Economic conditions in Germany

Underlying trends

Further slight decline in GDP

There were still no stimuli to the German economy in the spring months. Exports lost their sustaining power and domestic demand showed no more than subdued growth. Once again, retarding factors had the upper hand. Indicators for the international setting do give the impression of a turn for the better and surveys point to an improvement in sentiment in a number of major sectors in Germany as well. At the same time, there is renewed optimism on the financial markets. So far, however, these promising signs have not been reflected in the hard data of the official statistics.

Such a situation is by no means untypical before a cyclical turning point. Nevertheless, this incipient cyclical optimism cannot yet be regarded as self-sustaining, especially as the brighter mood in some sectors of the German economy is hardly matched by output expectations. The corporate sector continues to take a very sceptical view of the outlook for exports. Even so, there is still the chance that the economy will pick up again as the year goes on and break free of its present underlying trend of stagnation.

The latest flash estimate of GDP by the Federal Statistical Office revealed that the underlying condition of the German economy, at least in the second quarter, remained weak. According to the estimate, there was a further slight fall in overall output. After adjustment for seasonal and working-day variations, GDP was 0.1% lower than in the previous quarter. The unadjusted and working-day-adjusted figures were 0.6% and 0.2% down on the year respectively. For the first half of the year, this results in a fall of 0.1% in working-day-adjusted terms.

Weaker external stimuli

It was a deterioration in the external situation, in particular, which exerted an adverse impact on production in the second quarter. The volume of imports declined from the high levels recorded in the first few months of the year, which had been sustained not least by large volumes of imported energy. At the same time, however, exports of goods and services have perceptibly lost momentum. Real net exports showed a further fall.

Persistently low level of investment

This was not offset by domestic demand. Construction investment had been clearly negative in the first few months of the year, not least owing to the inclement weather, and recovered only in technical terms. Demand for construction work remained decidedly weak. The propensity to invest in new machinery and equipment remained very subdued. The crucial factor in this is likely to have been that capacity utilisation was declining up to the end of the period under review. The Ifo test shows that industrial utilisation in June was approximately 1 percentage point down on March, and thus 2 percentage points lower than the average medium-term level.

Households cautious

According to surveys, households' sentiment has improved somewhat of late. At the end of the period under review, economic expectations and the outlook for incomes were less pessimistic than they had been in the first few months of the year. Nevertheless, the

Economic growth in Germany

Adjusted for seasonal and working-day variations, quarterly

1 At 1995 prices. — **o** From 1999, in euro.

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propensity to make major purchases remained subdued. This was also reflected by retail turnover in the spring months. According to preliminary figures, at constant prices and seasonally adjusted, average turnover between April and June was no higher than it had been in the first quarter. In contrast to the first three months of the year, the figure was again significantly down on the year. This was one crucial reason why households' consumption spending probably remained largely unchanged at the end of the period under review. Evidently, caution still appeared advisable given the continuing unfavourable situation on the labour market, the occasionally very animated debate on rising taxes and social contributions and the financing of the promised tax relief.

Sentiment in the industrial sector and among households

Seasonally adjusted, monthly

1 Source: Ifo Institute. — **2** Western Germany. — **3** Bundesbank calculations based on data from the *Gesellschaft für Konsumforschung*.

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Output and labour market

Marked reduction in industrial output

Second-quarter industrial output was significantly down on the first three months of the year, showing a seasonally adjusted decline of around 2¼%. It should be noted, however, that the start of 2003 had the stimulus of backlog effects from last year and that, in cyclical terms, the decrease is thus probably somewhat overstated. The year-on-year fall of 1% in the last three months (compared with a figure of +1½% in the first quarter) does confirm a marked slowdown in business activity, however. This is also suggested by the above-mentioned decline in capacity utilisation.

The sharpest falls in output were felt by producers of durable goods as well as in the capital goods sector. In seasonally adjusted terms, their production fell by just over 4%. Particularly affected were manufacturers of machinery and equipment, but car manufacturers – partly as a result of strikes – produced significantly fewer vehicles as well. Reduced business activity with export customers is likely to have had an impact on both sectors. The decline was much smaller in the case of intermediate goods producers. In the non-durable goods sector, a high level of output by drinks producers owing to the hot summer weather had a positive impact.

Construction picks up after winter slump

Construction output picked up again after the end of the winter hold-ups. According to the currently available data, second-quarter construction output was only slightly up on the first three months of the year in seasonally adjusted terms. It is quite sure, however, that the figures will be revised upwards in the annual overall survey. In each of the past two years, the upward adjustment factor has been roughly 3%. Accordingly, the year-on-year decline will be less than the current figure of 5½%. Nevertheless, the fact that output will still be significantly down on the year even after adjustment is an indication of the continuing unfavourable development in the construction sector. At present, there is no sign of an end to the downward slide. General construction and civil engineering were both almost equally affected. The situation is now scarcely better in the finishing trades.

Further decline in employment

Up to the end of the period under review, the labour market was feeling the pressure of further job cuts. This means that, up to the present, there has been a distinct fall in employment. According to the present calculations of the Federal Statistical Office, which have recently been revised downwards, the net average monthly figure for job losses since the summer of last year is around 55,000. By May, the seasonally adjusted number of persons in work had thus fallen to 38.10 million, ie around 660,000 lower than last year, which had likewise witnessed sharp reductions in the level of employment. This corresponds to a fall of around 1¾%.

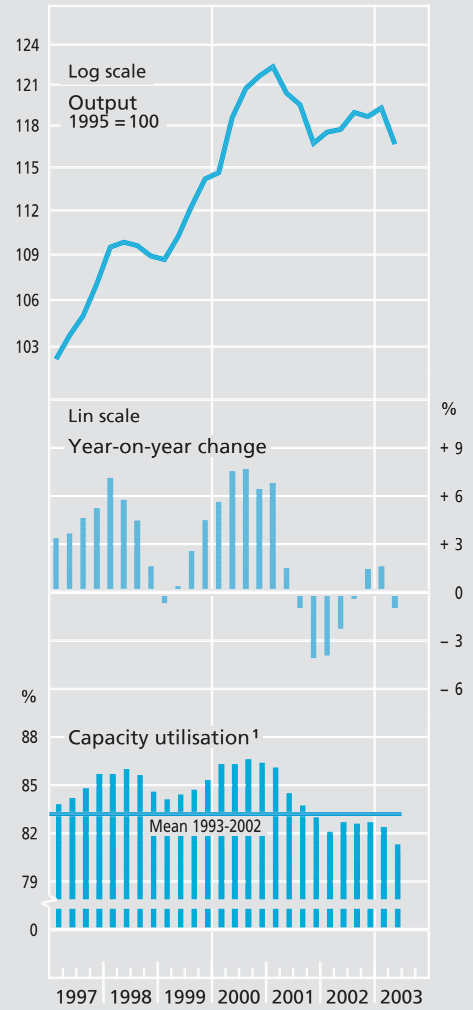
The largest reduction in jobs continued to take place in the construction industry. More than 6% of the workforce, ie around 150,000 employees, will probably have lost their jobs within the space of one year. However, there was also a further reduction in the number of persons employed in the manufacturing sector (excluding construction). The services sector, with only small increases in the number of jobs, did not offset this development to any great extent.

Lots of new mini-jobs?

The negative overall picture is not fundamentally altered by recent talk of nearly one million "new" mini-jobs having been created since April of this year. It is true that simplified legal regulations on low-paid jobs have been in force since April, but such a large increase within no more than a quarter of a year does not seem to be very probable in cyclical terms. Instead, it is more likely that the new provisions have made it significantly easier for some persons already holding low-paid jobs to be captured in the statistics. It may also be the case that more persons have taken up a second job. An additional factor to be considered in this context is that the average

Output and utilisation in industry

Seasonally adjusted, quarterly



1 Results of the Ifo business survey.

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Labour market

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number of hours worked in mini-jobs is very small. The change in the total number of hours worked is much smaller. Owing to the structural shifts in the forms of employment, it is becoming less and less possible to give an accurate description of the input of labour in the economy in terms of persons in work.

At the end of April, the seasonally adjusted number of persons officially registered as unemployed was roughly 4.41 million, ie 40,000 fewer than in April, the most recent month in which the figure peaked. The year-on-year increase went down to 305,000, compared with 415,000 in the second quarter. At the end of the period under review, the seasonally adjusted unemployment rate, as calculated by the Federal Labour Office, was 10.6%. Using the internationally standardised method, the figure was 9.4%.

Fall in official unemployment...

... due in part to special factors

Given a further decline in employment, the statistically measured fall in the official unemployment figure points to powerful special factors being in operation. This can also be seen from the fact that, up to the present, the year-on-year inflow into unemployment of persons previously in work was perceptibly higher than the number of those who found work and dropped out of the statistics during the same period. The fact that unemployment has nevertheless fallen is likely to be due mainly to the numerous legislative initiatives for restructuring the labour market (reorganisation of the Federal Labour Office; the "job placement offensive"; the *Job-AQTIV-Gesetz*, an act designed to get people back into work; the first and second Acts Promoting Modern Labour Market Services). These measures included a tightening of job-acceptance criteria and a stricter examination of eligibility for registering as unemployed. This has played a significant part in the sizeable increase in outflows of persons who have not taken up work or who have not de-registered for other reasons, such as illness or retirement, or owing to special regulations under the Social Security Code. Almost 880,000 de-registrations of this kind occurred in the first seven months of 2003, 160,000 more than 12 months previously. Although the number of renewed registrations (following failures to meet the reporting deadline) during the same period, at almost 175,000, was some 12,500 higher than in 2002, there is still a positive balance in terms of de-registration.

Furthermore, improved incentives have led to more persons leaving the unemployment rolls to become self-employed. The number of formerly unemployed persons who took up this option was around 67,000 higher than in the same period of 2002. By contrast, the expectations linked with the establishment of Personnel Service Agencies, which were intended to step up the placement of the unemployed in temporary and part-time work on a private basis, have not been fulfilled. Up to and including July, only 3,500 unemployed persons had been taken on by such agencies.

Orders

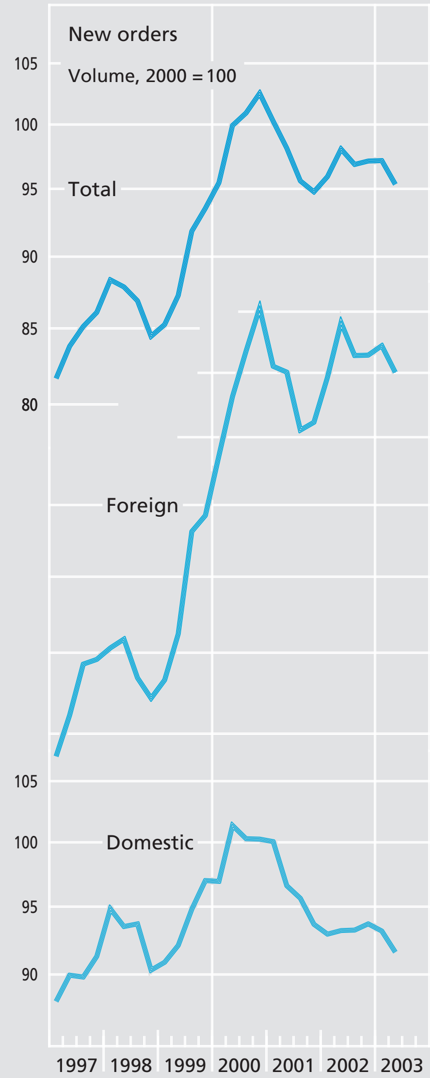
Deterioration in demand for industrial exports

Demand for industrial products has declined perceptibly over the past few months, with export business now also being affected. In terms of volume, seasonally adjusted new export orders on an average of the period from April to June were 2% down on the quarter. This meant that they were around 4% down on the year, compared with a year-on-year increase of 2¼% in the first quarter.

The decline was especially pronounced in the case of intermediate goods producers, where the seasonally adjusted flow of export orders went down by 4% on the quarter. The main sector affected was base metals. The decline was all the more apparent owing to the fact that demand up to the last few months of 2002 had been very buoyant – orders in the fourth quarter of last year had been 8% up on the year. Manufacturers of chemicals and chemical products also performed considerably less well than before, however. After seasonal adjustment, their orders fell by around 4½% in the second quarter. The de-

Demand in industry

Seasonally adjusted, quarterly, log scale



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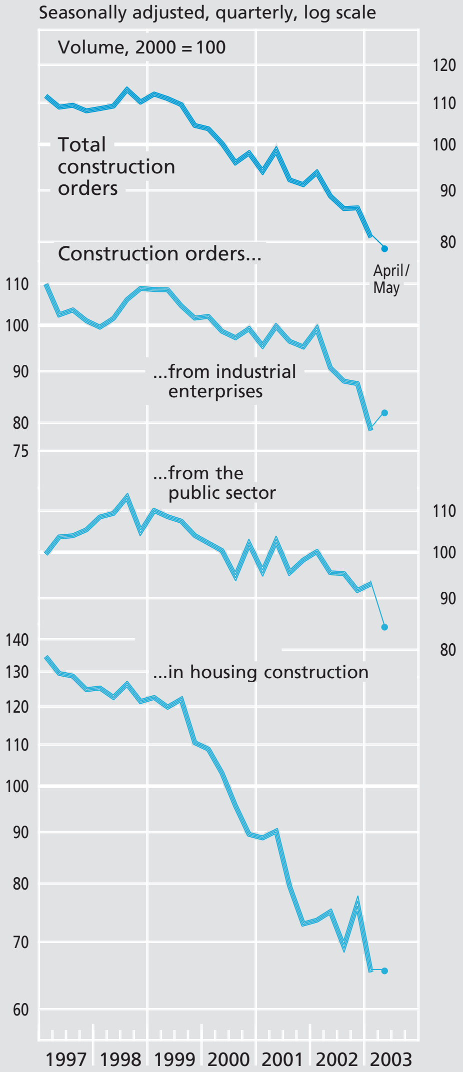
Demand for construction work



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cline was not so large in the case of capital goods producers, where a very large order in the "manufacture of other transport equipment" (aircraft, ships and boats, railways and rolling stock) had a positive impact. By contrast, manufacturers of machinery and equipment as well as manufacturers of computer and communications equipment reported a marked fall in orders. The non-durable goods sector held up comparatively well up to and including May, with clothing manufacturers receiving sizeable export orders, although the flow of orders decreased in this sector too in June.

Further losses in domestic business

The decrease in domestic business activity, which had already been subdued for some time, was only slightly less pronounced. Incoming domestic orders went down by 1¾% in the period from April to June. In terms of volume, this was likewise some 1¾% lower than in the same period of 2002, after the previous year's figure had been easily matched in the first few months. In contrast to exports, it was the capital goods sector that was affected more than average on the domestic markets. This was due not least to a significant decline in orders for private cars. In the basic materials sector, the chemical industry was largely able to hold its own, which meant that it partly counterbalanced the marked downturn in the steel industry.

Further fall in construction demand...

There was also less demand for construction work during the past few months. Seasonally adjusted new construction orders in April and May (more recent data are unavailable) were 2¾% down on the quarter. The figure for those two months was no less than 11½% lower than the already depressed level of 2002.

Given the critical financial situation, public sector contractors, in particular, were very cautious in placing orders. After seasonal adjustment, they reduced the volume of their new orders in April and May by nearly one-tenth compared with the winter quarter. Road construction and other public sector civil engineering work were especially affected. In the commercial sector, on the other hand, there was a slight increase in the volume of new orders. Even so, there had already been a dramatic decline in this sector during the first few months of the year. The level of orders was therefore very low even at the end of the period under review.

In housing construction, the debate on cuts in government assistance had triggered a surge of accelerated orders towards the end of last year. At the start of 2003, the level of business activity in this area was significantly lower and has not recovered since then. New orders continue to be a good one-tenth lower than in the same period of 2002. Taking the number of construction permits for dwellings granted in April and May as a yardstick for housing demand this year, a further overall reduction in rental housing construction is likely for 2003.

Consumer prices

Annual percentage change

Item	Percentage weighting	2002	2003		
		Q4	Q1	Q2	July
Energy	8.1	3.4	7.7	2.0	3.1
of which					
Refined petroleum products	4.2	8.4	14.4	0.7	2.2
Food	9.0	– 1.0	– 2.2	– 0.6	0.4
of which					
Seasonal products	1.6	– 4.6	– 9.5	– 2.6	1.2
Industrial goods	31.3	0.2	0	0.2	0.2
Services	27.1	2.1	1.4	1.4	0.8
of which					
Package holidays	2.0	1.3	1.0	2.5	– 3.8
Rents	24.4	1.4	1.2	1.2	1.1
Total	100.0	1.2	1.2	0.9	0.9
Memo item					
Harmonised Index of Consumer Prices	100.0	1.1	1.1	0.9	0.8

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Prices

Favourable price developments

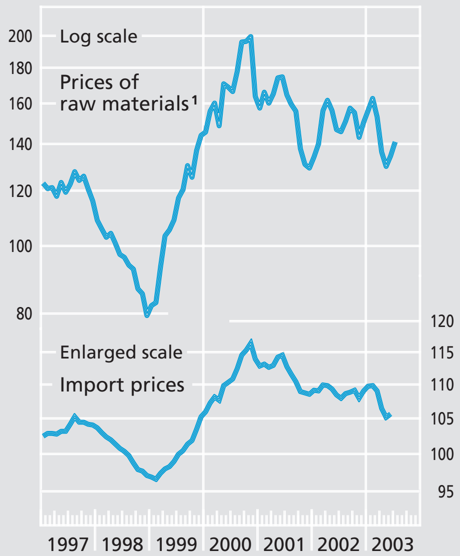
Price developments at the various levels of the economy were very calm up to the end of the period under review. Nevertheless, the dampening external effects have become weaker and oil prices have held firm at a fairly high level. The temporary upward pressure on prices due to unfavourable weather conditions has been limited so far. There are still no signs of a slide into deflationary tendencies, which many had been fearing until recently.

Stable consumer prices

In seasonally adjusted terms, consumer prices have been largely stable for some months. The year-on-year rate of increase, which is generally used as a measure of inflation, was 0.9% in July according to the national price index and 0.8% according to the Harmonised Index of Consumer Prices (HICP) used by the ECB. One factor in this was that the prices of seasonal food products, which had previously risen on account of the unfavourable weather conditions, returned to normal. The crop failures caused by the recent heat wave will probably not push up prices permanently either. Additionally, consumer prices for refined petroleum products have remained largely stable, and the shift in the main holiday period to August was one factor in the seasonal price increases for package holidays in July being comparatively small. This was one reason why the slight steady price increase for services did not continue towards the end of the period under review. In the case of in-

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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dustrial goods, numerous special offers caused the year-on-year rate of inflation to remain quite low.

High oil prices

Shortly before this report went to press, international oil prices were being quoted at just under US$30 for a barrel of North Sea Brent. They were thus above the limit set by OPEC, which is based on a basket of prices for seven types of oil. Prevailing concerns about further production losses in Nigeria and Venezuela, the slow pace at which production is being increased in Iraq and reports that stocks being built up for the coming winter are still at a low level were preventing a decline in prices. Moreover, from a European perspective, the price-dampening effects of a rising euro exchange rate have become less pronounced. As a result, German import prices, which are invoiced in euro, did not go down any further in June; the year-on-year fall in prices decreased to 2.7% from as much as 3.4% in April and May.

Producer prices unchanged

The phase of price reductions in industrial factory gate prices did not continue at the end of the period under review either. Seasonally adjusted producer prices for industrial products were unchanged in June, the year-on-year rate of increase remaining at 1.3%. Excluding energy, the price level continued to fall slightly. The year-on-year rate of price increase went down further to 0.4%. In May 2003, quoted prices for construction work largely held steady at their end-2000 level.