

Economic conditions in Germany

Macroeconomic situation

Quite strong economic growth in 2013 Q4

According to the Federal Statistical Office's flash estimate, German economic output continued to grow in the final quarter of 2013. Real GDP was up 0.4% on the preceding three-month period after adjustment for seasonal and calendar factors. In year-on-year terms, calendar-adjusted GDP went up by 1.4%. At year-end, aggregate output showed somewhat stronger growth than potential output, and capacity utilisation was at a high level. There was further growth in employment subject to social security contributions. The overall very satisfactory state of the German economy is also reflected in the data provided by enterprises. According to the survey of the Association of German Chambers of Commerce and Industry (DIHK) at the beginning of 2014, more

than nine out of ten firms rate their business situation as good or at least satisfactory.

The growth in aggregate output continued to be driven by domestic demand. Private consumption is benefiting from an extremely positive consumer climate and is still showing an underlying upward trend. The upturn in housing investment levelled off, although this can be seen more as a normalisation than a trend deceleration given the annual profile so far, which has been shaped by weather-related and catch-up effects. Export demand provided a distinct boost for the first time in over a year, which benefited industry in particular. Commercial investment picked up somewhat as a result. In the wake of the pick-up in foreign trade and the ongoing adjustment processes, there was a further marked increase in imports, particularly from the euro area.



German firms' export business picked up again in the fourth quarter of 2013 in the wake of the economic upturn in the industrial countries. Seasonally adjusted exports of goods grew 1½% on the quarter in real terms. Although exports to euro-area countries increased only slightly owing to the hitherto very subdued improvement in their economies, exports to non-euro-area countries expanded considerably. There was very strong growth in exports to the USA and the United Kingdom after sluggish export activity in the third quarter. Trade with the OPEC countries also grew substantially, where there had been a sizeable decline earlier. Exports to central and east European EU countries expanded significantly. By contrast, only moderate impulses came from China and the other Asian industrialised economies. Exports to Japan stagnated after rising considerably in the second and third quarters of 2013. There was a continuation of the marked downward trend in exports to south and east Asian emerging market economies. There was also a further clear deceleration in exports to Russia.

Marked rise in goods exports, especially to non-euro-area countries ...

... and also in intermediate goods

During the reporting period, there was a surge mainly in exports of intermediate goods. Sales of chemical and pharmaceutical products grew particularly sharply. Foreign trade in consumer goods also flourished. By contrast, capital goods exports posted only moderate growth. Exports of other transport equipment showed a marked rise, whereas sales of computers, electronic and optical products as well as electrical equipment and machinery failed to entirely match the previous quarter's figure. Motor vehicles showed a moderate decline; given the exceptionally strong growth in this segment in both the second and third quarters of 2013, however, the export volume in the first quarter of 2014 was still up considerably on the year.

Significant rise in imports of intermediate goods and motor vehicles

Imports are also likely to have picked up in the final quarter of 2013, although less so than exports. Imports of goods rose slightly by ¼% in price and seasonally adjusted terms. However, a significant rise in imports from the euro area in the first two months of the quarter contrasted with a slight decline in imports from other regions. It is striking that Portugal and Spain, two of the euro-area countries strongly affected by the crisis, have significantly increased their exports to Germany again. Growth in imports of capital goods was particularly robust. This was due primarily to a rise in imports of motor vehicles and motor vehicle parts. Close international production links mean that the ongoing expansion in foreign demand for German-manufactured motor vehicles is also likely to have played a part in this. In addition, there was a marked rise in imports of other transport equipment, which is to be seen in connection with the growth in demand for products of the European aviation industry. By contrast, there was a slight decrease in imports of machinery, which is consistent with continuing subdued domestic investment activity, and a marked decline in information and communication technology (ICT) products, as well as electrical equipment. Purchases of foreign-manufactured intermediate goods also picked up distinctly. Metal and metal products

Underlying trends in foreign trade

Seasonally adjusted, quarterly



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

showed exceptionally strong growth. There was a slight decrease in imports of energy and consumer goods, however.

Despite the improving situation in export activity and a higher level of capacity utilisation, firms still seem to be exercising restraint with regard to investment in new machinery and equipment. At all events, domestic sales by capital goods producers (excluding motor vehicles) were down on the quarter in seasonally adjusted terms. The same applies to imports of capital goods (excluding motor vehicles and the manufacture of other transport equipment). Nevertheless, the marked rise in the

Commercial investment still subdued

number of commercial motor vehicle registrations suggests that firms have been buying more vehicles for their car pools. Furthermore, there was a perceptible expansion in commercial construction investment following the strong surge in demand for commercial property in the second and third quarters of 2013.

Housing construction and public sector construction somewhat weaker

Housing investment is unlikely to have expanded further in the final quarter of 2013 after growing strongly owing not least to backlog and catch-up effects, particularly during the second quarter. At the same time, equipment utilisation in the construction industry also reached a new peak. This might be an indication that capacity constraints are sometimes standing in the way of more rapid growth. At all events, construction demand grew very sharply in the first three quarters of 2013 – as can be seen in the number of new housing construction permits – and property prices, too, are continuing to rise. Public sector construction orders appear to have been somewhat weaker in the fourth quarter than in preceding periods.

Private consumption still trending upwards

Private consumption is still on an upward trend path. This is suggested by rising real incomes and the continuing improvement in the consumer climate from an already high level. According to Federal Statistical Office data, seasonally adjusted retail sales in the fourth quarter did not quite match their third-quarter level. It should be noted in this context, however, that the index figures are to be regarded as provisional and that mail order trade, which is becoming increasingly important, is not fully captured. By contrast, the number of new car registrations by households has increased appreciably in line with the high propensity to purchase recorded by the market research institution Gesellschaft für Konsumforschung (GfK).

■ Sectoral trends

Moderate rise in industrial output

Industrial output in the final quarter of 2013 rose by a seasonally adjusted ¾% on the quar-

ter. There was, however, an exceptional number of bridge days in the later part of the year, the impact of which on output is not taken into account in the standard adjustment for calendar variations. This is why the cyclical trend is understated by the seasonally and calendar-adjusted quarterly rate. Furthermore, short-time working arrangements in a number of automotive manufacturing plants depressed output in October. This meant that the production of capital goods was slightly down on the third quarter (-½%). By contrast, manufacturers of intermediate goods substantially stepped up their output in seasonally adjusted terms (+2%), with the chemicals industry as well as the metal working and processing industry standing out in a positive way. Consumer goods producers also stepped up their output considerably (+1%).

The expansion of industrial output was accompanied by higher levels of capacity utilisation. According to the Ifo Institute, the level of capacity utilisation of tangible fixed assets in industry went up again slightly in January in seasonally adjusted terms. The multi-year average was matched at 84% of full operational capacity utilisation. This is an indication that industrial output is once again back within the range of normal capacity utilisation. This growth in output was largely attributable to the higher level of capacity utilisation in the manufacture of intermediate goods. The difference from the long-term sectoral average increased slightly to 1¼ percentage points. By contrast, the shortfall in the case of producers of capital widened goods to 1¾ percentage points.

Output in the main construction industry during the reporting period held up at the high level of the third quarter (+¼). This applies equally to general construction and civil engineering. At the same time, Ifo Institute data show that capacity utilisation in construction machinery reached a new peak in seasonally adjusted terms. According to initial – albeit still very provisional – reports, output in the finishing trades underwent a decline (-2%). Output

Near-normal industrial capacity utilisation overall at year-end

Contraction in construction activity and energy production

in the energy sector fell by a seasonally adjusted 3% in the final quarter of 2013.

Further growth in services sector

The services sector is likely to have expanded perceptibly in the fourth quarter of 2013. This is suggested in any event by the favourable assessments of the business situation in major sectors of the economy, which are reported to the Ifo Institute. Industry-related services benefited from the expansion in export activity and the pick-up in industry in a large number of areas. This has also had a positive impact on the transport sector. One indication of this is the significant increase in the mileage of domestic heavy goods vehicles on toll roads. Wholesale turnover was still down on the elevated level of the third quarter, however. Motor vehicle traders posted clear growth in sales. Not only did passenger car sales pick up perceptibly, sales to commercial customers, in particular, also saw strong growth. Consumption-related service providers benefited from the favourable consumer climate. Hotels and restaurants saw an increase in their turnover and, according to figures which are to be regarded as provisional, retail sales were down only slightly on their level in the third quarter.

Employment and labour market

Rise in employment, little change in unemployment

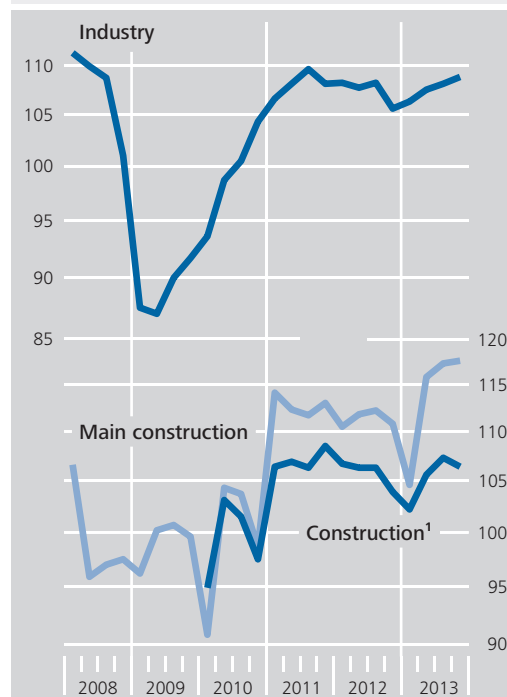
The slight upward trend in the labour market continued in the fourth quarter of 2013. The German labour market situation is still characterised by continuous employment growth and persistently high levels of immigration. Over the course of the fourth quarter, unemployment initially rose before falling a little, owing mainly to the weather.

Growth in employment with a broader sectoral base

The seasonally adjusted number of people in work in the final quarter of 2013 went up by 74,000, or 0.2%, on the average of the third quarter. This increase was due primarily to the positive development in employment subject to social security contributions, which, taking the average of the months of October and Novem-

Output in industry and in construction

2010 = 100, seasonally adjusted, quarterly, log scale



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

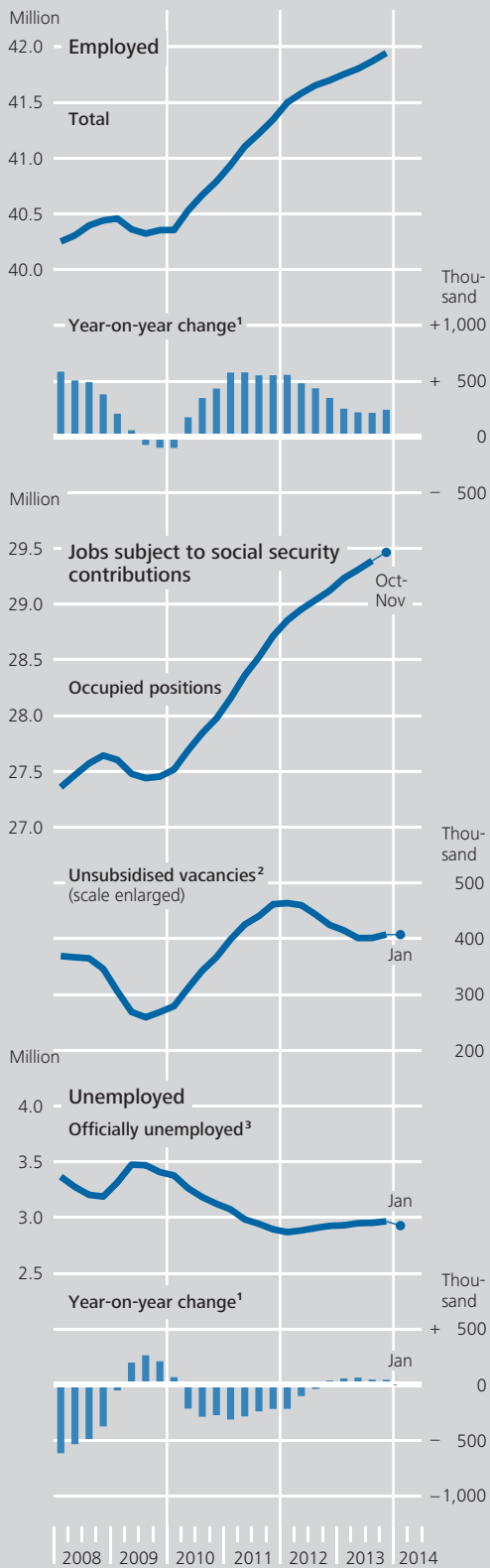
ber, was up by 64,000 persons on the summer level. The trend of the previous quarters therefore continued. The sectoral base of the employment growth became broader, however. Whereas in the previous quarters nearly half of the new jobs subject to social security contributions were in business-related services (excluding third-party hiring), the figure had fallen to one-fifth by the end of the year. Fairly sharp growth in employment was recorded in various services sectors of late, including healthcare and education, as well as in the logistics and hotel and restaurant sectors. There was also perceptible growth in employment in the manufacturing sector, as well as in temporary work, which is often used in industry.

Regular full and part-time work subject to social security contributions (excluding temporary employment) also grew much more strongly in 2013 than employment overall. Based on data provided by the Federal Employment Agency up to and including November, growth for the

Other forms of employment on the decline

Labour market

Seasonally adjusted, quarterly



Source of unadjusted figures: Federal Statistical Office and Federal Employment Agency. **1** Not seasonally adjusted. **2** Excluding seasonal jobs and jobs located abroad. **3** From May 2009, unemployed excluding persons newly registered on the books of private employment agencies.

Deutsche Bundesbank

year as a whole can be put at over 350,000 positions, whereas the current figures from the Federal Statistical Office show an increase in overall employment of only 233,000. Since as far back as 2006, growth in employment has been accounted for solely by regular employment contracts subject to social security contributions, whereas other forms of employment, such as self-employment, (exclusively) low-paid part-time employment, temporary employment and one-euro workfare jobs have been stagnating. Between 2002 and 2006, when the German labour market was still under considerable adjustment pressure, these other forms of employment gained considerably in importance for a time, albeit to the detriment of regular employment.

Unemployment in the period under review rose by a seasonally adjusted 13,000 persons to 2.97 million compared with the third quarter of 2013; the unemployment rate went up to 6.9%. This slight increase in the level of unemployment follows a trend that has been persisting for the past one-and-a-half years. The unemployment figures stabilised during the past quarter, however, and fell to 2.93 million in both December 2013 and January 2014, probably owing, above all, to the predominantly mild winter weather. The unemployment rate eased again to 6.8%. The figures for more short-term unemployment covered by the statutory insurance scheme have been tending to decline since May 2013, albeit at a very slow pace. By contrast, the number of unemployed persons receiving the basic welfare allowance hit the two million mark again for the first time since the second quarter of 2012.

Slight rise in registered unemployment, although stable over the course of the quarter

The leading indicators for the labour market suggest that the upward trend in employment could strengthen. The Ifo employment barometer, which provides information on the employment plans of trade and industry and business-related services over the coming three months, showed an increase on the quarter. The Federal Employment Agency's BA-X job index is also indicating a significantly positive

Pick-up in the hitherto subdued labour market developments on the horizon

trend again. This is due primarily to a greater number of reported vacancies for unsubsidised positions subject to social security contributions in areas which are particularly sensitive to the business cycle, such as industry, construction, logistics and trade. However, the DIHK survey from the beginning of 2014, while giving a generally positive assessment of the outlook for employment, also points out the risks stemming from the shortage of skilled workers and the planned introduction of a minimum wage. According to the IAB labour market barometer, unemployment – which had been showing a slight upward trend in 2013 despite the favourable developments in employment – could decline somewhat in the coming months.

■ Wages and prices

2013 saw moderate increase in negotiated pay and negative wage drift

In 2013, collective wage bargaining was typified by extended employment contracts with a phased increase in basic rates of pay. Negotiations proved difficult in some sectors, which led to delays in the introduction of pay increases. In the retail sector, the backpayments for the 3% rise in basic pay from July 2013, agreed in December, did not come into force until January 2014 in most cases. According to the Bundesbank's calculations, collectively agreed rates of pay therefore rose by only 2.4% on average in 2013,¹ although this was still slightly more strongly than actual earnings at 2.3% (at least according to the initial calculation by the Federal Statistical Office). One key reason for the slightly negative wage drift is the somewhat lower bonus payments, which had been extremely high in some sectors earlier. In the final quarter of 2013, compensation under collective wage agreements was 2.4% up on the previous year's level. In the first quarter of 2014, a distinctly stronger rise in negotiated rates of pay is expected owing in part to backpayments in the retail sector.

At 5½% on average, the trade unions' wage demands announced so far for the 2014 pay round are only slightly less than those in 2013.

Negotiated rates of pay

Year-on-year percentage change, on monthly basis



¹ Excluding additional benefits and lump-sum payments.

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With a base amount of €100 and an additional linear increase of 3.5%, the demands in the central and local government public sector go somewhat beyond them in fact. This implies similarly sizeable pay rises to those agreed in 2013. The first major pay agreement of 2014 in the chemicals industry with a 3.7% increase in pay running for a period of 14 months is also consistent with this picture. With regard to the planned introduction of a statutory minimum wage of €8.50 per hour from January 2015, special agreements for the lowest wage groups might be a factor in some industries so as to make use of the transitional arrangements up to 2017 announced in the coalition agreement. In January 2014, for instance, a nationwide agreement was reached for an industry-specific minimum wage for the roughly 100,000 employees in the meat industry. At €8 per hour until the end of September 2015, this is below the level of the announced statutory minimum wage, but it will go up to that level afterwards and reach €8.75 from December 2016. The wage bargainers are aiming to declare this pay agreement generally binding on the basis

2014 pay round: wage demands similar to 2013, special agreements for low-paid groups

¹ By contrast, the Federal Statistical Office reports an annual increase of 2.3% as a provisional figure for the agreed pay rates including one-off payments and ancillary agreements. Differences compared with the Bundesbank's pay index are due primarily to varying industry-specific employee weightings in the respective pay index.

of the German legislation governing the secondment of workers (*Arbeitnehmer-Entsendegesetz*). The industry-specific minimum wage would then also be binding for the 20,000 to 30,000 persons working under service contracts.² In the retail sector, a new wage category has been created for shelf-stackers whose wages are below the existing sector rates but above the planned minimum wage. This is designed to allow this category of workers to be reintegrated into the core workforces.

Slower decline in import prices, producer prices move sideways

The fall in prices at the upstream stages of the economy observed during the course of 2013 largely came to a halt in the final quarter. On a quarterly average, seasonally adjusted import prices were only slightly down on the quarter. Industrial producer prices in foreign sales remained unchanged; producer prices in domestic sales were trending slightly upwards. As a result, the terms of trade showed a further improvement, reaching their highest level for three years. The further decline in import prices by a seasonally adjusted 0.3% compared with the second quarter is essentially due to the declining energy component in the wake of the euro's appreciation against the US dollar. Whereas the prices of capital goods continued to decline, the prices of intermediate goods accelerated again for the first time in two years as a result of improved global industrial activity. Consumer goods prices remained stable. As producer prices for energy in Germany are dependent on crude oil prices only to a small extent, the decline here was not as strong as it was for imports. The other components of the producer price index showed a similar pattern to that on the import side with mostly somewhat higher rates. A slight seasonally adjusted rise of 0.1% overall on the quarter was therefore recorded. Due to the pronounced falls in prices in previous quarters, the year-on-year figure for imports was still clearly negative at -2.7%. The figure was -0.7% at the domestic producer level. On an average of 2013, imports became 2.5% cheaper, while German industry's domestic sales prices fell slightly by 0.1% in

Germany and somewhat more sharply by 0.6% for exports.

Despite the extremely high utilisation of equipment in the main construction sector, upward pressure on prices for construction work remained within fairly narrow bounds. Prices for residential construction work rose in the fourth quarter of 2013, as they did in the third quarter, by 2.0% on the year. The increase also averaged 2.0% for 2013 and in fact remained 0.5 percentage points below the 2012 rate. This was probably due chiefly to the decline in the cost of materials. The increase in prices for structural work, at 1.7%, was somewhat weaker than that in the finishing trades at 2.3%. According to the calculations of the Association of the German Pfandbrief Banks (*Verband deutscher Pfandbriefbanken*), prices for owner-occupied housing rose at an annual rate of 2.4% in the final quarter of 2013. More detailed comments on developments in the property markets and, in particular, on house prices in 2013 as a whole may be found on pages 64 to 66.

Construction and property prices still rising

Consumer price inflation weakened significantly in the final quarter of 2013 on the back of the euro's appreciation. After seasonal adjustment, prices were up by only 0.1% on the quarter compared with 0.5% earlier. The clearly flatter price trend was very largely due to energy prices, which declined substantially. Furthermore, there was a marked deceleration of the extremely sharp rise in food prices in the third quarter, caused by inclement weather conditions. Industrial goods became somewhat more expensive in spite of the appreciation of the euro and seasonal sales in clothing and shoes having been brought forward. By contrast, price increases in the case of services were somewhat weaker than in earlier quarters. The continuing rise in rents for new lettings is still exerting only a very dampened

Weaker consumer price inflation in final quarter of 2013

² Information provided in German by the wage bargainers (Gewerkschaft Nahrung-Genuss-Gaststätten und Arbeitgebervereinigung Nahrung und Genuss e.V.).

impact on the rent component of the Consumer Price Index. Annual inflation fell slightly to 1.3% in both the Consumer Price Index (CPI) and the Harmonised Index of Consumer Prices (HICP).

Consumer prices in 2013: sharp rise in food prices, marked decrease in prices of refined petroleum products

In 2013 as a whole, consumer price inflation was essentially characterised by sharply rising food prices, falling fuel and heating oil prices and by a number of special factors. The mainly weather-related increase in food prices at a rate of 4.4% was clearly sharper than the long-term average. By contrast, consumer prices of refined petroleum products declined by 4.1%, following an increase of 6.4% in 2012, as a result of lower crude oil prices and the appreciation of the euro. The 1.4% rise in energy prices for consumers was due to the 11.9% increase in electricity prices stemming from the rise in the renewable energy (EEG) levy. In spite of the euro's appreciation and the associated price reductions at the upstream stages of the economy, inflation in the case of industrial goods decelerated only slightly to 1.0%. Government measures, such as the abolition of the surgery visit charge at the beginning of 2013 (with a contribution to the CPI inflation rate of somewhat more than -0.2 percentage point) and the increase in the scale of charges for state lotteries the following May (with a contribution of +0.2 percentage point) influenced the sub-index for services.³ Overall, prices of services increased just as strongly as in the previous year. According to the national Consumer Price Index (CPI), consumer prices rose by 1.5% on average in 2013 and by 1.6% according to the Harmonised Index of Consumer Prices (HICP). The same rates are also produced even without the inclusion of the energy component.

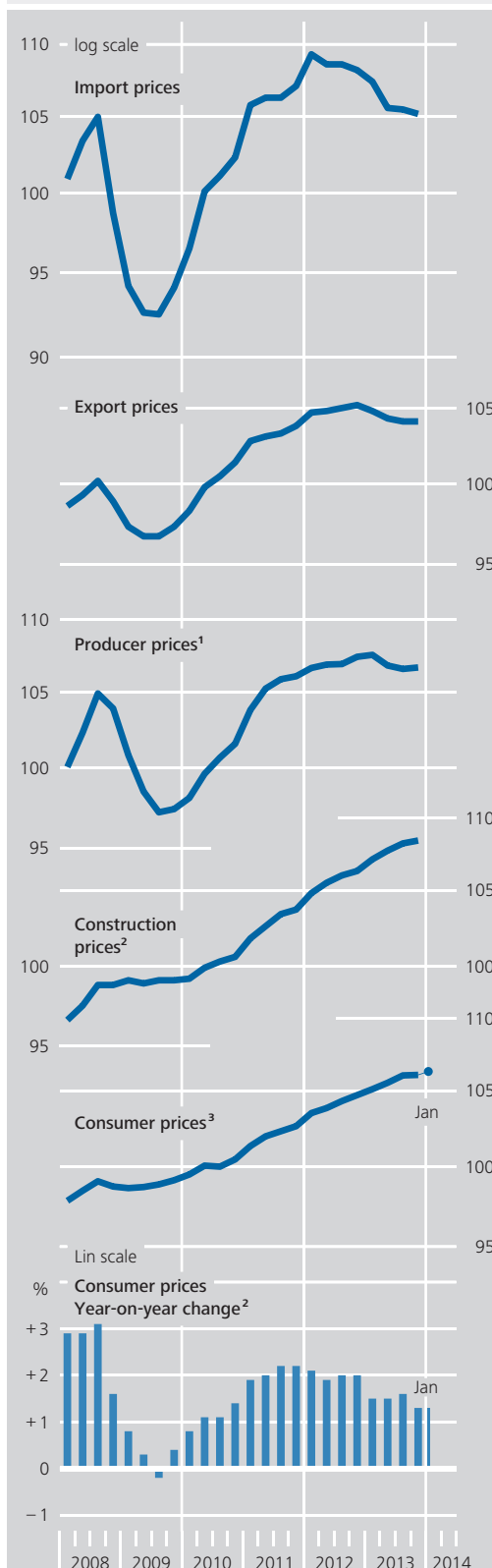
Special statistical factors in the HICP

It should be noted that, owing to special statistical factors, the German HICP rate was biased upwards by 0.3 percentage point in 2013. Changes in the price collection procedure for

³ The HICP basket of goods does not contain gambling. Thus, the lottery effect does not apply in this instance.

Import, export, producer, construction and consumer prices

2010 = 100, seasonally adjusted, monthly



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

Deutsche Bundesbank

House prices in 2013 in Germany

House prices in Germany continued their strong upward trend at a virtually unchanged pace in 2013. This was caused by demand on the German housing market being at a persistently high level for a number of years. A perceptible expansion of the housing supply and regional shifts in demand meant that there was no acceleration in prices on the overstretched urban property markets, however. Furthermore, the increase in new lettings in this segment slowed down somewhat. This contrasted with growing price pressure felt in the case of single-family housing and apartments in smaller urban areas. Looking at Germany as a whole, it is still the case that housing market prices are not generating any major macroeconomic risks.

According to calculations based on data from bulwiengesa AG, house prices in 125 German towns and cities in 2013 went up by 6¼% compared with 2012. This means that residential property has become almost one-fifth more expensive overall since the beginning of the identifiable acceleration in prices in 2010. This corresponds to an average annual rate of just under 5¼%.¹ The price index of the Association of German Pfandbrief Banks (Verband deutscher Pfandbriefbanken, vdp) for owner-occupied housing, which covers Germany as a whole, showed an average increase of 3¼% in 2013 compared with 3% in 2012.² The composite index published by Hypoport AG shows that house prices rose by roughly 5% in 2013, like in the year before. These differences are explained by the statistical uncertainties surrounding the measured values.³ This does not affect the basic finding of what may be described as a strong price trend for the German housing market.

As before, the rise in prices in 2013 was clearly stronger in towns and cities than in the rural areas. Once again, the largest increases were recorded in owner-occupied apartments in the seven largest German cities (+9%). As was the case in 2012, the gap

between urban and rural areas in terms of price dynamics is likely to have flattened somewhat.⁴ The price trend in the case of pre-owned housing, which accounts for a larger percentage of the housing stock in smaller towns and cities than it does in larger ones, has risen to +4¾%. The increase was therefore no longer lagging so far behind price inflation in owner-occupied apartments (7¼%) as in previous years. In the reporting period, the composite index showed resale prices going up somewhat more sharply than prices for new properties.

There appears to have been no further increase in demand pressure on the urban rental housing markets. In both larger and smaller towns and cities, rents for new lettings in the case of re-rentals and new housing were increased less sharply in 2013 than in the year before. According to the vdp index for new lettings of apartments in multiple-family dwellings, which also covers

¹ According to current data of bulwiengesa AG, the increase in house prices in 2012 is shown as being roughly 1 percentage point higher than previously estimated. The revision is due, first, to the inclusion of price data from the last few months of 2012 and a broader sample. Second, the comparison of prices is now based on a typical property with a somewhat larger living area. The amended definition of a typical property applies to data from 2012 onwards, which makes a year-on-year comparison of prices in 2012 more difficult. This is unlikely to affect the year-on-year comparison in 2013, however.

² The composite index of bulwiengesa AG for all the 402 administrative and urban districts, which is not available until a later date, shows a 4% increase in 2012. According to the broadly based house price index of the Federal Statistical Office, in which the annual figures likewise do not go beyond 2012, the rate of increase in 2012 for Germany as a whole amounted to 3½%.

³ The indicators differ from one another mainly in terms of their regional coverage and type of dwelling. They also display differences in the way in which the data are compiled. See the information on house prices in the Bundesbank's Monthly Reports of February 2009 (pp 52-53) and February 2010 (pp 58-59).

⁴ For a detailed analysis of the spatial interactions of house price increases in the past few years, see Deutsche Bundesbank, The determinants and regional dependencies of house price increases since 2010, Monthly Report, October 2013, pp 13-30.

rural regions to some extent, the cost of rental housing in the case of new lettings was 4¼% higher overall than in 2012, when housing rents increased by 2¾%. In line with the regional shift in demand towards housing in areas surrounding towns and cities, interest in rented property in these areas is likely to have increased. According to the calculations of vdp, the prices of multi-family houses overall, at a rate of increase of 4¾% in 2013, did not show any further acceleration.

The relative scarcity of housing, which is reflected in the high rise in prices, is bringing about significant expansions of supply. In 2012, almost 177,000 new dwellings were completed. Given the ongoing upward trend in the number of building permits for several years, the number of completions is likely to be higher in 2013. It is estimated that permits for somewhat more than 235,000 new dwellings were granted last year,⁵ compared with 200,000 in 2011 and 210,000 in 2012. Nevertheless, in view of the unchanged strong demand for housing and the already much smaller number of vacant properties in attractive areas, the resulting expansion of supply will not be enough to ease the situation on the housing markets significantly. Considering additionally the losses due to demolition and alternative use, around 260,000 new dwellings a year would have to be completed to cover the additional demand.⁶ What is needed in order to eliminate the existing tensions on the residential property markets in line with the market are reliable signals in the form of prices and rents for worthwhile investment in housing. By contrast, regulatory intervention in new rental agreements is counterproductive.⁷

⁵ In the past two years, the rise in the number of new construction permits was due mainly to permits for apartments, whereas there was virtually no further expansion of supply in the case of houses.

⁶ This is the result produced by a mathematical model based on a population projection broken down by age group and based on current migration assumptions as well as demographic and socio-economic factors of housing demand.

⁷ The regulation of existing rents on a limited scale, however, has the purpose of not overriding regulations for the protection of tenants.

Selected house price indices

2010 = 100, annual values, log scale



¹ Bundesbank calculations for houses and owner-occupied apartments based on data provided by bulwiengesa AG.
 Deutsche Bundesbank

The demand for property is receiving additional impetus from the decidedly favourable financing conditions for the acquisition of residential property. The average effective interest rate for new loans for house purchase fell further to 2¾% in 2013. The price-to-income ratio for residential property based on the vdp price index for owner-occupied housing remained virtually unchanged. Taking into account the financing costs, however, the affordability of housing is likely to have improved somewhat.

Despite the expansion in supply that is under way, existing overvaluations in the urban centres have tended to become reinforced, since residential property prices have risen more sharply than is suggested by the economic and demographic fundamentals.⁸ This is particularly true of urban property markets, for which overvaluations of between 10% and 20% are currently being measured. In the major cities, house prices are probably deviating upwards by

25% on average. Looking at the German housing market as a whole, prices are nevertheless still unlikely to have deviated perceptibly from their longer-term fundamentals. Moreover, at the aggregate level there are currently no indications of a destabilising interaction between higher property prices and lending.⁹ Banks' loans to households for house purchase rose comparatively moderately again last year, at 2¼%, compared with just under 2% in 2012. Furthermore, banks have tightened their lending standards again slightly.

⁸ The modelling and the estimation technique are explained in Deutsche Bundesbank, The determinants and regional dependencies of house price increases since 2010, Monthly Report, October 2013, pp 13-30, and in F Kajuth, T A Knetsch and N Pinkwart (2013), Assessing house prices in Germany: Evidence from an estimated stock-flow model using regional data. Bundesbank Discussion Paper, No 46/2013.

⁹ See Deutsche Bundesbank, Financial Stability Review, November 2013.

accommodation services and package holidays resulted in shifts in the seasonal pattern. Owing to the usual HICP chain-linking through the month of December (and not through the annual average as in the national accounts) these shifts biased the annual average of the rates of change upwards.⁴ Thus, the subindex for accommodation services rose by 16.5% on an annual average in the HICP compared with only 2.3% in the CPI, which was not affected by this disruption owing to the customary back-calculation in this instance. Package holidays stood at 5.3% in the HICP compared with 2.5% in the CPI. The months of January to November were affected to varying degrees by the bias. This effect has no longer applied since December 2013.

Consumer prices in Germany began to increase more sharply again in January, going up by a seasonally adjusted 0.2% on the month. In seasonally adjusted terms, this was due to marked increases in industrial goods and services.

Housing rents also showed a distinct rise. Energy prices declined due to steep falls in the prices of refined petroleum products. Despite a further perceptible increase in the renewable energy (EEG) levy, electricity prices were raised only slightly at the beginning of the year owing to declining procurement costs. Food prices showed no change in seasonally adjusted terms. As in December, there was a 1.2% annual rise in the Harmonised Index of Consumer Prices (HICP), while the annual rate of the Consumer Price Index CPI went down slightly from 1.4% to 1.3%.

■ Orders received and outlook

The underlying growth dynamics of the German economy are likely to have strengthened

⁴ See Deutsche Bundesbank, The contribution of the accommodation services sub-index to explaining the current deviations between CPI and HICP inflation rates, Monthly Report, April 2013, p 7.

Good prospects for stronger economic growth

distinctly in the final quarter of 2013 and the first quarter of 2014. One indication of this is the virtually continuous improvement in firms' and households' assessments of the current situation and outlook. However, this will not be fully reflected in the GDP growth rates until after the turn of the year when the higher inflow of orders starts to have an impact on output. The key factors behind stronger economic growth, given unchanged robust domestic activity, will be greater stimuli from export demand. Although the debt crisis continues to impose some strains within the euro area, there are nonetheless increasing signs of a gradual economic recovery, and other advanced economies should see growth pick up pace. The difficulties facing a number of emerging market economies are likely to be of smaller importance by comparison. With levels of industrial capacity utilisation now largely at a normal level and supported by favourable underlying conditions on the financial side, the steady improvement in the economic outlook means that the key conditions are now in place for overcoming the corporate sector's reluctance to invest and for domestic demand to gain further impetus from increasing purchases of machinery, equipment and commercial property. The DIHK survey at the beginning of 2014 suggests, however, that growth could face impediments from economic policy factors relating to energy and the labour market alongside a growing shortage of skilled workers.

Further increase in orders received

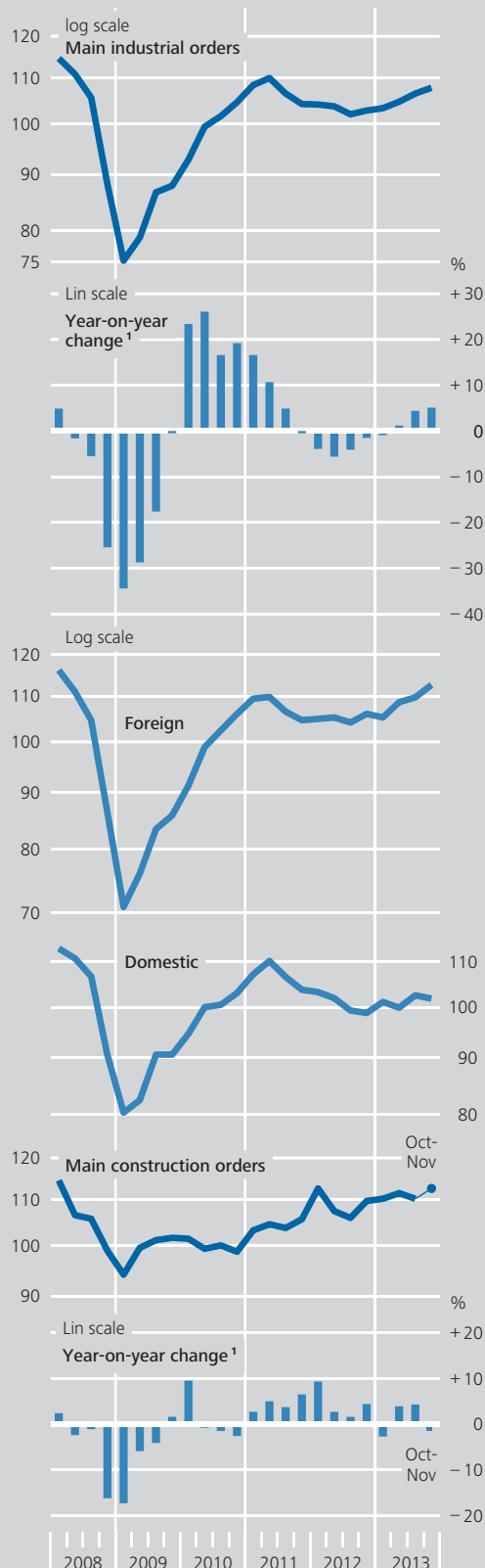
In autumn 2013, the inflow of industrial orders was up again on the quarter, this time by a seasonally adjusted 1¼%. The somewhat smaller rise compared with the third quarter was due to the irregular inflow of large orders. Therefore, the growth in the volume of capital goods, at ¾%, was also clearly weaker than in the previous quarter. By contrast, there was a substantial increase of 1¾% in the intermediate goods sector. Orders of consumer goods grew by 1½%.

More foreign orders ...

Demand stimuli for industry came solely from abroad (+2¾%) in the final quarter of the year.

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

The increase in euro-area orders (+6¼%) was much stronger than that in non-euro-area countries (+¾%). A key part in this was played by orders from the aircraft and aerospace industry, which originate from non-euro-area countries, but are passed on within the European production network. There was also an increase in the case of computers, electronic and optical equipment, as well as electrical equipment. In addition, the automotive industry booked more export orders from non-euro-area countries. It is notable that demand for intermediate goods has increased sharply both inside and outside the euro area, which suggests that the global economy is picking up. Moreover, customers in the euro area ordered significantly more consumer goods, although there was admittedly a steep decline in the previous quarter.

... but fewer domestic orders

By contrast, the underlying trend in domestic orders is continuing to show a muted upward trend. During the reporting period, domestic orders were in fact somewhat down on the fairly high level of the previous quarter (-¾%). This was due mainly to a considerably smaller volume of orders in the other transport equipment sector, which shows strong fluctuations from quarter to quarter. Excluding this economic sector from the calculation, the order inflow was unchanged on the level of the third quarter. German enterprises' reluctance to invest was still evident in the case of some items of machinery and equipment. Following an increase in the previous quarter, there was a clear decline for manufacturers of machinery. Domestic orders for computers, electronic and optical products more than matched their level in the previous quarter. By contrast, domestic orders of motor vehicles and motor vehicle parts even exceeded their strongly elevated level of the preceding period. Both the intermediate and consumer goods industries recorded a small increase in orders.

The business outlook for trade and industry has continued to improve since the final quarter of 2013. In manufacturing, this is in line with optimistic export and production expectations. The outlook for industrial firms has now been stable at a high level for several months. This also has a knock-on effect on other major sectors. Positive expectations have become much more widespread in the wholesale trade and in the case of the service providers since the autumn. Retailers are also making an increasingly favourable assessment of their future business activities. Moreover, the already above-average expectations of the main construction sector have been clearly revised upwards again.

Business expectations improve again

The underlying trend in demand for housing construction is likely to continue on an upward path in view of immigration-related demand, households' positive income prospects and favourable financing conditions. Following the wave of permits granted in the first three quarters, the autumn provided a breathing space. By contrast, commercial properties recorded a sharp surge in orders.

Temporary lull in demand for housing construction, but surge in commercial construction

Domestic economic activity continues to be sustained by private consumption. According to surveys by the consumer research institution, Gesellschaft für Konsumforschung (GfK), consumer confidence, which was already exceptionally buoyant, has improved still further since the fourth quarter, chiefly on the back of more positive economic and income expectations. The clear increase in the existing very pronounced propensity to purchase is consistent with this. Against this backdrop, wage growth in the coming quarters can be expected to bolster the domestic component of growth. This is likely to give a distinct impetus to imports and open up additional sales opportunities for enterprises from European partner countries, which in turn will ease the adjustment processes in the euro area.

Private consumption still pointing upwards