

## Economic conditions in Germany

### Underlying trends

---

In terms of the underlying trend, in the first few months of this year the German economy remained on the flat expansionary course on which it had embarked in the second half of 2000. Although the economic climate has become markedly cooler, overall economic output has held up comparatively well, not least owing to work being performed to fill the large volume of orders on hand. According to an initial Bundesbank estimate, real gross domestic product (GDP) in the first quarter as a whole, may have been around ½% up on autumn last year after eliminating seasonal and working-day variations. Compared with the first three months of 2000, this signifies a growth rate of 2%, compared with slightly more than 2½% before. On calendar-month terms the increase was 1½%. Overall capacity utilisation is thus likely to have remained largely unchanged.

*Subdued  
economic  
growth*

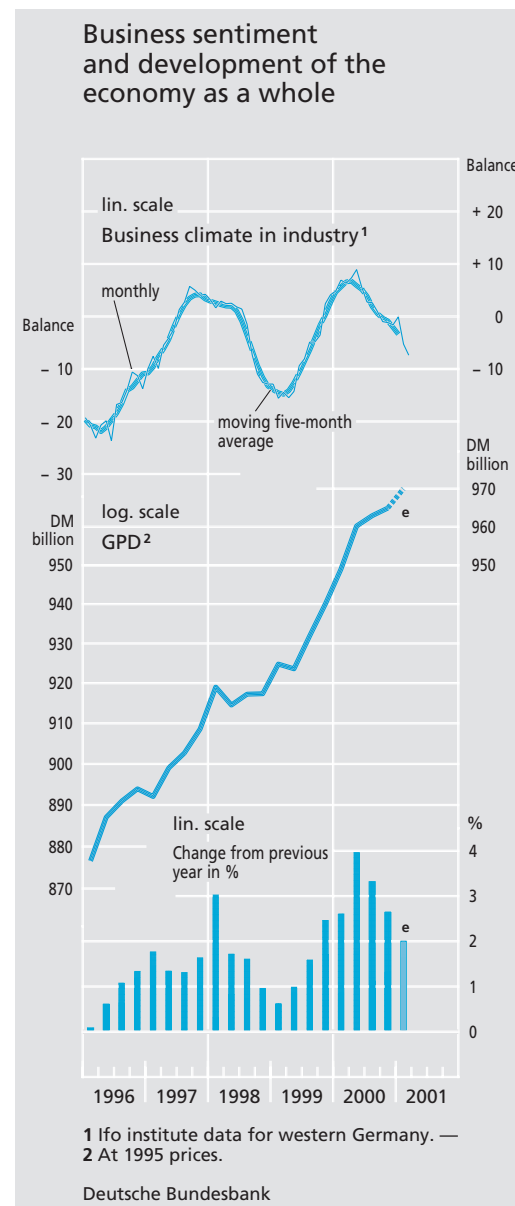
In the first few months of the year, manufacturing was, once again, a mainstay of output. Whereas industrial activity – despite buoyant demand – had remained essentially unchanged towards the end of last year, in the ensuing period more work was started on the existing increased level of orders on hand. According to ifo institute data, the manufacturing sector reported that capacity utilisation, despite a slight decline, remained higher than the average in March. Commercial service providers probably benefited only in part from this. Although they are likely to have further expanded their business, growth (as also reported by the Centre for European Economic Research) remained limited. The

*Sharp increase  
in manufactur-  
ing output*

situation with regard to financial service providers, which had previously experienced very dynamic growth, has now become much less buoyant. In the construction sector, pressure to adjust remained quite heavy at the start of 2001 as well.

*Depressed  
business  
sentiment*

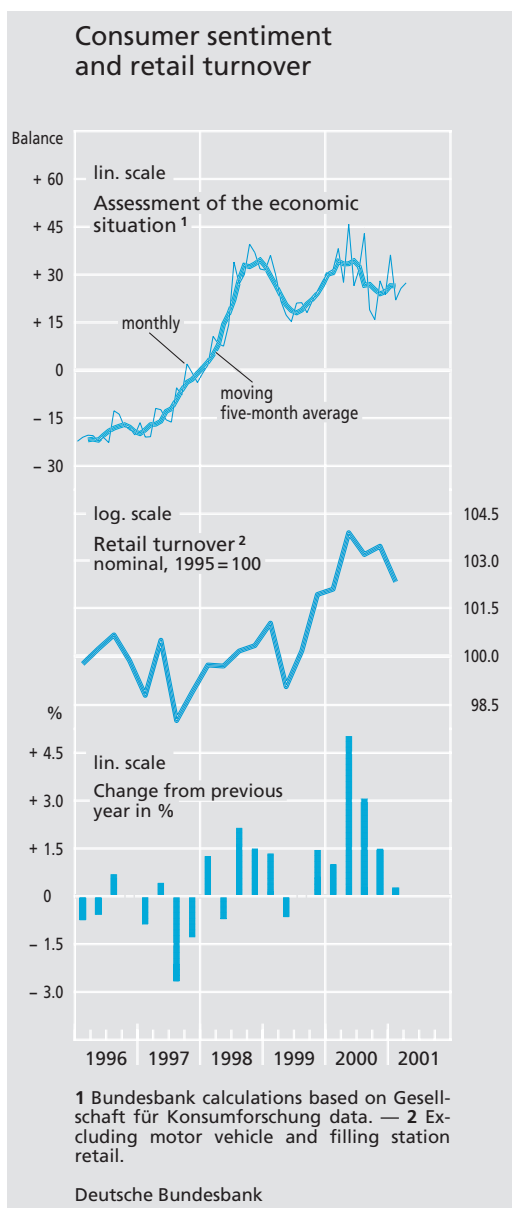
Despite the fact that overall economic output was still quite considerable, general business sentiment in the commercial sector was predominantly subdued in the winter months, too. Apart from a brief improvement at the start of the year, the business climate indicator surveyed by the ifo institute showed a further downward movement, continuing the trend which had been prevailing since summer 2000. In March (more recent data are unavailable at present), the balance of positive and negative business assessment attained a level that roughly matched the longer-term average, thus reflecting a more or less "neutral" position between optimism and pessimism. The gloomier outlook for earnings is likely to have been the main reason why the surveyed firms were no longer so optimistic. Firstly, price expectations have been very depressed for some time. Secondly, there are also probably fewer prospects – at least in the short term – of achieving adequate profits by stepping up sales. In particular, foreign business – which had been much more buoyant than domestic demand – has lost momentum with the calming of the international environment. On the cost side, expenditure on personnel has remained moderate, however, and there have at least been initial signs of an easing in terms of imported intermediate goods. The terms of financing, especially in the longer-term range, may still be described as



largely favourable, although the capital markets are yielding fewer resources in the wake of dramatic share price adjustments.

Domestic demand in the first few months of the year did not adequately offset the decline in foreign business. According to the surveys of the consumer research institution, *Gesellschaft für Konsumforschung*, households' assessment of the general economic

*Weak  
consumer  
demand from  
households*



situation has definitely stabilised, however. Not least, the outlook for incomes was rated as being somewhat more favourable – something which is undoubtedly due in part to the lowering of tax. Households continued to be affected by considerable strains induced by oil prices, however: in many cases, there are likely to have been additional payments for heating and hot water on annual bills. Monthly instalment payments, moreover,

have been adjusted upwards. Besides this, petrol prices (which had to sustain a further rise in ecological tax at the start of the year) remained at a high level. The real scope of income available for retail purchases was significantly reduced as a result. Seasonally adjusted, turnover in this sector in the period of January to March was noticeably down on the level in autumn 2000 and was barely up on the same period last year. After eliminating price movements, there was, in fact, a clear fall.

### Output and labour market

As mentioned above, manufacturing output became perceptibly more buoyant in the first few months of 2001. According to the available Federal Statistical Office data (which are, however, still provisional and likely to be adjusted later in the year), seasonally adjusted output in the first quarter was 2½% higher than the level in autumn last year. However, this rise overstates the pace of economic growth in manufacturing insofar as there had been a temporary slowdown towards the end of 2000. Given a flow of orders that initially remained buoyant, the comparatively small number of working days in December and the increased number of short holidays taken during that period may have been a factor. In March, the effects of catching up on filling those orders petered out and seasonally adjusted output declined significantly. Even though, at around 7%, the year-on-year increase in output in the first quarter of 2001 was no longer as sharp as in the second half

*Sharp expansion in manufacturing output*

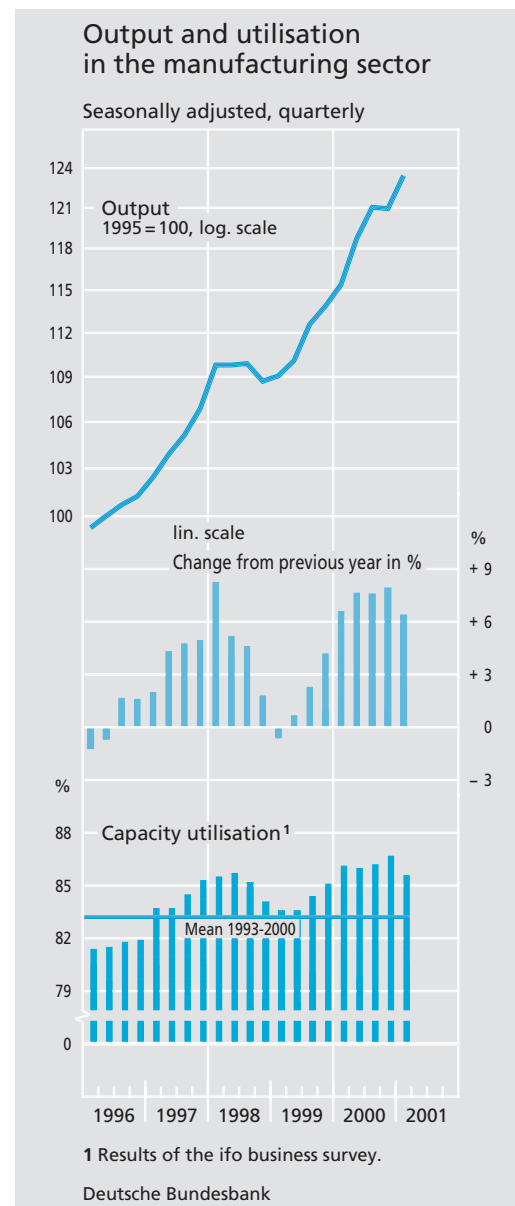
of 2000, the level of manufacturing production remains very high.

*Above-average  
rise in exports*

In terms of turnover, there was again an above-average expansion in output for export purposes in the first few months of the current year. Taking the lead in this development were the capital goods sector, in particular, along with producers of durable and non-durable consumer goods. Now that the boom in telecommunications equipment and IT hardware appears to have abated somewhat, car production and the manufacture of other transport equipment (which includes ships and boats, aircraft and rolling stock) have recently come to the fore. There has likewise been a significant rise in production for the domestic market. In addition to capital goods, a sharp surge in turnover was also identifiable in the basic goods sector.

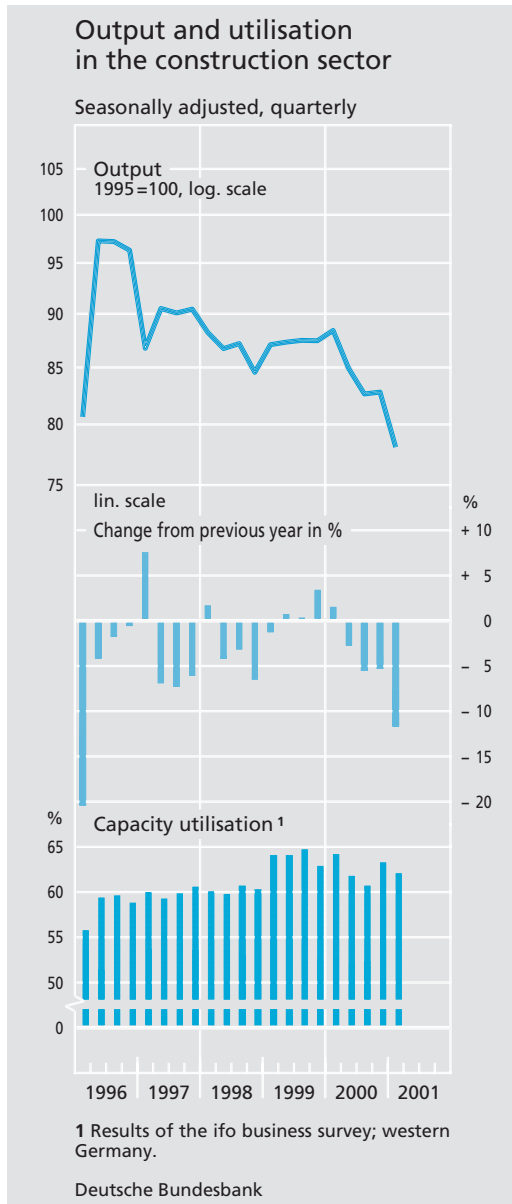
*Weak construction  
activity*

Construction activity in the first few months of the year was affected by changing weather conditions. While the cold snap in January led to marked hold-ups, the comparatively mild temperatures in February meant that it was possible to make up for some of the delays. Nevertheless, including March, seasonally adjusted construction output was significantly down on its level in autumn 2000. The year-on-year fall, which, at 3½%, had been comparatively slight in the fourth quarter of 2000, became larger again, reaching almost one-seventh. This clearly reveals that the situation in the construction industry remains unfavourable and that the process of adjustment affecting eastern Germany, in particular, has not yet been brought to an end.



Residential construction was hit particularly hard by the further deterioration in the situation. New construction had already been cut back dramatically last year, as it had been many times before. No more than just under 425,000 dwellings were completed – around one-tenth, or 50,000 fewer, than in 1999. Compared with the peak of more than 600,000 in the mid-nineties, the decline amounts to 30%. There was a well above-

*Fewer  
dwellings  
completed*



average fall in the number of completed units in rented housing construction (buildings with three or more apartments). This was especially the case in eastern Germany: at somewhat more than 20,000 apartments in 2000, the number was no more than one-fifth of the figure for 1997. The growing number of vacant properties, which are estimated to amount to more than 10% of the total stock of dwellings and to account for al-

most one-third of older apartments in inner-city areas, means there is very little incentive to build additional dwellings in eastern Germany at present. Similarly, less work was started on buildings with one or two dwellings, which are likely to be mainly owner-occupied single-family houses. Following several years of sharp growth, there was a slight fall in 2000 in the number of single-family houses that were completed in western Germany as well. At over 180,000 dwelling units, the number nevertheless remained very high.

There has been no further improvement since the start of 2001 in the situation on the labour market. In addition to the, at times, unfavourable effects of the weather, the economic slowdown is also likely to have had an increasing impact. According to the estimates of the Federal Statistical Office, the increase in employment (which had been very sharp throughout 2000) came to a standstill in January. In February, the seasonally adjusted number of persons in work amounted to 38.73 million, which was still 365,000 persons, or 1%, more than 12 months previously. In the fourth quarter of 2000, however, the increase had amounted to almost 1½%. The services sector is increasingly unlikely to have offset the continuing shedding of labour in the construction sector, particularly as studies by the Centre for European Economic Research reveal that the dynamic growth in the commercial service providers sector has waned. Hiring and employment of personnel may also have become more cautious in the retail trade as well as in the hotel, restaurant and catering industries. At the turn of 2000-01 the number of vacancies notified to

*No further employment growth*

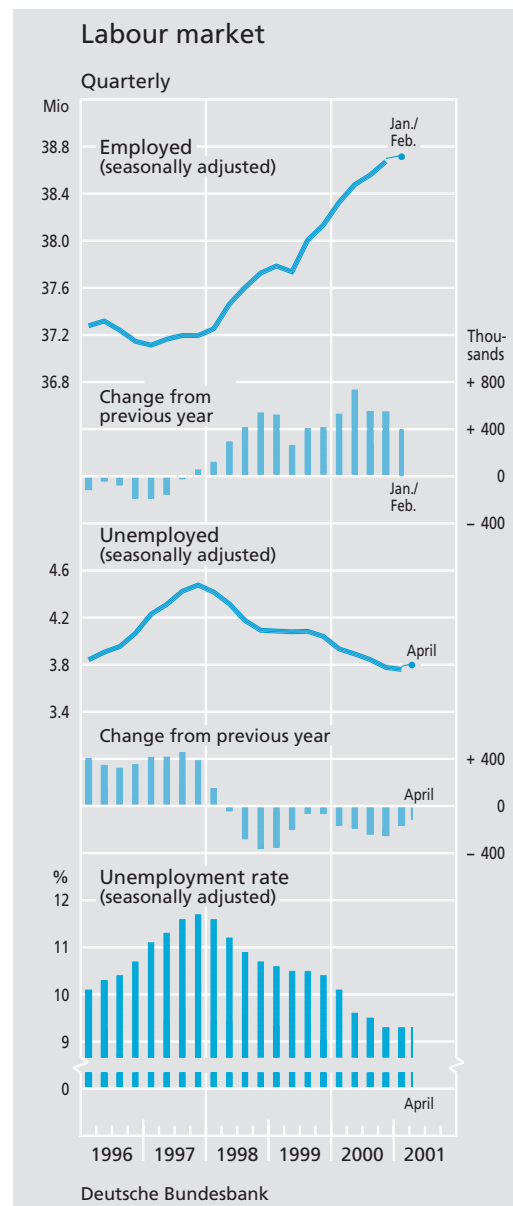
the labour exchanges appears to have passed its peak.

*Slight rise in unemployment*

There was a continuous slight increase in unemployment during the winter months. According to the figures of the Federal Labour Office, the seasonally adjusted number of persons registered as unemployed was 3.81 million at the end of April. Compared with the low in December 2000, to which the mild weather made a positive contribution, this was an increase of around 40,000 persons. Even though this still signifies a year-on-year fall of roughly 120,000 in the number of jobless, the corresponding figure for the fourth quarter of 2000, for example, was more than twice as large, at 260,000. At 7.7 % in April, the seasonally adjusted EU-standardised unemployment rate was at a level which had remained virtually unchanged since late summer 2000.

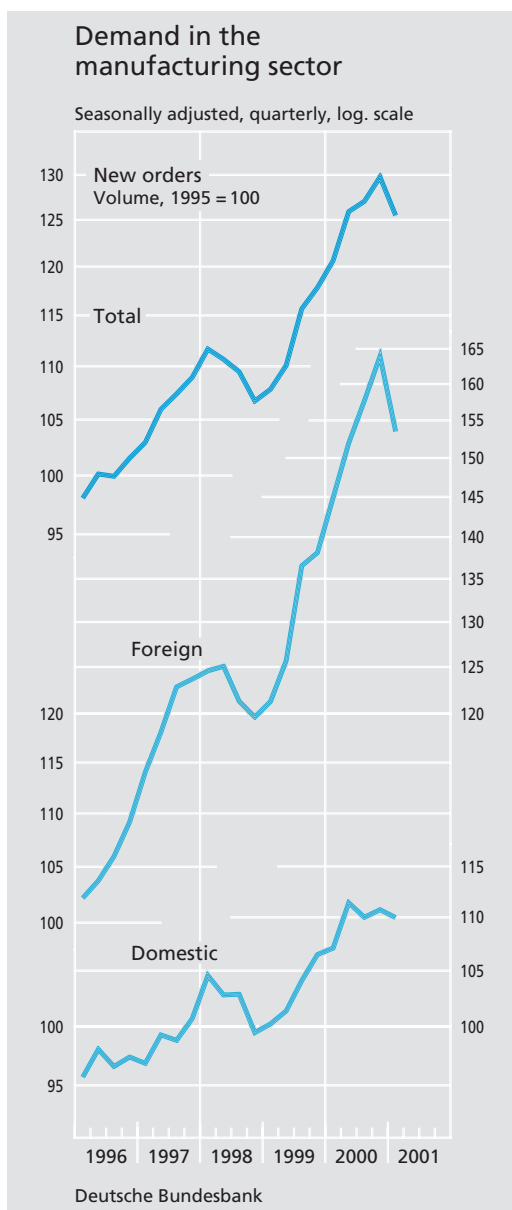
*High level of unemployment among older members of the workforce*

According to data on movement and structural analysis on the labour market which was recently published by the Institute for Employment Research, older members of the workforce were affected by unemployment far more than average in 2000 as well. For instance, the unemployment rate among persons aged over 55 was almost twice as high as on the average of all jobless persons. At over 20 months, the period of unemployment for persons of that age was almost two-and-a-half times longer than on average. They thus form a significant hard core of unemployment, which may largely be regarded as structural.



The economic slowdown had an impact on the labour market which was all the more severe as a result of a more reserved deployment of labour market policy measures continuing at the start of 2001. In the first quarter, the number of persons taking part in vocational training courses was still somewhat higher than 12 months before. There was also an increase in the number of grants for assisting people into jobs and in assistance

*Reduced deployment of labour market policy measures*



measures provided by the Federal Labour Office in addition to the regulated programmes. However, this only partly offset the marked cutback in job creation schemes and structural adjustment programmes. On balance, there was a further decline in the number of persons receiving assistance, even though the fall was not as sharp as it had been in 2000.

## Orders

The demand for industrial products subsided noticeably at the start of 2001. Seasonally adjusted orders received by the manufacturing sector in the first quarter were 2¾% down on the autumn months of 2000, when – not least owing to a number of large-scale orders – they had been at a very high level. The year-on-year increase was also smaller than before. Whereas the rise had been just under 10% in the third quarter and slightly more than 10% in the fourth quarter, the figure was now 4½%. Taken in isolation, this indicates that there continues to be a considerable flow of orders. The pace of growth, however, has changed perceptibly.

*Falling demand for industrial products ...*

Foreign orders, in particular, were no longer on the same scale as before. On an average of the first quarter, they were 5¾% down on the high level at the end of last year. The increase over 12 months fell from almost one-fifth in the fourth quarter of 2000 to 6%. The downturn in world trade accompanying the cooling of the US economy is likely to have played a part in this, added to which was the slower pace of growth in Europe. Goods especially associated with the “New Economy”, such as office equipment, IT hardware and telecommunications systems were far less in demand internationally. By contrast, ordering of German cars was buoyant up to the end of the period under review. Enterprises’ price competitiveness remained high given the predominantly weak quotations of the euro on the foreign exchange markets. In some cases, in fact, enterprises were able to push through foreign-currency

*... especially from abroad*

price increases for their own range of products.

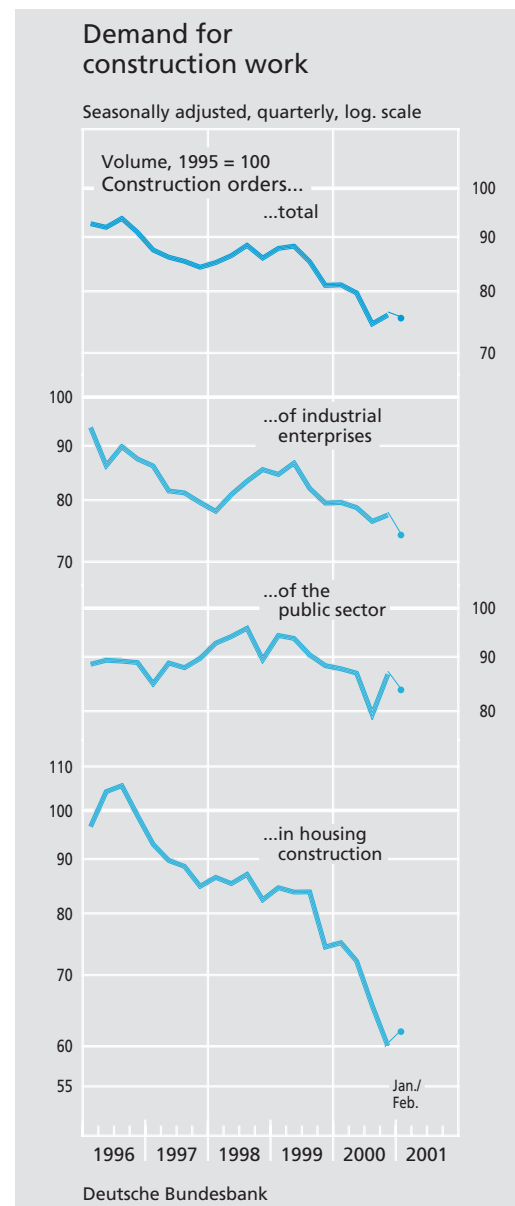
*Development not offset by domestic orders*

Incoming domestic orders did not offset the decline the export demand although, in seasonally adjusted terms, they did manage to almost maintain the autumn level in the first quarter. The year-on-year increase was 3%, compared with 4% in the final quarter of 2000. While orders for both intermediate and consumer goods declined only slightly, the capital goods sector suffered sharp losses – not least in the IT sector.

*Further decline in demand for construction work*

Demand for construction work did not point to a turn for the better in the first few months of 2001 either. On the contrary, orders received by the construction sector in January and February showed a further sharp decline in seasonally adjusted terms. Not only were they below the somewhat increased level of the fourth quarter, they were also down on the low level of summer 2000. At 8%, they declined more sharply on the year than in autumn ( $-6\frac{3}{4}\%$ ).

While the reduction in orders placed by public sector contractors may be regarded as a return to normal following a surge in orders at the end of last year, the renewed decline in demand for industrial and commercial construction interrupted the hopes of a steady cyclical upturn in this sector which had emerged along with the positive developments at the end of last year. In residential construction, the order books in January and February showed a slight improvement on autumn, which had been very unfavourable. Seasonally adjusted, new orders went up



somewhat and the year-on-year shortfall had been reduced from  $-19\frac{1}{2}\%$  in the fourth quarter of 2000 to  $-16\frac{1}{2}\%$  at the end of the period under review. This should not be overrated as a positive sign, however. The fall in the number of construction permits for dwellings last year, at one-fifth, was sharper than at any time since German reunification. Moreover, in regional terms, the situation in western Germany was scarcely any different



## Consumer price index

Changes from previous year in %

Item	2000		2001	
	3rd qtr	4th qtr	1rd qtr	March/ April
Energy sources	14.2	15.8	11.2	11.4
of which Mineral oil prod- ucts	24.2	19.3	5.2	6.4
Food	0.2	1.1	2.7	4.4
of which Seasonal products	1.3	2.5	2.9	6.1
Meat and fish products	0.6	1.5	4.6	6.9
Manufactured goods	0.3	0.4	0.5	0.7
Services	1.5	1.5	3.0	2.8
of which Radio and TV licence fee, motor vehicle tax	0.6	0.1	20.0	20.0
Rents	1.4	1.3	1.2	1.2
Total	2.0	2.4	2.5	2.7

Deutsche Bundesbank

from that in eastern Germany. There were only minor differences in demand between owner-occupied housing and rented housing construction as well.

### Prices

*Deterioration  
in the price  
climate*

The price climate in Germany, which had shown a temporary improvement towards the end of 2000, worsened again perceptibly during the first few months of this year. Measured by the year-on-year rate of increase in the consumer price index, inflation went up to 2.9% by April, having been 2.2% in December. Among the contributory factors, developments in energy prices are the most prominent. Prices for crude oil on the international markets went up again in

April, for example. At US\$ 27½ for a barrel of Brent North Sea Oil at the end of the month, the price reached a level that had last been recorded in the second half of February. The upward movement in prices was much sharper on the spot markets for petrol, where the quoted prices were hardly lower than their peak of mid-2000. Prices were driven up, in particular, by heavy demand from the United States, where supply shortages were feared owing to scarce refinery capacities. By contrast, there was no more than a comparatively slight increase in heating oil prices, as the heating period had ended. Following the international product markets, petrol prices went up to a new record high at German filling stations. In line with the past rise in mineral oil prices, there was also a further increase in gas prices and tenants' payments for heating and hot water. According to the official statistics, consumer prices for energy in April were more than 10% higher than in the same month last year. Food was another factor contributing to higher prices. Firstly, the lengthy spell of wet and cold weather had an adverse impact on prices for seasonal food products. Secondly, BSE and foot and mouth disease had the effect of driving up prices for both meat products from non-affected sources and for the substitution products of fish and cheese. In total, households paid 5% more for food in April than one year before.

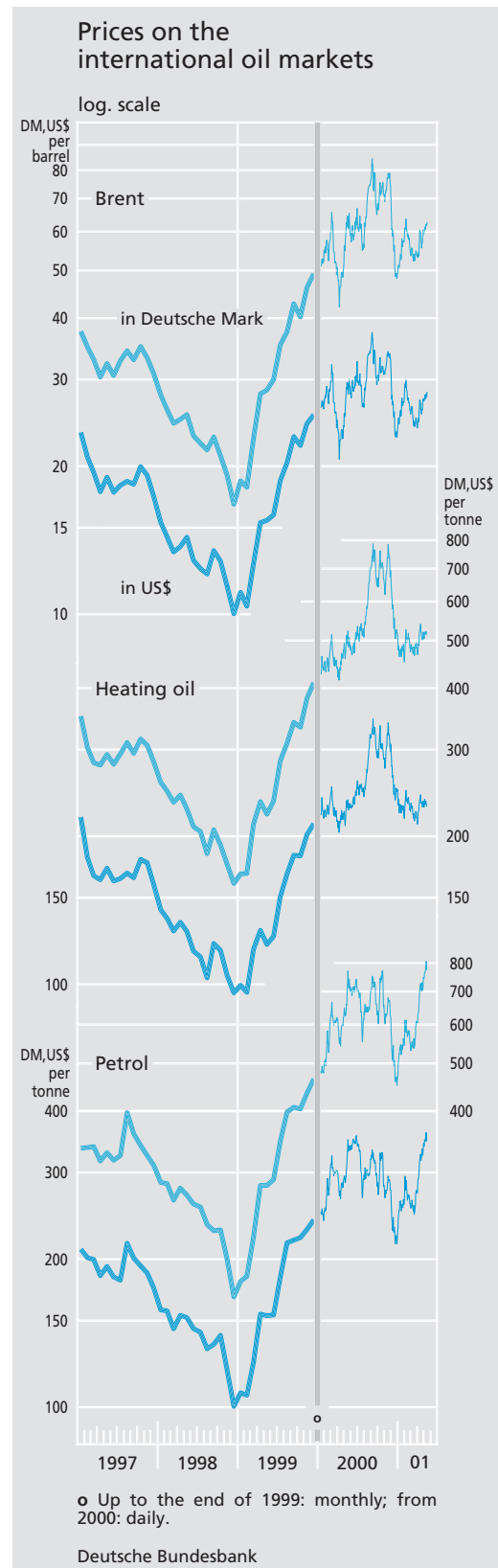
Excluding energy and food, the year-on-year rate of consumer price inflation amounted to 1.5% in April. At the end of last year, the rate had been just under 1%. A similar picture is presented by the core rates, which

*Underlying  
price trend  
remains  
moderate*

show the underlying trend of price movements omitting shorter-term fluctuations. In March and April together, the figure was 1.7%, compared with around 1% in the second half of 2000. Price developments in manufactured goods, in particular, remain moderate. In the last two months under review, they were no more than 0.7% more expensive than 12 months previously. Although the rise in house rents, at 1.2%, was obviously sharper, it has been on this scale for some while. The year-on-year rate of price increase for services, which amounted to 2.8% on the average of March and April, continued to be affected by the sharp rise in administered prices at the start of 2001. Excluding the radio and television licence fee and excluding motor vehicle tax, the price rise was 1.5%.

*Industrial prices put under strain by energy*

In March, domestic industrial selling prices were 4.9% up on the year, compared with a rise over 12 months of 4.5% in the fourth quarter of 2000. The faster pace of inflation was due solely to energy, where the easing of mineral oil prices at that time was more than offset by the lagged price adjustments for gas and district heating and by higher electricity prices. The rate of price increase for manufactured products on their own (excluding mineral oil products) has not gone up. At 2.2% in March, the rate of increase was scarcely different from the fourth quarter, when it had measured 2.1%. Whereas prices of food products were raised more sharply in the wake of BSE and foot and mouth disease, some price movements in basic goods were more moderate than in 2000.



### Indicators of consumer prices

Change from previous year in %

Item	2000		2001	
	3rd qtr	4th qtr	1st qtr	March/ April
Headline rate of inflation				
Consumer prices	2.0	2.4	2.5	2.7
Statistical core rates <sup>1</sup>				
Consumer prices excluding seasonal food and energy	0.9	1.0	1.6	1.8
Consumer prices with modified weights <sup>2</sup>	0.8	1.1	1.4	1.6
5 % trimmed mean <sup>3</sup>	1.2	1.3	1.8	2.2
Weighted median <sup>4</sup>	1.1	1.1	1.2	1.3
Mean of the core rates	1.0	1.1	1.5	1.7

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

*Rise in import prices somewhat weaker*

The basic pattern was similar in the case of import prices. Moreover, since price increases for imported capital goods slowed down again after some acceleration, the overall year-on-year rate of increase in import prices fell from double digits last year to 4.2% in March 2001. There were also reductions in export prices at the turn of the year. As these

were not as marked as they were for imports, however, the terms of trade were not quite as unfavourable as they had been previously.

Agricultural producer prices were clearly affected by BSE and the outbreak of foot and mouth disease. Whereas prices for cattle and for calves were around one-fifth cheaper year-on-year, pigs, lambs and poultry became significantly more expensive. In March 2001, animals for slaughter as a whole cost around 15% more than in the same period of 2000. Since agricultural selling prices for vegetable products fell slightly over 12 months, price increases for all agricultural products amounted to 8.4% year-on-year at the end of the period under review.

*Agricultural prices affected by BSE and foot and mouth disease*

The rise in construction prices still remained within narrow bounds at the beginning of 2001. Overall, construction work cost only 0.6% more than in the same period last year. Whereas road construction in February, despite a declining rate, was still 2% more expensive than in the same month last year, prices for construction work for residential buildings were almost unchanged. Shell construction work was, in fact, 1% cheaper.

*Construction prices stable*