

## Economic conditions in Germany

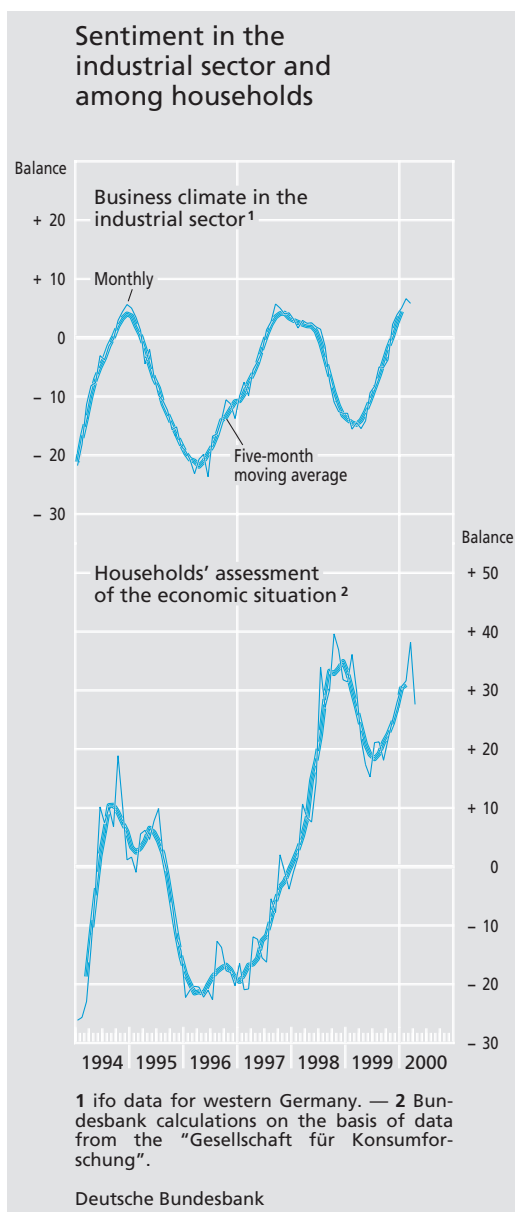
### Underlying trends

---

In a favourable international and European setting, the German economy got off to quite a good start into the year 2000. The sharp expansion of economic activity in the current period of growth, which had begun during the summer months of last year, led to a steadily increasing utilisation of overall economic capacity. The labour market, too, benefited perceptibly from this development. Another positive factor is that this year's pay round has so far resulted in settlements for the current and the coming year which are well in line with the macroeconomic requirements for a wage policy that is consistent with price stability and conducive to employment. The price climate remained largely calm, which is likewise an important requirement for a further consolidation of the upswing. Consumer price increases have slowed down considerably in recent months. Headline inflation has thus again drawn closer to the statistical core rate, which attempts to eliminate temporary price movements.

*Robust growth  
in the economy  
as a whole*

In manufacturing and some other sectors of the economy, the production process slackened temporarily at the turn of 1999-2000. This was probably due to the fact that quite a number of companies were cutting back production in the short term in view of the widespread expectations of computer problems in connection with the millennium date change and, in some cases, were extending downtimes beyond the holidays. However, when it soon became clear that the fears of serious disruptions were not being substantiated and that the date change was largely running



smoothly, thanks to extensive technical and organisational preparations, production was rapidly stepped up again. According to the Bundesbank's initial estimates, overall output on an average of the first three months of this year is likely to have increased by  $\frac{3}{4}\%$  compared with the final quarter of 1999. This signifies a year-on-year rise in real gross domestic product (GDP) of around  $2\frac{1}{4}\%$ , which was roughly just as much as in the au-

turn of last year. These figures take account of both seasonal fluctuations in economic activity and the impact of a different number of working days.<sup>1</sup> Measured on the basis of calendar months, the annual rate of growth in real GDP is estimated to amount to just under  $3\frac{1}{2}\%$ , compared with  $2\frac{1}{2}\%$  in the fourth quarter of 1999.

It was again manufacturing that generated crucial stimuli to growth. In particular, export orders continued to be very extensive. Not only did the supply of goods by German industry match well with a sharply growing world economy, it is also likely to have been assisted by a high level of price competitiveness at present. At the same time, there was a marked increase in domestic activity. Given the sharp rise in capacity utilisation, the need to step up production capacity was appearing to become increasingly acute. Although rising domestic demand was frequently satisfied by foreign suppliers, more and more German firms were being called on, too. As a result, industrial confidence has been showing an improvement right up to the present. According to the surveys of the ifo institute, positive appraisals of current business conditions predominated over the more restrained assessments at a level not attained for almost two years, while the business expectations for the next half year were assessed more favourably than at any time for five years.

*Growth again  
driven by  
industry*

<sup>1</sup> However, it is not certain to what extent special features, such as those associated this time with the leap year, can be taken into account. In addition, a comparatively mild winter, such as the one this year, has, taken by itself, output-boosting effects, which may result in a slight overstatement of the underlying economic trend.

*Positive stimuli  
in the services  
sector, retail  
trade subdued*

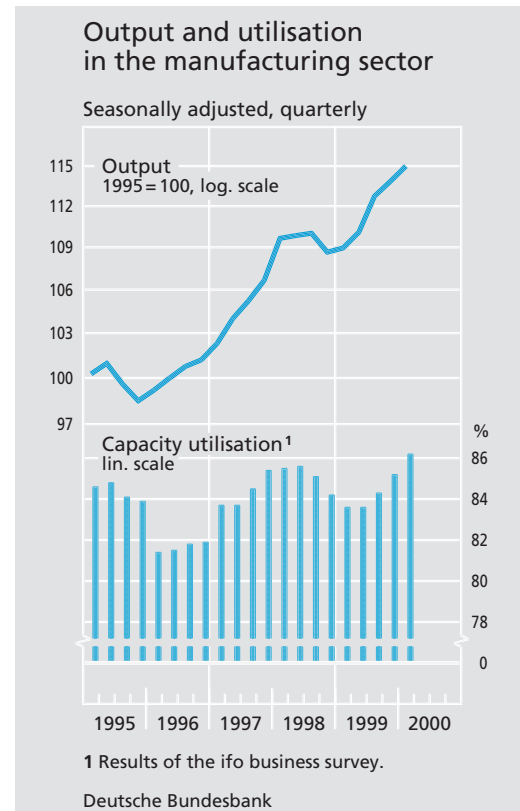
Along with the continuing revival in industry, the situation among commercial service providers also continued to improve. According to the findings of the *Zentrum für Europäische Wirtschaftsforschung (ZEW)*, current developments in the first quarter of 2000 were again assessed somewhat more favourably. Employment, in which there had been a change for the better as early as the second half of 1999, is to increase further. Furthermore, ifo data suggest that the retail trade, during the first few months of the current year, was comparatively optimistic about the future. This optimism may have been underpinned by households' favourable assessment of income expectations and the economic outlook, which were indicated by the surveys of the consumer research institute, *Gesellschaft für Konsumforschung*. Consumers' propensity to purchase, however, latterly remained well below its peak figures of early 1999. In addition, retail sales in the first few months of 2000 were perceptibly down on last autumn, according to official statistics.

*Unfavourable  
situation in the  
construction  
sector*

The assessment of the current situation in the construction industry remained largely pessimistic in early 2000. Moreover, the expansion of output in the construction sector scarcely indicates a lasting change for the better. Rather, this expansion was mainly due to the aforementioned special calendar effects and the mild winter weather. The development of orders received during the winter months does not suggest any reversal of trend in the near future either.

*Improvement  
in the labour  
market*

In spite of these developments in the construction sector, there has been an improvement in the labour market situation. Employ-

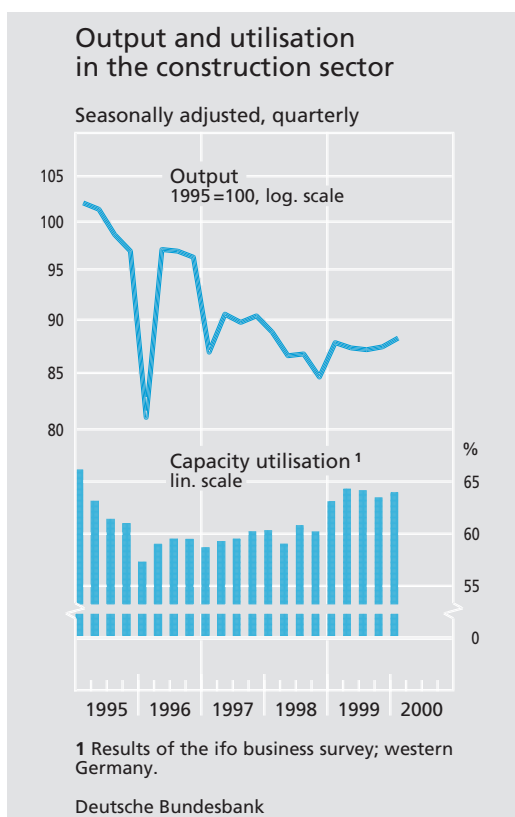


ment has shown a distinct increase since the beginning of autumn 1999, while the number of unemployed has fallen sharply. Owing to a further decrease in the supply of labour, the decline in unemployment was latterly also greater than the accompanying upturn in employment. According to data published by the Federal Labour Office, the seasonally adjusted unemployment rate fell below 10% for the first time since 1995.

## Output and labour market

Seasonally adjusted manufacturing output in the first quarter of 2000 went up again by around 1½% compared with autumn 1999, when a similarly favourable result had been achieved. The year-on-year rate of growth

*Manufacturing  
output*



thus rose to 6½%, compared with 4% in autumn 1999.<sup>2</sup> Capacity utilisation has increased perceptibly. According to the ifo surveys, fixed capacity utilisation rose by 1 percentage point in seasonally adjusted terms between December 1999 and March 2000. It thus reached its highest level since the early 1990s, when the first statistics for Germany as a whole were compiled. In western Germany alone, the medium-term average level of utilisation was exceeded by more than 4 percentage points at the end of the period under review.

The sharpest expansion in output was among producers of durable industrial goods, a development which offset the temporary slow-down observed last autumn. Output was more buoyant than before not only in the

field of consumer electronics but also in car production, which was stepped up again. In addition, producers of capital goods recorded significant rates of growth, with sales of machinery showing a sharp increase for the first time in a long while. In terms of turnover, not only foreign, but also domestic business picked up perceptibly. Manufacturers of communications equipment, by contrast, were no longer quite able to match their successes of last year, although they continued to achieve high double-digit year-on-year growth rates. In the winter months, production of intermediate goods largely remained at the level of autumn 1999, which signifies a year-on-year increase of around 6%.

Seasonally adjusted construction output on an average of the first three months of 2000 was nearly 1% up on the previous quarter. The year-on-year increase was likewise 1%, compared with 2½% in autumn 1999. However, this result should not be interpreted as an indication of a positive trend in construction, but rather as being mainly due to the favourable situation in February. Only minor delays due to weather conditions and the leap-year effect meant that seasonally adjusted output in that month was more than one-tenth higher than in the rest of the first quarter. The annual growth rate, at more than 20% in February, was likewise well above the levels of the two other months in the same quarter, which were, on average, down on the figure for 1999. Another factor may have

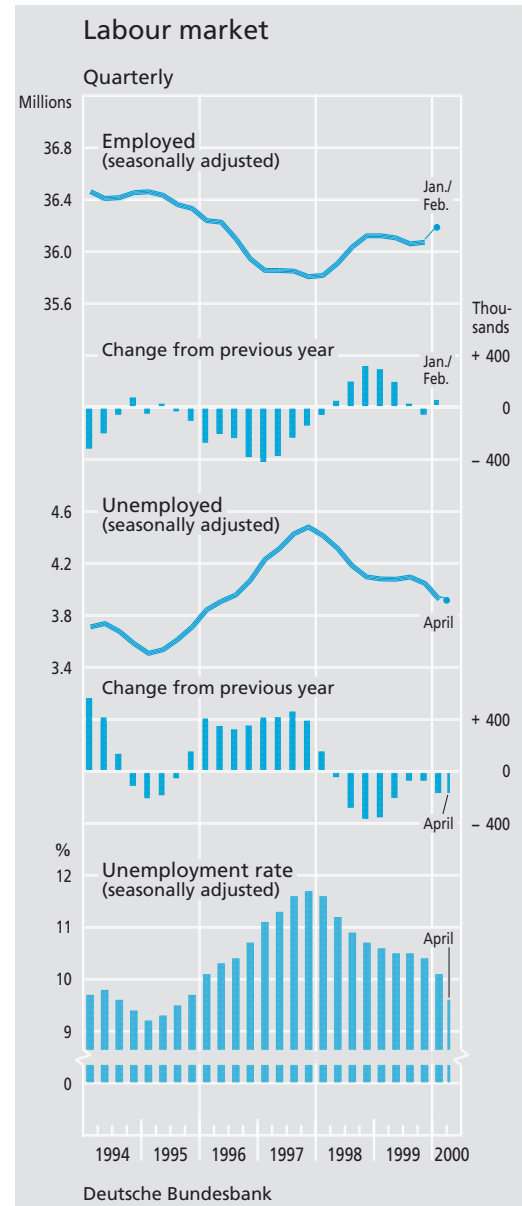
*Construction output*

<sup>2</sup> However, these figures still have to be regarded as provisional as no precise information is available for adjusting the monthly results to the quarterly survey; instead, last year's corrective factors have been used.

been the decline in the number of weather-induced redundancies as a result of the act on the revision of year-round employment in the construction industry. In addition, capacity utilisation in west German enterprises in February, according to the data of the ifo institute, was clearly higher than its comparable level in the past four years.

*Special factors  
in the labour  
market*

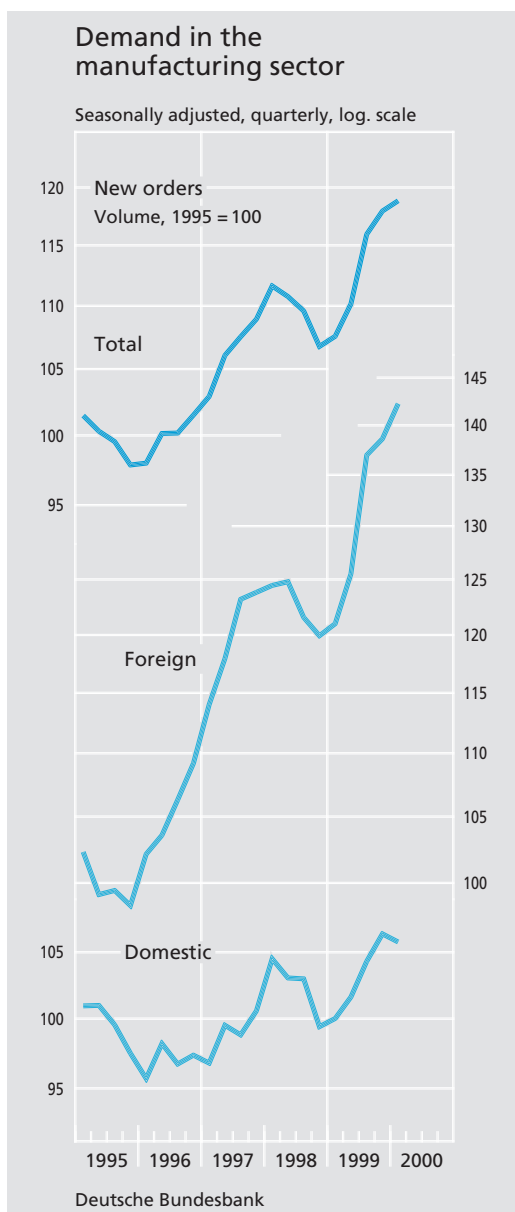
The particular combination of mild weather conditions and the revision of employment regulations for the construction sector also had an impact on unemployment in the months around the turn of the year. At least, the rise in the number of persons out of work in the construction industry between autumn 1999 and February 2000, which is usually the period in which the highest level of unemployment during the winter months is reached, was not so sharp as in previous years. Instead of an increase of 215,000 as in the winter of 1996-7, for example, the rise amounted to no more than 135,000. The number of unemployed went up to just 325,000 (starting from roughly the same level), compared with 400,000 in 1996-7. As a consequence, the subsequent reduction in winter unemployment remained within relatively narrow bounds. Much the same applies to other outdoor occupations, which, in addition to construction workers, include the groups of agriculture and forestry occupations. Although the available data in this area do not permit an analysis that goes back somewhat further, the available information indicates a comparable development. At all events, such occupations accounted for around two and a half times as many un-



employed persons in February 2000 as the immediate construction sector.

These developments are certainly among the main reasons why the number of unemployed persons fell quite sharply during the early winter months in seasonally adjusted terms, i.e. after adjustment for normal fluctuations on a multi-year average, but showed scarcely any further decline at the

*Fall in  
unemployment*



start of spring. At the end of April, the Federal Labour Office reported a seasonally adjusted 3.93 million unemployed persons, which was around 190,000 fewer than in autumn 1999.

According to the data of the Federal Labour Office, the unemployment rate at the end of April amounted to a seasonally adjusted 9.6%, compared with 10.1% in March. This

*Regional differences*

decline largely reflected a sharp statistical increase in the labour force, which is predominantly due to the inclusion of a greater number of part-time workers earning 630 DM a month or less. In western Germany the labour market clearly benefited from the economic upturn, the unemployment rate being 7.8% at the end of the period under review. In eastern Germany, by contrast, the unemployment rate was 17.3% at the end of April, which was just as much as 12 months earlier. In this context, it should also be borne in mind that there has been a cut-back in labour-market promotion, i.e. job-creation measures and vocational training. Within 12 months, the number of persons taking part in such programmes dropped, altogether, by around 150,000.

Employment in the German economy continued to rise in the first two months of the year. In February (the latest month for which estimates by the Federal Statistical Office are available at present), the number of persons in work amounted to a seasonally adjusted 36.22 million (compared with 36.15 million in the first quarter of 1999). This more than offset the redundancies recorded between winter and autumn 1999.

*Rise in employment*

## Orders

After a temporary slowdown at the turn of 1999-2000, orders received by the manufacturing sector became perceptibly more buoyant in the following months. Taking the first quarter as a whole (which is advisable in order to identify the current trend), the

*Ordering in the manufacturing sector*

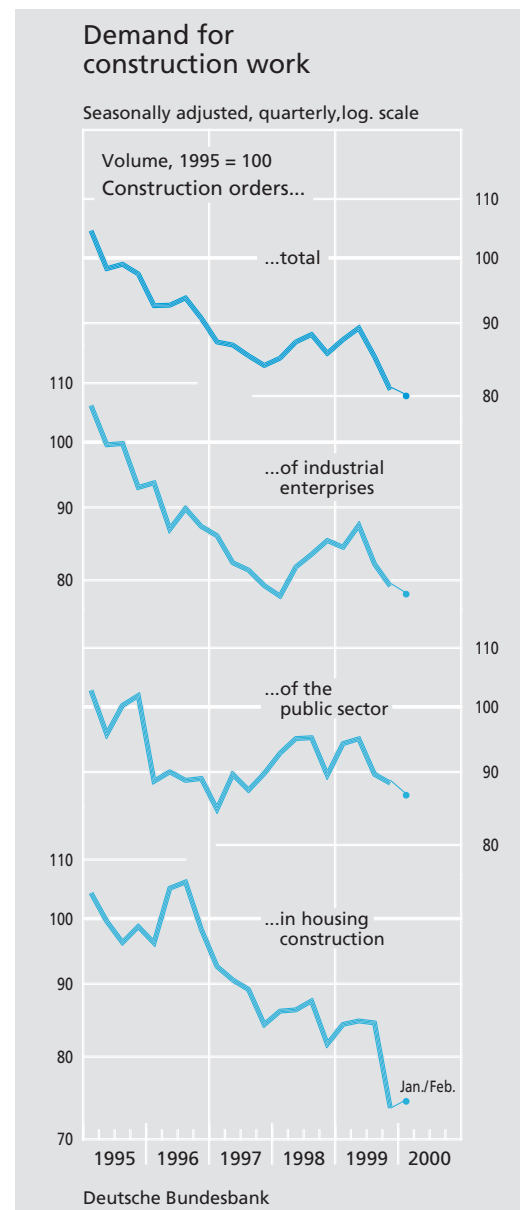
already-high level reached in autumn 1999 was again exceeded by just over 1% in seasonally adjusted terms. There was a year-on-year rise in new orders of 11%, which was somewhat more than in the fourth quarter of 1999. As reported by the ifo institute, the seasonally adjusted forward reach of orders thus matched the good level attained at the end of last year, while its assessment by enterprises showed a further improvement.

*Foreign demand*

Orders from abroad again played a crucial part in the expansion of the flow of orders. On an average of the first three months of the year, foreign orders showed a rise of 3% in seasonally adjusted terms, and were 18¼% up on the year. The rise in demand for capital goods was well above average. Demand for machinery and equipment, which had been in the doldrums somewhat for quite some time, accelerated sharply. In addition, demand for communications equipment as well as precision and optical instruments remained buoyant, outstripping both the intermediate goods sector, which had been at the forefront for much of 1999, and the durable and non-durable goods sectors.

*Domestic demand*

In the first few months of the year domestic demand, which had gone up distinctly in the autumn of 1999, was somewhat down on its previous level in seasonally adjusted terms. It was 6% up on the previous year, which was less than in the final quarter of 1999. The capital goods industry did comparatively well, with office machines and communications equipment continuing to be in the lead. In addition, demand for machinery and equipment gained somewhat in momentum, while



demand for vehicles lagged behind. In durable consumer goods, it was manufacturers of radio and television equipment, in particular, that recorded positive stimuli. Demand for intermediate goods remained high.

There continued to be no improvement in construction sector order books at the start of 2000. New orders reported by the construction sector in the two-month period of

*New orders in the construction sector*

January and February were even somewhat down on the fourth quarter of 1999, after eliminating seasonal fluctuations. The year-on-year decline, which had been as much as 6¼% last autumn, increased to more than one-tenth. Although it was public sector clients that cut back their orders most distinctly at the beginning of the year, trade and industry, too, were showing restraint in placing orders with the construction industry. Taking construction permits as a yardstick (for which, owing to revisions of the statistics, data are available only up to the end of 1999), there was little demand for office and administrative buildings or for factories and workshops. It was only in the case of shopping facilities and warehouses that the picture was slightly more favourable. Incoming orders in housing construction in January and February were not down on the final quarter of 1999 in seasonally adjusted terms, but they had already fallen to quite a low level even then. This applies particularly to the new Länder, where the volume of orders, after having fallen almost continuously, has now nearly halved since 1995. At the same time, the number of vacant dwellings has risen. In western Germany the situation is far less unfavourable, although the number of construction permits granted for dwellings declined last year even there.

## Prices and wages

*Slowdown in consumer price increases*

Price rises in Germany slowed down again markedly in April for the first time in some while. Year-on-year, consumer price inflation dropped to 1.5%. In March it had reached its

## Price trend indicators for Germany

Change from previous year in %

Item	1999		2000	
	3rd qtr	4th qtr	1st qtr	April
<b>Headline rate of inflation</b>				
Consumer prices	0.7	1.0	1.7	1.5
<b>Statistical core rates 1</b>				
Consumer prices excluding seasonal food and energy	0.1	0.2	0.7	0.9
Consumer prices with modified weights 2	0.5	0.5	0.8	0.8
5% trimmed mean	0.6	0.6	0.8	0.8
Weighted median 4	0.9	0.7	1.0	0.9

1 Bundesbank calculations. — 2 Reduction of the weights of volatile components. — 3 5% exclusion of components showing a high/low degree of volatility. — 4 Price change for the component at which the cumulative individual weights reach 50%.

Deutsche Bundesbank

highest level since the end of 1997, at 1.9%. Measured by the Harmonised Index of Consumer Prices (HICP), which shows some special features not found in the national index (see explanatory notes on page 39), a quite similar pattern is revealed.

The current rate of inflation has thus again become noticeably closer to the figures for indicators of what is known as core inflation, which is intended to show the somewhat longer-term price trend not marked by special influences. Although the calculation of such core rates is somewhat ambiguous and different approaches lead to different results,<sup>3</sup> core

*Core inflation*

<sup>3</sup> See Deutsche Bundesbank, Core inflation rates as a tool of price analysis, Monthly Report, April 2000, pages 45–58.



inflation is, at present, likely to correspond to a year-on-year rate of just under 1%.

*Energy*

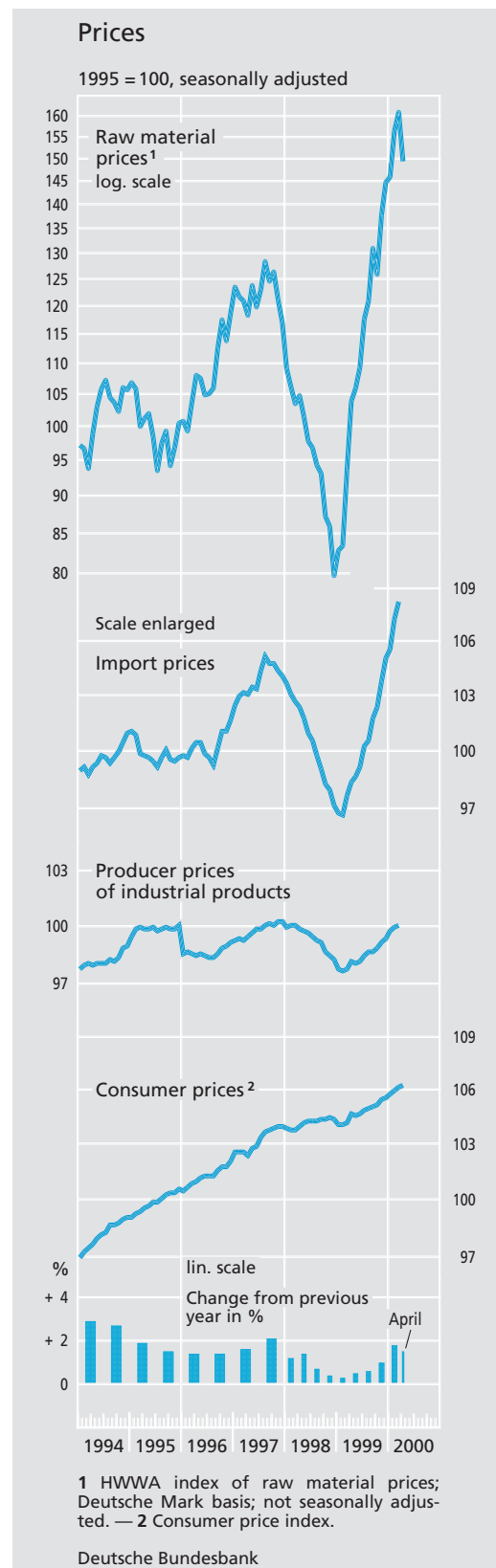
Energy price movements were the main reason for the slowdown in the upward movement of prices. Firstly, the baseline effect resulting from last year's raising of energy taxes was making itself felt. Secondly, heating oil and petrol prices were lower because of falling oil prices on the international markets in April. All in all, the consumer prices for energy were around 1½% down on the previous month; the year-on-year rise fell from 18% in March to roughly 9¼% in April.

*Services*

By contrast, the year-on-year rate of price increase in the service sector rose appreciably to 2¼%. This was mainly due to the fact that price reductions for package tours, which are typical of April, were only minor in scale owing to the late Easter holidays. Since many other services did not record any particular price movements, however, service prices are likely to slow down again in the near future.

*Housing rents*

Housing rents were continuing to rise of late (by just over 1¼% year-on-year). In particular, comparatively small increases in rents for apartments in new buildings – for which higher rents were probably agreed when the tenants first moved in – contrasted with sharper rises in rents for apartments in older buildings built before 1948. In addition, there were higher-than-average rises in incidental costs, which include not only charges for fresh water and sewerage, and for refuse disposal, but also tax on land and buildings.



*Food*

Food prices have had a clearly moderating effect on prices up to present. Overall, food prices in April were roughly 1½ % down on their April 1999 level. The reductions were most evident in fruit and vegetable prices, although meat and meat products as well as sugar and jam were also cheaper than in 1999.

*Industrial products*

Consumer prices for industrial products were scarcely up on the previous year, being just 0.2 % higher in April than their 1999 level. Whereas books and newspapers as well as tobacco were more expensive than one year before, household appliances, and radio, television and computer equipment continued to be distinctly cheaper at the end of the period under review than in 1999.

*Industrial producer prices*

Selling prices for durable and non-durable industrial goods were increased only slightly during the past 12 months. On aggregate, they went up by no more than 0.1 % between March 1999 and March 2000. At a year-on-year rate of 0.4 %, price movements in capital goods were not much greater. The fact that overall industrial producer prices were 2.4 % up on the year in March had much to do with the preceding sharp surge in oil prices making itself felt in the intermediate goods sector.

*Import prices*

With regard to import prices, the slowdown in oil price increases has at least meant that, for the first time in 15 months, there was no further rise in the year-on-year rate of change in March. In February and March it amounted to just under 11 %. This moderation would have been even more pronounced if the euro

had not depreciated further against the US dollar, in particular.

By mid-April, international oil prices had fallen distinctly from their peak level in early March, when Brent North Sea Oil cost US\$ 32¼ per barrel. For a short period of time, quotations had even fallen to slightly below US\$ 21. However, they had recovered to approximately US\$ 29½ by the time this report went to press. The persistent fluctuations largely reflect market uncertainties about the OPEC countries' production strategy; on the one hand, the OPEC countries have committed themselves to stepping up production, but, on the other, they do not want prices to fall again as dramatically as in 1999. At the same time, demand is rising in the wake of the international economic recovery. So far, the spot market quotations for petrol and heating oil on the Rotterdam market, which is of major importance for Europe, have followed the movements in crude oil prices only to some extent.

The agreements that have been concluded so far in this year's pay round were lower than last year. This means that management and labour have, on balance, returned to the basic strategy of moderate pay raises which they had pursued in previous years. This not only represents a major contribution to maintaining the favourable price climate, but will also lead to an improvement in employment. Unit labour costs are likely to decrease perceptibly overall in 2000. This will form a clear counterweight to the upward movement in import prices for raw materials and energy. The total cost burden on enterprises is unlike-

*Oil prices*

*2000 pay round*

## Harmonised Indices of Consumer Prices

Price developments in the euro area and in the European Union as a whole are measured by the Harmonised Index of Consumer Prices (HICP). This index, which is compiled by the Statistical Office of the European Communities, was first published for January 1997. It is based on the harmonised indices of the 11 (15) Member States of the euro area (European Union).

In compiling consumer prices for the various regions, the national statistical offices use a standardised methodological framework. Firstly, this framework relates to the selection of the goods and services that are included, i. e. the composition of the basket of goods. The classification is very similar to the Classification of Individual Consumption by Purpose (COICOP). Secondly, there are commonly agreed methodological rules and standards. In particular, these concern the extent to which quality changes in the analysed goods and services are taken into account, the aggregation of the measured individual prices to form an overall index, and the methods applied in cases where prices temporarily cannot be measured, for example, owing to works holidays. Furthermore, there are standards for the statistical procedures to be followed if products are taken off the market or new products are launched.

Finally, it was decided that special regional features concerning households' consumer habits have to be maintained. The indices are adjusted to changes in consumer habits once a year, which, technically speaking, results in a chain index. The weights of the individual goods and services prices in the overall national indices are not standardised across the European Union or the euro area. The national price indices are summarised to form a euro area or EU-wide index, with the weight of each national index depending on the respective share in consumption.

### National and harmonised price indices for Germany

Change from previous year in %

Period	National price index <sup>1</sup>	Harmonised price index <sup>2</sup>
1996	1.4	1.2
1997	1.9	1.5
1998	1.0	0.6
1999	0.6	0.7
1st qtr 2000	1.7	2.0

<sup>1</sup> Consumer price index. — <sup>2</sup> Harmonised Index of Consumer Prices (HICP).

Since, in the first few months after the introduction of the HICP, it was not possible to fulfil all the requirements for all goods, the degree of coverage was initially limited. In the case of Germany, 85 % of the goods and services contained in the national consumer price index were taken into account. Since then, the coverage has been progressively broadened; it amounted to nearly 90 % at the end of 1999, when further major health services were included. However, the adequate inclusion of owner-occupied dwellings is still an open question.

As a result of the broadening of the coverage, the differences between the HICP and national data on prices have diminished. Whereas HICP inflation in Germany in 1997 as an annual average, for example, at 1.5 %, was still nearly  $\frac{1}{2}$  percentage point lower than the rate of inflation measured in terms of the national price index, the difference amounted to no more than 0.1 percentage point in 1999.

ly to deteriorate on balance, which also means that investment conditions have become more favourable. In addition, the fact that the negotiated pay rates were appropriate to the situation of the economy as a whole may likewise owe something to the fact that both sides of industry were endeavouring to ensure that the January 9, 2000 declaration by the *Bündnis für Arbeit, Ausbildung und Wettbewerbsfähigkeit* (Alliance for Jobs, Training and Competitiveness) on a longer-term pay-rate policy fostering employment is implemented in specific agreements. This is also reflected in the longer duration of the wage settlements, which provides enterprises with more certainty of planning. It is doubtful, however, whether the extended provisions on age-related part-time work will really help to solve the current labour market problems. In the longer term, this is expected to lead to certain additional costs for enterprises, although it is hardly possible to quantify them at this juncture. From a macroeconomic point of view, the reduction in working hours for older persons is merely a redistributive measure in favour of those who are younger, rather than a contribution to increasing overall employment. This instrument has to be handled flexibly in order to prevent the resultant shortening of the working life reducing potentials for growth.

*Agreement in  
the chemical  
industry*

The standard for the 2000 pay round was set by the wage agreement in the west German chemical industry. This agreement has a duration of 21 months and provides for a two-stage increase in negotiated pay rates by 2.2 % from June 1, 2000 and by 2.0 % from June 1, 2001. Enterprises will incur additional

costs due to the improvements in the provisions on age-induced part-time work, particularly the lump-sum severance payments which are to compensate for pension deductions at the end of age-induced part-time work. Including the costs for additional old-age pensions, which were also agreed and which are to provide young staff, in particular, with a capital-backed supplementary pension, the volume of the agreement probably amounts to just under 3 %, expressed on a 12-month basis. In addition, the chemical industry introduced a liberalisation clause aimed at ensuring employment and improving competitiveness. It permits the adjustment of negotiated pay rates in the chemical industry to the level of competing agreements and the conclusion of company-specific agreements. A further adjustment of wages and salaries in line with the basic remuneration in western Germany was agreed for east German employees. On July 1, 2000 and July 1, 2001, negotiated wages and salaries will be raised by 2.8 % in each case. In addition, benefits under the German Personal Asset Acquisition Act will be paid to the amount of DM 312 as from January 2001. The wage agreement has a duration of 22 months.

In the metal-working and electrical engineering industry, management and labour reached a two-year agreement, which provides for a 3.0 % increase in negotiated pay rates from May 1, 2000 and another 2.1 % increase from May 1, 2001 for east and west German employees. Including the lump-sum payments for March and April 2000, the volume of the "wage component" amounts to

*Metal-working  
and electrical  
engineering  
industry*

an annualised 2¾ %. As had been the case in the chemical industry, this component is supplemented by additional cost components arising from the future extension of the provisions on age-induced part-time work and the progressive introduction of benefits under the German Personal Asset Acquisition Act in east Germany as from May 2001.

*Construction  
industry*

The west German construction industry also concluded a wage agreement with an agreed duration of two years. Although this year's 2.0 % and next year's 1.6 % rise in negotiated pay rates lag behind other sectors of industry, they are still relatively high considering the persistently difficult overall situation in the construction sector. Following the example of the chemical industry, a capital-backed additional pension will be introduced on a volun-

tary basis as from the year 2001, which will be funded by increasing and transforming the former benefits under the German Personal Asset Acquisition Act. The statutory minimum standards will apply to the new provisions on age-induced part-time work for construction workers, which has been introduced recently. Management and labour additionally agreed to increase the statutory minimum wage in the construction industry at the same rate as wages and salaries from September 1, 2000. For the construction industry in eastern Germany the mediator's suggestion is to freeze negotiated pay rates in 2000 and to raise them by 1.4 % from April 1, 2001. In terms of the minimum wage, the proposal provides for the same adjustment rates as those in the construction industry in western Germany.