The German economy

Macroeconomic situation

German economy flatlined in Q1 2023

The German economy flatlined in the first quarter of 2023, after having shrunk in the previous quarter. According to the Federal Statistical Office's flash estimate, real gross domestic product (GDP) remained unchanged on the quarter after seasonal adjustment.[1] High inflation weighed on private consumption expenditure and consumption-related service providers. Government consumption declined as well.[2] The phasing out of pandemic-related expenditure is likely to have played a key role in this. By contrast, the easing in energy markets, high order backlog, and diminishing supply bottlenecks gave a boost to industry. Exports of goods picked up again, too. Construction activity benefited from the relatively mild weather conditions at the beginning of the year, while high construction prices and increased financing costs continued to weigh on demand for construction work. Economic output in the first quarter was somewhat weaker overall than recently had been expected.[3] This is notably because, after making a buoyant start to the year, industrial activity suffered a setback in March that markedly curbed output growth in the first quarter. New orders, which had picked up previously, also went back down significantly in March. Intermittent signs that demand for industrial products might bounce back failed to materialise.

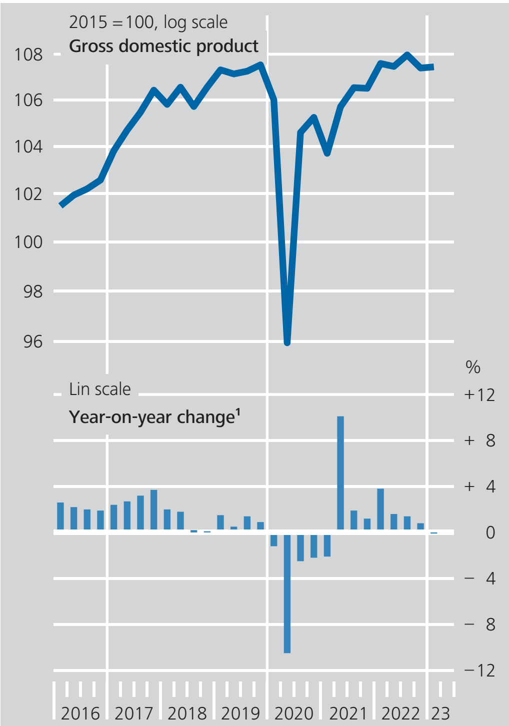
Economic activity in detail

High inflation weighed on private consumption and consumption-related service providers

High inflation weighed on consumers' purchasing power. In the first quarter, there is likely to have been a significant dip in private consumption expenditure as well as in the economic activity of consumption-related service providers, as signalled by price-adjusted sales, which were distinctly lower in the retail trade sector and stagnant in the restaurant and hotel sector. Car purchases were also considerably lower. This is indicated by the number of new private car registrations, which dropped sharply according to the German Association of the Automotive Industry (VDA). Part of the reason for this was the phasing out of some government subsidies for plug-in hybrids and fully electric vehicles at the end of last year. The services sector as a whole is unlikely to have provided any impetus for growth in the first quarter. According to the data available up to February, price-adjusted wholesale sales fell and services production (ex-

Aggregate output

Adjusted for price, seasonal and calendar effects



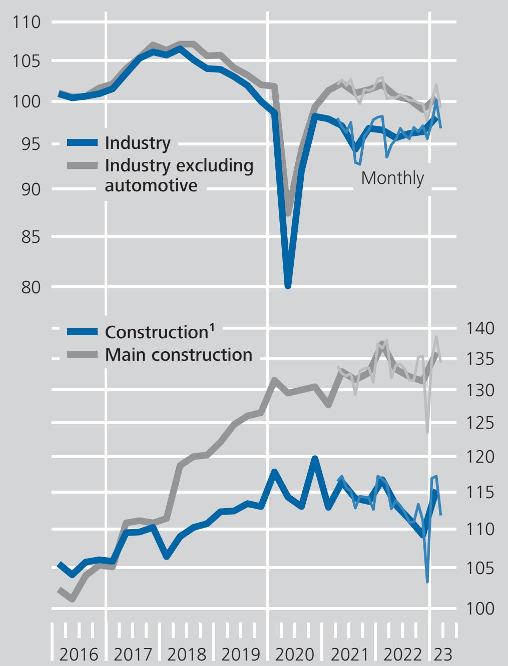
Source of unadjusted figures: Federal Statistical Office. **1** Price and calendar adjusted.

Deutsche Bundesbank

1 Seasonal adjustment here and in the remainder of this text also includes adjustment for calendar variations, provided they can be verified and quantified. According to revised data, real GDP in the fourth quarter of 2022 fell by a seasonally adjusted 0.5% on the previous quarter.
2 See Federal Statistical Office (2023).
3 See Deutsche Bundesbank (2023a).

Output in industry and in construction

2015 = 100, seasonally and calendar adjusted, quarterly data, log scale



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

cluding trade) stagnated.[4] The ifo Institute's survey of the business situation in the services sector (excluding trade), which held steady in the first quarter at the previous quarter's average, paints a similar picture.

Easing supply bottlenecks and lower energy prices supported industrial output and exports …

Seasonally adjusted industrial output rose steeply in the first quarter. Surveys conducted by the ifo Institute and S&P Global indicate that bottlenecks in the supply of intermediate goods eased further, allowing more of the high order backlog to be processed. This benefited the automotive industry in particular. The increase in output was also boosted by declining wholesale energy prices. A number of energy-intensive sectors, such as the chemicals industry and the manufacture of basic metals, stepped up their production substantially. In other such sectors, however, there have not yet been any overall signs of easing. Production in the paper and glass industries continued to decline significantly, for example. At the end of the quarter, industrial output experienced a strong setback across sectors. This may have been due, in part, to a renewed increase in sickness rates, according to data from company health insurance funds. Above all, though, domestic and foreign demand for industrial goods, which had previously risen steeply, tailed off again distinctly in March. This was also reflected in a major month-on-month decline in exports of goods. Overall, however, real exports of goods were up somewhat in the first quarter.

… and also commercial investment in machinery and equipment

The easing in energy markets and lessening of supply bottlenecks are also likely to have provided a boost to business investment. However, this was counteracted by the further deterioration in financing conditions. Manufacturers of capital goods experienced a distinct rise in price-adjusted domestic sales. By contrast, price-adjusted imports of capital goods declined. Enterprises invested less in their vehicle fleets, as indicated by the sharp drop in domestic sales of motor vehicles. According to data from the German Association of the Automotive Industry, motor vehicle registrations by commercial owners were down steeply.

Mild weather in Q1 benefited construction output and investment

Seasonally adjusted output in the finishing trades as well as the main construction sector picked up substantially in the first quarter. The mild weather in January and February was one particular factor behind this increase. In March, construction output fell sharply on the month, partly because the tailwinds previously provided by the weather effect had faded. It is notable that the level of output in the main construction sector was still so high, given that demand is being severely depressed at present by higher construction prices and financing costs. This is reflected in order intake, for example: averaged over January and February, it was clearly down on the fourth quarter of 2022 and just over 18% lower than its level

4 Services production encompasses the economic sectors of transportation and storage; restaurants and hotels; information and communication; real estate activities; professional, scientific, and technical activities; and business and support services.

one year earlier. According to the ifo Institute, the share of firms with a shortage of orders also went up further in the first quarter, and the reach of order books contracted significantly. In line with output, the existing order backlog probably also led to an increase in construction investment in the first quarter.

Labour market

Labour market very robust

In the labour market, the marked increase in employment seen in the autumn continued into the first quarter of 2023. Unemployment also came in somewhat higher in recent months, however, and there was a further slow decline in the number of vacancies. Leading indicators point to only fairly minor improvements in what otherwise remains a robust labour market in the coming months.

Favourable developments in employment subject to social security contributions and low-paid part-time work

The favourable developments are broadly based across different forms of employment. Averaged over the reporting quarter, seasonally adjusted total employment was up by 150,000 persons, or just over 0.3%, from the previous quarter's level. The majority of new jobs are likely to be subject to social security contributions. That said, the number of people in exclusively low-paid part-time work also continued to grow considerably up to February 2023, the last month for which data are available. The number of such workers only began to recover from the pandemic-related slump in the second quarter of 2022. Given the declining trend that had already set in before the pandemic, however, it is not expected to return to pre-crisis levels. In the case of self-employment, on the other hand, the protracted downward trend is continuing, albeit at a relatively slow pace at present.

Employment subject to social security contributions grew more strongly in Q1 than in second half of 2022

Employment subject to social security contributions already grew more strongly in the first two months of the first quarter of 2023 than in each of the two preceding quarters. Averaged over January and February, the figure for the fourth quarter of 2022 was exceeded by 90,000 employees subject to social security contributions, an increase of 0.3%. The majority of this growth was in the services sectors. A particularly large number of jobs were created in business-related services (excluding temporary agency employment) as well as in the IT sector and the restaurant and hotel sector. By contrast, employment declined in the wholesale and retail trade, which is suffering from consumers' reluctance to buy owing to the high rates of inflation. Strains such as comparatively high energy prices are still evident in the manufacturing sector, where employment stagnated. There was also a drop in the number of temporary workers subject to social security contributions, who are often employed in the manufacturing sector. Moreover, the moderate increase in short-time work for economic reasons took place largely in the manufacturing sector, although notifications of short-time working arrangements recently declined again.

Slight rise in unemployment due to weak activity in some economic sectors …

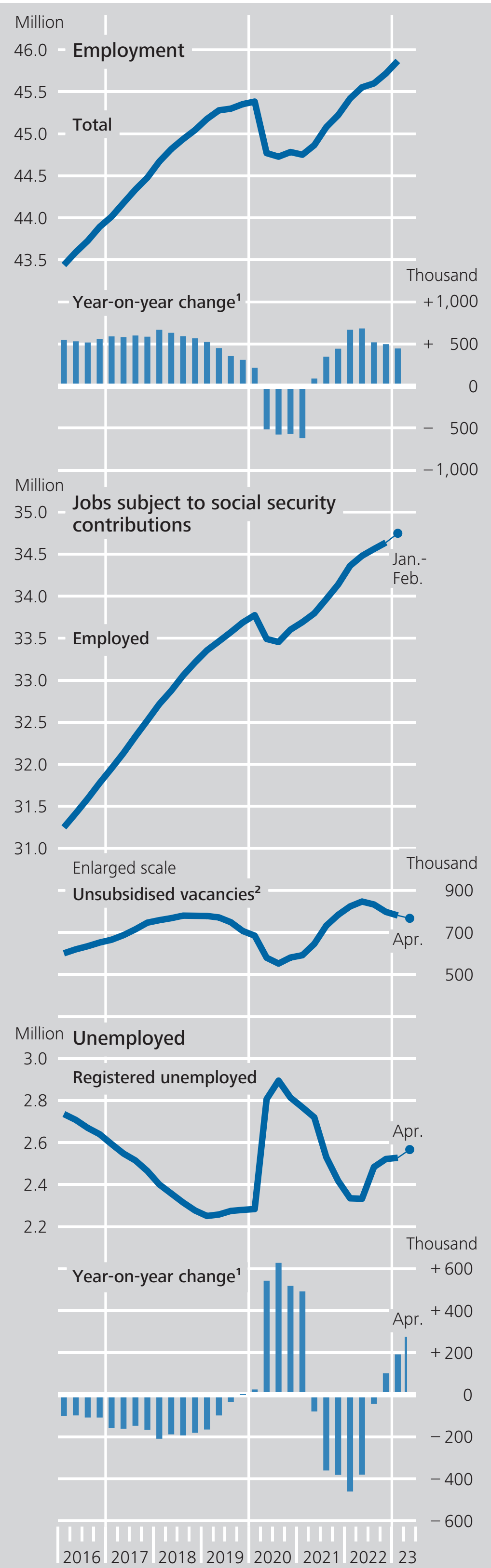
Compared with the previous quarter, registered unemployment went up only marginally in the reporting quarter, and the unemployment rate held steady at 5.5% in seasonally adjusted terms. However, in March and April, the total number of unemployed persons increased by 43,000 and the unemployment rate climbed by 0.1 percentage point to 5.6%. In April, the Federal Employment Agency recorded 2.57 million persons as unemployed, which was around 276,000 more than in April 2022. Unemployment was up over the past six months not only among those receiving insurance benefits under the statutory unemployment insurance scheme, which is probably due in part to the current weak activity in some sectors of the German economy. It also increased among persons receiving the basic welfare allowance, which includes refugees from Ukraine.

… as well as integration of refugees into labour market

The large influx of people – not only from Ukraine – is leading to an expansion in the active labour force as efforts are made to integrate them into the labour market. This can

Labour market

Seasonally adjusted, quarterly data



Sources of unadjusted figures: Federal Statistical Office and Federal Employment Agency. **1** Not seasonally adjusted. **2** Excluding seasonal jobs.

Deutsche Bundesbank

cause both employment and registered unemployment to rise, as is currently the case. The majority of the year-on-year increase in unemployment is attributable to the inclusion of Ukrainian refugees in the statistics.[5] At present, 185,000 more Ukrainian nationals are registered as unemployed than one year earlier.[6] On top of this, a considerable share of job-seeking Ukrainians in Germany are attending language and integration courses. Since these individuals are not available to the labour market, they are not counted in the unemployment figures. However, it is to be expected that some of them will complete their courses in the next few months and will initially register as unemployed. This effect is likely to explain part of the unemployment growth seen over the past two months.

Leading indicators of employment largely unchanged in slightly positive territory

Although the outlook for the labour market is slightly positive overall, it has not brightened further in recent months. Over the past few months, the employment barometers of the ifo Institute and the Institute for Employment Research (IAB) have been broadly stable in slightly positive territory, which suggests that a somewhat higher number of people can be expected to be recruited than dismissed in the next three months. The number of vacancies subject to social security contributions reported to the Federal Employment Agency and the Agency's job index have both declined of late. Even so, both indicators are still at a comparatively high level. The IAB's survey indicator of unemployment developments over the next three months fell significantly in April and is now in neutral territory.

5 One year ago, refugees from Ukraine had not yet been integrated into the German social security system and therefore were not counted in the unemployment statistics.

6 See Statistics provided by the Federal Employment Agency (2023), p. 13.

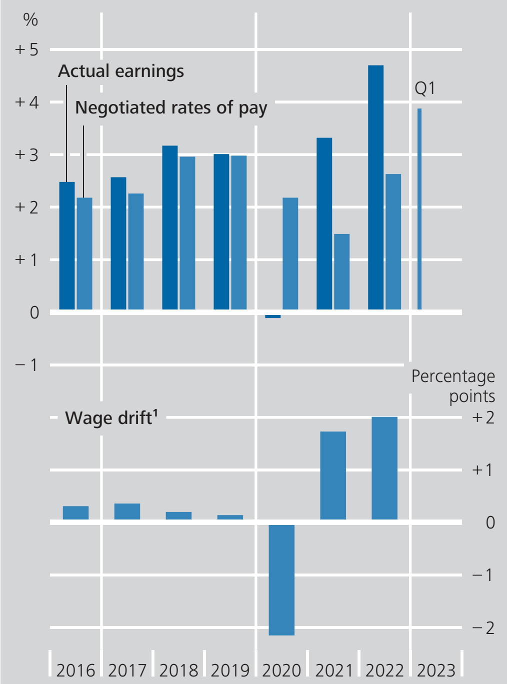
Wages and prices

Rise in negotiated wages and actual earnings

Negotiated wages rose considerably more strongly in the winter of 2023 than they had in the autumn. Including additional benefits, they were up by 3.9% on the year in the first quarter, compared with 2.0% in the quarter before. In this context, bonus payments, such as inflation compensation bonuses, caused the growth rate to rise sharply in the winter.[7] However, even excluding bonus payments, negotiated wages rose by 2.7% on the year in the reporting quarter, representing slightly stronger growth than in the fourth quarter, which saw growth of 2.4%. In the first quarter of 2023, as in the preceding quarters, growth in actual earnings is likely to have significantly exceeded growth in negotiated wages. One factor contributing to this development was that inflation compensation bonuses were also paid out by enterprises that are not bound by collective agreements; another was that aggregate wages adjusted, with a time lag, to the rise in the minimum wage to €12 per hour as of October 2022.

Rates of pay and wage drift

Year-on-year change, on monthly basis



Sources: Federal Statistical Office (actual earnings) and Deutsche Bundesbank (negotiated rates of pay). **1** Wage drift is calculated as the annual change in the ratio of actual earnings to negotiated rates of pay.

Deutsche Bundesbank

Recent wage agreements higher than in previous year

The latest wage agreements exceeded the wage increases agreed upon last year. For temporary work, an annualised wage increase of 7% was agreed upon; this is primarily attributable to the adjustment of the sector-specific wage structure to the sharp rise in the minimum wage as of October. In the central and local government areas of the public sector, the annualised increase in wages of 6.3% was higher than in all of this sector's agreements from the past 15 years.[8] For Deutsche Post, too, the agreed annualised wage increase of 6.1% was above average. Macroeconomic developments – specifically high inflation, growing labour shortages, and the expected improvement in economic activity this year – played an important role in this context. At Deutsche Post, employees also considered it important to have a notable participation in the group's good profits. In both of the agreements, inflation compensation bonuses were paid out in the maximum amount and disbursed over several months. As of March and April 2024, respectively, scheduled rates of pay will be increased substantially. Furthermore, recent wage agreements in other sectors (e.g. automobile trade and service, textiles and clothing) exhibit a combination of large inflation compensation bonuses and significant, long-term wage increases.

Additional high wage agreements likely

The high wage agreements in the public sector are likely to be seen as a strong signal for ongoing wage negotiations. This applies, for example, to retail trade as well as wholesale and foreign trade, where wage demands are unusually high, at 16% and 13%, respectively,

7 In terms of wage growth, the wage-boosting effect of inflation compensation bonuses was offset by the negative base effect of the coronavirus bonus in the amount of €1,300 that was disbursed by the public sector of the Federal states in March 2022.
8 Calculated for a notional recipient of the agreed basic pay rate (pay grade 5). The increases in wages are relatively high for low pay grades due to the large bonus payments and agreed base amount; for higher pay grades, however, the increases are smaller in percentage terms.

over a term of 12 months. Given the high inflation, robust labour market situation, and anticipated improvement in economic activity, high wage settlements are to be expected in the coming months as well.

Second-round effects on prices to be expected

Inflation, which is now broad-based and rather persistent, is increasingly leaving its mark on wage increases. This is reflected, first, by the fact that the option of paying out inflation compensation bonuses is being utilised in recent wage agreements to an increasingly large degree. These bonuses are also being paid out in sectors that are not bound by collective wage agreements. Second, the new agreements that have been concluded thus far, particularly for 2023, include very strong rises in negotiated wages that are greater than had been expected. In 2023 and 2024, they could result in gross real wage increases in the metal-working and electrical engineering industries or the public sector, for example. With regard to the current rounds of wage negotiations, the expected improvement in economic activity and reduced uncertainty surrounding the supply of energy are providing tailwinds for efforts to do more than has been done thus far to offset past real wage losses. There is much to suggest that firms will pass on part of the increased wage costs through their prices as the year progresses.

High inflation eased somewhat in winter due to lower energy prices

Consumer prices (HICP) rose less sharply at the beginning of the year than in the preceding quarters. Averaged across January to March 2023, they increased by a seasonally adjusted 0.9%, compared with 2.6% in the autumn. Looking at the year-on-year figures, the inflation rate declined in the first quarter of the year from 10.8% to 8.8%. Inflation receded mainly because energy prices declined over the course of the quarter for the first time in two years. In addition, one-off effects contributed to the lower inflation rate. First, the year-on-year rate was dampened – in arithmetical terms – due to the sharp rise in energy prices resulting from the Russian invasion of Ukraine one year ago. Second, the annual update of HICP weights reduced the share of energy in the basket of goods, which subdued the rate of inflation.[9] Finally, the implementation of the electricity and gas price brakes provided some relief.

Strong rise in rate excluding volatile components

The price dynamics of the non-energy components remained very high, however. The prices of non-energy industrial goods increased at a similar rate to that in the previous quarter, while the prices of food products – particularly those resulting from energy-intensive production processes – and services rose more sharply. Excluding volatile components such as energy, food, travel services and clothing, the inflation rate rose significantly in the spring, climbing from 5.0% to 5.8%.[10] It thus exceeded the core rate (5.5%), which does not include the prices of energy or food.

Inflation rate still at high level in April

In April, inflation barely fell from its very high level and thus remained higher than expected. Consumer prices climbed by 7.6% on the year, compared with 7.8% in March.[11] In this context, energy prices again rose somewhat more sharply than in the preceding month. By contrast, the inflation rate for food, services, and industrial goods decreased slightly. Accordingly, the rate excluding energy and food fell only slightly from 5.9% in March to 5.6% and remained well above expectations.

In the coming months, the inflation rate is likely to continue to decline in line with the flatten-

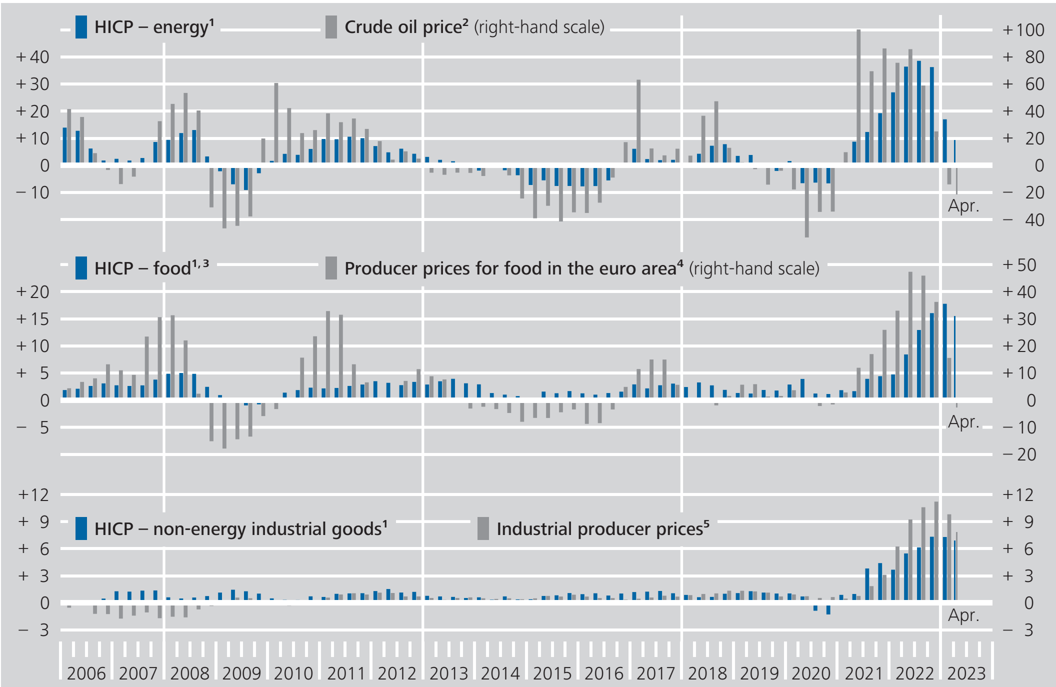
9 The HICP weights are based on the weights of the national consumer price index (CPI), which were rebased to 2020 at the beginning of the year. In the 2019 to 2021 reporting years, which were used as the basis of the calculation, energy expenditure was lower on average than in the previous base year of 2015. See Deutsche Bundesbank (2023b).

10 Due to a change in methodology, the annual rate of inflation for the prices of travel services is only of limited informative value up until the end of 2023. Price collection for package holidays and flights was changed when the CPI was rebased to 2020. While the CPI was revised up until 2020, the HICP contains a methodological break for the affected price series. This is now apparent when comparing the annual rates of inflation for travel services in the CPI and the HICP. See also Deutsche Bundesbank (2022b).

11 The CPI figure was 7.2%, compared with 7.4% in the previous month.

Price developments at economic stages as classified for HICP purposes

Year-on-year percentage change



1 Eurostat. **2** Bundesbank calculations (in euro) based on daily prices in USD as quoted by Bloomberg Finance L.P. **3** Including beverages and tobacco products. **4** ECB calculations of DG AGRI prices based on the European Commission's farm gate and wholesale prices. **5** Analogous to HICP classification "non-energy industrial goods"; Bundesbank calculations based on data from the Federal Statistical Office.

Deutsche Bundesbank

Inflation likely to abate only slowly over the year

ing of prices at the upstream stages of the economy. However, given that inflation for non-energy components – particularly food – remains exceptionally high, this will occur only very gradually. In addition, price pressures along supply chains have waned somewhat, but are still having an impact. Furthermore, the strong wage growth is likely to contribute to the underlying price pressures over the remainder of the year. These factors are offsetting the effect of falling energy prices.

Order books and outlook

Economic output expected to rise again slightly in second quarter of 2023

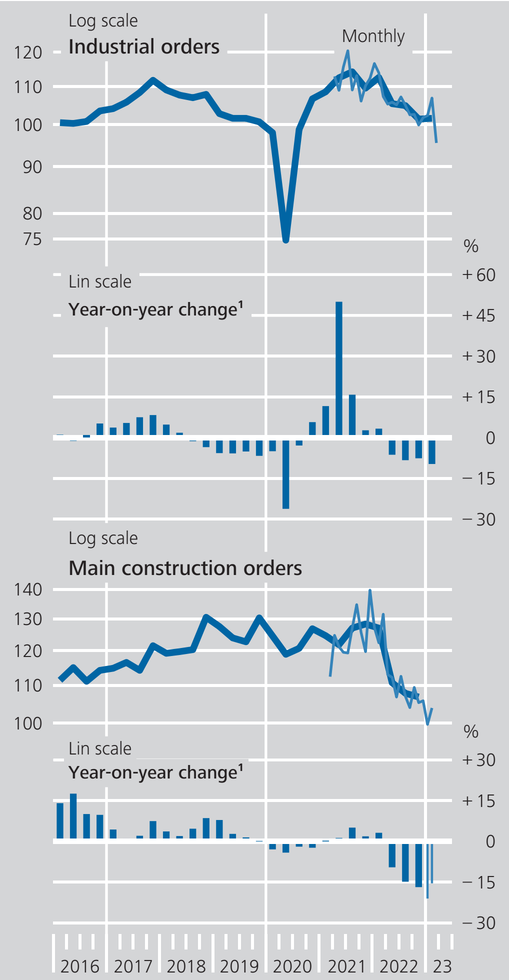
Economic output is expected to rise again slightly in the second quarter of 2023. Diminishing supply bottlenecks, large order backlogs, and lower energy prices are all supporting the continued recovery in industry. This is also likely to bolster exports, especially as global activity has regained some momentum. Despite continued high inflation, robust wage increases should at least mean that households' real net income does not fall any further. Private consumption is therefore likely to more or less stagnate. Construction, on the other hand, looks set to see declining output. The sharply lower demand is likely to take its toll and the tailwinds once provided by the mild weather conditions will fade.

Brighter sentiment amongst enterprises and consumers

Sentiment amongst enterprises and consumers, which continued to brighten in April, was also indicative of a cautiously optimistic outlook. The most recent rise in the ifo business climate index, however, was due to a significant improvement in business expectations. By contrast, the situation was considered somewhat less favourable. While the business climate in manufacturing and services (excluding trade) was positive, sentiment in the main construction sector and the trade sector remained, on balance, in negative territory. Although the GfK consumer climate index also improved, it was still at a low level.

Demand for industrial goods and construction services

Volumes, 2015 = 100, seasonally and calendar adjusted, quarterly data



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

Industry set for further recovery due to good order situation and improved export outlook

In the second quarter, industry is likely to remain on a moderate course of recovery, even without any new major demand stimulus. On average over the first quarter, the number of incoming industrial orders was, due to the downturn in March, only marginally higher than in the previous quarter. This increase was also mainly attributable to the manufacture of other transport equipment, which is not particularly representative of industry as a whole. However, orders on hand and the reach of orders remained exceptionally high of late. As, according to surveys by the ifo Institute and S&P Global, supply bottlenecks continued to ease in April, industrial enterprises were able to process their order backlogs more quickly. Short-term production planning and export expectations in the manufacturing sector, which continued to improve according to surveys by the ifo Institute, are also indicative of better industrial activity.

List of references

Deutsche Bundesbank (2023a), Commentaries, Economic conditions, Monthly Report, March 2023, p. 5.

Deutsche Bundesbank (2023b), Impact of the new HICP/CPI weights on inflation developments in Germany, Monthly Report, March 2023, pp. 8-11.

Federal Statistical Office (2023), Gross domestic product stagnant in 1st quarter of 2023, press release No 169 of 28 April 2023, https://www.destatis.de/EN/Press/2023/04/PE23_169_811.html

Statistics provided by the Federal Employment Agency (2023), Berichte: Blickpunkt Arbeitsmarkt – Monatsbericht zum Arbeits- und Ausbildungsmarkt, Nuremberg, April 2023.