

## Economic conditions in Germany

### Underlying trends

---

In the summer months, the German economy was moving on the path of moderate growth on which it had embarked at the start of the current year after having overcome the phase of contraction in the second half of 2001. We estimate that the increase in overall output in the third quarter may have been more or less as high (despite adverse accompanying circumstances) as in the two preceding quarters which – after seasonal and working-day adjustment – had each recorded an expansion of 0.3%. This gives a working-day-adjusted year-on-year ½% increase in real gross domestic product (GDP). The corresponding calendar-month figure is likely to have been 1%. This means that overall capacity utilisation was probably down again in the third quarter and noticeably below its normal longer-term level.

*Continued  
increase  
in GDP...*

At present, economic activity is still too weak to relieve the labour market. What is mainly lacking at present is some kind of positive outlook – which, as experience shows, is essential if investment and job recruitment is to pick up. It is therefore especially important that negative underlying sentiment does not become entrenched. As before, responsibility for finding the key to solving the structural weakness of growth and the persistent labour market problems lies at the national level.

*...but still  
lacking in  
momentum*

Third-quarter growth was largely sustained by an increase in exports of industrial goods. After the end of the summer holiday period, more work is likely to have been undertaken in processing the fairly large number of orders

*Export stimuli,  
investment  
remains weak*

Real GDP				
Percentage change				
Period	seasonally adjusted quarter on quarter	year on year		
		working- day adjusted	in calendar- month terms	
2000 Q3	0.0	3.1	2.4	
Q4	0.1	1.8	0.9	
2001 Q1	0.6	1.9	1.4	
Q2	0.0	0.7	0.6	
Q3	-0.2	0.4	0.4	
Q4	-0.3	0.0	-0.1	
2002 Q1	0.3	-0.2	-1.2	
Q2	0.3	0.1	0.5	
Q3 (Bundes- bank estimate)	¼	½	1	

Deutsche Bundesbank

received from abroad in the spring. The third quarter is likely to have seen a further decline in spending on machinery and equipment, however. An end to the existing restraint in investment is not in sight. According to the Ifo test, there was still extensive unutilised capacity in manufacturing up to the end of the period under review. Although utilisation of available machinery and equipment has recovered somewhat from its low at the start of this year, it was still well down on its normal level. In surveys, too – such as that of the Association of German Chambers of Industry and Commerce (DIHK) – available unutilised capacity is cited as a major reason for the low propensity to invest. Added to this is the fact that, on the whole, bank lending conditions have been tightened. The slump in stock market prices and higher risk premia for corpor-

ate bonds are reinforcing that effect. The comparatively high wage increases agreed in this year's pay round are placing a strain, not least, on small and medium-sized enterprises.

In the third quarter, too, construction investment was characterised by the persistent weakness of demand for residential construction. Both industrial investors' and households' interest in construction activity continued to be very subdued, whereas consumers' propensity to consume had increased at the end of the period under review. While retail turnover in autumn failed to match its spring-quarter level, car sales were up. Nevertheless, according to the surveys of the consumer research institution *Gesellschaft für Konsumforschung* (GfK), households' assessment of the economic situation has deteriorated of late. This suggests that private consumption will tend to remain weak in the immediate future.

*Household demand*

## Output and labour market

There was a distinct increase in industrial output in the third quarter. Seasonally adjusted, it went up by nearly 1% compared with the preceding three-month period. Although the figure was still down over 12 months, the year-on-year fall, at ½%, was perceptibly smaller than it had been in the second quarter (-2%). A particular contribution to the rise in output was made by the capital goods sector, which showed a quarter-on-quarter increase in production of around 1¼%. According to the data on turnover, exports played a significant part in achieving that fig-

*Rise in industrial output*

ure. Both motor vehicle manufacturers and producers of intermediate goods expanded their output. Manufacture of machinery and equipment did, at least, hold up. As before, however, developments in the consumer goods sector remained quite unfavourable.

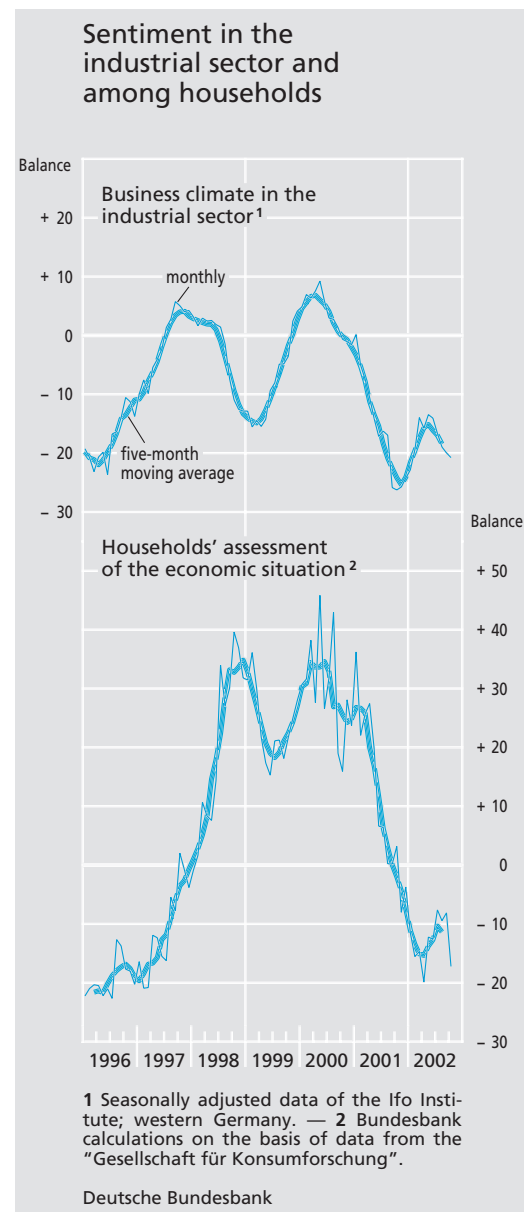
*Somewhat higher capacity utilisation*

According to the Ifo surveys, capacity utilisation in manufacturing – measured against the standard level of utilisation – was a seasonally adjusted 82½% in September. Compared with the low at the end of the first quarter, this represented an increase of 1 percentage point. At the end of the period under review, the longer-term average utilisation ratio was still being undershot by ¾ percentage point.

*Persistent weakness in construction output*

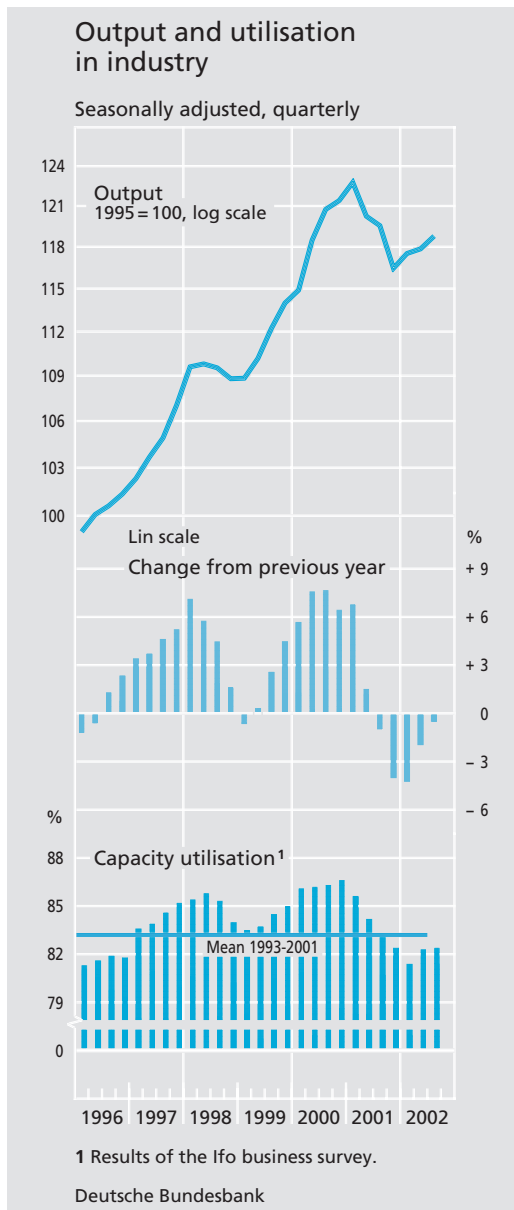
Construction output in the summer months remained at the low level of the preceding quarter. The last time a similarly low level was recorded – apart from weather-induced slumps – was in the early 1990s. Even the output of the finishing trades – which accounts for roughly half of activity in the construction sector as a whole – was showing a noticeable year-on-year fall. Capacity utilisation in the firms surveyed by the Ifo Institute has continued to decline.

Construction sector turnover indicates that public sector construction, in particular, has suffered losses in the past few months. The negative tendency in residential construction, which has been recognisable for quite some time now, continued up to the end of the period under review. By contrast, industrial construction was still holding up comparatively well.



On the labour market, the decline in employment accelerated perceptibly in summer. Up to August, the number of persons in work, according to the figures of the Federal Statistical Office, had fallen to a seasonally adjusted 38.62 million. This figure was 160,000 below the average level of the second quarter and 310,000, or 8%, lower than in the same period of 2001. In spring, the year-on-year fall had been 175,000, or 0.4%.

*Continued reduction in employment*



In the period under review, as had been the case for some time, the continuing reductions in staffing levels in industry and construction were being offset less and less by a positive development in the services sector. The employment situation deteriorated especially in financing, renting and leasing, and services to enterprises, but there were also negative developments in trade and transport as well as for public and private service providers.

The accelerated decline in employment during the past few months is undoubtedly connected with an increasing use of the leeway provided by working hours accounts. This is suggested, for example, by the fact that the average number of hours worked increased in the third quarter. For quite a long period before that, total hours worked were being reduced far more sharply than the number of employees. Short-time working was also cut back. While the number of persons on short-time work in the second quarter of 2002 was more than 100,000 higher than 12 months previously, the year-on-year increase in July and August narrowed to somewhat over 60,000. In September and October, the number of persons on short-time work did show a clear rise again, but this was connected, not least, with special measures in the wake of the flood disaster in eastern Germany.

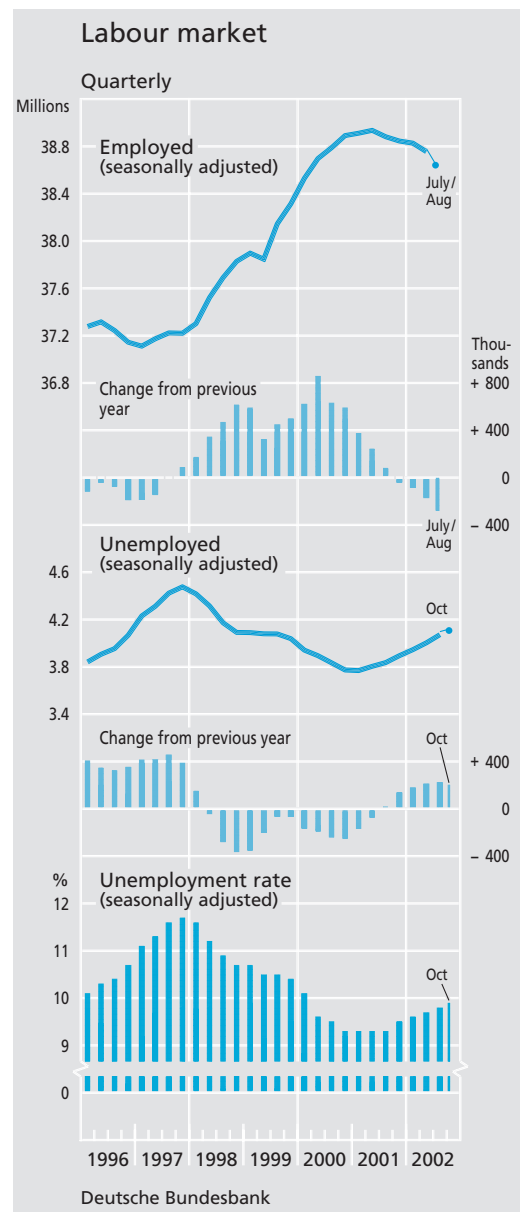
Over the past few months, there has been scarcely any change in the seasonally adjusted number of persons registered as unemployed at the Federal Labour Office. Since the end of June, the figure has persisted at around 4.1 million. The year-on-year increase, which had been more than 250,000 in mid-year, dropped to little more than 200,000 in October. At 9.9% in early autumn, the seasonally adjusted unemployment rate, as calculated by the labour exchanges, was marginally higher than in June. According to the standardised EU method, the figure remained unchanged at 8.3%.

The fact that unemployment is tending to stagnate does not signal a cyclical stabilisation of the labour market situation, however.

*Stagnation of unemployment...*

*... owing to special factors and Job-AQTIV act*

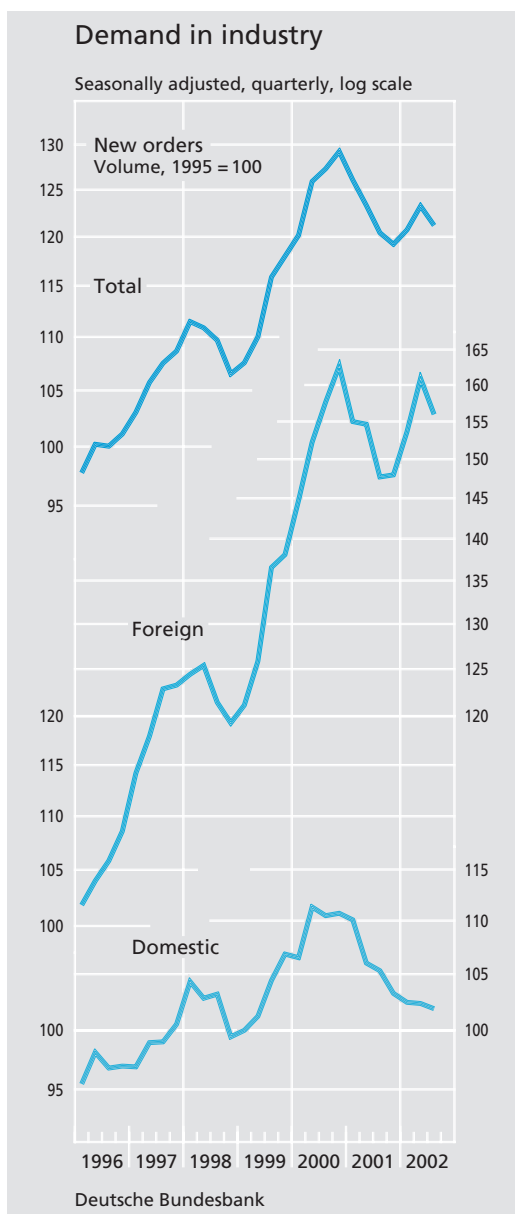
Rather, this stagnation is due to a number of special factors. In July, for example, there was a sharp fall in the number of persons out of work in eastern Germany, since the switch from a training school to unemployment that usually occurs in that month had already taken place owing to the early end of the school year this time. This led to a seasonally untypical increase in unemployment in June. By contrast, August benefited from the comparatively early end to the holidays in some east German Länder insofar as a large number of persons left unemployment mainly to take part in job creation schemes and attend training courses. In September and October, the labour exchanges responded to the flood disaster with special programmes. There was a further fall in the seasonally adjusted number of persons out of work, with the level in October being 40,000 lower than in June. In western Germany, where such special factors did not have any major importance, seasonally adjusted unemployment showed a steady slight rise, leading to the number of jobless, at the end of the period under review, being around 60,000 higher than in mid-year. In this case, however, the cyclical trend is distorted by the fact that a large number of persons are deregistering as unemployed as a result of intensified contacts between the labour exchanges and jobless persons under the *Job-AQTIV Gesetz* (an act which is designed to get people back into work). This has led to a clear-out of the unemployment register, which has an accompanying level effect on the stock figures. Between January and October of this year, more than two-thirds of the increased numbers of those leaving unemployment in western Germany (an



increase of 270,000 compared with 2001) was due to non-renewal of registration or to deregistration for other or non-specified reasons.

### Orders received

Demand for industrial goods was somewhat lower in the third quarter than it had been in



*Slowdown in industrial demand*

the spring months. At constant prices, there was a seasonally adjusted fall of around 1½% in the order intake compared with the second quarter, when there had been an accumulation of very sizeable new orders. Even so, the year-on-year figure, which had been negative in the preceding quarters, shows a slight increase of just over ½%.

Export business was the main factor in the reduced flow of orders. In autumn, orders from abroad were a seasonally adjusted 3% down on the three-month period from April to June. However, the figure was still a good 5½% up on the year because the situation 12 months previously had been even more unfavourable. Losses were suffered by all the major subsectors of industry. Manufacturers of consumer goods sustained the heaviest decline. The fall in the case of capital goods producers was less severe – the fact that German road vehicles were once again highly favoured by buyers had a positive impact. By contrast, new orders for machinery and equipment went back down again following an interim peak in spring.

Domestic demand for industrial goods just about held up in the summer months. In seasonally adjusted terms, demand was somewhat lower in the third quarter (-½%) than in the preceding period, which had been marked by a broad degree of stagnation. Although the figure was again down on the year, the decline, at ¾%, was not quite as large as before. Here, too, the capital goods industry is a positive exception among the other sectors. This was due mainly – as in the case of exports – to a rise in car sales. The other subsectors including, in particular, manufacture of machinery and equipment as well as production of office machinery and computers, remained quite weak, however.

Construction orders fell to a new low in July and August. Seasonally adjusted, they under-shot the already low level of the second quarter by 4% and were nearly 8% down on the

*Low in construction orders*

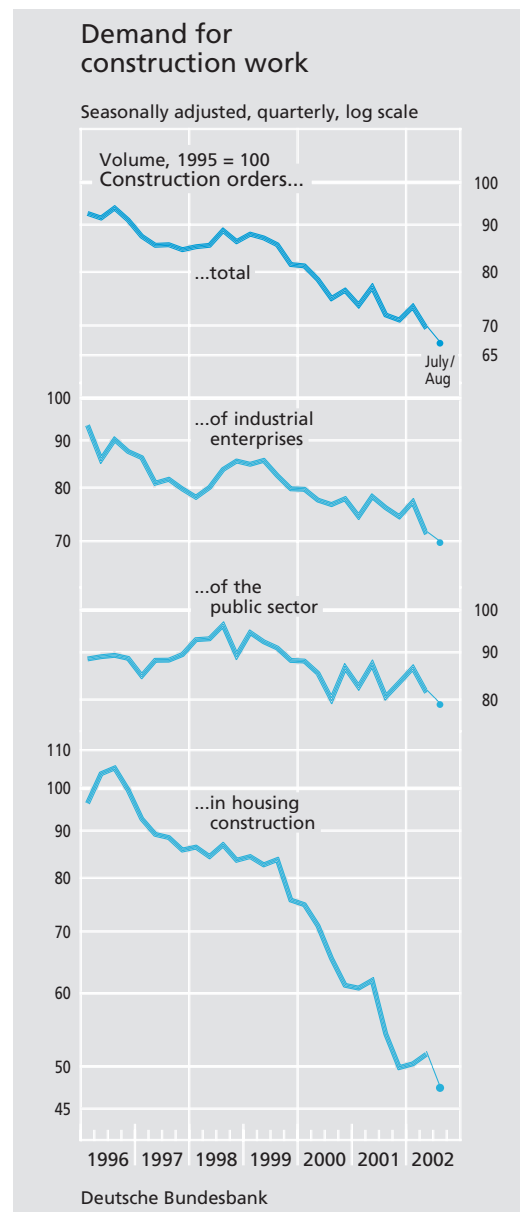
year, even though there had been a perceptible decline in the corresponding period of 2001.

The recent decline in incoming orders hit all the major subsectors of construction. By comparison, industrial construction was not much affected by this. Nevertheless, the quite sharp 9½% year-on-year decline makes clear that, in the somewhat longer term, a marked fall in level has been recorded in this subsector as well. Public sector construction orders have likewise continued to decline in the past few months. There were especially sharp falls again in residential construction. This meant that the impression of a gradual stabilisation, which emerged in the first half of this year, had to be revised again. In July and August, there was a seasonally adjusted decline in new orders of 8½% on the preceding three-month period. Judging by the number of housing construction permits granted, no improvement is likely in the near future either. The number of planned dwellings continued to decline, in fact, in July and August. In western Germany, it was down to a level which was lower than at any time since the end of the 1980s.

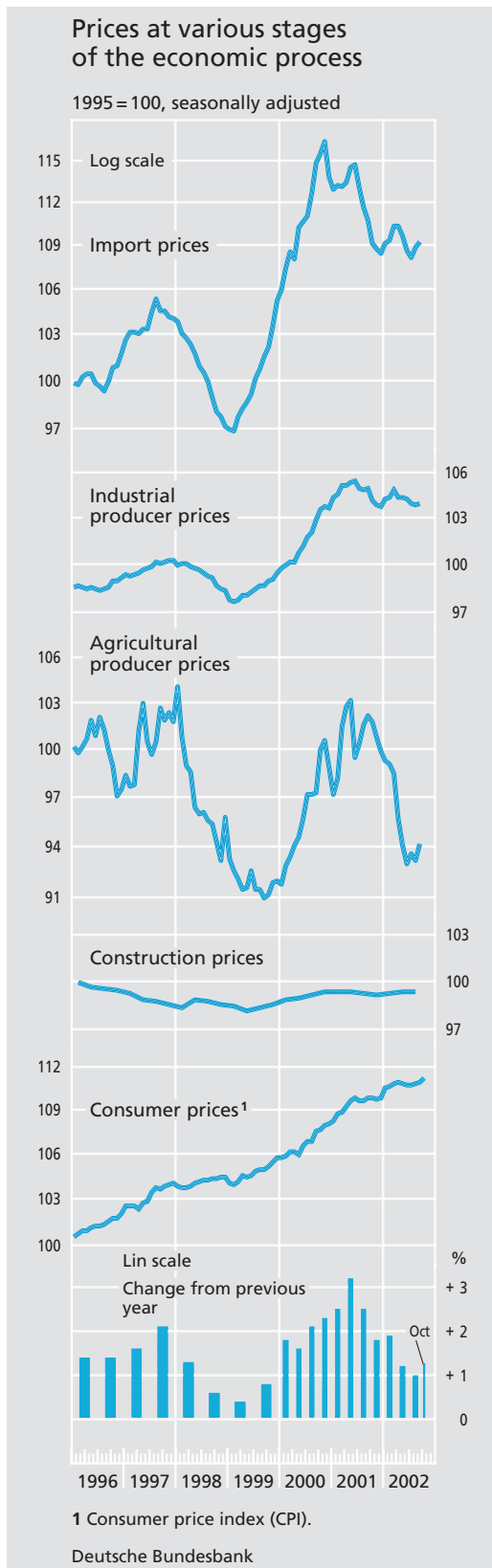
## Prices

*Rise in consumer prices remains moderate*

Price rises remained within narrow bounds. The year-on-year rate of consumer price increase went up to 1.3% in October, having been at around 1% for several months beforehand. The main reasons for this were, first, that refined petroleum products have become more expensive as a result of the



high prices on the international markets. This contrasts with a marked fall in the corresponding period of 2001. Second, upward price pressure in the case of services intensified somewhat at the end of the period under review. Price movements in the case of industrial goods remained quite small, however. In seasonally adjusted terms, the general price level in October was still slightly lower than at the end of winter. The year-on-year



rate of inflation was below 1%. Although food prices have gone down recently, the fall is less than is seasonally usual. Weather-induced hold-ups in many parts of Germany were a factor in this. At -0.9%, food prices still showed a clear year-on-year fall, however.

At the end of the period under review, prices of agricultural and forestry imports became somewhat more expensive again after falling in mid-year. In September, prices showed a year-on-year rise for the first time in five months. In addition, energy imports were becoming more expensive well into September. They thus followed the rise in international oil prices, which, at the end of September, peaked at somewhat over US\$29 per barrel of North Sea Brent. These factors were the main reason for the overall decline in import prices coming to an end and giving way to an increase. While it is true that imports in September were still 1.4% cheaper over 12 months, in June they had been as much as 5.2% down on the year. During recent weeks, oil prices were showing an appreciable fall, going down to below US\$25 at the end of the period under review.

*Imports somewhat more expensive*

In September, seasonally adjusted domestic industrial selling prices rose slightly for the first time since spring. The year-on-year fall narrowed marginally to 0.9%. Excluding energy, the rise over 12 months went up to +0.5%, having been +0.2% in the second quarter. In the intermediate goods sector, the prices of chemical products have shown a particular increase. Among capital goods, however, office machinery and computer

*Hardly any change in producer prices*



equipment continue to show sharp year-on-year reductions in prices, whereas both motor vehicles and machinery have become significantly more expensive. Construction prices remained largely unchanged in summer and were no more expensive than one year previ-

ously. Price reductions in road construction were offset by slight price increases for office and commercial buildings. In residential construction, quoted prices remained largely constant.