

## Economic conditions in Germany

### Macroeconomic situation

*Pick-up in economic growth at year-end 2016 ...*

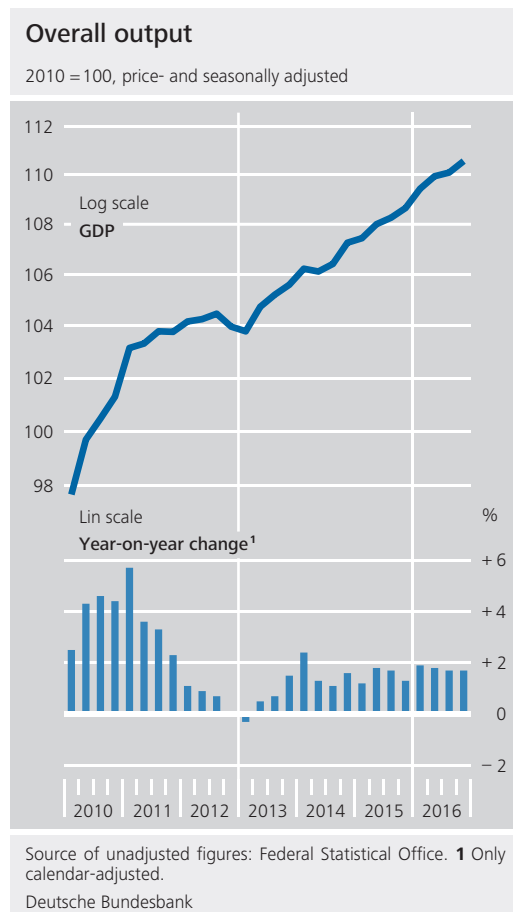
The pace of growth in the German economy accelerated perceptibly at the end of 2016. According to the Federal Statistical Office's flash estimate, real gross domestic product (GDP) in the fourth quarter of 2016 rose by a seasonally and calendar-adjusted 0.4% on the quarter and thus considerably more strongly than in the summer, when the increase stood at just 0.1%. In 2016 as a whole, real GDP increased by 1.9% year-on-year (1.8% in calendar-adjusted terms). This means that the upswing in the German economy with growth rates significantly above the rate of potential growth has been under way for three years now, and overall capacity utilisation is now exceeding normal levels.

Stronger growth stimulus was generated on the demand side towards the end of the year, driven primarily by exports, which overcame their third-quarter lull and posted strong growth. Construction activity also picked up momentum again in the final quarter of 2016. Private consumption continued to expand given that labour market and income prospects remained on an expansionary path. By contrast, investment in machinery and equipment, which had waned in the previous two quarters, remained lacklustre.

*... thanks to stronger exports and ongoing buoyant domestic demand*

Following subdued growth in the summer months, seasonally adjusted German exports expanded sharply on the quarter at the end of 2016. According to the figures available up until November, the increase in the value of exports was broadly based in regional terms. German exports to other euro-area countries rose significantly, while demand from non-euro-area countries was even more buoyant. German enterprises, for example, considerably increased the value of their exports to the United States. One possible factor behind this might have been that the US dollar appreciated markedly against the euro during the period under review. German exporters also saw strong growth in trade with China, Japan and other export markets in Asia. Exports to the OPEC countries likewise showed positive growth. By contrast, the value of goods exported to the United Kingdom underwent a marked decline, which is likely to have been connected with the continuing weakness of the pound sterling. Exports of goods to Russia also showed a marked drop following their strong upward movement in the third quarter.

*Strong growth in exports*



Against the backdrop of still subdued growth in industrial output, despite the strong increase in new orders, investment in machinery and equipment remained sluggish in the final quarter of 2016 after declining in the second and third quarters. Although manufacturers of cap-

*Lull in investment in machinery and equipment not yet overcome*

ital goods posted significant domestic sales growth in real terms, the decline in the number of registrations of commercially used vehicles, both for passenger cars and utility vehicles, suggests that investment in enterprises' motor vehicle fleets was very weak.

*Marked increase in construction investment*

Construction investment accelerated significantly at the end of 2016 compared with the rather modest pace of the third quarter. This is likely to have been due primarily to housing construction. Measured in terms of turnover in the construction sector – figures for which are available up until November – investment in commercial construction, which has been trending downwards in recent years, may also have shown an increase.

*Private consumption still showing strong momentum*

Private consumption at the end of 2016 continued its upward movement on the back of ongoing favourable income and labour market prospects. The loss of purchasing power resulting from the sharp rise in energy prices evidently did little to dampen households' strong appetite for consumption. In the retail sector, textiles, clothing and footwear were in particular demand following subdued sales of such goods in September on account of the weather. Trade in information and communication technology (ICT) equipment was also flourishing. By contrast, consumers were probably more cautious in terms of their spending in the hotel and restaurant sector. The same goes for motor vehicle purchases, as is indicated by the decline in the number of new registrations in the case of households.

*Stronger pace of growth in imports*

Imports saw a sharp rise in price and seasonally adjusted terms in the final quarter of 2016. This was probably due mainly to the renewed pick-up in export activity as well as ongoing buoyant domestic demand. There was greater demand for goods from virtually all major economic regions. In terms of value, imports from non-euro-area countries showed a particularly strong rise. The surge in domestic demand chiefly benefited Chinese exporters, who saw quite substantial increase in their exports to

## Foreign trade

Seasonally adjusted, quarterly



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

Germany. Considerably more goods were also imported from the United Kingdom. The value of imports from the OPEC countries and Russia were pointing markedly upwards. This is likely to have been due to higher energy prices. Imports of goods from the United States and Japan stagnated, however.

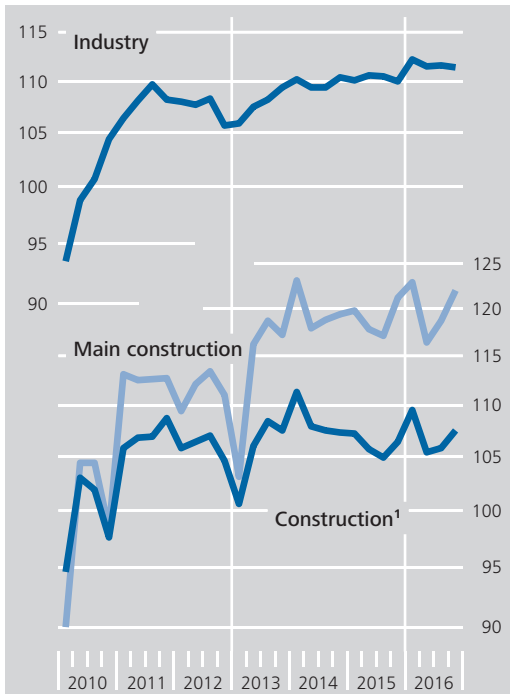
## ■ Sectoral trends

Industrial output was still not fully taking off in the fourth quarter either. Following a period of stagnation in the summer months, industrial output in the final quarter of 2016 fell slightly

*Industrial output proving weak owing to production cut-backs in December*

### 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

capacity utilisation in the capital goods sector contracted somewhat.

Seasonally adjusted construction output in the final quarter of 2016 rose substantially on the quarter by 1½%, with output in the main construction sector posting particularly strong growth (+2¾%). Building construction, which also includes residential housing, was the dominant factor in this regard with marked rates of growth. Substantial growth rates were also recorded in civil engineering, however. On the whole, the situation in the construction industry is still exceptionally favourable, with the Ifo Institute's assessment of the business situation in the construction sector being at its highest level since 1991. Equipment utilisation in the construction sector is also persisting at a record high. This is consistent with the rising trend in construction prices in the final quarter of the year, even though the rates of increase are still relatively moderate. Compared with the previous year, they were up by 2.2%. At the beginning of 2016, the rate stood at 1.7%. Property prices continued to rise unabated. According to the Association of German Pfandbrief Banks (Verband deutscher Pfandbriefbanken – vdp), the prices of owner-occupied housing rose by 6.6% on the year. More detailed comments on housing price developments last year may be found on pages 51 to 53.

*Construction activity still buoyant*

on the quarter (-¼%) in seasonally adjusted terms. The weak result was, however, due solely to the sharp cutback in production in December. This is likely to have been due, above all, to many manufacturers, as is customary, shutting down their plants between Christmas and the New Year and the number of working days affected by this last year being greater than on a longer-term average. Output of capital and consumer goods fell considerably in the quarter as a whole (-¾%). By contrast, manufacturers of intermediate goods saw a marked increase in output (+¾%).

Economic activity in the fairly heterogeneous services sector is likely to have picked up distinctly in the final three months of the year. In the wholesale trade, sales are beginning to show a clear increase in real terms after declining twice successively, which is due also, in part, to foreign trade activity becoming stronger again. This is consistent with the fact that the Ifo Institute's assessment of the business situation showed an improvement again towards the end of the year. Motor vehicle sales – statistical data for which are available up until November – also showed a marked upward movement, although the number of newly registered motor vehicles decreased. Real retail sales (excluding motor vehicles) rose

*Services sector in good shape*

*Industrial capacity utilisation at a high level*

According to Ifo Institute data, there was a distinct rise in the capacity utilisation of tangible fixed assets in manufacturing. At 86% in January 2017, it reached its highest level since mid-2011 and was therefore well above its longer-term average. Manufacturers of intermediate and consumer goods reported a higher level of utilisation than in the previous quarter, whereas

moderately, as they did in the third quarter. Other services, excluding trade, probably finished the year 2016 quite buoyantly. This is suggested at all events by the clear improvement in enterprises' business expectations in this sector.

## ■ Labour market

*Slight increase in employment, further decline in unemployment*

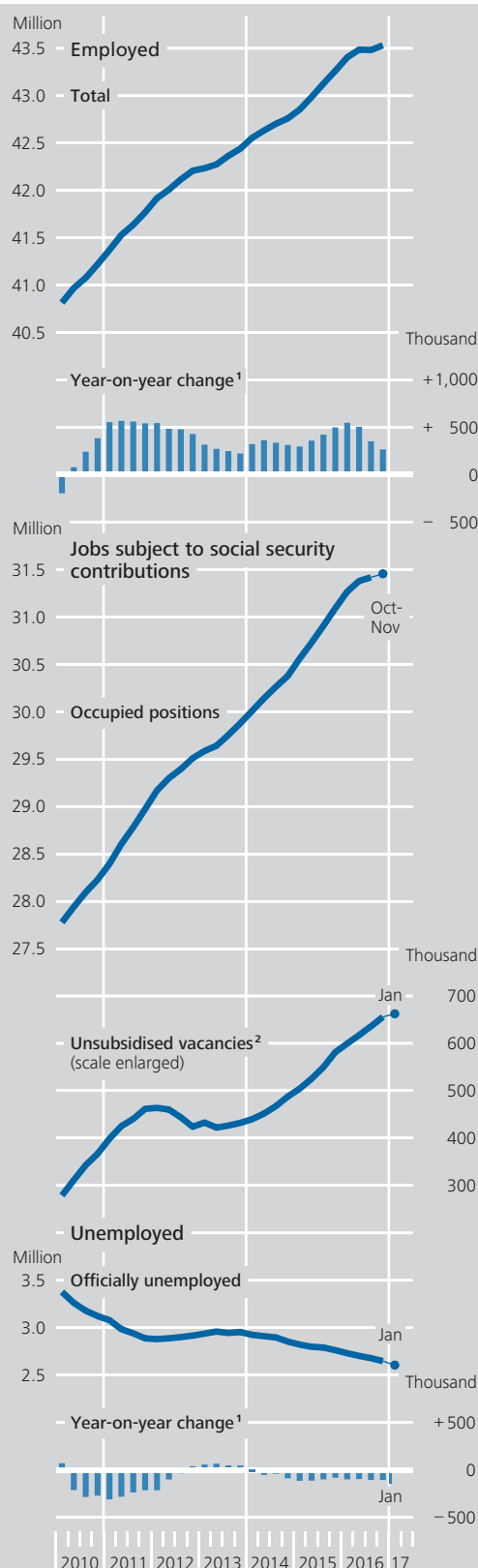
Employment rose again during the fourth quarter of 2016, following a slight dip in the summer months. However, measured in terms of developments during the first half of the year and the – sometimes very optimistic – leading indicators, the employment figure showed only a moderate increase. Employment subject to social security contributions posted only a modest increase in the fourth quarter, and exclusively low-paid part-time employment continued to fall. Following years of decline, self-employment showed something of a recovery after picking up slightly, as it had also done in the previous quarter. The outlook for employment is still favourable, although it is becoming increasingly clear that it is becoming more difficult to fill vacant positions. Unemployment fell significantly throughout the reporting period, despite the large number of refugees registering as job seekers after their applications for asylum had been approved.

*Employment subject to social security contributions increased only slightly in Q4*

Employment in Germany in the fourth quarter of 2016 rose by a seasonally adjusted 51,000 persons, or 0.1%, compared with the third quarter, when there was a small decline by 6,000 persons. The year-on-year increase shrank to 267,000 persons (+0.6%). Employment subject to social security contributions, which had been the main driver of employment growth up until the middle of the year, showed only a small increase. According to the initial figures of the Federal Employment Agency, the number of employees subject to social security contributions in October and November rose by a seasonally adjusted 0.1% (or 28,000 persons) compared with the average of the third quarter.

### 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

*High level of sectoral heterogeneity*

Sectoral heterogeneity has increased. Three sectors of the economy, including manufacturing and trade, have been reporting a significant decline in employment subject to social security contributions since June 2016. In the preceding quarters, the number of persons employed under regular employment contracts was pointing clearly upwards, or was at least broadly stable, in almost all sectors of the economy. The health and welfare sectors reported a positive, albeit somewhat muted, development in employment in the final quarter of 2016. Other services sectors continued to recruit new staff on a sizeable scale, such as in business-related services (including temporary agency employment), logistics, hotels and restaurants, and the information and communication sector. Employment in the construction sector picked up again further of late owing to the high level of capacity utilisation.

*Weaker dynamics, also as a result of demographic trends*

Demographic factors may go some way towards explaining the weaker employment dynamics. The reduction in the potential domestic labour force observed over the last few years will no longer be fully offset by rising labour market participation, and, according to the Federal Employment Agency, the increased demand for labour is likely to have been met very largely by immigration,<sup>1</sup> with a prominent role being played by EU nationals. The number of persons in employment subject to social security contributions or working in low-paid part-time jobs coming from the most significant war-torn and crisis-stricken countries of Asia and Africa went up by no more than 55,000 in November in comparison with the previous year.<sup>2</sup> The frequent limited employability of refugees in the German labour market probably also played a part in this.

*Significant decline in unemployment, especially among German nationals*

Unemployment fell perceptibly during the fourth quarter of 2016. Taking the average of the reporting period, 2.65 million persons were registered as unemployed in seasonally adjusted terms, which is 31,000 fewer than in the third quarter. The unemployment rate declined by 0.1 percentage point to 6.0%. In January

2017, the unemployment figure showed a further significant fall, with the unemployment rate currently standing at 5.9%. In addition to the favourable economic setting, labour supply effects are also likely to have played a significant role in the fall in the unemployment figure of 143,000 compared with the same month last year. The number of registered unemployed persons with German nationality declined by as much as 215,000 within the past 12 months, while the number of unemployed persons originating from the most significant war-torn and crisis-stricken countries went up by 87,000.<sup>3</sup>

According to the leading labour market indicators, the upward movement in employment should continue in the next few months. The Ifo employment barometer, which surveys the employment plans of trade and industry over the coming three months, is at an exceptionally high level and the IAB labour market barometer is well into expansionary territory, too, despite a slight decline in the past few months. The Federal Employment Agency's BA-X job index, which contains information on both the existing number of reported vacancies and their dynamics, is rushing from one record high to another. Even so, it is noticeable that the number of job vacancies reported to the Federal Labour Agency in recent quarters was rising more quickly than the aggregate supply of jobs as determined by the IAB Job Vacancy survey. This implies that the growth in job vacancies reported to the Federal Labour Agency could be due in part to a higher reporting rate by enterprises; in an environment of hardly any further growth in the labour supply, enterprises

*Positive employment outlook with slower momentum*

<sup>1</sup> See Federal Employment Agency, Statistik/Arbeitsmarktberichterstattung, Der Arbeits- und Ausbildungsmarkt in Deutschland – Monatsbericht, January 2017, p 9.

<sup>2</sup> See Institute for Employment Research (IAB), Zuwanderungsmonitor Januar 2017, Aktuelle Berichte des IAB. The Middle Eastern countries of Syria, Iraq, Iran, Afghanistan and Pakistan as well as the African countries of Eritrea, Nigeria and Somalia as classed as being among the most significant countries at war or in crisis.

<sup>3</sup> See Federal Employment Agency, Statistik/Arbeitsmarktberichterstattung, Der Arbeits- und Ausbildungsmarkt in Deutschland – Monatsbericht, January 2017, p 15.

are increasingly making use of the Federal Employment Agency's placement efforts. Job growth could continue overall, although it is unlikely to match its momentum of a year ago. The unemployment subcomponent of the IAB labour market barometer is currently well above the neutral threshold. The downward trend in unemployment is therefore likely to remain intact over the coming months.

## ■ Wages and prices

*Only moderate rise in negotiated wages in fourth quarter too*

Once again, negotiated wages rose only moderately in the final quarter of 2016. Including additional benefits, they went up 2.2% on the year and thus hardly any more strongly than in the third quarter. By contrast, at 2.3%, the annual rate for basic negotiated rates of pay, which are less subject to special factors, was again slightly higher than in the two preceding quarters. Actual earnings are likely to have risen more sharply, as was the case in the previous quarter.

*Negotiated pay rates only moderately higher in 2016*

Negotiated pay rates also showed only moderate growth when looking at last year as a whole. Including additional benefits, the increase, at 2.1% year-on-year, was marginally weaker than in 2015. This was due chiefly to the predominantly moderate new agreements along with the small increases in negotiated rates of pay from the second stage of earlier wage rounds. No less significant, moreover, were months when there was a pay freeze with lagged wage increases. One probable factor behind moderate growth in negotiated wages – measured by the favourable situation on the labour market – is that in a number of sectors, the social partners reached supplementary agreements which entail additional costs for employers and are of benefit to employees in the medium and longer term, but which are not reflected directly in the remuneration tables. These agreements often include modified regulations to boost occupational pension schemes. The wage drift remained clearly positive in 2016 at 0.4 percentage point, which

### Rates of pay and wage drift

Year-on-year percentage change, on monthly basis



Sources: Federal Statistical Office (actual earnings) and Deutsche Bundesbank (negotiated rates of pay).  
 Deutsche Bundesbank

was probably due largely to cyclical factors. According to the provisional data of the Federal Statistical Office, growth in actual earnings, at 2.5%, was distinctly stronger than it was in negotiated pay rates, even though they went up at a slightly slower pace than in the previous year.

At the beginning of 2017, the Federal Government raised the statutory minimum wage from €8.50 to €8.84 per hour. The Minimum Wage Act provides for exemptions, which can still be applied under certain conditions until the end of 2017, to allow specific sectors and professions, such as agriculture, forestry, horticulture and the meat industry, to pay rates below the general minimum wage. With effect from 1 January 2018, these special regulations will cease to apply to paid employees.

*General minimum wage raised by 4%*

This year's pay round will affect fewer employees than last year and mainly covers the services sectors. Under the wage agreements con-

*"Small" 2017 pay round mainly affects service providers*



### 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

marked depreciation. However, consumers had to pay noticeably more for food, too, because of very steep increases in the prices of dairy products. Moreover, prices of industrial goods (excluding energy) accelerated again after moving sideways in the third quarter. This was mainly due to a countermovement in the prices of clothing and footwear, which had fallen considerably in the preceding quarter, probably on account of the unusually warm weather in September. The prices of services, by contrast, went up only slightly owing to a notable fall in the prices of package holidays. Apart from that, prices of services rose at roughly the same pace as in the third quarter. This was also true of rents, which once again went up somewhat more sharply than on the long-term average. Annual headline HICP inflation increased significantly overall from 0.4% to 1.0%.<sup>4</sup> Over the course of the quarter, the rise from 0.5% in September to 1.7% in December was even more pronounced. The fact that prices of fuel and heating oil fell markedly at the end of 2015 played a part in this. Excluding energy and food, the year-on-year rate remained at somewhat over 1% in the fourth quarter.

On an average of 2016, consumer prices showed barely any upward movement. Overall, annual HICP inflation increased to no more than 0.4%, following 0.1% on average in 2015 (CPI: 0.5%, from 0.3%). The main reason for the low inflation rate was the fall in crude oil prices, although an oversupply of certain food products played a part, too. Excluding these volatile components, annual inflation remained at 1.1%, thus corresponding to the long-term average, even though overall capacity utilisation exceeded its normal level. As was the case in 2015, relief was provided by international effects in the shape of lower commodity prices, excess global capacity and lower hotel prices when travelling abroad. Furthermore, the rise

*Inflation low again on average for 2016, mainly due to energy costs*

cluded last year, 2017 will see low phased increases of less than 2½% in most cases. The figures released so far for trade unions' wage demands are within a range of 4.5% to 6% and are thus on a scale similar to last year.

*Sharper rise in consumer prices in the final quarter owing to higher energy and food prices*

Consumer price inflation as measured by the Harmonised Index of Consumer Prices (HICP) rose quite sharply by a seasonally adjusted 0.6% in the fourth quarter of 2016, which was more than in the preceding quarter (0.2%). Energy, in particular, became significantly more expensive as a result of the rebound in crude oil prices, especially as the price increase was even higher in euro terms owing to the euro's

<sup>4</sup> The annual rate of consumer inflation according to the national Consumer Price Index (CPI) rose from 0.5% in the third quarter to 1.1% in the final quarter of the year.

## Housing prices in Germany in 2016

Residential property prices increased markedly last year. The growth in housing price inflation was broadly based, both in regional terms and across the various housing types. Ultimately, the expanding housing supply was not enough to curb the price pressures emanating from the continuing strong demand for residential property. In towns and cities, residential property prices are likely to have deviated even further from the level that would appear reasonable based on longer-term economic and demographic factors.

According to data from the Association of German Pfandbrief Banks (*Verband deutscher Pfandbriefbanken, vdp*), prices for owner-occupied housing in Germany rose by 6% in 2016, compared with a 4½% increase in 2015. Other regionally broad housing price indicators also show that residential property prices in Germany rose more sharply in the year under review than previously. After having grown by 4¾% in 2015, the house price index of the Federal Statistical Office (Destatis) was 5½% higher in the first three quarters of 2016 than in the same period a year earlier. Hypoport AG's Europace house price index (EPX) indicates that housing prices in Germany rose by 8% in 2016, meaning that their growth was 2½ percentage points stronger than in the year before. All three indicators reveal that last year's housing price inflation was significantly higher than the average annual growth rate recorded since the onset of the property boom in 2010.

The upsurge in housing prices was once again particularly rapid in Germany's towns and cities. According to calculations based on data provided by bulwiengesa AG, residential property prices rose by 8% there, compared with an average increase of 6¾% between 2010 and 2015.<sup>1</sup> Above-

average price rises were again recorded in Germany's seven biggest cities, where housing price inflation had already been strongest over the past few years.<sup>2</sup> This continued to affect mainly freehold apartments in the major conurbations. The rate of increase for rented apartments likewise rose markedly in towns and cities. The pace of growth of multiple-family house prices in Germany as a whole, by contrast, was more or less unchanged at a high level. Price increases for single-family houses are also likely to have converged across regions in the reporting year.

In addition, the urban housing markets saw substantial rent increases for new and rentals at a rate of 4¾%. The last time rents in German towns and cities had grown so fast was during the early stages of the last surge in housing demand in 2011-12. The big cities, which had recorded marked rent increases up until 2014, saw much more moderate rent rises over the past year than the cities and towns as a whole.

The persistently strong demand for housing remains broadly in line with households' positive income prospects and the favourable labour market conditions. The ratio of property purchase prices to annual rents, which has been elevated since 2013, remained largely static in 2016 on balance. While the prices of residential property rose faster than households' average disposable income in the past three years, the ongoing extremely favourable financing conditions

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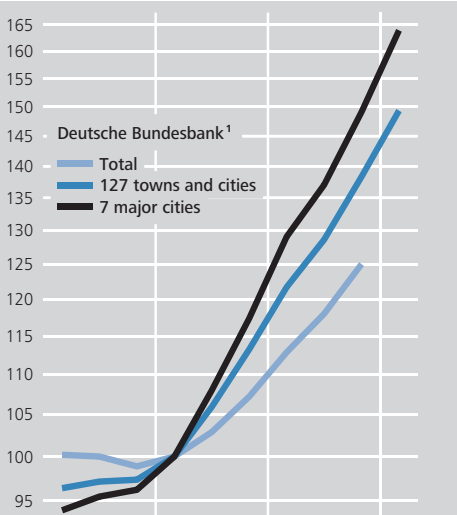
<sup>1</sup> Price statistics for housing in the 127 towns and cities in 2015 have been adjusted upwards quite substantially by an average of 1½ percentage points in line with the latest data.

<sup>2</sup> The seven biggest cities are Berlin, Cologne, Düsseldorf, Frankfurt am Main, Hamburg, Munich and Stuttgart.

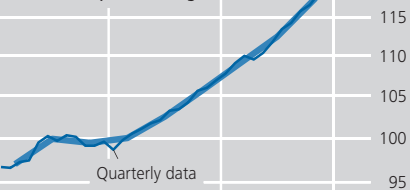


### Price indices for housing

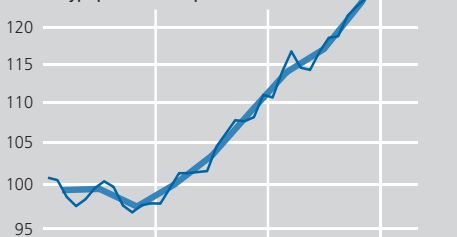
2010 = 100, annual data, log scale



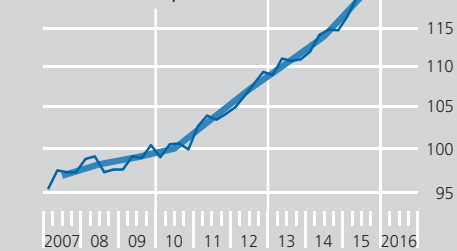
#### vdp price index for owner-occupied housing



#### Hypoport AG composite index



#### Destatis house price index



<sup>1</sup> Weighted by transaction. Bundesbank calculations based on price data provided by bulwiengesa AG.  
 Deutsche Bundesbank

relieved pressure on property purchasers.<sup>3</sup> The average mortgage rate, which had already reached an all-time low, fell even further to 1.6% in 2016. Given the limited returns available from alternative investments, investors may have focused more attention on the major conurbations, which are both relatively liquid and promise strong growth. In addition, demographic factors seem to have again influenced demand in 2016. Population density in the major conurbations is likely to have increased further in the past year. Between 2011 and 2015, it grew by a further 3.8% in the biggest cities from an already high base.<sup>4</sup> Moreover, the bulk of the immigrants who came to Germany over the past two years may have settled in urban areas.<sup>5</sup>

Housing supply surged again in 2016. It probably exceeded the rise in 2015, when almost 250,000 new dwellings were completed. At almost 380,000, the number of planned housing units was almost one-quarter higher than the number of building permits granted in 2015, which had already surpassed the 2014 figure by 7.7%.<sup>6</sup> The planned new construction also reflected the housing demand component relating to the influx of refugees. In the category of residential homes, which includes refugee accommodation, well over twice as many

<sup>3</sup> See the Deutsche Bundesbank's System of indicators for the German residential property market, available at [http://www.bundesbank.de/Navigation/EN/Statistics/Enterprises\\_and\\_households/System\\_of\\_indicators/system\\_of\\_indicators.html](http://www.bundesbank.de/Navigation/EN/Statistics/Enterprises_and_households/System_of_indicators/system_of_indicators.html).

<sup>4</sup> See Regional database of the Federal Statistical Office. The percentage of the population living in towns and cities as a whole also increased in the period from 2011 to 2015, while it fell slightly in rural areas.

<sup>5</sup> See Deutsche Bundesbank, Housing prices in Germany in 2015, Monthly Report, February 2016, pp 53-56. Although the urban-rural ratio of foreign residents fell slightly between 2011 and 2015 on balance, in 2015 it was still around twice as high as the ratio for German nationals.

<sup>6</sup> The number of building permits may also have been inflated by frontloading to forestall the tightening of energy standards for new residential buildings from the start of 2016.

building applications were submitted in the first quarter of 2016 alone than on average in 2015. The extremely high level of capacity utilisation as well as the backlog of construction orders suggest, however, that the supply of additional housing cannot be stepped up very easily. Prices for construction work on new residential buildings rose somewhat in 2016, after increasing moderately in the preceding years. In some regions, the scale of new building construction is also linked to the limited availability of land. According to data from the Federal Statistical Office, the price of building plots jumped by 5% in the first half of 2016, thus accelerating considerably in relation to the annual average growth rate between 2010 and 2015. In addition, the price-dampening effect of mobilising vacant properties in urban areas is likely to have largely worn off. Data from the Federal Institute for Research on Building, Urban Affairs and Spatial Development indicate

housing vacancy rates in 2015 of no more than 1% in some big cities.<sup>7</sup>

Overall, the accelerating housing price dynamics in the year under review probably surpassed the growth rate consistent with the demographic and economic fundamentals, which can only partly be explained by the further fall in borrowing costs. According to current estimates, housing in German towns and cities was overpriced by between 15% and 30% in 2016. The size of the price exaggerations increased notably in the case of freehold apartments in the biggest cities.

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<sup>7</sup> See Federal Institute for Research on Building, Urban Affairs and Spatial Development, *Wohnungsl Leerstände*, February 2017, available at <http://www.bbsr.bund.de/BBSR/DE/WohnenImmobilien/Immobilienmarktbeobachtung/ProjekteFachbeitraege/Wohnungsl Leerstand/wohnungsl Leerstand.html>. In the urban municipalities, the vacancy rate was probably below 3% in 2015.

in unit labour costs decelerated somewhat in Germany.

*Consumer prices unchanged in January 2017*

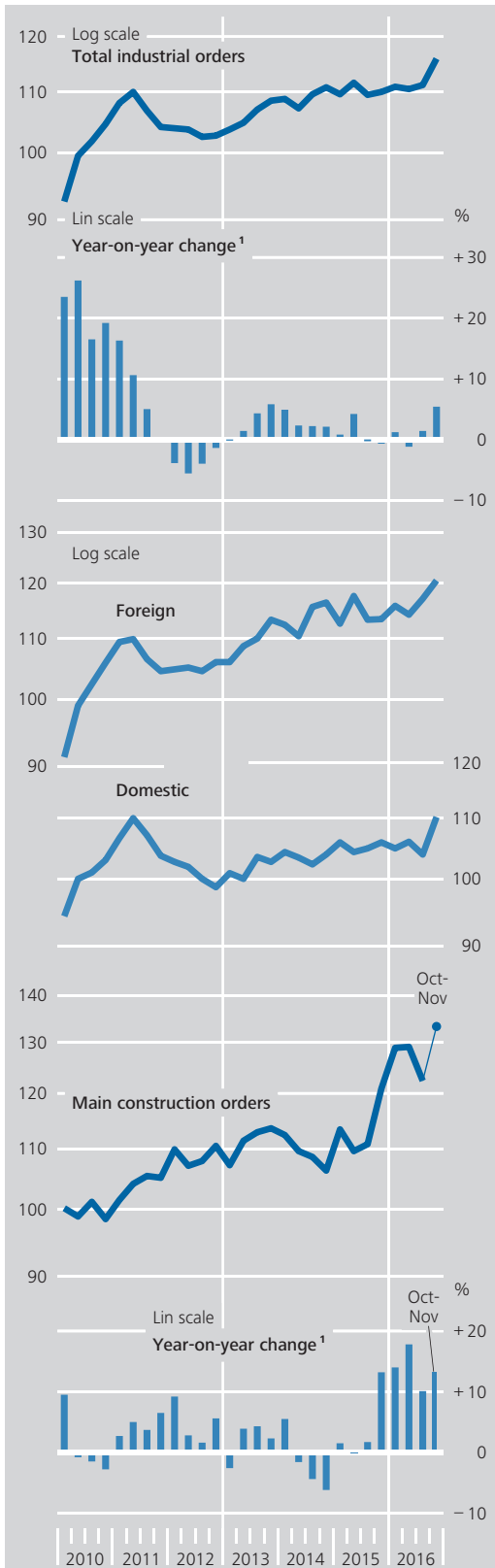
At the beginning of the year, consumer prices as measured by the Harmonised Index of Consumer Prices (HICP) remained unchanged in seasonally adjusted terms. Energy prices rose moderately. Prices of mineral oil products edged up further in line with crude oil prices and electricity tariffs for households were raised against the backdrop of higher network charges. Rents were also rising again somewhat more sharply. By contrast, prices of food and industrial goods (excluding energy) showed very little change. Services (excluding rents) were distinctly cheaper in fact, mainly due to legislative changes in long-term care services. Lower energy prices at the beginning of 2016 also played a part in annual headline inflation, as measured by both the HICP and CPI, going up from 1.7% to 1.9%.

Under the current underlying conditions, annual HICP inflation is likely to fluctuate around the 2% mark in the coming months. This is partly due to the waning base effects from last year. Forward quotations for crude oil suggest that there is very little scope for further energy price increases but, excluding energy, inflation could gain pace slowly. For example, the import prices of capital and non-food consumer goods, which are a major determinant of consumer prices for “industrial goods excluding energy”, were showing a marked rise at the upstream stages in the final quarter of 2016. This was probably due chiefly to the depreciation of the euro. Even though this increase has not yet passed through to industrial producer prices, it is likely to be reflected in consumer prices in the foreseeable future. Prices of energy and intermediate goods have already been picking up owing to markedly higher prices for crude oil and industrial commodities at both import and producer levels, leading to transport and materials becoming more expensive,

*Upward tendency at upstream stages points to slow acceleration in consumer price inflation excluding energy*

### 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

for example. However, consumer prices excluding energy are likely to reflect this only with a considerable time lag and in a more moderate form.

### Orders received and outlook

Growth in the German economy is likely to strengthen further in the first quarter of 2017. Given the very dynamic intake of new orders, major impulses are expected from industrial activity, in particular. This is also likely to be reflected in exports, as indicated by enterprises' optimistic export expectations. Enterprises are also expected to invest more in machinery and equipment in view of the fact that capacity utilisation is now significantly above-average. Construction activity is also likely to remain exceptionally buoyant in the first quarter, as long as it is not severely affected by adverse weather conditions. Finally, the sustained improvement in labour market conditions, employees' favourable income prospects and the healthy consumer climate all point to a continuation of buoyant consumption, even though the higher rate of inflation is constricting consumers' scope for spending.

*Further expansion in economic growth likely at start of 2017*

The sentiment indicators for the German economy paint a predominantly optimistic picture after the start of the year. According to the Ifo Institute, industry's assessment of the business situation and expectations about output and exports in the short term are at a high level. By contrast, business expectations have deteriorated. In the main construction sector, too, the clearly lower expectations at the end of the period under review stand in contrast to the extremely favourable assessment of the business situation, which is setting one record high after another. In the trade and services sectors, the slight deterioration in sentiment is likewise mainly due to lowered business expectations. It is not clear whether these more cautious expectations are a reflection of growing concerns and uncertainty about possible global trade restrictions. By contrast, the economic

*Positive sentiment at start of year*

outlook is clearly more optimistic according to the latest survey by the Association of German Chambers of Commerce and Industry (DIHK), in which both the business situation and business expectations show an improvement on the autumn survey.

*Industry with strong inflow of orders on broad basis*

Seasonally adjusted industrial orders posted an exceptionally steep increase of 4¼% in the final quarter of 2016 compared with the third quarter. The inflow of orders was broadly based, meaning that there were only a few branches of industry that received fewer new orders than in the third quarter. Even excluding large-scale orders, German enterprises on the whole were able to record strong growth in orders on the same scale. In regional terms, domestic impulses had the upper hand. Nonetheless, there was also a substantial flow of orders from the euro area and non-euro-area countries. In this respect, the German motor vehicle manufacturers were especially prominent, reporting considerably more orders from all three economic regions. The order capacity index, which measures the deviation of new orders from production capacity in order-based industry, climbed to its highest level since the Great Recession. This suggests that industrial activity will pick up significantly in the first few months of this year and that there will be an expansion in both exports and investment in machinery and equipment.

Construction activity is also likely to remain favourable in the first quarter of 2017. This is indicated, amongst other things, by the steep increase in new orders reported by the main construction sector in the previous quarter. The number of building permits issued and their estimated costs also went up sharply. These developments were broadly based and affected all subsectors of the construction industry. It is therefore hardly surprising that the assessment of the business situation reached a new peak since German reunification. Given such an extremely high level, it comes as no surprise that there was a decline in the percentage of enterprises expecting a further improvement in business.

*Continuing positive outlook in the construction sector*

Private consumption is likely to remain a mainstay of growth at the beginning of the new year, too. Labour market conditions remaining favourable and significant income growth are the key factors in this. This is also reflected in the consumer climate as determined by the market research institution Gesellschaft für Konsumforschung (GfK), which recently increased moderately from an already very high level. By contrast, higher energy prices are likely to have a negative impact, as they restrict the financial scope of consumers.

*Private consumption remains a key growth factor in new year*