

## Economic conditions in Germany

### Underlying trends

---

In autumn 1999, the German economy continued along the path of growth on to which it had moved during the summer months. The Bundesbank's initial estimates indicate a  $\frac{3}{4}$  % rise in real gross domestic product in the fourth quarter in seasonally and working-day-adjusted terms. This was roughly as much as in the preceding three-month period and signifies a year-on-year rise in overall output of  $2\frac{1}{2}$  %, compared with  $1\frac{1}{2}$  % in the previous quarter. In the second half of 1999 as a whole, GDP was thus around 2 % higher than in the corresponding period of 1998. The pace of the economic upswing – measured as a seasonally and working-day-adjusted annual rate – amounted to approximately 3 % in autumn.

*Overall output*

There has been a marked increase in the degree of overall capacity utilisation recently, and the labour market situation brightened perceptibly at the turn of the year. The underlying conditions for the current year are thus also favourable. The leading indicators that are available point to the economic expansion continuing, which is reflected not least by the improved business confidence of enterprises and consumers. Current domestic price trends continue to be influenced by the upward thrust of external prices and, together with other factors, this will lead to a "price bulge" in the first few months of this year. Even so, the basic underlying price climate has remained largely unaffected. As far as it is possible to determine, the rise in prices for imported intermediate goods has not led to strong cost pressure so far. The 2000 pay

round, which has now started, should contribute to wage-rate policy not jeopardising the favourable economic prospects.

*Favourable  
outlook for  
exports*

As before, industry was generating strong stimuli to the upswing up to the end of the period under review. Surveys show a marked improvement in enterprises' sentiment. There was a noticeable improvement in the business climate ascertained by the ifo institute, and it was increasingly obvious that favourable opinions were outnumbering the judgements that remained guarded. The outlook for exports, which was judged to be favourable, continued to be the main factor underpinning this improvement. This outlook is mainly a reflection of the upturn in international economic activity and world trade, which is largely due to the quite rapid improvement in the Asian emerging markets and the continuing strength of the US economy. In addition, the German economy itself has successfully endeavoured to meet the requirements of competition by means of rationalisation and modernisation. Stable underlying conditions are provided by relatively low inflation rates and capital market conditions that remain comparatively favourable. Price competitiveness is being additionally supported by the continued strength of the US dollar against the euro.

*Positive stimuli  
provided by  
domestic  
economy*

Domestic trends are also likely to have positively influenced industrial sentiment and to have contributed substantially to a growing majority of enterprises now describing the current situation as good. Not only did cyclical expansionary trends become more pronounced, economic policymakers set a posi-

tive tone in several respects, too. This includes the Federal Government's commitment to pursuing a clear course of consolidation. Furthermore, the Government has promised greater tax relief than was previously envisaged.

The improvement in industry also spread to the business prospects for commercial service providers. According to the surveys of the *Zentrum für Europäische Wirtschaftsforschung* (Centre for European Economic Research), computer specialists and firms of management consultants, in particular, gave favourable assessments. Moreover, the cyclical upturn benefited the forwarding industry. More consumer-oriented industries, by contrast, remained circumspect. This may be due to the fact that, according to surveys of the consumer research institution, *Gesellschaft für Konsumforschung*, households were cautious in assessing the climate for consumption up to the beginning of the current year. Although general expectations of cyclical trends have become more optimistic, there has not yet been a fundamental improvement in personal income prospects from the point of view of households. The fact that turnover in the retail trade in the autumn months of 1999 was a seasonally adjusted 1% higher than in the third quarter is consistent with there nevertheless having been a rise in the propensity to purchase.

*Service  
providers  
upbeat,  
households still  
restrained*

According to the surveys of the ifo institute, the past few months have not produced any further reduction in the construction sector's predominantly negative assessment of the current situation. This is indicative of the fact

*Lack of  
momentum  
in the  
construction  
industry*



that efforts to overcome the largely structural difficulties of adjustment came to a halt in the second half of 1999. As is revealed by the quite favourable business expectations in western Germany up to the present, west German construction firms are, however, comparatively upbeat about future developments in this respect. In eastern Germany, by contrast, even the outlook is assessed pessimistically.

## Orders

The volume of orders in the manufacturing sector, which has been on the rise since autumn 1998, increased again appreciably in the fourth quarter of last year. In seasonally and price-adjusted terms, orders were just over 2½ % up on the preceding quarter, and rose by slightly more than one-tenth on the year. This was, however, also due to special factors. Firstly, there was an increase in the number of reporting firms and, secondly, several larger-than-average new orders were placed in the period under review.

*Ordering in the manufacturing sector*

Both factors affected domestic business and contributed to the level of incoming orders in the last quarter of 1999 being a seasonally adjusted 3½ % higher than in the preceding three-month period. Year-on-year growth accelerated to almost 8 %, compared with no more than ¼ % in summer. The order intake was particularly buoyant in the capital goods sector. After undergoing a fall of almost 3 % in the third quarter of 1999 against the corresponding period of 1998, orders at the end of the period under review were slightly more than one-tenth up on the year. The manufacturers of intermediate goods likewise reported an increase in new orders; their annual growth rate went up from 3¾ % in summer to 8¾ % in the period under review. The clear upward trend in incoming orders continued in both the chemical industry and the metal-working industry. By contrast, there was scarcely any seasonally adjusted rise in orders placed with manufacturers of durable and non-durable goods in autumn 1999 compared with the corresponding period of

*Domestic demand*

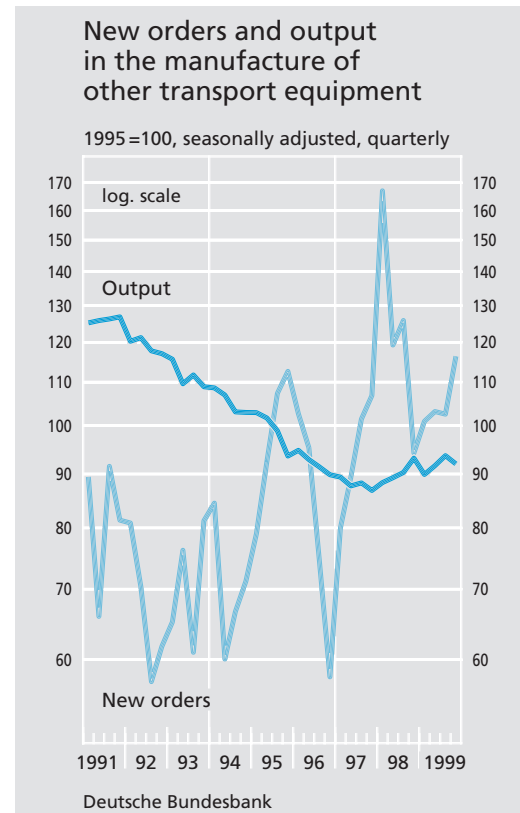
1998; as had already been the case for more than one year, they again remained (by about 1¾ %) below their level of 12 months previously. The main reason for this was a decline in orders for motor vehicles.

*Foreign demand*

In the fourth quarter of 1999, foreign demand for industrial products exceeded its summer level by around 1¼ % in seasonally adjusted terms. This is all the more noteworthy since export demand had already been very buoyant during the preceding months. This is mirrored by a year-on-year growth rate of no less than 16 % for the last quarter of 1999; in the fourth quarter of 1998, by contrast, the annual rate of change was still negative (– 3 ¼ %). Even though all major industrial sectors achieved double-digit year-on-year growth rates, the intermediate goods sector was well to the forefront with an increase of around 20 %, while the manufacturers of durable and non-durable goods remained quite clearly below the average.

*Assessment of large orders*

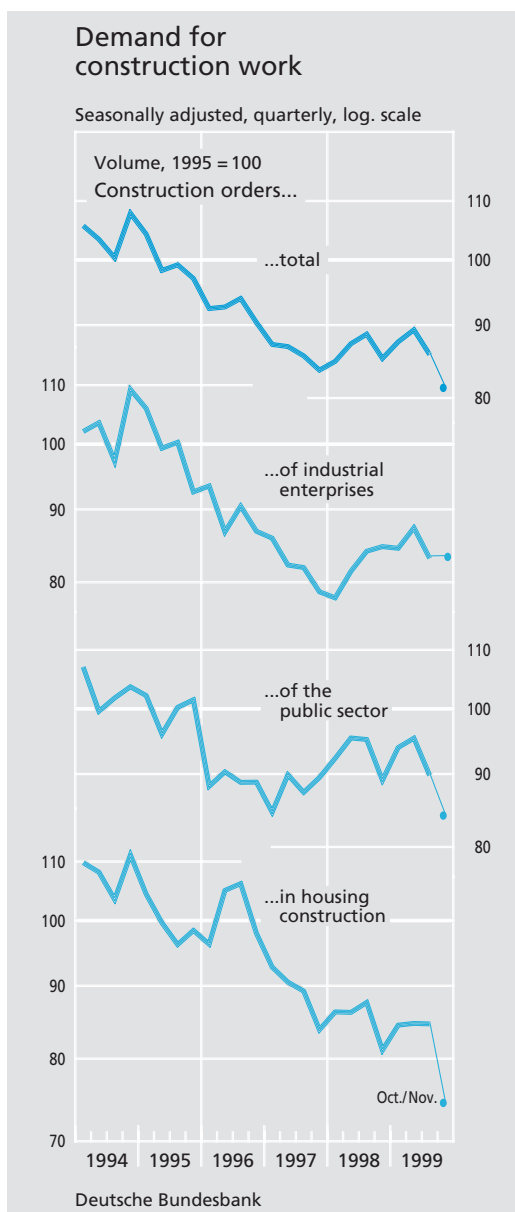
In the reporting on incoming orders in the manufacturing sector, reference was made – as had also frequently been the case earlier – to individual, particularly large-scale orders. Knowing this makes it easier to assess the orders placed with firms in terms of their importance to current economic developments. Large orders normally require longer organisational lead and production-related processing times, which result in a relaxation of the usually quite close time relationship between an order being received and production. Large orders therefore overstate the cyclical trend at the end of the series, although they, too, have a positive impact on economic



growth and employment, of course. A good example of this is the economic sector “manufacture of other transport equipment”. In this sector, for example, the statistics combine the building and repairing of ships and boats, the manufacture of aircraft and spacecraft as well as the manufacture of railway and tramway locomotives and rolling stock. Each individual order placed in one of these subsectors usually has a comparatively large volume and pushes up the quantity of new orders. Production, by contrast, responds to this only progressively and without any strong fluctuations – as is apparent from the chart on this page.

There was a further decline in demand for construction services in autumn 1999. In seasonally and price-adjusted terms, incoming

*Demand for construction work*



orders in the construction sector on an average of October and November (more recent statistical data are unavailable at present) were down by 5 ½ % on the preceding quarter. Since the figures for the previous quarter had already been lower than those for the spring, there was an overall decline in demand of almost one-tenth since the second quarter. The level was 6 ¼ % down on the year at the end of the period under review.

The level of new orders decreased particularly sharply in eastern Germany, where the overall decline since the second quarter of the year totalled almost one-fourth in seasonally adjusted terms; in October/November, the rate of change from the previous year came to around – 18 %. In western Germany, by contrast, the slowdown has so far been much more limited. In seasonally adjusted terms, the spring figure was undershot by 4 %, and the annual rate of change was just under – 2 %.

*Large gap between East and West*

Industrial construction still managed more or less to hold its own in the autumn. In this sector, the overall level of new orders in Germany was no lower than in the summer. Although the public sector, taken by itself, cut back its orders sharply (– 6 ½ % in seasonally adjusted terms), the decline in the housing sector was much sharper, at somewhat more than 12 %.

*Construction subsectors present mixed picture*

Taking construction permits as a yardstick, construction of rented housing and owner-occupied dwellings was drastically curtailed. On an average of October and November, the number of dwellings in buildings with three or more units, for which a permit was granted, was slightly more than one-fifth down on the year. Permits for 27,500 dwellings had been requested in October and November 1998, whereas only 21,800 dwellings were applied for in the same period of 1999. Among the reasons for this decline are a high level of housing provision in western Germany, which limits the rise in rental payments, and a large number of vacant dwellings in parts of eastern Germany, which, in

*Permits for construction of rented housing*

some regions, amount to up to one-sixth of the housing stock. In addition, given the (in any case) depressed profit expectations and the increased interest rate level, investment decisions in this sector may be influenced by the fact that a revision of the tenancy law is planned, which is intended to restrict the scope for rent increases.

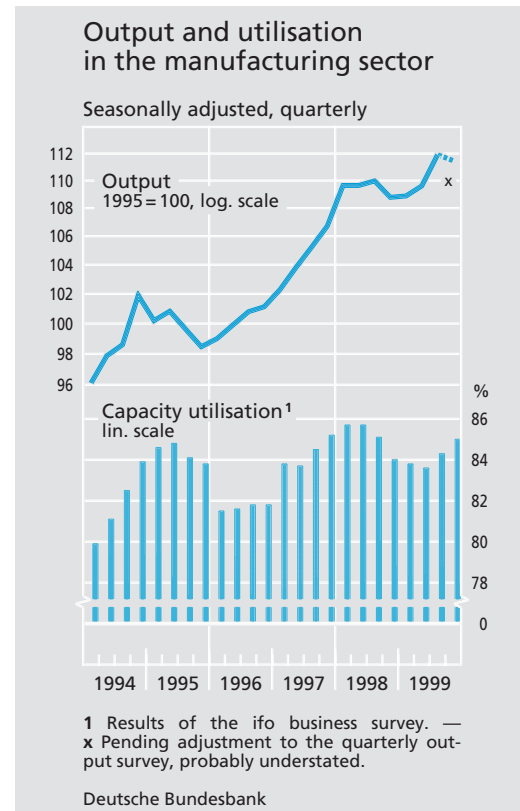
*Single-family houses*

The number of construction permits for single-family houses (buildings with 1 or 2 dwellings), by contrast, showed a further increase in the autumn, although this did not offset the decline in apartment house construction. At all events, this segment's share in housing construction rose latterly to 64 %, compared with just under 57 % one year earlier. The submission of applications for building permits may have been boosted during the last few months of 1999 by the fact that income limits for tax concessions for the acquisition of residential property were lowered at the beginning of this year.

### Output and labour market

*Industrial output*

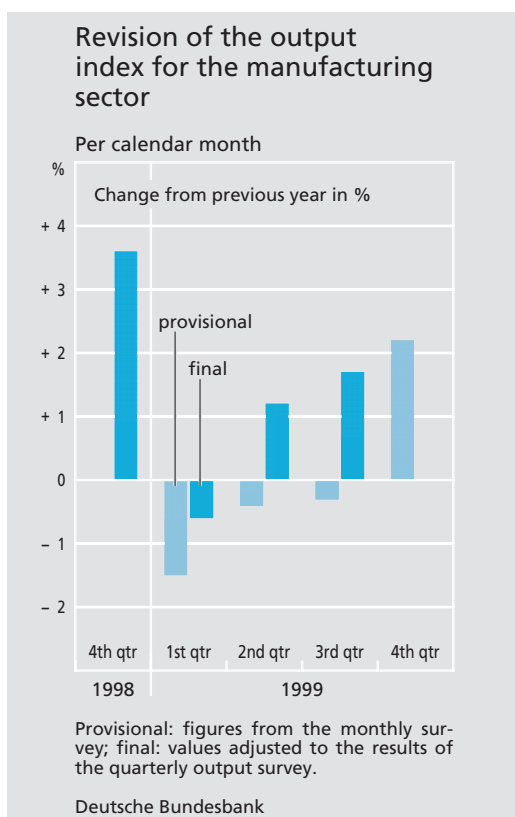
Industrial production is likely to have been stepped up further in view of the broad flow of orders. However, there is no statistical evidence to support this at present. Instead, the official data currently available for the manufacturing sector suggest a seasonally adjusted decline in output of about ½ % in the fourth quarter compared with the summer. However, it should be noted in this context that the monthly figures, which are collected from a selection of reporting firms, give an excessively unfavourable picture of the overall per-



formance when compared with the quarterly figures, which cover all the firms required to report. In the third quarter, the corrective factor amounted to + 2 %. It is still uncertain at present to what extent the figures for the period from October to December will have to be adjusted.

An increase in output during the fourth quarter is suggested, for one thing, by the fact that – according to the ifo surveys – utilisation of production capacity in industry increased considerably during the autumn months. In seasonally adjusted terms, capacity utilisation in December was around ¾ percentage point higher than at the end of the summer and 1 percentage point up on the year. For another, price-adjusted turnover in the manufacturing sector in the last quarter of 1999

*Capacity utilisation*



was 1% higher than in the preceding three-month period.

*Output in the construction sector*

Precise information on developments in output in the construction sector is likewise unavailable at present. In this sector – unlike the three-month period from October to December – the statistical data for the preceding period have not yet been adjusted to the results of the overall survey. During the past few years, incorporating them has regularly led to an upward revision. Therefore, it may be assumed that the seasonally adjusted increase in output that is currently shown will not be maintained in the fourth quarter. The year-on-year rate of change, which is already final, shows that the basic trend in output in the last three months of 1999 was scarcely higher than one year before.

*Employment*

On the labour market, there have recently been growing signs of a change for the better. Firstly, overall employment in the German economy rose again slightly according to the Federal Statistical Office and, secondly, the unemployment rate around the turn of 1999–2000 was distinctly lower than in the summer of 1999. According to the official statistics, the number of persons in work amounted to a seasonally adjusted 36.08 million in November. Although this was 0.2% less than in the same period of 1998, it was somewhat more than in September, when the decline in employment, which had persisted since the spring of 1999, came to an end. Information from industry suggests that there was no further net fall in that sector. The construction industry, by contrast, is likely to have continued to shed jobs.

*Unemployment*

According to the data of the Federal Labour Office, the number of persons out of work went down to a seasonally adjusted 3.96 million in January. This was around 165,000 fewer than at the end of September; the year-on-year figure again showed a decline of 160,000, after the difference had dwindled to just under 10,000 in October.

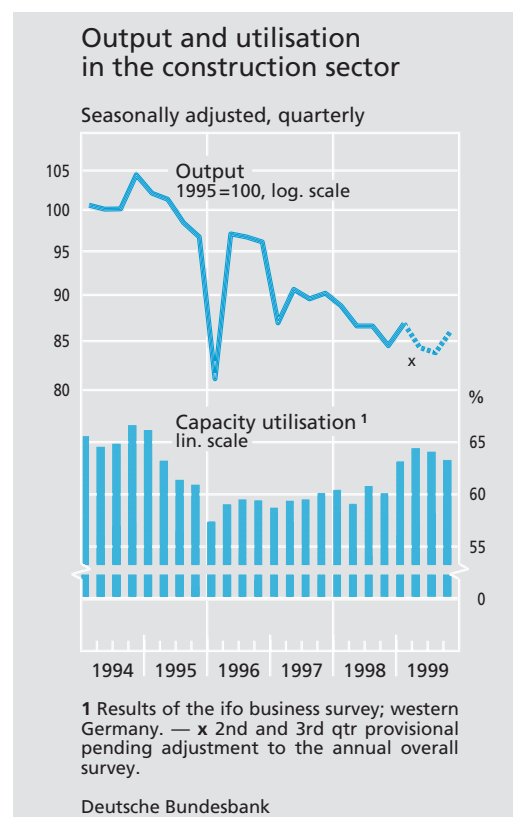
The unemployment rate at the end of January came to a seasonally adjusted 10.1%, compared with 10.5% at the beginning of autumn 1999. Whereas the share of unemployed persons in western Germany, at 8.3%, was perceptibly lower, it was more than twice as high in eastern Germany. In the new Länder, 17.5% of the labour force were registered as unemployed at the end of the period under review, compared with 17.2%

one year previously. One of the reasons for this increase is the curtailment of labour market policy measures. In January, no more than 390,000 persons in eastern Germany were taking part in vocational training courses and job-creation measures, which still account for a major part of labour-market promotion; this was 150,000 fewer than 12 months earlier.

### Prices and wages

#### Consumer prices

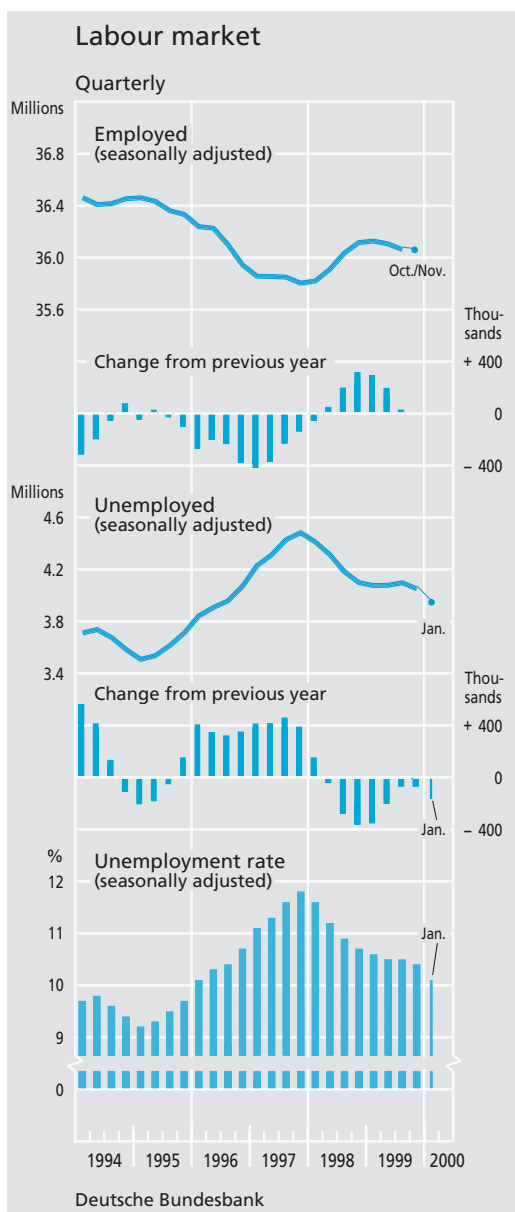
The upsurge in prices accelerated again slightly at the beginning of 2000. The year-on-year rate of change in consumer prices, which is often used as a measure of inflation, reached 1.6% in January; at the end of 1999, the year-on-year rate had been 1.2%, and in mid-year it had been 0.5%. However, the rise in the annual rate of inflation owed something to a number of special factors, which means that those figures do not reflect the underlying tendency of general price developments. Firstly, energy taxes on petrol and electricity were raised at the beginning of the year. Arithmetically, this signifies a consumer price increase of 0.2%. Secondly, baseline effects made themselves felt. These resulted from the substantial lowering of telephone charges and the reduction in contribution payments to prescription medicines, which had been recorded at the beginning of 1999 and are now no longer reflected in a year-on-year comparison. Excluding petrol and electricity as well as telephone charges and contribution payments, the year-on-year rate amounted to 1.0% in January, compared with 0.9% in December 1999.



The prices for mineral oil products (before tax) remained largely stable around the turn of 1999–2000. Before that, however, they had increased perceptibly in the wake of the sharp rise in crude oil prices on the international markets. Excluding the estimated tax increase, heating oil and petrol were 4¾% more expensive in January than at the end of summer 1999. Compared with January 1999, the price rise amounted to about one-quarter. Owing to their linkage to heating oil, gas prices likewise showed upward movement. The same applies to tenants' district heating and hot water costs. However, the general energy price increase was curbed by further reductions in electricity charges. Excluding the computational tax effect, electricity charges were lowered by about 8½% on a

#### Energy prices





national average between September 1999 and January 2000.

*Services and housing rents*

Services have likewise become appreciably more expensive at the consumer level recently. Prices in this sector were raised by slightly more than 1%, seasonally adjusted, between September and January. The main factors contributing to this development were insurance services, package tours and education ser-

vices. There were further increases in housing rents, too. In terms of the year-on-year rate of price change, the low point now appears to have been passed in this sector; in January, the annual rate of increase was 1.2%, having been no more than 1.0% in September.

By contrast, price movements in the case of food and industrial products, which together account for almost half of the basket of goods, remained comparatively moderate up to the end of the period under review. The level of prices for food was roughly 1¾% down on the year in January. This is substantially attributable to the major chain stores' fierce competitive struggle to gain market shares. At the beginning of 2000, consumer prices for industrial products were no higher than 12 months before. In this sector, too, markets are being affected by keen competition, which may even have intensified in the euro area as a result of the introduction of a single currency.

*Food and industrial products*

This is supported by the fact that German industrial producer prices for durable goods have remained virtually unchanged for the last nine months and that the year-on-year rate of price increases has not exceeded +½% for quite some time. At the start of 2000, prices for domestic non-durable industrial goods, which include food products and beverages, continued to be around ½% down on the year. In addition, capital goods producers' selling prices had risen by no more than 0.2% during the past 12 months. The sole reason for overall producer prices still being 1.1% up on the year in December (the most recent month for which data are avail-

*Industrial producer prices*

able) was the sharp rise in prices for intermediate goods. In this sector, the upsurge in prices for mineral oil products combined with price increases for iron and steel as well as non-ferrous metals.

*Import prices*

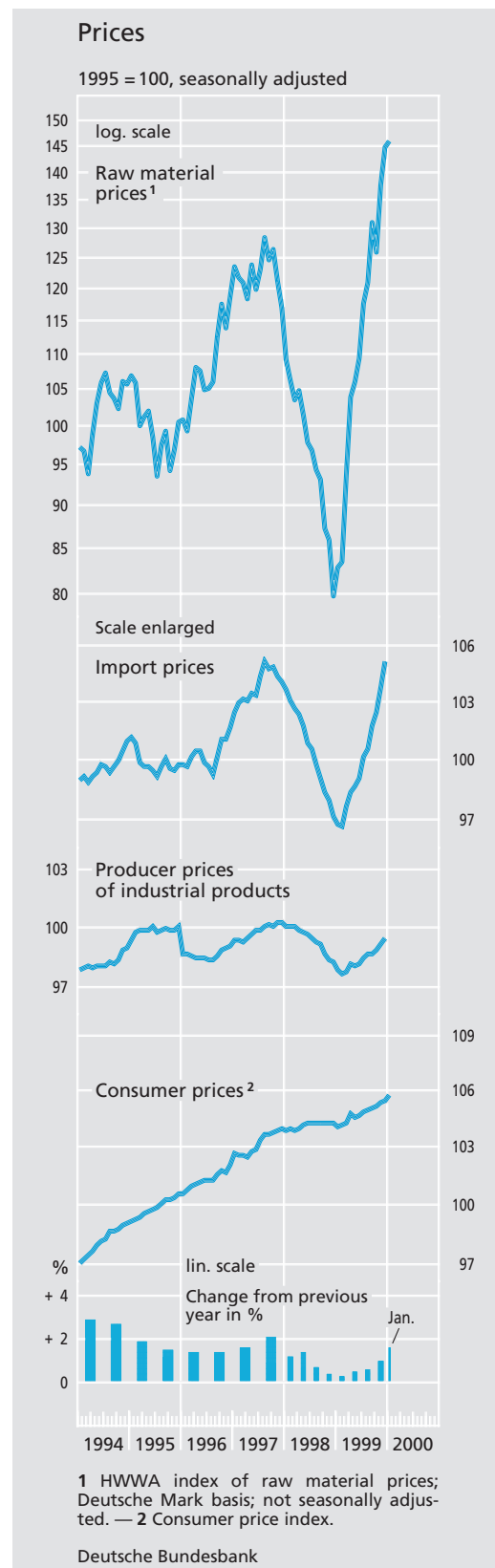
Import prices for those products likewise went up noticeably under the impact of the world markets. In the field of mining products (crude oil and non-ferrous metals), the year-on-year price increase amounted to around 85 % in December 1999, and prices for intermediate goods rose by no less than just under 10 % on the year. Although the rise in prices for imported capital, durable and non-durable goods also accelerated during the past few months (not least owing to the decline in the euro exchange rate), the annual rates of increase, at between slightly less than 1% and almost 1½ %, remained within comparatively narrow bounds up to the end of the period under review.

*Construction prices*

Domestic prices for construction work remained largely unchanged up to the end of last year. Although the aggregate construction price level – which combines individual information on residential construction, commercial and office buildings, and road construction – increased slightly in seasonally adjusted terms in the fourth quarter of 1999, the rise did not exceed the corresponding level in 1998.

*Negotiated pay rates in 1999*

The wage agreements which were concluded or came into effect in 1999 resulted in an overall year-on-year increase in monthly wages and salaries of slightly more than 2½ %. This means that, relative to the annual



## Macroeconomic requirements for a pay-rate policy fostering employment

Setting the level of wages in an economy is a complex process of weighing-up and reconciling a large number of different considerations. Mechanistic derivations of the appropriate increases in wages and salaries are scarcely possible for the individual pay agreements at the sectoral and regional level. However, from a macroeconomic perspective, it is entirely possible to develop criteria for assessing a basic employment-oriented strategy. Not only in the economic literature, but also in the broad guidelines of the economic policies of the European Community's member states, for example, which have been approved by the European heads of government, the following determinants of a pay-rate policy for promoting employment are used as a yardstick:

### 1. Nominal wage increases must be consistent with price stability

The ESCB has made it clear that price increases which are inconsistent with the stability objective will not be "financed". The monetary policy strategy is medium-term-oriented. This requires market players and, in particular, management and labour to adopt a forward-looking approach which disregards short-term volatilities and non-monetary shocks to which the price level is exposed. If, for example, there is a rise in oil prices or indirect taxes, the resultant distribution effect in favour of non-residents and the government must be accepted. Attempts to shift those burdens entirely to the corporate sector would either trigger further inflationary impulses or, owing to the decline in profits, reduce employment opportunities. The oil-price and tax-induced year-on-year rate of inflation will at all events probably amount to roughly 0.5 percentage point in 2000. However, market participants generally expect oil prices to drop significantly again in the further course of the year. Moreover, an accumulation of special factors will result in a "price bulge" in the first quarter of 2000, and this fact must be taken into account when assessing the "price component". Even if the oil price (which is currently at just under US\$ 29 per barrel of Brent oil) and the euro exchange rate remain at their present levels, the year-on-year inflation rate will go down significantly from the spring onwards. In spite of the current comparatively high rate of consumer price inflation, which was 1.6% in January, the Federal Government, in its Annual Economic Report for the year 2000, has put overall inflation at no more than 1% or 1½%.

### 2. A general gearing of the envisaged level of real wages to productivity is entirely appropriate in a situation of full employment. If there is high unemployment – as has been the case for many years –, the scope for real wage increases is, by contrast, limited.

The profitability of capacity-extending and job-creating investment must be strengthened and maintained. In practice, this means that the rise in real wages must be lower than the expected growth in productivity if employment is to rise. The margin required is not easily determined empirically. By no means can there be a distribution of that part of the statistically measured productivity gain which results from the shedding of jobs. This would only "cement" unemployment. The Council of Experts for the Assessment of Overall Economic Trends has proposed that real wage increases be geared to that rate of productivity growth at which the largest number of unemployed – i.e. including those persons with a productivity which is below current average – would be able to find new jobs.

### 3. The wage structure is to be geared to the pattern of productivity

Uniform wage increases in all sectors of the economy do not accommodate the differing skills of employees and the specific job requirements, nor do they take account of the necessary structural adjustments in the individual sectors and regions. The potential for job opportunities can be fully utilised only if there is a local "fine-tuning" of wages. Both sides of industry can play a crucial part in this by setting a framework which is as flexible as possible. This would also leave enough scope for laying greater stress again on the idea of gearing wages and salaries more to performance.

Overall, wage trends should provide a reliable basis for corporate decisions and therefore be longer-term-oriented and forward-looking. A basic strategy of this kind would make it possible not only to maintain the high degree of price stability that has been achieved but also – embedded in a non-inflationary and stable macroeconomic environment – to strengthen the foundations of economic growth on a sustained basis and enhance the job-creating efficiency of the growth process.

growth rate of consumer prices of 0.6%, negotiated real wages and salaries went up by 2%, compared with a rise of  $\frac{3}{4}$ % one year earlier. However, owing – *inter alia* – to the reduction in wages paid above the agreed scale, the increase in actual earnings was not as high. Nevertheless, labour costs increased markedly from the enterprises' perspective. Overall unit labour costs rose by  $\frac{3}{4}$ %, after having declined in the two years before. Labour's share in the national income (adjusted for shifts in the employment pattern), which is a rough measure of the functional distribution of income, was around  $72\frac{3}{4}$ % at the end of the period under review; this was just under 0.5 percentage point more than in the good period for the economy during the early nineties.<sup>1</sup> Compared with the average of the nineties, the difference in 1999 amounted to –  $\frac{3}{4}$  percentage point.

*Requirements  
for a pay-rate  
policy fostering  
employment*

An appropriate share in output growth and the demand for compensation for the decline in the purchasing power of money usually play a key role in pay bargaining. A productivity-oriented real wage policy attempts to accommodate the dual nature of wages as production costs for enterprises and demand-relevant component of households. If the imputed inflation rate remains consistent with the central bank's anti-inflation policy objective, and if the imputed rate of productivity corresponds to the general increase in labour productivity, wages are not expected to cause macroeconomic disturbances. Moreover, there is no change in the primary distribution ratio between enterprises' profits and employee's wages and salaries. However, such a strategy requires a labour market which is largely in equilibrium. If, by

contrast, there is high unemployment – as is the case in Germany – management and labour bear particular responsibility in terms of employment policy. Wage developments should promote, or at least not hamper, the creation of new jobs. Consequently, on January 9 of this year, the parties involved in the *Bündnis für Arbeit, Ausbildung und Wettbewerbsfähigkeit* (Alliance for Jobs, Training and Competitiveness) agreed in a joint declaration to recommend that employment-oriented and longer-term agreements be concluded in the forthcoming pay round.

The appropriate wage level and wage structure cannot be settled precisely in advance at the "negotiating table": instead, they have to be verified repeatedly against market performance. Nevertheless, a number of general observations can be made, which may serve as macroeconomic benchmarks (see the notes on page 38). Accordingly, a "pay-rate policy with staying power", which uses some of the real scope for income distribution for preserving or creating new competitive jobs, can play a major part in bringing relief to the labour market. When assessing the price component in wage settlements, pay settlements should take account of the fact that the relatively high annual inflation rates recorded in the first quarter of this year are due to an accumulation of special factors; later on in the year, rates of inflation are likely to fall again significantly in a year-on-year comparison.

---

<sup>1</sup> The adjustment of labour's share in the national income is confined here – as usual – to the aspect of changes in the employment ratio. There is also empirical evidence that the development of labour's share in the national income has also been influenced, over the longer term, by shifts in the sectoral distribution of employment.