Economic conditions in Germany

Underlying trends

Growth still stagnating

Overall output in the German economy, which had not been increasing since the end of 2002, showed no signs of a recovery in the first few months of this year either. According to a still provisional estimate by the Federal Statistical Office, real gross domestic product (GDP), after seasonal and working-day adjustment, was 0.2% down on the final quarter of 2002. In working-day adjusted terms, this was a 0.2% increase on the year, compared with a previous figure of 0.7%. Without taking account of the different number of working days, the figure was 0.5% (as in the fourth quarter of 2002).

The persistent period of stagnation in the German economy, which has now lasted for nearly three years, thus continued into the winter months of 2003. Given such a flat underlying trend, even minor disruptions can lead to cutbacks in output, without this necessarily implying a slide into recession and a slump in production. Nevertheless, this should be seen in the context of a further decline in overall capacity utilisation and the fact that the labour market has come under increased pressure.

Technical recovery in industry; further decline in construction

Looking at overall output by sector, only industry has been generating quite positive stimuli during the past few months. The way public holidays fell in the final quarter of 2002 had led to reductions in output, but production was stepped up again in the first few months of this year. A large part of output is likely to have gone abroad; this was, however, accompanied by a high level of

Overall economic growth

Percentage change in real GDP

Period	Seasonally adjusted quarter on quarter	Year on year: Working-day adjusted	Year on year: Unadjusted figure
2000 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	1.0
Q4	– 0.0	0.7	0.5
2003 Q1 [1]	– 0.2	0.2	0.5

1 Initial estimate by the Federal Statistical Office.

import activity. The propensity to invest remained weak. Construction activity at the start of the year showed a marked decline, in fact, not least on account of the prolonged period of cold weather. The slight improvement in construction investment, which had become apparent at the end of 2002 following an almost three-year period of contraction, has thus faltered again for the time being. The cyclical weakness of the economy has now also left its mark on the services sector. According to surveys conducted by the Centre for European Economic Research in the first quarter of 2003, major business service providers reported a slowdown in sales growth as well as a deterioration in profitability.

Somewhat higher consumption spending by households

Households' consumption in the first few months of 2003 was influenced by higher spending on energy. Given the long period of frost, there is likely to have been an increased demand, not least, for heating oil. Additionally, retail purchases, which had fallen to a very low level in the last few months of 2002, were stepped up again somewhat. By contrast, there was a marked decline in new private motor vehicle registrations compared with the autumn of last year.

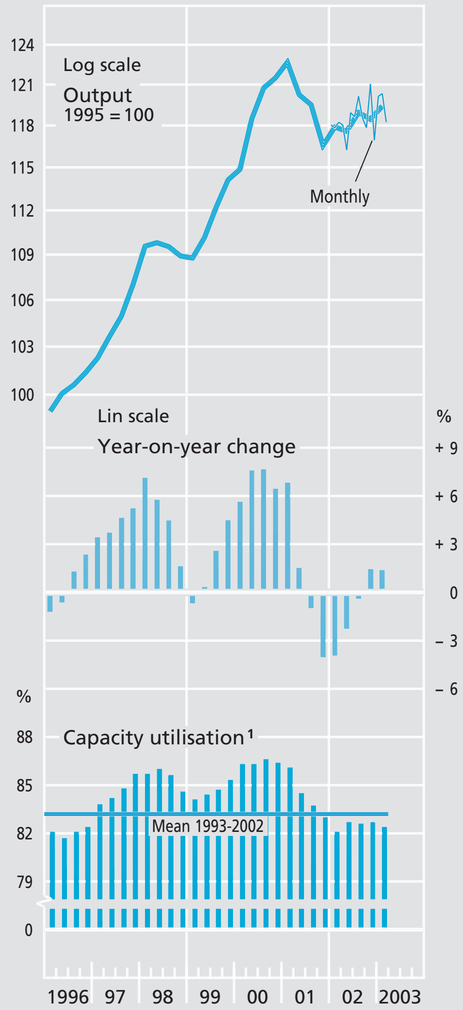
As is revealed by the surveys of households conducted by the consumer research institution, Gesellschaft für Konsumforschung (GfK), the underlying sentiment of consumers over the past few months has remained negative but has picked up somewhat from its low in the autumn of last year. This was mainly due to an improvement in the propensity to purchase durable consumer goods, which made a noticeable recovery from what was an exceptionally low level by historical standards. However, the majority of those surveyed remained very sceptical with regard to expectations about incomes and the economy. Along with the adverse labour market outlook, the continuing uncertainty about the Federal government's economic policy reform plans is also likely to have been a factor in this.

Depressed sentiment in industry

Industry's assessment of its business situation and prospects has also continued to be characterised by caution and uncertainty of late. Following a temporary improvement, the business climate, as surveyed by the Ifo institute, has been tending to deteriorate again at the end of the period under review, probably also reflecting exchange rate influences. None of this points to confidence in a cyclical upturn emerging in the foreseeable future, although there is just as little indication of a sharp downturn. There is much to suggest that the stagnant underlying trend in which German finds itself will continue for the time being.

Output and utilisation in industry

Seasonally adjusted, quarterly



1 Results of the Ifo business survey.

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Output and labour market

Increase in industrial output

In the first quarter of 2003, industry more than made up for the dip in output in the final quarter of last year. On an average of the first three months, seasonally adjusted output was around ¾% up on its autumn 2002 level. The last peak in summer 2002 was exceeded by ¼% and there was a 1½% increase on the year.

The sharpest upturn was in intermediate goods. In the first three months of 2003, producers of intermediate goods raised their output by around 1½% on the quarter in seasonally adjusted terms. The year-on-year increase was more than 2½%. Especially in the chemicals industry, there was a perceptible expansion in output at the start of the year. Manufacturers of base metals also increased their production. The capital goods sector also registered a slight increase. The fourth-quarter decline in this sector had been quite marked, however. The recent expansion in output thus merely signifies a return to the level of summer 2002. Losses in the case of motor vehicle manufacturers contrasted with positive developments in the manufacture of machinery and equipment as well as in medical and surgical equipment, electrical control equipment and photographic equipment. By contrast, consumer goods showed an entirely unfavourable development in output, with production declining recently following stagnation for much of 2002. The figure was more than 2% down on the year.

Slowdown in construction

After appearing to flatten out somewhat for a time, the decline in construction sector out-

Output in the construction sector

Seasonally adjusted, quarterly

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put accelerated again markedly in the first few months of 2003. In the first three months of the year, seasonally adjusted construction output was 4¾% down on the already low level of the final quarter of 2002. One factor in this was the cold winter weather in January and February. The year-on-year fall, which had been around 6% on average in the period from October to December, increased to 14%. General construction and civil engineering were both almost equally affected. In addition, turnover in the construction finishing trades were noticeably down on the comparable levels of 2002.

Continuing decline in employment

Sluggish growth and the subdued economic outlook have now taken their full toll on the labour market. Employment has been continuing to fall significantly. In the first quarter, the seasonally adjusted number of persons in work fell to 38.36 million. Especially in the first two months of this year, there was an accelerated decline in employment, which was partly due to the unfavourable weather conditions. The average monthly fall in the second half of 2002 had been just under 40,000, compared with almost 50,000 in January and February 2003. The year-on-year decline increased from 360,000 in the fourth quarter of 2002 to 480,000 in the first three months of the year. This is equivalent to a fall of 1.3%. In mid-April, there were 240,000 persons working reduced hours, ie there were roughly just as many persons working short time as 12 months previously.

Marked increase in unemployment

Almost exactly mirroring cuts in staffing levels, there was a sharp rise in unemployment. At the end of April, a seasonally adjusted 4.46 million persons were officially registered as unemployed, ie 240,000 more than at the end of 2002 and 470,000 more than 12 months previously. The seasonally adjusted unemployment rate, as calculated by the Federal Labour Office, went up to 10.7%. As defined internationally, the figure was 9.4%.

Cutback in traditional labour market assistance

There has been a further reduction in traditional labour market policy measures as part of a reorientation of labour market promotion to standards of greater efficiency. The number of participants in vocational training, job creation schemes and structural adjustment programmes fell to 400,000 at the end of April. This was 130,000 fewer persons than one year earlier. The number of persons receiving assistance from the Federal Labour Office in addition to the regulated programmes also fell by 30,000 on the year. This contrasts with an increase in the number of back-to-work grants and bridging allowances. These payments were made in roughly 210,000 cases, ie almost 50% more than 12 months previously. There were 340,000 persons who made use of the fairly long-standing arrangement under which older unemployed persons are allowed to decide against a further job placement (and are thus removed from the statistics). The opportunity of pre-retirement part-time working promoted by the Federal Labour Office was taken up by 70,000 persons.

Labour market

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Orders

Falling demand for industrial goods

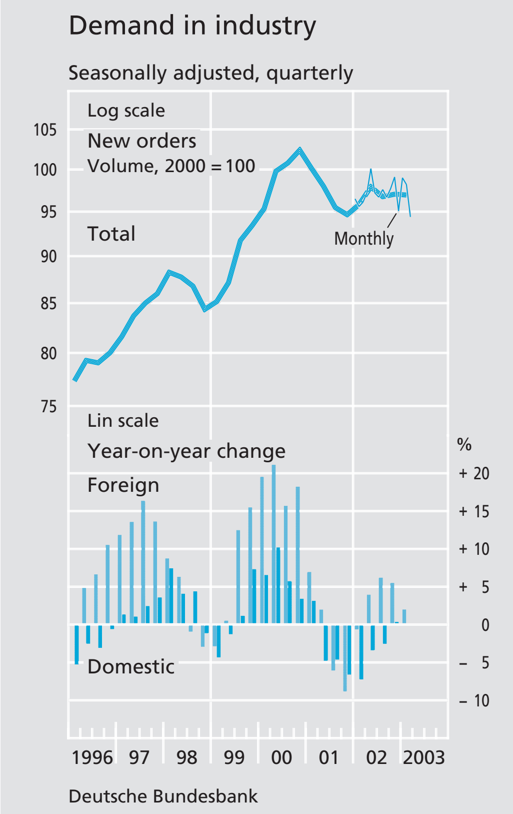
Demand for industrial goods has been declining for some time. On an average of the first quarter, the volume of seasonally adjusted incoming orders was, in fact, more or less as high as in the second half of 2002, but this was mainly due to backlog effects from the autumn of 2002 coming into operation in the first few weeks of this year.

Decline in export business sharper...

This was especially the case in export business. Taking December and January together in order to smooth out the special factors, it becomes apparent that seasonally adjusted foreign demand had been showing a general tendency to decline from its former fairly high level since late summer 2002. It is not only the appreciation of the euro which is likely to have had a retarding effect; the slowdown in the global economy as well as paralysing uncertainty surrounding the Iraq conflict were undoubtedly of major significance. Foreign orders in October and November had been almost one-tenth up on the year, but only matched their previous year's level in February and March.

... than decline in domestic demand

Domestic demand (in which there were scarcely any identifiable special factors at the turn of the year) was largely holding up well into winter 2003. Nevertheless, it showed a marked seasonally adjusted decline in March.



An increase on the year of somewhat more than 1% in January and February was followed by a fall of just over 2% in the final month of the quarter. There was a slowdown both in the intermediate and consumer goods sectors. Only capital goods producers recorded a significant seasonally adjusted quarter-on-quarter and year-on-year rise in orders. One major factor in this was a high level of orders for transport equipment, which also had a ripple effect on the subcontracting sectors.

Further decline in demand for construction work

Demand for construction work declined dramatically in the first few months of the year. In January and February, seasonally adjusted construction orders were around 5% down on their level in the fourth quarter of 2002. This was more than one-tenth down on the same period last year – a figure that was already very low owing to the fact that new orders had been declining persistently for several years. The decrease in demand was especially obvious in residential construction. In part, this was due to quite a large number of customers placing their orders during the last few months of 2002 in anticipation of the cutbacks in government assistance for owner-occupied housing initially announced for the beginning of 2003. This resulted in a "gap" in ordering at the start of 2003, even though the cutback in subsidies was not then adopted.

The downward trend in industrial construction orders, which had already been noticeable in 2002, accelerated further during the early part of the current year. In January and February, they were around one-tenth down on the fourth quarter in seasonally adjusted terms. The year-on-year fall, at not quite 15%, was almost twice as large as in autumn 2002. Taking the statistics on construction permits as a yardstick, the decline was especially marked in the case of factory and workshop buildings, although projects planned for retail outlets and warehouses as well as for administrative buildings and office space also shrank at a double-digit rate. It was only in the case of public sector contractors that there was no seasonally adjusted fall in January and February. An improvement is hardly to be expected, however, given the unfavourable budgetary situation, especially of the municipal governments – the biggest construction customers.

Prices

Stable prices

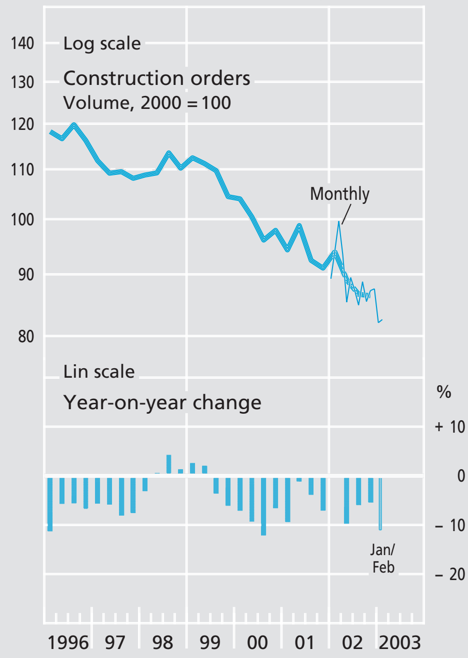
Prices have remained virtually stable recently. In seasonally adjusted terms, there was even a slight fall in import prices in March and producer and consumer prices went down slightly in April, the year-on-year rates of increase showing a distinct decline. The main reason for this was the pass-through of marked adjustments in international oil prices. In the euro area this effect was reinforced by the appreciation of the single currency on the foreign exchange markets. Prior to the war in Iraq, fear of possible disruptions to oil supplies had intermittently pushed up prices to more than US$33 for a barrel of North Sea Brent – a trend that was reversed immediately after the outbreak of the war. Recently, spot prices have been no more than US$26. For the first time in some while, the price was therefore somewhat down on the year. Calculated in euro, this represented a fall in price of just over one-quarter.

Fall in import prices

With the seasonally adjusted rise in import prices having already come to a standstill in February, imports became around ¾% cheaper in March. The year-on-year rate went back down to -0.8%, compared with roughly +½% in the preceding months. Much of this price dampening was due to crude oil and refined petroleum products, but the fall in prices of other goods has continued as well. This reflects both the subdued world economy and the appreciation of the euro on the foreign exchange markets. Capital goods, in particular, have been cheaper to import than they have been for some time. Much

Demand for construction work

Seasonally adjusted, quarterly



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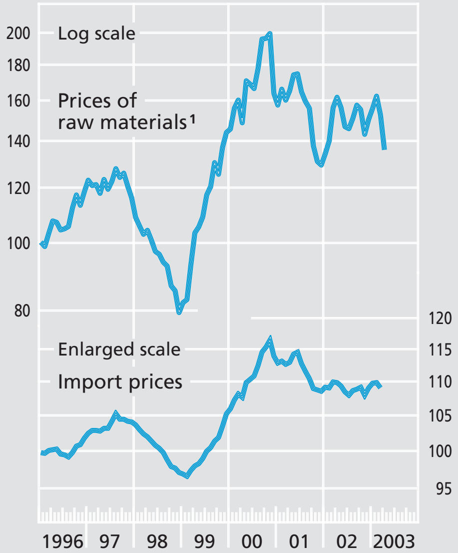
the same applies, albeit not quite so noticeably, to consumer products.

Slight rise in industrial prices

For the first time in some while, seasonally adjusted industrial producer prices fell, too, in April. The year-on-year rate of increase fell back slightly to 1.6%, having been 1.7% in the first quarter. Excluding energy, industrial producer prices showed no change from the start of the year and, at the end of the period under review, the year-on-year rate of increase remained at 0.7%. At 0.5%, the year-on-year rate of increase in the case of capital goods was far lower. This was due to significant reductions in the prices of office machinery, computers and communications equipment. Consumer goods cost 0.3% more in April than 12 months previously. The rate of

Prices of raw materials and imports

1995 = 100, seasonally adjusted



1 HWWA Index of World Market Prices of Raw Materials, on a euro basis (up to and including 1998 on a DM basis); not seasonally adjusted.

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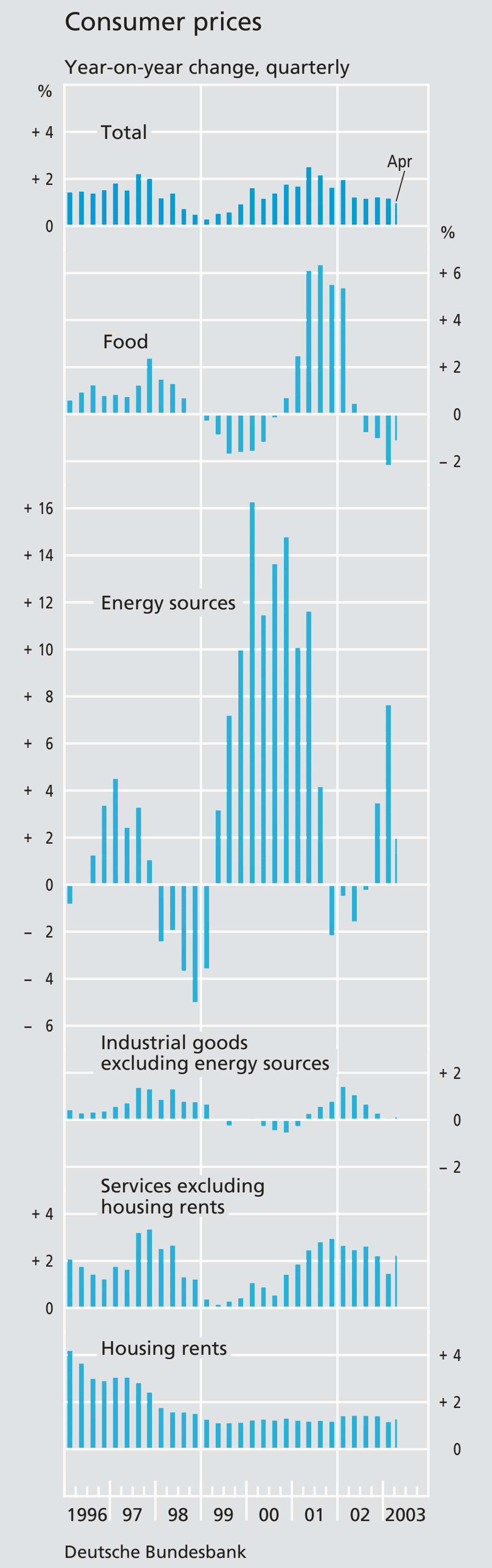
price increase in the category of intermediate goods was 1.0%.

Consumer prices on a stable underlying trend

The year-on-year rate of consumer price inflation fell from 1.2% in the first quarter to 1.0% in April. In seasonally adjusted terms, there was a slight month-on-month decline. This was due, in particular, to sharp reductions in the prices of heating oil and petrol. Taken together, they were around 6½% cheaper than in March, thus falling to their lowest level since the beginning of the year. Excluding energy, seasonally adjusted consumer prices rose again somewhat, with the year-on-year figure going up from +0.6% to +0.9%. This was mainly due to the fact that some services, such as package holidays and accommodation, were significantly more expensive than in the same period of 2002 owing to the late Easter holiday. Additionally, the steady slight increase in housing rents has continued. At the end of the period under review, rents were 1.3% up on their corresponding 2002 level. By contrast, industrial goods became slightly cheaper on average in seasonally adjusted terms, and were thus hardly more expensive than 12 months earlier. Not only were computers and electronic home entertainment equipment cheaper; lower prices were also reported for clothing and shoes. These reductions more than offset the slight increase in the prices of furniture and lighting equipment, motor vehicles as well as books, magazines and newspapers. Although food did become slightly more expensive in April, the increase was smaller than is usual at the time of year. This meant that, in seasonally adjusted terms, an increase in March was followed by a fall and that prices were moving back towards their early-year level.

Stable construction prices

The actual construction costs for newly built dwellings remained largely constant. In the first quarter of 2003, the construction cost index for residential buildings was scarcely higher than one year previously. A steady slight increase in the cost of finishing work contrasted with falling prices for shell construction work. Price movements in the case of other construction measures also remained within narrow bounds. The year-on-year rate of increase for office buildings was no more than 0.3% and, for commercial buildings, no more than 0.4%. In road construction, there were price reductions of 0.5%. The overall level of construction prices has been more or less stable for over two years.



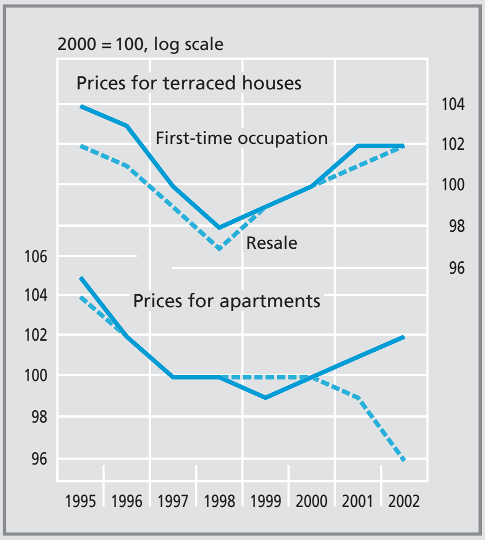
New price index for housing prices

While data on residential building construction prices are published regularly in the official statistics, up to now there has been much less information on house prices as a whole, ie including the land component. There was also a lack of data on the values of used apartments and houses. To close this gap, the Bundesbank has calculated price indices for such properties on the basis of data from the Bulwien AG. Further details on this may be found in the explanatory notes on page 38.

New price indices for housing in Germany

In recent years, house prices, just like stock prices, have been attracting greater attention from economic analysts. In some countries, especially the United States and the United Kingdom, the available data show that house prices rise much more rapidly than consumer prices. For Germany, however, the indicators published so far by the BIS and other institutions point to a slump in house prices. Price fluctuations may trigger macroeconomic effects that are relevant to monetary policy.[1] This raises questions as to the reliability and international comparability of house price indices.

Apart from complex problems of a conceptual and practical nature, price analysis on the housing markets is made more difficult by the scarce availability of official statistical data. The Bundesbank bases the calculation of its new price indicators on information provided by Bulwien AG, which *inter alia* collects price data on apartments and terraced houses for both first-time occupation and resale in 60 German towns and cities. This information is condensed into indices by means of year-2000 population percentages. Although the new findings generally indicate a stagnation or slight fall in prices in the second half of the 1990s, they by no means point to a price collapse. The overall series do conceal quite divergent developments from one region to another, however. A more detailed report on this as part of a separate study is scheduled for the second half of 2003.



1 See European Central Bank, Structural Factors in the EU Housing Markets, Frankfurt am Main 2003, on the monetary policy significance of the housing markets.

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