Overview

Flat path in the second quarter after strong growth at the start of the year

GDP in the second quarter unchanged from the preceding quarter

Following a sharp surge in growth at the start of 2005, the German economy followed a flat path in the second quarter. According to initial Federal Statistical Office data, after adjustment for the usual seasonal and working-day variations, aggregate output in the second quarter was just as high as it had been in the first three months of the year. However, the somewhat longer-term tendency becomes clearer if the first two quarters are viewed together. This shows a ¾% rise in real GDP in the first half of 2005 compared with the second half of 2004. The year-on-year increase was on the same scale.

Disparate developments in individual sectors

After a very strong start to 2005, industrial output was more subdued in the second quarter. On an average of April to June, seasonally and working day-adjusted output was up by ½% on the first quarter. In the wholesale and retail trade sector, wholesale business activity recorded a very favourable development in the second quarter. At all events, sales, which had already seen a slight year-on-year increase in the first quarter, rose sharply in April and May. This is particularly true of those wholesale branches related to the production sector, while the turnover of companies trading in consumer goods lagged well behind, as did retail sales. Among the remaining service sectors, commercial service providers, in particular, recorded a positive sales trend. In the consumer-oriented service sectors, such as hotels and restaurants, business activity contracted vis-à-vis the comparable period in 2004.

Higher investment ...

Aggregate output in the second quarter was bolstered by a slight improvement in domestic demand. However, this was due mainly to stockbuilding of intermediate and consumer goods. The positive trend in investment in machinery and equipment recorded at the start of the year continued into the second quarter. As the period progressed, however, momentum tailed off considerably. The weather-related fall-off in construction activity showed a slight rebound; however, real expenditure on new buildings remained subdued. It is still too early to speak of a widespread revival of investment. According to the Ifo surveys, the industrial business climate did not begin to pick up until the middle of the year.

... and exports

German export business continued to generate expansionary impulses in the second quarter, although not as strongly as in the first few months of the year. Owing to comparatively high imports of intermediate and consumer goods, this resulted in a decline in net exports. The increased inflow of orders from abroad, which accelerated towards the end of the period under review, and the ongoing optimistic export expectations of industry point to a continuation of the favourable environment for German exports in the coming period.

Further fall in private consumption

Private consumption remained subdued. Seasonally adjusted household consumption fell again slightly in the second quarter. This was associated mainly with the weak demand in the conventional retail trade sector, while seasonally adjusted new vehicle registrations rose sharply in the second quarter from their very low level in the first few months of the year. According to the July survey carried out by the consumer research institution, Gesellschaft für Konsumforschung (GfK), consumer sentiment has not deteriorated any further and respondents' propensity to purchase has even picked up slightly of late. At the same time, however, households' economic and financial situation was again considered to have deteriorated. The high level of uncertainty regarding employment prospects and the sustainability of the social security systems is clearly continuing to cloud households' outlook.

Structural changes on the labour market

The picture presented by the labour market remains overlaid by the effects of labour market policy measures which are tending to obscure the cyclical changes. For example, the sustained increase in the number of persons in work up to the end of the period under review was due mainly to the expansion of government-promoted supplementary forms of employment ("one-euro jobs"). Prior to this, the rises in subsidised low-paid part-time work ("mini-jobs") and one-person business start-ups had contributed to a decline in unemployment and to higher numbers of persons in work. The ongoing job cuts in industry and construction were offset by new jobs created in the services sector, in particular with commercial service providers and in the health and social work sector. Many of the latter are likely to be part-time jobs whereas it is largely full-time positions that have been lost in the industrial sector. Overall, the seasonally adjusted number of unemployed persons fell to 4.81 million by mid-July. This is equivalent to an unemployment rate of 11.6%.

Moderate wage increases

Against this backdrop, there was a continuing trend towards moderate wage rises, increasing working hours, and phasing out special payments under collective wage agreements. Moreover, an increased number of escape clauses were incorporated into industry-wide collective labour agreements. As a result, in the first six months of 2005, negotiated wage rate rises ranged from 0.4% in the construction sector to 3.4% in the iron and steel industry. Across the economy as whole, an average increase of around 1½% is emerging for this year. The increase in effective wage costs will, however, be much smaller, which should go some way towards reducing the entrenched structural unemployment in Germany.

Consumer prices and oil prices

In recent months, price developments have been shaped largely by rising oil prices, which have reached ever new highs. The impact of increasing oil prices on the domestic price level was reinforced by temporary depreciations of the euro in the foreign exchange markets. In line with this, there was a sharper rise in seasonally adjusted consumer prices in July. Year-on-year inflation increased from 1.7% in the second quarter to 2% in July. Excluding energy, at the end of the period under review, the cost of living was less than 1% up on the year.

Monetary policy course still appropriate

At the euro area-wide level, too, there have been no signs so far of a build-up of domestic inflationary pressures which would indicate a need to alter the current, steady interest rate course. Consequently, the Governing Council of the ECB made no changes to the Eurosystem's key interest rates in the past few months. The rise in oil prices during the summer months and the depreciation of the euro up to the middle of the year have, nevertheless, led to increased inflation risks. Moreover, the ample liquidity in the euro area still calls for a high degree of monetary policy vigilance. At any rate, monetary growth has continued to gain momentum; between April and June, euro-area M3 grew by 9½% in annualised terms. Medium and long-term market interest rates fell again in recent months, resulting in a further flattening of the yield curve. This fostered investors' pronounced preference for liquidity and is boosting demand for credit in the euro area, in particular for real estate and corporate financing. Banks in Germany likewise recorded increases in private-sector borrowing in the course of the second quarter. In terms of financing, therefore, there are no obstacles to a stronger economic recovery in Germany either.

Strained public finance situation

The continuing strained financial situation of general government is a cause for concern. It now appears that the general government deficit ratio (as defined in the national accounts) will exceed 3% in 2005, too, and the government debt ratio looks likely to rise further. The financial plans of central and state government also indicate a substantial need for consolidation in the medium term. This will make it far harder to achieve structural compliance with the limits set by national budgetary law than with the 3% ceiling for the deficit ratio laid down by European law. Speedy consolidation is not an end in itself, but is urgently needed in order to widen fiscal policymakers' constrained radius of action and to avoid imposing an additional burden of high government debt on future generations, who will already have to bear a heavier load ensuing from demographic changes. Ultimately, strategies are needed which will also create a long-term sustainable basis for the social security systems and, by means of further reforms of the labour market and taxation system, lay the foundations for more employment and growth.