

## Economic conditions in Germany

### Underlying trends

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The German economy was stagnating in the last few months of 2002. According to the Bundesbank's initial figures, fourth-quarter real gross domestic product (GDP), adjusted for seasonal and working-day variations, may have been slightly down on the preceding three-month period. This would mean a year-on-year increase – as in the third quarter – of around ½% in working-day and calendar-month terms. This assessment is consistent with initial calculations by the Federal Statistical Office, according to which overall output in 2002 went up by no more than 0.2% on an annual average.

*Stagnation  
but...*

This means that the economy has been in a period of quasi-stagnation for more than two years. One factor in this has undoubtedly been the global slowdown in growth, especially as Germany is particularly heavily embedded in the international division of labour. Even so, the present sluggishness of the economy is probably not due solely to cyclical – and therefore rapidly reversible – factors. Home-made causes are becoming increasingly apparent. These include rigidities on the labour market, the heavy burden of taxes and levies as well as misincentives in the social security systems. Uncertainties about the course of economic policy have also placed a strain on underlying sentiment in the business sector.

Nevertheless, it would be rash to conclude on the basis of the present bleak findings that a self-perpetuating downward process is under way. In fact, the results of business surveys as well as incoming orders give cause for hope

*...no danger  
of recession*

## Overall economic growth

### Percentage change in real GDP

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	0.2	-0.1	0.4
Q3	0.3	0.4	0.9
Q4 (Bundes- bank estimate)	-0	½	½

Deutsche Bundesbank

that the German economy can make up ground again during the first few months of this year. That applies especially to industry, where demand picked up slightly following the slowdown in summer. Enterprises' output expectations, which are surveyed by the Ifo Institute, have also shown some improvement. By contrast, actual production in the final quarter of 2002 was lower than in summer – not least owing to the particular pattern of public holidays and "bridge days" (days taken off work to make up a long weekend). Furthermore, the intermittent cold weather led to hold-ups in the construction sector. This is likely to have caused a delay in starting work on the increased number of single-family houses commissioned by households.

Consumers remained very cautious in their current consumption spending. As is revealed by the surveys of the consumer research institution, *Gesellschaft für Konsumforschung* (GfK), sentiment worsened dramatically towards the end of 2002. Both the outlook for incomes, which had recovered temporarily in summer after the conclusion of the pay round, and expectations regarding economic activity remained well in the negative range. The already low propensity to make major purchases showed a further deterioration. As a result, retail purchases were cut back perceptibly in November. Even December, with its traditional Christmas trade, failed to bring a turn for the better. Registrations of new motor vehicles did hold up at quite a high level, however.

*Weak  
consumption*

The unfavourable labour market situation with its continuing decline in employment and a further rise in unemployment certainly also played a part in weak consumer demand. The Federal government has initiated some reform measures acting on the proposals of the Hartz commission, but time is required for their implementation. Also, further steps are needed. There are, however, no indications of a reluctance to consume resulting from the expectation of a deflationary price trend. In actual fact, price reductions undertaken by the retail trade in one-off promotions attracted lively interest from buyers.

## Output and labour market

Industrial output in the fourth quarter was down on the summer months. In seasonally

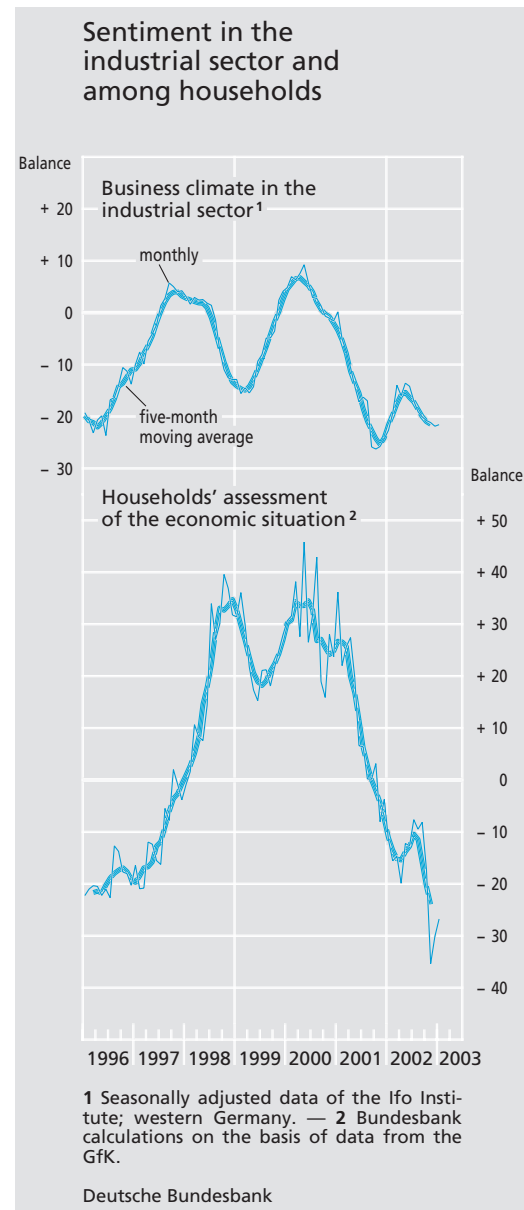
*Special effects  
in terms  
of output*

adjusted terms, it was around ½% lower. Even so, for the first time in some while there was year-on-year increase of 1%, since an even sharper fall in output had been recorded in autumn 2001. As mentioned, the current development was not due to a weakening of demand but rather to the way in which the public holidays fell. Combined with “bridge days”, these were apparently often used for a holiday, which led to matching adjustments of production. The months most affected were October and – to a somewhat lesser extent – December. This was only partly offset by November, which had no particular features affecting the number of working days. According to the Ifo surveys, reduced production led to an increase in the volume of orders on hand.

The decreases in output were far greater than average in the consumer goods sector. Producers of both durable and non-durable goods made a marked cutback in production. In the other sectors, however, such cutbacks were on a smaller scale. Among the intermediate goods sectors, manufacture of plastics and of glass and ceramics held up quite well, while there were fairly sharp falls in production in the chemicals and man-made fibres industry. In the capital goods sector, a marked reduction in the volume of production in the motor vehicle industry contrasted with a stable output in the manufacture of precision instruments and in the aircraft industry.

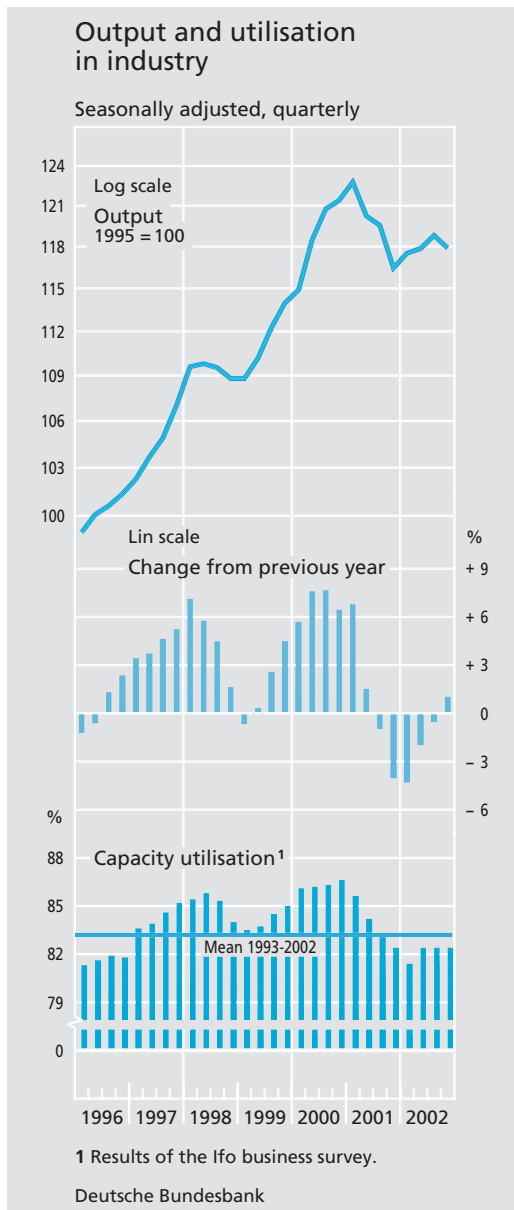
*Stagnating  
capacity  
utilisation*

In seasonally adjusted terms, industrial capacity utilisation, which is surveyed regularly by the Ifo Institute, was no higher in December than it had been at the end of the second



quarter. It did not show an increase on the year either and remained well below the longer-term average. While utilisation of fixed assets in the intermediate goods sector was somewhat higher towards the end of the year than it had been 12 months earlier, the other sectors failed to match that level.

Construction activity in autumn was affected adversely not only by the particular holiday



*Decline in  
construction  
work*

effects but also by intermittently unfavourable weather conditions. Seasonally adjusted construction output in the fourth quarter is likely to have been lower overall than in the preceding months. It is still not possible to gauge the precise scale at present owing to the fact that the revisions for the months from March to September 2002, derived from the overall survey, have not yet been incorporated into the figures. The year-on-year

fall of 7¼%, which is already known, indicates that developments have remained quite unfavourable. It is very likely that much the same applies to the finishing trades as well. Turnover in this subsector (for which figures are currently available up to and including the third quarter) also showed a perceptible decline.

The situation on the labour market has deteriorated further over the past few months. First, there was an accelerated reduction in employment. Second, following a temporary hiatus, unemployment began to increase strongly again. According to the figures of the Federal Statistical Office, the seasonally adjusted number of persons in work had fallen to 38.5 million by November, with the pace of the decline latterly showing a marked increase. The year-on-year fall increased from 250,000 in mid-2002 to 375,000 in November, which corresponds to a figure of -1%.

*Significant fall  
in employment*

Construction and industry were the main contributors to this development, although the services sector, too, showed very little employment growth on the year. The situation became increasingly unfavourable especially in the trade, hotels and restaurants and transport sectors. Only public and private services have largely maintained their overall staffing levels.

The rise in unemployment, which had nearly come to a standstill in summer owing to a number of special factors, has continued again during the past few months. By the end of January, the number of persons officially registered as unemployed had risen to a

*Unemployment  
up again*

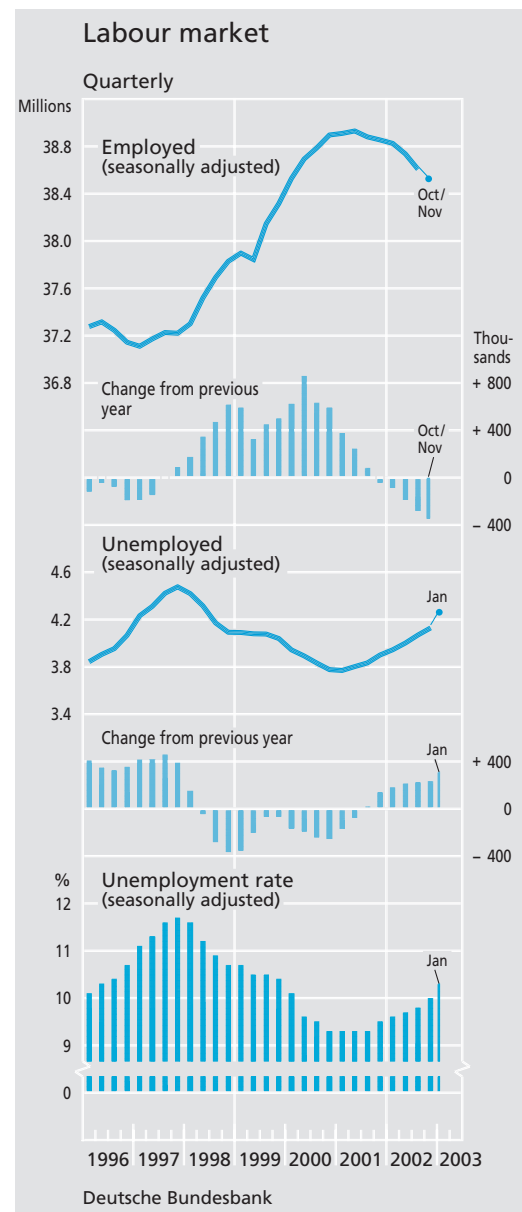
seasonally adjusted 4.27 million. The seasonally adjusted average monthly increase in the period from October to January was almost 44,000. In January 2003, the figure showed a rise of 335,000 on the year. The seasonally adjusted unemployment rate, as calculated by the Federal Labour Office, went up to 10.3%. According to the standardised EU method, which is based on the number of unemployed persons as a percentage of the civilian labour force, the figure was 8.6%.

The fact that most jobs are being cut back in industry is evident, not least, from the continued disproportionately large increase in the level of male unemployment. With an average of more than 26,000 persons affected between October and January, the rise was one-and-a-half times higher than the rise in unemployment for women, a larger proportion of whom are employed in the services sector.

The use of labour market policy measures continued to hold up at a high level recently, although it was somewhat lower than one year earlier. At the end of January, the number of persons attending vocational training courses and taking part in job creation schemes, receiving assistance from the Federal Labour Office in addition to the regulated programmes or on back-to-work grants totalled somewhat more than 640,000.

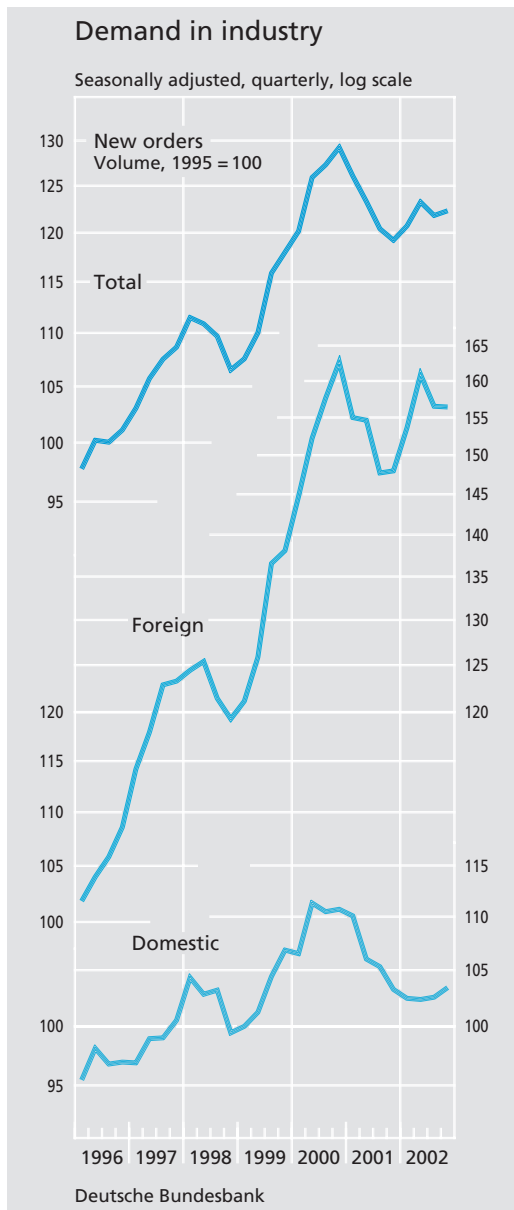
## Orders

The flow of orders to industry became somewhat broader again during the last few



months of 2002. In seasonally adjusted terms, the volume of new orders during the period from October to December was just under ½% up on the third quarter. The year-on-year figure, which in the third quarter – at slightly more than +1% – had turned positive for the first time in some while, went up to +2½%.

*Increase in volume of orders*



*Subdued export  
business*

Demand from abroad, in particular, showed a sharp rise in October and November. The fact that December lagged considerably behind this may, to a certain extent, have been due to the continuing slowdown in the world economy and the persistent appreciation of the euro on the foreign exchange markets. What is likely to have been the crucial factor – judging from past experience – is that the specific pattern of working days with the ex-

tended Christmas break had a marked adverse impact on the flow of orders. On an average of the fourth quarter, seasonally adjusted new orders were just as high as in the preceding quarter. The year-on-year increase amounted to 5½%.

Following a fairly long period of stagnation, the domestic orders situation was pointing upwards slightly in autumn. Seasonally adjusted, their level in the period from October to December was ¾% up on the third quarter. This meant that, for the first time in one-and-a-half years, they were also somewhat higher in year-on-year terms. All the major sectors of industry shared in this upturn. It was most marked in the case of consumer goods producers, however, which were thus able to offset a good part of the sharp losses sustained during the summer. The intermediate and capital goods sectors also recorded positive figures, however.

*Slight increase  
in domestic  
orders*

Construction demand, which was declining well into the summer of 2002, has flattened out. In seasonally adjusted terms, incoming construction orders in the fourth quarter are likely to have been just as high as in the preceding three-month period. Housing construction, in particular, had a stabilising effect, recording a surge in orders in November and, probably, also in December. (The statistics for December will not appear until after this *Monthly Report* has been published). This surge was so powerful that a seasonally adjusted increase of around one-tenth may be expected for the quarter as a whole. Taking construction permits as a yardstick, orders were mainly for single and two-family hous-

*Expansion  
in demand  
for housing  
construction*

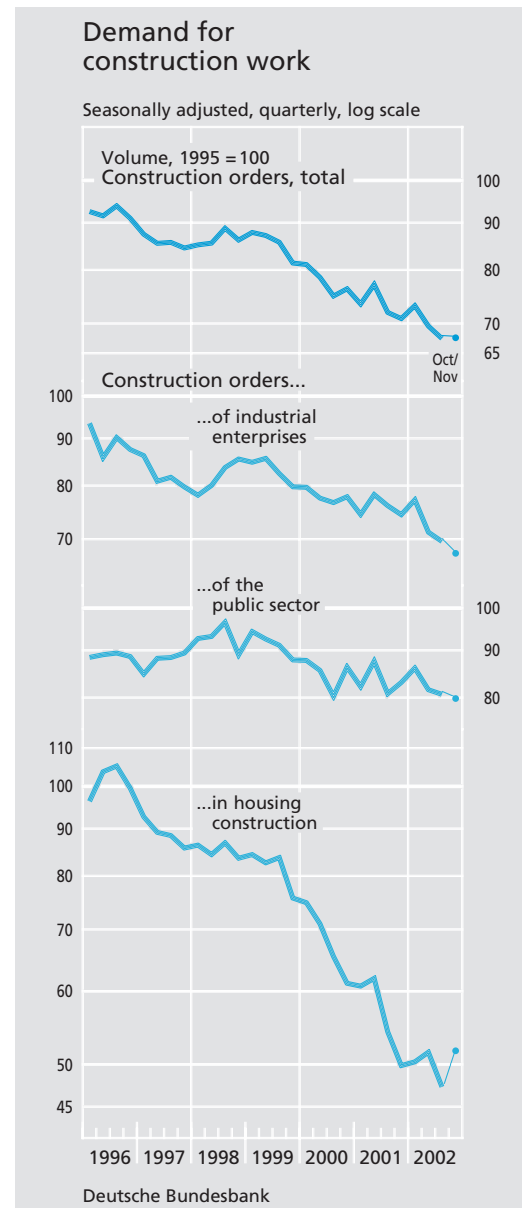
ing. It may be concluded from this that clients were principally concerned with placing an order before the announced changes in assistance for housing construction came into effect in 2003, thus ensuring that they benefited from the earlier, more favourable terms. The pick-up in demand might therefore be followed by a renewed slowdown at a later date.

This would imply that the tendency to weakness in construction demand might continue as before, especially as there was no identifiable improvement in the other subsectors up to the end of the period under review. At all events, industrial construction orders in the two-month period of October and November were a seasonally adjusted 3¼% down on the third quarter, with the corresponding figure for public construction being -1½%. The year-on-year figures were -11¼% and -7%, respectively.

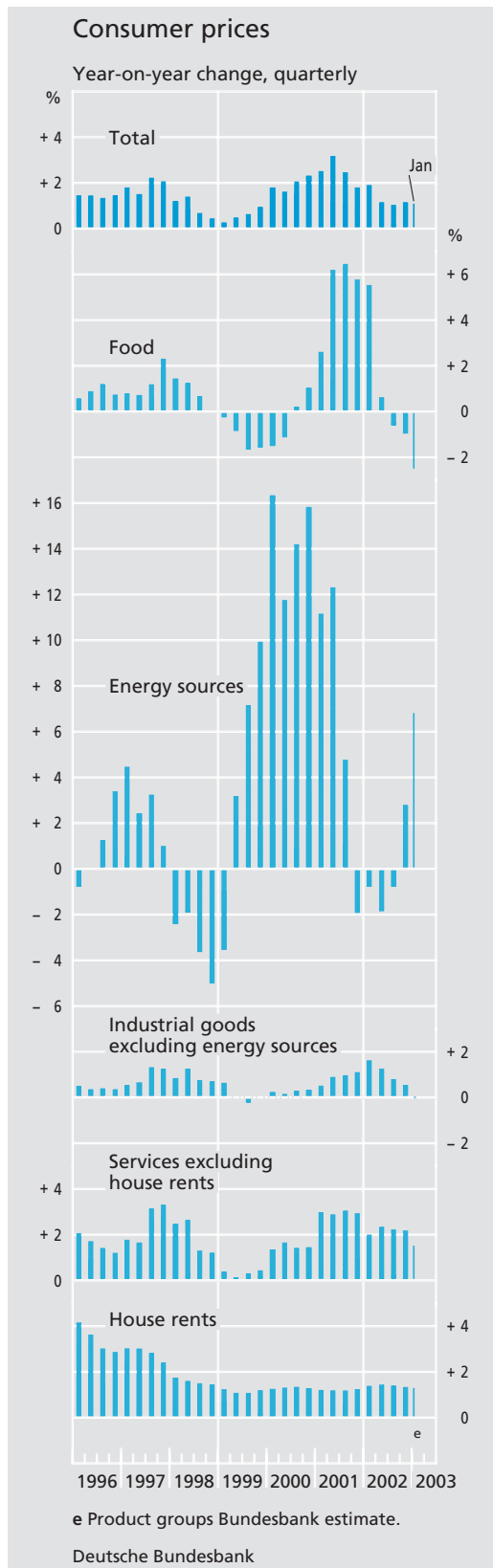
## Prices

### *Sharp oil price rise*

At the turn of 2002-03, prices in the domestic markets became caught up in the wake of the dramatic increase in international oil prices. Following a period of stabilisation persisting into the autumn, during which prices for a barrel of Brent North Sea Oil fell to around US\$23, prices in the past few weeks have gone back up to over US\$30. The main reason for this was not so much general supply shortages. The crucial factors were fear of a war in Iraq with its potential consequences and an almost total loss of Venezuelan production, which plays a major role in supplying



the United States. An end to this speculation-driven surge in oil prices is not in sight. The appreciation of the euro against the US dollar is alleviating the situation to a certain extent, especially as the appreciation affects not only imports of energy but also many imported goods. Even so, compared with their low in November, German import prices have been showing a distinct increase again, rising by a seasonally adjusted 1% in December (more



recent statistics are unavailable at present). The year-on-year figure, which had been clearly negative in November at -0.6%, went up to +0.5%. Excluding energy, there was a seasonally adjusted fall of 0.3%. The year-on-year decline increased to 1.6%, compared with -0.8% in October.

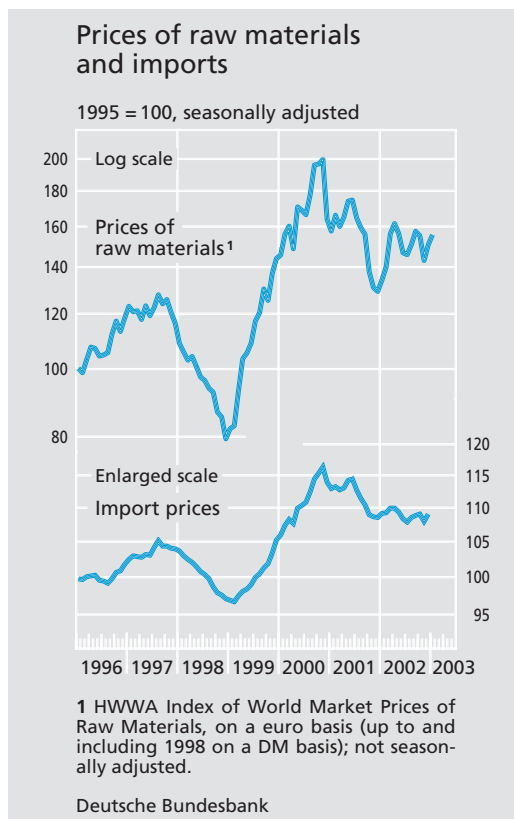
At the consumer level, the effects of the oil price increases were intensified by further tax rises. For example, taxes on electricity and fuels have been increased in the fifth stage of the ecology tax. Added to this was a two-thirds increase in tax on gas. The second stage of the tobacco tax also entered into force. According to reports from some *Länder*, the consumer price index went up by a total of just over ½% in January in seasonally adjusted terms. Excluding energy and taxes, it is likely to have remained stable. The year-on-year rate of price increase – as in November and December – was 1.1%. Without the further tax measures, the inflation rate would have been roughly ½ percentage point lower.

*Further consumer tax increases*

The domestic factory gate prices of industrial products likewise showed an identifiable energy effect. The rate of price increase in December, at a seasonally adjusted 0.3%, was noticeably higher than in the preceding months. The year-on-year inflation rate went up to 0.9%, having been as low as 0.4% in November. Excluding energy, producer prices remained nearly constant over the past few months. Against a backdrop of the persistent sluggishness in business, there were still no identifiable price adjustments for construction work towards the end of 2002: the price level remained nearly unchanged in both sea-

*Producer prices show a stable underlying trend*





sonally adjusted and year-on-year terms. Seasonally adjusted producer prices for agricultural products did go up somewhat during the past few months, but were still 4.9% down on the year in December.