The health and social work sector, which has been expanding strongly for quite some time, again posted above-average growth. Compared with the strong gains in employment in the overall economy, the increase in the manufacturing sector was rather modest, as was the case in the preceding quarters. Employment growth in trade and in the public sector was also below average.

Very sharp rise in employment in winter half-year

■ Labour market

Labour market: situation and outlook still very favourable

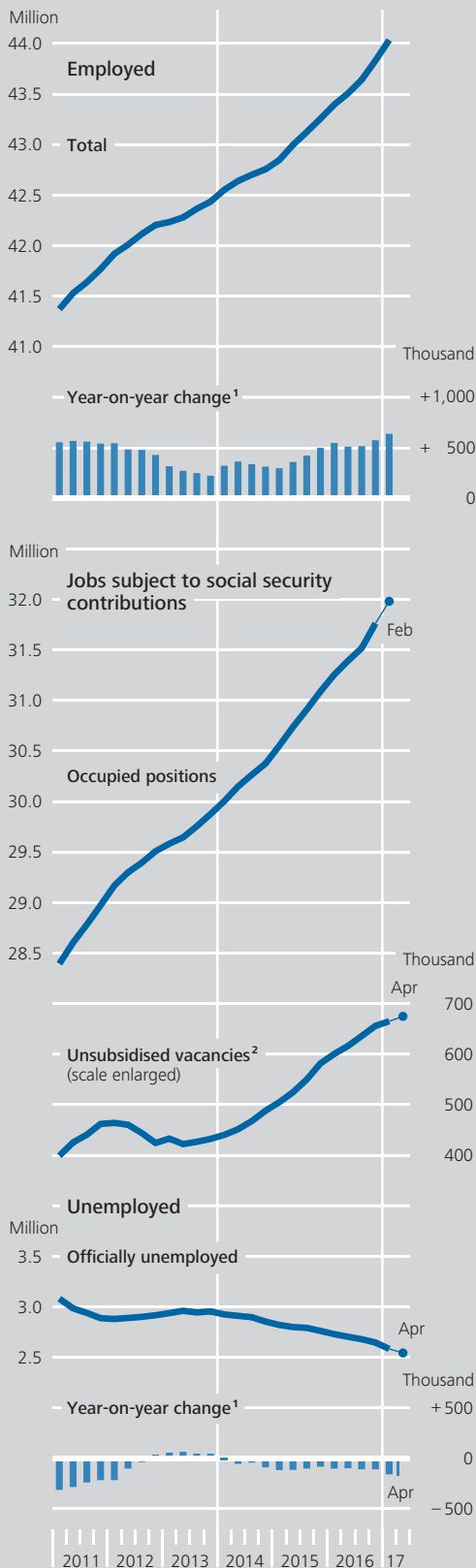
The German labour market remains in very good shape. As in the last three months of 2016, employment surged again in the first quarter of this year.² This is attributable almost exclusively to the creation of new jobs subject to social security contributions. The low-paid part-time employment segment continued to contract and the number of self-employed persons is also likely to have decreased further. Registered unemployment fell quite significantly in the period under review. The leading labour market indicators suggest that this very

¹ Once a year, those construction firms which are required to report for the first time are included in the statistics. According to the Federal Statistical Office, these are either “new firms operating in the German market or firms which have grown beyond the threshold of 20 or more employees”. This adjustment to the reporting population, which in the past took place in the final quarter of the year, will now take place at the beginning of the year from 2017 onwards. The expansion of the reporting population was particularly pronounced this year. See Federal Statistical Office, Anpassungen beim Produktionsindex für das Bauhauptgewerbe, May 2017.

² After a data processing error by the Federal Employment Agency was remedied in March 2017, employment subject to social security contributions underwent a huge upward correction in the second half of 2016. See Statistik der Bundesagentur für Arbeit: Grundlagen: Hintergrundinfo – Beschäftigungsstatistik: Korrektur vorläufiger Werte für das 2. Halbjahr 2016, March 2017. The situation in overall employment also later turned out to be significantly more favourable than previously reported.

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.

Deutsche Bundesbank

The increased demand for labour compared with the previous year was not covered by domestic labour reserves alone. Foreign passport holders accounted for almost half of the increase in regular jobs subject to social security contributions within the last 12 months (+318,000 persons). The central and east European countries that joined the European Union in 2004 were still the most significant region of origin (+148,000 persons). Persons from the main countries of origin of asylum seekers are also gradually becoming more important in employment subject to social security contributions (+44,000).³

Demand for labour covered by immigration to a considerable extent

After seasonal adjustment, registered unemployment declined more strongly in the first quarter of 2017 than in the preceding quarters. On an average of the reporting period, the official unemployment figure was 63,000 lower than in the final quarter of last year. The unemployment rate contracted by 0.2 percentage point to 5.8%. The unemployment figure posted a further fall in April. The Federal Employment Agency's figures show that, above all, the risk of losing one's job has decreased significantly. The chances of ending unemployment with a new job have hardly improved of late, however.⁴ There was a very strong decline in unemployment among German nationals, in particular, compared with the previous year. By contrast, unemployment in the group of persons who only recently immigrated from the most significant countries of origin of asylum increased (+55,000 on the month), although the expansion of labour market policy measures to integrate refugees had a dampening effect.⁵

Clear decline in unemployment, especially among German nationals

3 See Federal Employment Agency, Statistik/Arbeitsmarktberichterstattung (2017): Migration-Monitor Arbeitsmarkt – Eckwerte Deutschland (May). The Middle East countries of Syria, Iraq, Iran, Afghanistan and Pakistan, as well as the African countries of Eritrea, Nigeria and Somalia, are classed as being among the most significant countries of origin of asylum seekers.

4 See Federal Employment Agency, Statistik/Arbeitsmarktberichterstattung: Der Arbeits- und Ausbildungsmarkt in Deutschland – Monatsbericht, April 2017, pp 17-18.

5 See Federal Employment Agency, Statistik/Arbeitsmarktberichterstattung (2017): Migration-Monitor Arbeitsmarkt – Eckwerte Deutschland (May).

Continuation of favourable labour market development reported

The leading labour market indicators are still exceptionally optimistic. Enterprises are set to continue an expansive recruitment policy in the coming months. Both the Ifo employment barometer and the IAB labour market barometer are close to the peaks reached in the autumn of last year. The Federal Employment Agency's BA-X job index is at the highest level since its introduction in 2004. The very high number of job vacancies reported to the Federal Employment Agency is the main reason for this, but increasing difficulties in filling the open vacancies adequately are also likely to have played a part. According to the Federal Employment Agency, the average vacancy period has already been increasing for quite some time. The unemployment subcomponent of the IAB labour market barometer is well above the neutral threshold. Unemployment is therefore likely to fall in the coming months, too.

Wages and prices

Earnings up somewhat more sharply in first quarter

Although the increase in wages accelerated slightly in the first quarter of 2017, it remained fairly moderate compared with the exceptionally positive labour market situation. The year-on-year increase in negotiated pay rates of 2.4% was somewhat stronger than in the autumn of 2016. Growth in actual earnings may also have risen slightly in the first quarter. In addition to the positive effect of the high demand for labour, this is suggested by the 4% increase in the general minimum wage as from January 2017, as well as by the rise in sectoral minimum wages laid down in collective agreements at the turn of the year.⁶

Recent wage agreements with moderate rises

Negotiated pay agreements to date in this year's "small" wage round have largely mirrored the level of last year's collective bargaining agreements. This applies both to the size of the wage increases, which have mostly been moderate so far, and to the normally two-year duration of the agreements. On an annual basis, employees in the public service of the Federal state governments were granted a

Negotiated rates of pay

Year-on-year percentage change, on monthly basis



¹ Excluding additional benefits and lump-sum payments (eg holiday pay, bonuses).
 Deutsche Bundesbank

wage increase of around 2½% and negotiated rates of pay for employees in the west German textile and clothing industry and the steel industry went up by only 2%.

Further wage negotiations are planned for this year, mainly in the services sectors, such as retail and wholesale trade, the insurance sector and office cleaning. Current wage demands by unions vary between 4.5% and 6.5%, thus matching last year's range. However, the outstanding labour negotiations will probably not be limited to higher pay increases but will also feature other aspects such as pension arrangements or the impact of digitisation.

Wage demands in similar range as previous year

Consumer prices as measured by the Harmonised Index of Consumer Prices (HICP) rose fairly sharply in the first quarter of 2017, as they had in the final months of 2016; they were up by a seasonally adjusted 0.5% on the quarter. Inflation was still mainly driven by energy and food. Prices of refined petroleum products continued to appreciate in line with crude oil prices. Fur-

Consumer price inflation still driven by energy and food

⁶ This applies to the main construction sector, vocational education and training, the roofing industry, electricians and office cleaners, agriculture and forestry, horticulture and the care sector. The generally binding collective agreement in temporary employment expired on 31 December 2016 and the sector-specific minimum wage, which has since been raised, will probably not be declared generally binding before 1 June 2017.

Import, export, producer 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** Harmonised Index of Consumer Prices. **3** Not seasonally adjusted. Deutsche Bundesbank

thermore, electricity prices went up moderately. Lower wholesale gas prices are likely to have partially offset the higher renewable energy (EEG) levy and the increase in network charges. The unusually cold weather in large parts of Europe pushed up the cost of food.

By contrast, the prices of industrial goods excluding energy rose only moderately, as in the previous quarter. The significant depreciation of the euro in the final quarter of last year, which had already led to a marked increase in prices at the upstream stages of the economy, was now also reflected in prices for consumer durables, such as information processing equip-

By contrast, rise in prices of industrial products and services remains moderate

ment. In addition, there were marked increases in prices of goods which are set by the national authorities, such as medicines. On the other hand, there were no further adjustments in clothing prices, which had seen a distinct rise in the previous quarter. The prices of services as a whole registered another slight increase despite a marked drop in patients' contributions to the cost of long-term care following the recent reform. Travel services became markedly more expensive and prices of other services, including rents, continued to go up considerably, as in the previous quarter.

Overall, annual HICP inflation jumped very sharply from 1.0% to 1.9% on a quarterly average.⁷ A key baseline factor in this was that energy prices had declined significantly at the beginning of 2016. Over the course of the quarter, the rate declined from 2.2% in February to 1.5% in March, mainly because Easter fell early last year. This also meant that inflation excluding energy and food fell from 1.2% to 1.0% on the average of the quarter.

Annual inflation up sharply

The moderate rise in consumer prices continued in April. Owing to the shift in the timing of Easter from March in 2016 to April in 2017 and to the sharp drop in prices for package holidays in April last year, the year-on-year increase in prices rose again overall from +1.5% to +2.0%.⁸ Excluding food and energy, the figure was +1.6%, compared with +0.9%.

Inflation picks up in April, mainly owing to Easter

Inflation is likely to fall again significantly with the loss of this special effect in the coming months. Furthermore, the recent decline in crude oil prices should be reflected in consumer prices for energy. The recent very cold weather conditions could put upward pressure on food prices, however. With regard to the other components, the most recent increase at the upstream stages has probably already been partially passed on to end customers. The continu-

Inflation likely to be lower again in coming months

⁷ The annual rate of consumer inflation according to the national Consumer Price Index (CPI) rose from 1.1% to 1.9%.

⁸ The annual CPI rate likewise rose to +2.0% from +1.6%.

ing increase in prices of intermediate goods, driven by higher prices for industrial and agricultural commodities, is also likely to lead to consumer price inflation in the future, however.

■ Orders received and outlook

Steep growth set to continue in second quarter

The German economy's strong growth looks set to continue in the second quarter of 2017. Industrial activity is likely to remain on an upward trajectory, buoyed by lively domestic and external demand. This is also suggested by the positive sentiment in manufacturing in conjunction with still optimistic export expectations. Given that utilisation of production capacity remains above average, this should support the ongoing momentum of private investment in machinery and equipment. The construction sector should continue to flourish, and the services industries are also likely to remain on an expansionary course. All this is likely to have a positive impact on households' income and labour market prospects, which should ensure that consumer spending remains stable in the second quarter, too.

Positive sentiment in German economy

Sentiment in the German economy is still very optimistic. According to the Ifo Institute, the business climate in the manufacturing sector remains at its highest level since mid-2011. A further improvement in the assessment of the business situation contrasted with a slightly less upbeat evaluation with regard to future business. Meanwhile, the assessment of the business situation in the construction sector rose to the highest level since 1991. The broadly neutral data on business expectations point to a continuation of the positive sectoral activity. Moreover, sentiment in retail brightened distinctly. By contrast, sentiment in the services sector weakened somewhat but was still clearly above the longer-term average.

In the first quarter of 2017, industrial orders did not quite match the high level of the final quarter of 2016, where there had been an exceptionally strong inflow of orders, however.

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

High level of orders in industry in fourth quarter of 2016 and first quarter of 2017

Nevertheless, they were significantly higher than the level of the third quarter of 2016. On an average of the fourth quarter of 2016 and the first quarter of 2017, new orders were up by 31¼% from the summer 2016 level. The exceptionally favourable order situation is also reflected in the order capacity index and in the assessment and the reach of the order books. In regional terms, growth in orders was broadly based in the final quarter of 2016 and first quarter of 2017. Strong impetus was provided by Germany as well as by the euro area and non-euro-area countries. This likewise applies in terms of the individual sectors.

Construction boom expected to continue in second quarter

Construction activity is also likely to flourish in the second quarter. After seasonal adjustment, new orders in the main construction sector in January and February – the most recent period for which statistics are available – even showed a slight increase on the exceptionally strong final quarter of 2016. This development was for the most part underpinned by the substantial

influx of orders recorded in building construction, in which residential and commercial construction dominated. By contrast, there were significantly fewer new orders in civil engineering.

Private consumption will probably remain a key cornerstone of economic developments in the second quarter of 2017. This is largely due to the ongoing favourable labour market situation and the positive earnings development among households associated with this. Another alleviating effect is the fact that crude oil prices were not up again in the second quarter and thus consumer purchasing power did not shrink further on the back of higher energy prices. This is consistent with the consumer climate index calculated by the market research institution Gesellschaft für Konsumforschung (GfK) still being at a very high level. Sentiment in retail trade, which has recently picked up greatly, also points to a continuation of brisk consumption.

Consumer spending probably key growth factor in the second quarter as well