

Economic conditions in Germany

Underlying trends

The cyclical upturn in the German economy continued in the second quarter of 2007. According to initial figures from the Federal Statistical Office, overall output in the second quarter went up by 0.3%, after adjustment for seasonal and calendar effects, compared with 0.5% in the first quarter. There was a 2.5 % rise on the year after adjustment for working-day variations. This means that in the first half of 2007, the annualised gross domestic product was 2.3% greater than in the previous six-month period compared with 3.8% in the second half of 2006. However, the slowdown in the pace of growth may in fact understate the underlying economic dynamics. This is particularly true if account is taken of the impact of the fiscal withdrawal due to the VAT increase since the beginning of the year and the advance purchases in 2006 associated not just with consumer durables but also with residential construction. The fact that growth has not ground to a complete standstill in these circumstances and that the cyclical blip predicted by many did not arise may therefore be seen as a clear indication of the stronger endogenous base of the current upswing.

*Economic
upturn
continues*

No detailed figures on the national accounts are yet available. However, the indicators available point to a positive growth contribution by private consumption in the second quarter. In the first quarter the negative effects of the VAT increase had resulted in a clear dampener from which the spending patterns of private households are only gradually recovering. The propensity to purchase which

*Recovery in
private con-
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had been – at times severely – impaired by the VAT increase, is now showing a counter-swing, which indicates that the negative impact of the VAT increase on the consumer climate has probably weakened significantly on the whole. The turnover pattern in traditional retail outlets and the increased number of purchases of private cars likewise signal a revival in private consumption in the second quarter.

Growth process supported by expenditure on machinery and equipment

Investment in fixed assets in the second quarter is also to be seen in the context of the fact that construction activity benefited from mild weather at the beginning of the year. A certain “technical counter-reaction” was therefore expected in this sector. At the same time, expenditure on machinery and equipment in the second quarter exceeded the level of the

first quarter. Over the course of the first six months, this expenditure was important in supporting the growth process and the strong recovery of the labour market. In view of the high level of capacity utilisation and the healthy order book situation, the incentive to expand has become more pronounced. The various sentiment indicators have not risen any further of late. However, in view of the highs reached and given the very favourable developments in 2006, this is not an indication of a turning-point. The underlying sentiment in the German economy is still better than average, and the increasing willingness to recruit new staff shown by many small and medium-sized enterprises as well as large enterprises is proof of the generally optimistic assessment of the future prospects.

Real exports of goods and services increased in the second quarter. At the same time, imports decreased markedly compared with the first quarter, during which they had increased discernibly. As a result, foreign trade made a significantly positive contribution to overall economic growth in the second quarter. If, however, account is taken of the deterioration in the terms of trade, which means a loss in real income from non-residents, external influences may have been generally less significant in the period under review.

External sector adds to positive growth

Output and sales

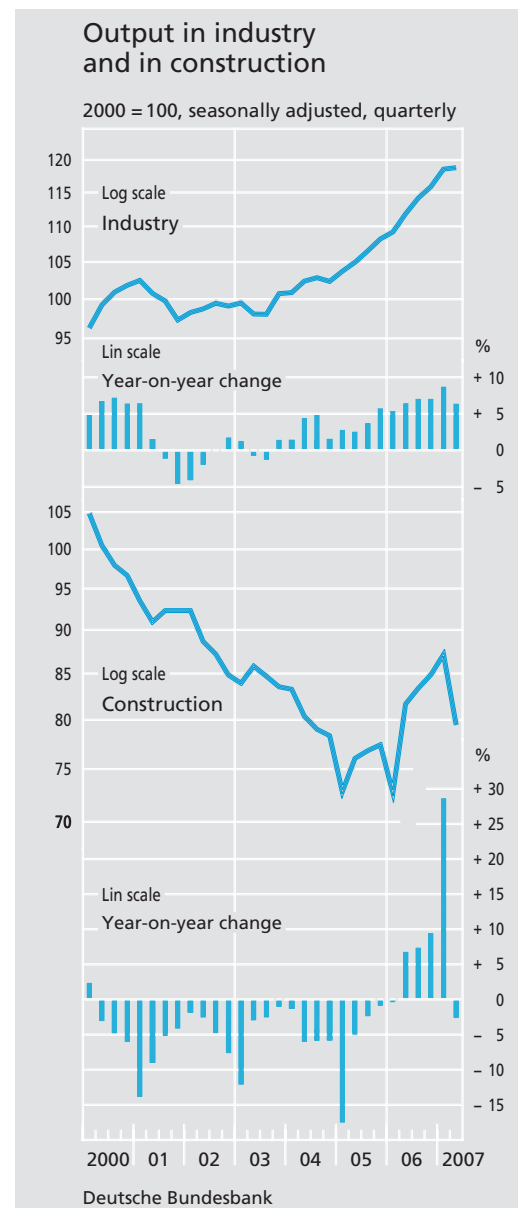
Industrial output was in full swing when this report went to press. The momentum in growth, however, slowed in the second quarter. After seasonal and calendar adjustment,

Industrial activity in full swing

second quarter production increased by ¼%, compared with an increase of 2¼% in the previous three-month period. A bridge-day effect in April subdued the quarterly result.¹ April saw warning strikes, particularly at car manufacturers, which resulted in production losses. Furthermore, capacity shortages may have played a role. The year-on-year increase went down to 6½%. In June capacity utilisation in industry declined from the very high level reached in March, a development which is due primarily to the production of durables. However, capacity utilisation exceeded the previous year's level by ½ percentage point and therefore remained above the level of 2000, which was a buoyant year. The increased use of factors of production is also reflected in the growing shortage of specialised labour in many sectors of industry.

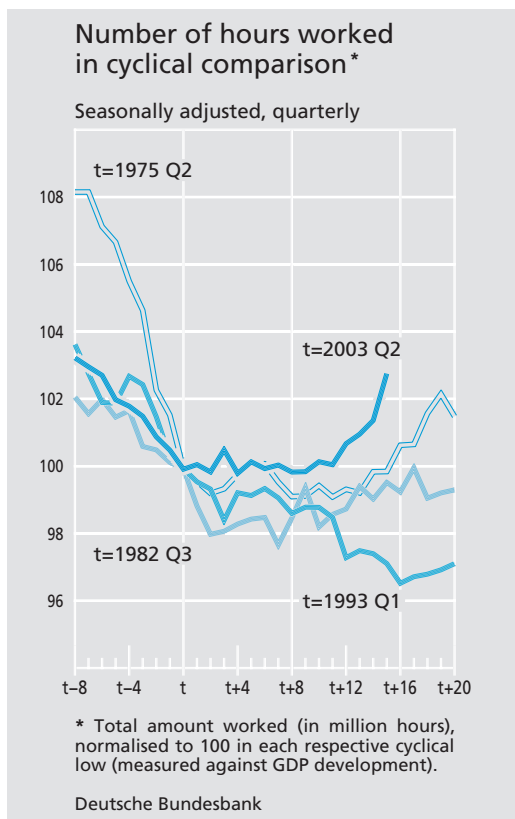
Construction output back to normal

Construction output after seasonal and calendar adjustment in the second quarter fell by 8¾% against the first quarter. This, however, is not to be seen as an economic downturn. Instead, as already mentioned it was attributable to the fact that the second-quarter upturn was less pronounced owing to increased production in the unusually mild winter months. General construction was particularly affected by the decline whereas the situation for civil engineering was more favourable. Residential construction showed a general decline in turnover of 16¼% after adjustment for seasonal factors in the second quarter compared with -7¼% in the first quarter. For finishing trades, which are less weather-dependent, data are currently available for the first quarter of 2007 only. According to these data, the number of hours worked was



7¾% above the previous-year level. Even if account is taken of the fact that the finishing trades have continued to profit from maintenance work, residential construction overall was weak in the second quarter.

¹ Experience has shown that working days before and after public holidays are often used by employees to take a long weekend or a short holiday break. Such special features cannot be captured fully by the statistical adjustment procedures.



Positive assessment of situation for service providers

Recent indicators of cyclical growth in the service sector show a favourable picture. The indicator of the business situation produced by the Ifo institute was markedly higher in the second quarter than in the first quarter. This is largely a result of the strong increase in April. Since then the indicator has been falling slightly. According to the business survey "Service Providers of the Information Society", the ZEW subindicator for the assessment of the business situation, survey respondents reported that the situation was better than at the beginning of the year.

Employment and unemployment

The favourable development in the labour market continued in the second quarter. The

number of persons in work increased in the period from April to June by a seasonally adjusted 109,000 to 39.70 million. This is equivalent to a year-on-year increase of 676,000 persons or 1.7%. However, employment did not increase as fast in the second quarter of 2007 as it had done in the first quarter. Nonetheless, seasonal adjustment, which is based on the multi-year average, also overstates here the improvement during the mild winter months. During the first six months of 2007 annualised employment gains stood at 1.8%, significantly higher than the employment gains in the first and second halves of 2006 (0.9% and 1.4% respectively).

Employment-intensive upturn

The current cyclical pattern in the labour market is very similar to previous recoveries. If work volume is taken as the most comprehensive indicator, a more advantageous trend than in earlier cycles can be observed, and this despite relatively moderate rates of increase in total economic output. The main reason for the increased number of persons in work in the current upswing is probably the wage restraint of previous years. However, the positive effects of the labour market reforms have certainly also played a roll.

Estimations by the Federal Employment Agency suggest that there is stronger growth in employment subject to social security contributions than in employment as a whole. In May – more recent data are not yet available – the number of persons in employment subject to social security contributions was 560,000, or 2.1%, higher than in the same month of the previous year. Almost half of the increase was attributable to the sector

Rise in employment subject to social security contributions

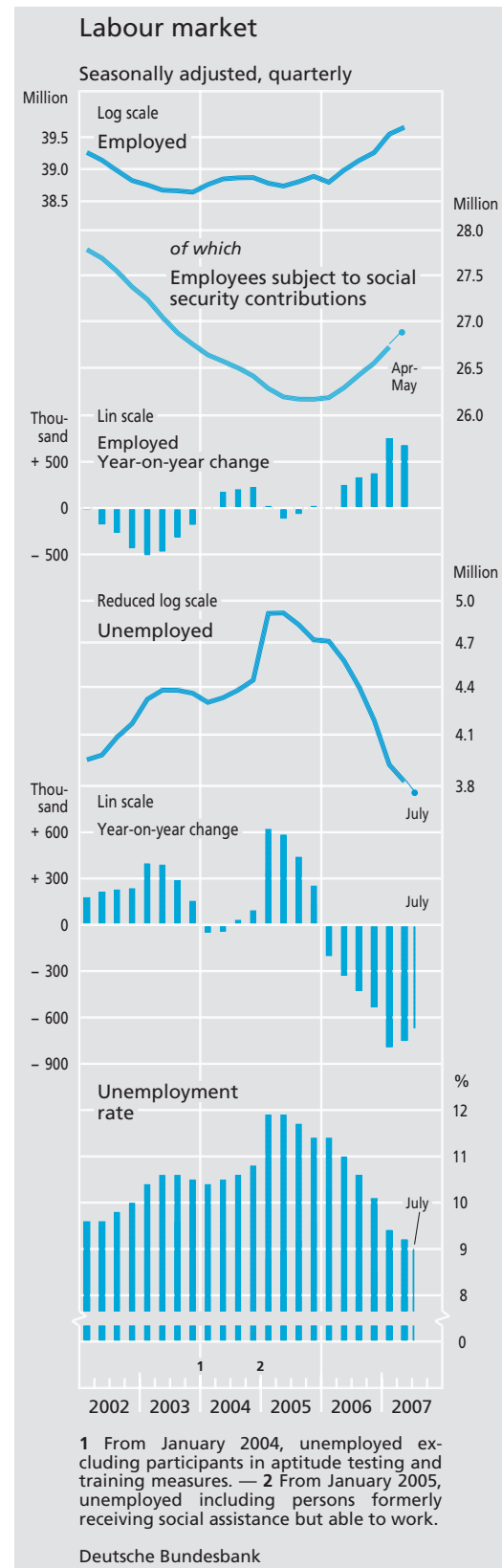
“financing, renting and business services”, which also includes labour leasing. This was markedly lower than in the previous year. Increases were also observed in the cases of self-employed persons, “mini-jobs” and “midi-jobs” and government-assisted jobs.

Signs of shortages

Various indicators are now showing partial shortages in the labour market. The delay in filling an advertised vacancy according to the employment offices markedly exceeded the multi-year average for the third quarter in succession. In the Ifo business survey, an increasing – though still limited – number of enterprises are responding that a shortage of workers is the reason for the lack of output growth. The BA-X index of non-government-assisted jobs, which has data on jobs – provided they are known to the Federal Employment Agency – from 2004 to the present, currently stands at a record high. The Ifo employment barometer, which aims to measure the willingness of trade and industry to recruit new staff, has likewise been recording record highs since measurements began in 1998 from the beginning of the year.

Sharp reduction in long-term unemployment

It is becoming increasingly difficult to find those workers amid the strong demand for labour, that are well-educated, experienced and perfectly suited to a given vacancy. For this reason, people are increasingly being employed who have similar or lower qualifications or generally have difficulty finding employment. Accordingly long-term unemployment is now falling perceptibly just as short-term unemployment has been falling for some time. The number of people in receipt of unemployment benefit II is now falling al-



most as quickly as those in receipt of unemployment benefit I. In a year-on-year comparison there were 313,000 fewer recipients of unemployment benefit II registered as unemployed compared to a decrease of 358,000 in the case of unemployment benefit I. It must be remembered that, as a result of the reduction in the period of entitlement to unemployment benefit which came into force at the beginning of 2006, there has been a much quicker rate of change from unemployment benefit I to unemployment benefit II since February 2007.² Without this effect the decrease in the number of unemployed recipients of unemployment benefit II would presumably have been even greater. Furthermore, a significant number of these people are participating in employment through mini-jobs. As a result, the long-term unemployed are also benefiting from the strong demand for labour. This is clearly supported by the fact that low wages can be "topped up" with unemployment benefit II. According to calculations by the Federal Employment Agency, this form of support has become more significant. Consequently, there is now a chance that the hard core of unemployment will be reduced in size.

Unemployment falls further

Once the favourable special factors caused by the weather had come to an end, the seasonally adjusted decline in registered unemployment slowed slightly in the second quarter. Unemployment figures decreased in the past quarter by 97,000 to 3.84 million, 754,000 fewer than one year earlier. The fall in unemployment was, therefore, somewhat stronger than the rise in employment, a development which was connected to the

demographically related reduction in the size of the labour supply. The seasonally adjusted unemployment rate fell from 9.4% in the first quarter of 2007 to 9.2 % in the second quarter.³ It was therefore 1.9 percentage points lower than at the same time last year. In July the seasonally adjusted decline in unemployment continued. The unemployment rate is now 9.0%.

Wages and prices

The 2007 pay round continued in the second quarter with important agreements in the metal-working industry, the printing industry, at Deutsche Telekom AG as well as in the wholesale and foreign trade sectors. In the construction industry it is still unclear whether the arbitrator's suggestion put forward in May will be finally accepted. The process had become necessary because the initial agreement failed after being vetoed by some re-

2007 pay round continues

² Nevertheless, the number of recipients of unemployment benefit II has also declined owing to demographic reasons. In addition, the efforts of the employment agencies and joint social entities comprising employment agencies and municipalities to encourage recipients of benefits back to work probably resulted in a fall beyond the extent of the pure employment effect.

³ The unemployment rate calculated according to the criteria of the International Labour Organisation (ILO) used for international comparisons has been estimated since May 2007 using the change in the number of registered unemployed. Since the beginning of 2004, the ILO ratio has been calculated using the results of a telephone survey. This survey was supposed to bridge the gap until the transition to a continual labour force survey as part of the microcensus, however this was postponed in April 2007. As the new continual survey is still not able to deliver sufficiently reliable results, a further bridging solution had to be found which is based on the traditional estimation procedure used before 2004. According to an EU Regulation, this procedure should have been replaced by a continual labour force survey in 2002 (for Germany however, a transition period applied until the end of 2004). This is now planned for the reporting month of September 2007.

gional employers associations. The rejection of the arbitrator's suggestion by two north German employers associations led to strikes lasting several weeks in the corresponding wage-bargaining areas. The arbitrator's suggestion provided for an agreement running for 24 months and starting with two "zero months" followed by a permanent increase in wages of 3.1% and further increases of 1.5% and 1.6% in 2008. Additional elements included lump-sum payments. A final agreement has also still to be reached in the case of Deutsche Bahn AG. In this case, the trade unions Transnet and GDBA have already agreed on a sustained uniform increase in negotiated wages of 4.5% and a one-off payment of €600 over a period of 19 months. The GDL engine drivers' union is still pursuing a much larger wage increase for train drivers.

The agreement reached in the printing industry came into force in mid-May.⁴ In this case it was agreed that wages would be increased by 3.0% after three "zero-months". With a total running time of 24 months, it is planned that after 12 months there will be a further permanent increase in the weekly wage of 2.1%. In the wholesale and foreign trade industry regional representatives of employers and employees agreed on an increase in wages over 24 months of 2.4% from July or August 2007 with a further 2.0% increase from mid-2008. In addition, graduated monthly lump-sum payments were agreed which would not affect scheduled rates of pay. In the case of Deutsche Telekom AG, it was agreed that around 50,000 employees would be outsourced to subsidiaries with different pay conditions. These would include,

above all, a gradual reduction in remuneration by a total of 6.5% and an increase in working hours from 34 to 38 hours without a corresponding pay increase. The new wage agreement also contains various measures to make working conditions more flexible as well as a reduction in starting wages of approximately 30%. A "zero-round" until the end of 2008 was agreed for the 100,000 Deutsche Telekom AG employees who were not to be outsourced.

Agreements this year vary distinctly from sector to sector and reflect the different economic situations of these and the relative strength of their bargaining positions. For example, the large settlement in the metal-working industry bears testimony to the exceptionally positive conditions in this industry while the agreement in the printing industry is to be seen in the context of the moderate economic growth that has been recorded in this sector. The tough negotiations in the construction industry as well as in the case of Deutsche Bahn AG illustrate the difficulties in reaching a consensus, both for employers and employees. The agreement in the case of Deutsche Telekom AG shows that even in economically positive times employees are willing to accept pay cuts and longer working hours if jobs are threatened. Overall, the trend appears to be towards more differentiation and towards the agreement of one-off payments, which are less of a burden in the future than increases in scheduled rates of pay (see box on page 50).

Sectoral differences in negotiating positions

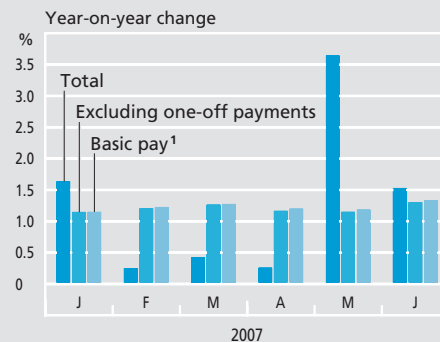
⁴ The agreement in the metal-working industry was already reported in the Monthly Report of May 2007.

Extension of the reporting categories in the Deutsche Bundesbank's negotiated pay rate statistics

Collectively negotiated labour agreements between employers associations and trade unions have become more complex in recent years in several respects. For example, (flat-rate) one-off payments, paid in addition to the normal remuneration, are playing a greater role. One reason for such one-off payments, which do not affect scheduled rates of pay, is to ensure that, particularly in times of growing competitive pressure, a company's future earnings are not burdened by too high a cost base. Thus one-off payments are often made during the first months of a pay agreement or even throughout the lifetime of the agreement, instead of a permanent percentage increase in the regular wage. One-off payments may also be awarded as financial compensation for increases in regular weekly working hours. In the context of an improving macroeconomic situation – particularly in export-related industries – one-off payments are also a way of allowing the employees to participate in the company's commercial success (which was facilitated by their preceding wage restraint) without pushing up marginal production costs. The flat rate means that those in lower wage brackets benefit more from such additional payments, and thus such agreements also contain a "social" component.

Within the Deutsche Bundesbank's negotiated pay rate statistics, agreed pay rates, including all one-off payments and fringe benefits (notably holiday pay, the Christmas bonus and saving subsidies) are recorded in the months in which they are payable according to the collective labour agreement. This is designed to ensure consistency between the monthly negotiated wage index and the quarterly figures on actual earnings (including benefits that are not covered by the collective agreement) in the national accounts, in which one-off payments are, as a general rule, likewise recorded at the time that the payment is actually made. The overall index of negotiated pay rates, on which the Bundesbank's reporting of employee remuneration has been based up to now, has become much more volatile in recent years owing to the increased frequency of

Negotiated rates of pay



one-off payments. Large one-off additional payments push up the index and its year-on-year increase during the month that payments are made. One year later, the annualised rate is then, as a general rule, pushed down (baseline effect). This makes it far harder to interpret the true development of negotiated wages. During the first six months of the current year, for example, the year-on-year average increase in the negotiated pay rate index varied between 0.2% and 3.6%. If, by contrast, temporary additional payments are factored out of the calculation, the development is much more even. And if basic pay rates alone are considered (ie also disregarding fringe benefits) the development is smoother still. From a medium-term perspective, these three statistical series nevertheless show a similar evolution of negotiated wages.

Starting now, table X.9 in the Statistical Section of the Monthly Report will include, alongside overall negotiated pay rates, the growth rate of negotiated wages excluding one-off payments and also of basic pay rates, in each case for the economy as a whole. Information on the production sector (including construction) can be found at http://www.bundesbank.de/statistik/statistik_zeitreihen.en.php

Negotiated rates of pay

Year-on-year change (%)

Item	2001	2002	2003	2004	2005	2006	Average 2001 to 2006
Total	1.9	2.7	2.1	1.4	1.1	1.3	1.7
Excluding one-off payments	2.2	2.3	2.2	1.3	0.9	0.9	1.7
Basic pay ¹	2.2	2.3	2.4	1.7	1.0	1.0	1.8

¹ Negotiated pay rates excluding one-off payments and excluding regular fringe benefits (holiday pay, Christmas bonus, saving subsidies etc).

Deutsche Bundesbank

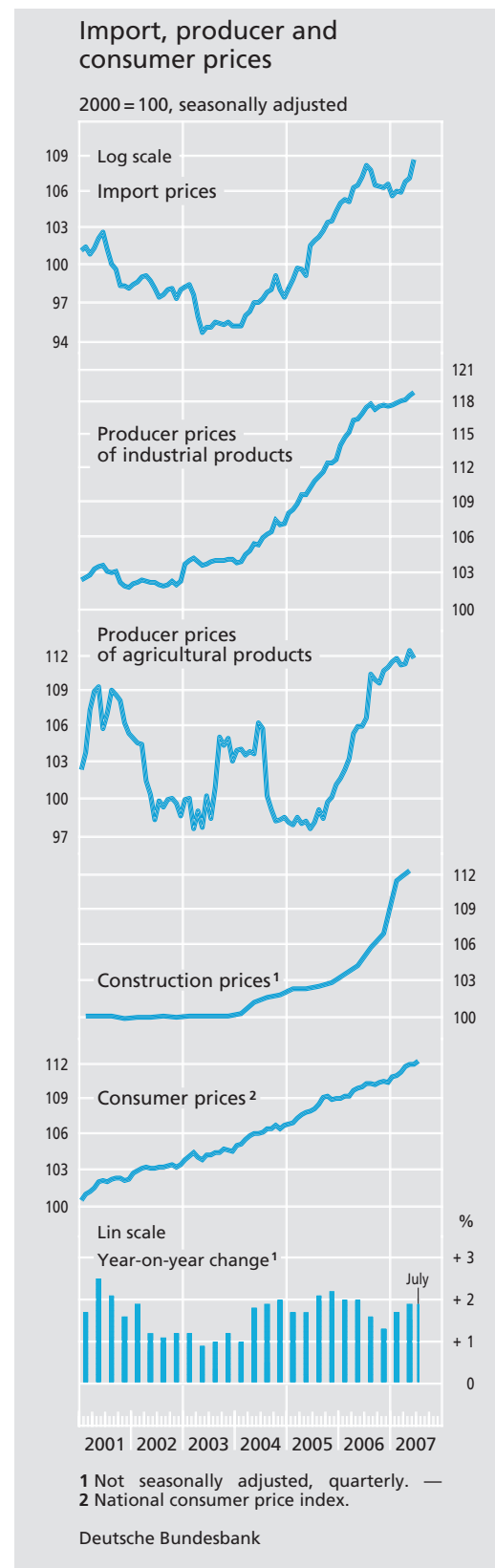
Negotiated wages and salaries in the economy as a whole

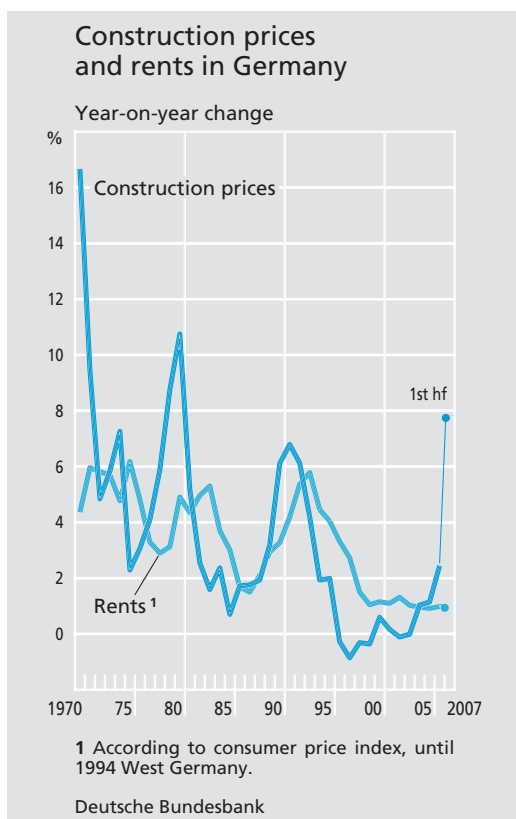
According to the Bundesbank's pay rate statistics, the negotiated rates of pay in the second quarter of 2007 were 1.8% up on the year. A one-off lump-sum payment in the metal-working industry is included in this. In the first quarter, base effects from one-off payments from 2006 dampened the annual rate of increase to 0.8%. If one-off payments and collective additional payments are excluded, the increase in basic remuneration was 1.2%. The new increased scheduled rates of pay as a result of wage agreements will first be reflected in the negotiated wage index in the third quarter.

Very strong rise in import prices...

Price developments in Germany were again significantly determined by developments in the markets for energy and other commodities. The resultant increase in prices was eased by the appreciation of the euro. Overall, the price of German imports increased strongly in the second quarter of 2007. In comparison with the first quarter, importers had to spend 1.6% more after seasonal adjustment. As a result, the reduction in prices in the two preceding quarters was reversed. Even if energy is excluded, however, there was once again a notable increase in seasonally adjusted terms. Strong price increases in intermediate goods overcompensated for decreases in the price of capital goods. The relatively unfavourable development in the case of consumer goods continued. Year-on-year inflation stood at 0.7%, or 1.8% if energy is excluded.

The price of German manufactured goods intended for domestic sale also increased notably, by 0.6% after seasonal adjustment. Ex-





... and clear increase in price of manufactured goods

cluding energy, the increase was similarly strong, particularly because the increased price of imported intermediate goods was passed on. The overall unfavourable trend in agricultural producer prices was reflected in industrial producer prices for consumer goods. The main contributor to this was the increase in farm gate prices of dairies. The price of industrial products, excluding energy, increased by 2.7% on the year, or 1.7% if energy is included. As export prices increased discernibly, albeit significantly less than import prices, there was a deterioration in the terms of trade. Even so, there was still a plus of 1.1% on the year. In July the price increase of German industrial goods declined to 1.1%, or 2.5% if energy is excluded.

The increase in construction prices slowed markedly in comparison with the first quarter. However, at 0.8%, the rise was still stronger than in mid-2006. The year-on-year increase went up to +7.9%. As in the quarter before, the increase in prices stretched across all sub-sectors of construction. The substantial increase in construction costs may also have medium-term effects on housing rents, whose weight in the German CPI is 21.2% (HICP 10.8%). In the past, rents have followed construction prices, although, generally with a certain time lag. At present the increase in rents is being subdued by broadly stable land prices.

Further sharp rise in construction prices

At a seasonally adjusted 0.7%, consumer prices rose slightly faster in the second quarter of 2007 than in the first quarter. According to calculations by the Federal Statistical Office, around 0.2 percentage point was the result of the introduction of tuition fees in several federal states. In addition, just under 0.3 percentage point was due to the ongoing increase in energy prices. This aside, price increases overall were fairly subdued. Food prices were 2.0% more expensive year on year. The influence of the hike in prices in the international markets for a number of agricultural commodities gradually became noticeable to consumers. In the case of industrial goods (excluding energy) the annual inflation rate was only 1.7% despite the increase in VAT. Price-dampening influences were the result of the appreciation of the euro. The price of services went up by 2.8% on the year mainly as a result of the VAT increase and the introduction of tuition fees. If the average increase of 1.8% in energy prices and the 1.1%

Consumer price increases due mainly to tuition fees and crude oil prices

rise in housing rents are taken into account, the annual rate of increase for the second quarter of 2007 amounts to +1.9%, according to the national consumer price index. According to the harmonised index of consumer prices, the figure was +2.0%.

Increasing consumer prices in July due to package holidays and energy

In July consumer prices increased by 0.3% after seasonal adjustment. This was mainly attributable to significantly higher prices for package holidays. The cost of energy increased further, especially that of fuels and heating oil as a result of sharp increases in crude oil prices. The lifting of the requirement that domestic electricity prices had to be approved, led on average to no more than a moderate increase in prices. The cost of food went up sharply. A contributory factor was that more retailers passed on to customers the increases in farm gate prices for dairy products which had taken place in June. The year-on-year increase in the CPI increased from 1.8% to 1.9% in June. The year-on-year increase according to the harmonised index of consumer prices was unchanged at 2.0%. Owing to the comparatively low energy prices in the second half of 2006, significantly higher annual rates are to be expected in the coming months, if only as a result of the baseline effect. A risk of further increases is posed by the fact that oil prices have increased strongly of late and there are shortages in agricultural markets.

Orders received and outlook

The prospects for a continuation of economic growth remain favourable. This is suggested

at all events by the orders situation and the relevant sentiment indicators. New orders received by enterprises increased strongly again in the second quarter of 2007, rising by a seasonally and calendar-adjusted 4% from their already high level in the first quarter when they had already increased by 3½%. The year-on-year increase went up to 11½% after calendar adjustment. Unusually large orders in June, especially from abroad, played a role here. This applies to the aircraft and aerospace industry as well as to shipbuilding. Large orders included in the statistics and with a value of more than €1 million are by no means as rare as one might imagine. For this reason it would not be appropriate to exclude them completely from the current orders situation in order to measure the basic trend in orders received. Admittedly, large orders generally take longer to have an effect on output than "normal" orders, which are relatively quickly converted into output. The strong growth in orders in the second quarter therefore overstates the response usually to be expected of output in the third quarter. If those large orders which may be considered unusual are excluded, the order volume in the second quarter is still 2% greater than the average of the first quarter.

Demand for manufactured goods rises further

Not least as a result of the large orders received, export orders increased by 6½%. New orders received from domestic customers also increased by a further 2%. All major sectors of industry, the capital goods industry in particular, were able to profit from the favourable growth in orders received.



In view of the continued buoyant growth in orders received and the cyclical “breather” in the industrial sector, the level of orders of many enterprises has grown further. This means that the ratio of the order volume in the order-based manufacturing industries to the production capacity available is increasing further. The order capacity index which is regularly calculated and now continuously published provides information on this. It currently stands well above its long-term average.⁵ The index stands not only at the highest level in this cycle but also has reached a level which has not been measured since reunification. The situation regarding the length of order books is similar. In June, the value of this indicator at 3 months, was only slightly below the very high level reached in March. Also when seen against this backdrop, the economic outlook remains favourable.

Large number of orders on hand

The sentiment indicators for the near future are at a high level. However, they have not increased further of late. Although the Ifo business expectations in the second quarter were above those of the first quarter, they have been decreasing slightly since June. The ZEW expectations also reached a high in May. Following a generally more volatile course, the

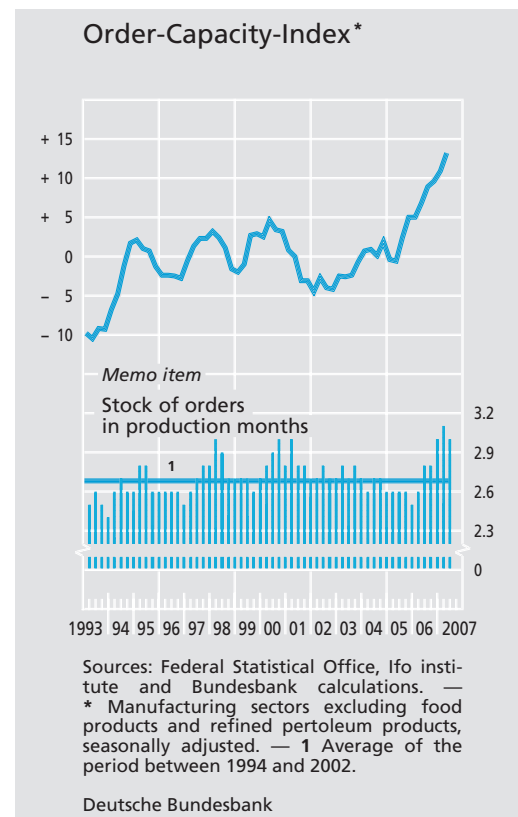
No further improvement in business prospects of late

⁵ For information on the design and interpretation of the order capacity index see Deutsche Bundesbank, Industrial orders and production: how informative is the order capacity index?, Monthly Report, February 2007, p 52. Output and the orders received in the order-based manufacturing industry are measured by aggregating the individual results and the weighted value added. Furthermore, capacity utilisation in the manufacturing sector excluding food and refined petroleum products, which is established by the Ifo institute is included in the calculation. The order capacity index is calculated on a quarterly basis and is available on the website of the Deutsche Bundesbank under Business Statistics (http://www.bundesbank.de/statistik/statistik_konjunktur.en.php) in the “time series” section.

indicator fell relatively sharply in the following months. It must be remembered, however, that for the ZEW financial market test it is not enterprises but instead financial experts that are questioned. Furthermore, the ZEW indicator is based only on expectations. It also covers trade and industry and the financial sector. The indicator, therefore, tends to react more sensitively to changes in and estimations of the capital and foreign exchange markets than the Ifo business expectations. It may also be more profit-oriented. It is significant that the greater caution in the July result is due to expectations for the financial sector and the other services (excluding trade). The Ifo business expectations for commercial, non-financial service providers have not been as high since May. The Reuters Purchasing Managers' Index for the services sector had an upward trend in the second quarter; however, in July it dropped slightly.

*Normalisation
of construction
demand*

In the construction industry, the business expectations for the coming six months became slightly more cautious in the second quarter after extremely positive developments at the beginning of the year. The balance of positive and negative reports, however, still lies far above the level of the final six months of 2006. The demand for construction work was 1% less than the average of the first quarter in April-May (more recent figures are not yet available). This is linked to the volatile nature of public sector orders. The demand for housing construction, which has again increased, is to be valued positively as this had fallen dramatically during the winter owing to the dampening effects of the VAT increase. Industrial construction will probably increase



once again due to the positive effects of the generally favourable investment environment even if no additional demand stimuli have recently come from this area.

Overall, the available indicators point to a continuation of the positive underlying trend. During the rest of the year fixed investment is likely to benefit more from the high capacity utilisation in the industrial sector and the positive order situation following the normalisation in the construction industry, which had temporarily curbed growth in the second quarter. The prospects of continuing strong export growth are also good given the increasing inflow of export orders and German firms' high, and still sustainable, level of competitiveness and attractive range of goods. To date, the euro's higher rate of exchange has

*Underlying
trend still
favourable*

hardly altered the picture. This is also due to the fact that today the German economy has a product range whose sales profile responds far less sensitively and fairly slowly to shifts in exchange rate patterns. Moreover, world trade is continuing to grow most favourably, as has recently been confirmed by the IMF.

Labour market stimuli increasingly important for private consumption

The dampening effects of the VAT increase could have a lingering impact on private consumption. The higher oil prices are likewise squeezing the purchasing power of disposable income. However, households' spending

behaviour, which was temporarily constricted by their response to the VAT rise, should be bolstered more and more in the next few months by the improved situation in the labour market and the wage agreements reached this year. The GfK gauge of consumer confidence has improved since March, and income expectations in the second quarter were significantly higher than in the first quarter. Households' economic expectations show that the upswing is now also looming ever large in the perception of consumers.