

Economic conditions in Germany

Overall economic developments

The cyclical upturn in the German economy continued in the third quarter of 2007 at a faster pace. According to initial figures from the Federal Statistical Office, overall output went up by 0.7% after adjustment for seasonal and calendar effects, compared with 0.3% in the second quarter. The year-on-year increase after calendar adjustment was 2.5%. This means that overall capacity utilisation is likely to have shown a further increase during the year. The sharp increase in VAT at the beginning of the year as well as the short-falls in demand as a reaction to the earlier anticipatory effects was placing a strain on private consumption and housing construction in the first half of the year. The expansionary cyclical forces began to have a greater influence again in the quarter under review, however.

*Faster pace of
growth in Q3*

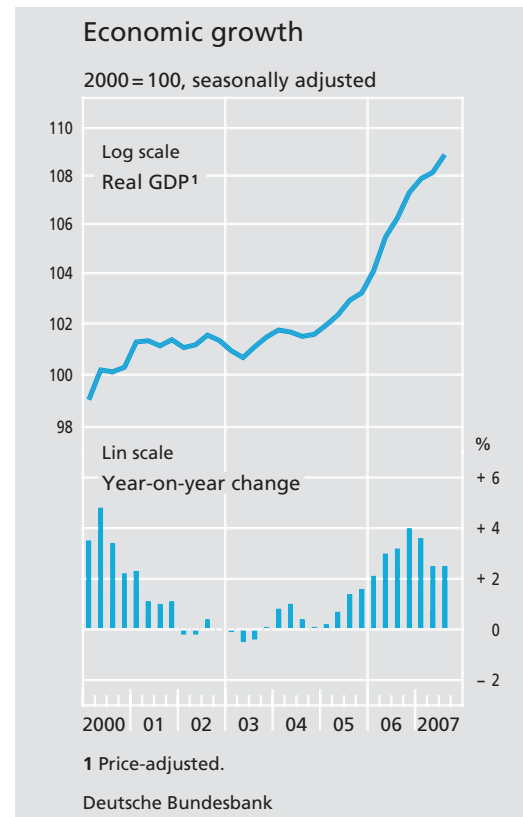
No detailed figures on the development of the individual demand components are available yet for the third quarter. However, the available indicators point to stronger domestic impulses. As a result, private consumption, which had already recovered somewhat in the second quarter from its low in the first quarter, is likely to have continued to make a contribution to growth. The main reason for this was the sharp rise in expenditure on new cars, while traditional retail sales increased only slightly. Towards the end of last year, there had been, in particular, a large number of new car purchases in anticipation of the VAT increase, which led to a considerable decline in demand during the first half of this year.

*Stronger
domestic
demand stimuli*

Enterprises simultaneously increased their investment. In view of the high level of capacity utilisation and the continuing buoyant demand for labour, the incentive to expand, as before, played a key role. This is consistent with underlying sentiment in the German economy, which remains more than averagely positive, although the survey indicators in the third quarter failed to maintain the peak figures of the second quarter. Given the euro's appreciation, the renewed increase in oil prices, and the risks – which are difficult to estimate – in connection with the turbulence in the financial markets, the somewhat more cautious assessment of future economic developments was reflected mainly in the expectation components. Construction investment, along with investment in machinery and equipment, contributed to overall economic growth in the third quarter. So far this year, the pattern of growth has been quite volatile, however. This was due not only to pronounced anticipatory effects but also to weather-induced delays in production during the first half of the year. The recovery in construction activity in the third quarter probably stemmed largely from industrial building, whereas housing construction continued to show a weak trend.

*Buoyant
foreign trade*

Foreign trade also remained a major driver of growth in the German economy in the third quarter. Recently this has been the case not only for manufacturers of capital goods, which are traditionally heavily dependent on exports, but also for sales of consumer goods. The fact that the vast majority of sectors were able to benefit from this indicates both the breadth of the cyclical upturn and

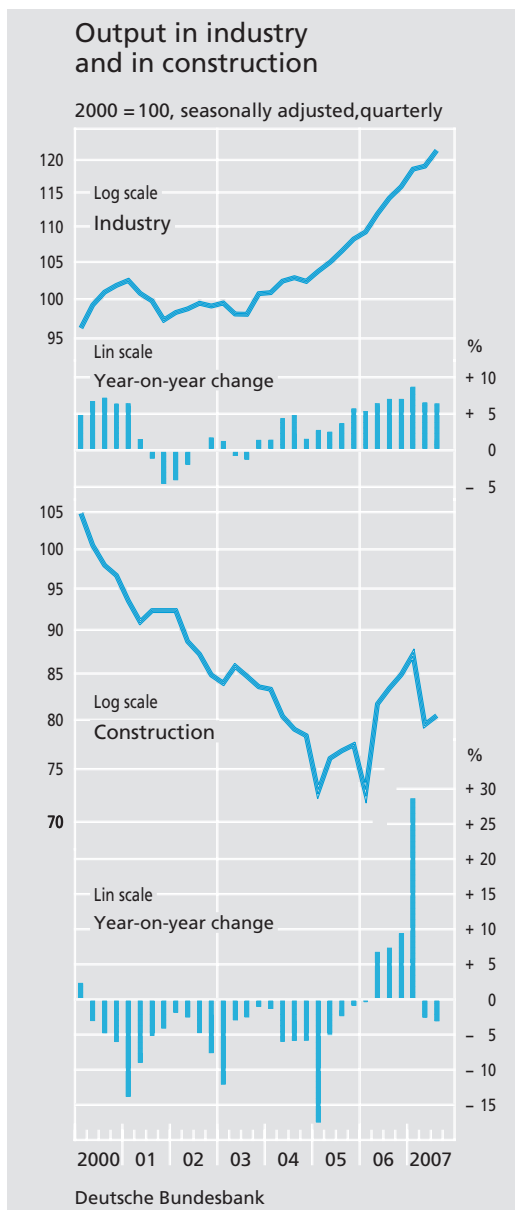


German firms' favourable market position, especially in the euro area. Moreover, along with increasing domestic demand and, not least, in connection with the increased accumulation of stocks, imports gained in importance. In net terms, foreign trade therefore made a neutral contribution, at most, to overall economic growth.

Sectoral trends

In terms of production, overall economic growth continued to be driven mainly by industry. With quarter-on-quarter growth of 2% in the third quarter, industrial output clearly gained renewed momentum following an increase of no more than ½% in the second quarter. The fact that industrial activ-

*Strong
industrial
output*



ity was decidedly buoyant was evident, on the one hand, in the case of manufacturers of intermediate and capital goods. Among the individual subsectors, mechanical engineering, in particular, showed strong growth again. In line with demand, there was, on the other hand, a further significant increase in the production of consumer goods. It was only in the manufacture of non-durable

goods that there was a slight fall on the quarter.

Industrial output has been on a strong upward path for some time and has recently shown a further acceleration. This has now led to a sharp increase in capacity utilisation in this sector. At plant level, processing orders as swiftly as possible has been helped by greater flexibility in the deployment of labour. This was only made possible by matching agreements between both sides of industry and, not least, by structural reforms in the labour market in recent years. Nevertheless, capacity shortages are already becoming apparent in some subsectors, such as mechanical engineering and the electrical engineering industry. Furthermore, many enterprises are complaining about a growing shortage of skilled labour.

Continuing high capacity utilisation

In construction, the economic picture remained mixed up to the end of the period under review, although output in the third quarter showed an increase of 1¼% on the preceding three-month period after seasonal and calendar adjustment. This result also has to be seen against the backdrop of a marked seasonally adjusted decline in construction activity in the second quarter, however. Accordingly, output in the third quarter was still more than 3% below its depressed level of the first half of the year. The finishing trades, which also benefited especially from government-sponsored assistance programmes for the environmentally friendly renewal of the housing stock, performed better than construction. In the first half of the year, the number of hours worked in the construc-

Construction output recovered slightly from low level

tion industry fell by a seasonally adjusted 4¼% compared with the second half of 2006, whereas the number of hours worked in the finishing trades during the same period went up by 5½%.

*More cautious
assessment of
situation for
service
providers*

In the wake of strong industrial activity, both commercial service providers and the transport sector are likely to have grown strongly. The ports and logistics enterprises, in particular, reported capacity shortages. In the case of services as a whole, the business situation indicator of the Ifo institute points to a slight weakening in the third quarter, however, compared with a marked increase in the second quarter. According to the ZEW subindicator "Service Providers of the Information Society", too, those surveyed also assessed the business climate more cautiously at the end of the period under review than in the second quarter, when the indicator had risen.

Employment and unemployment

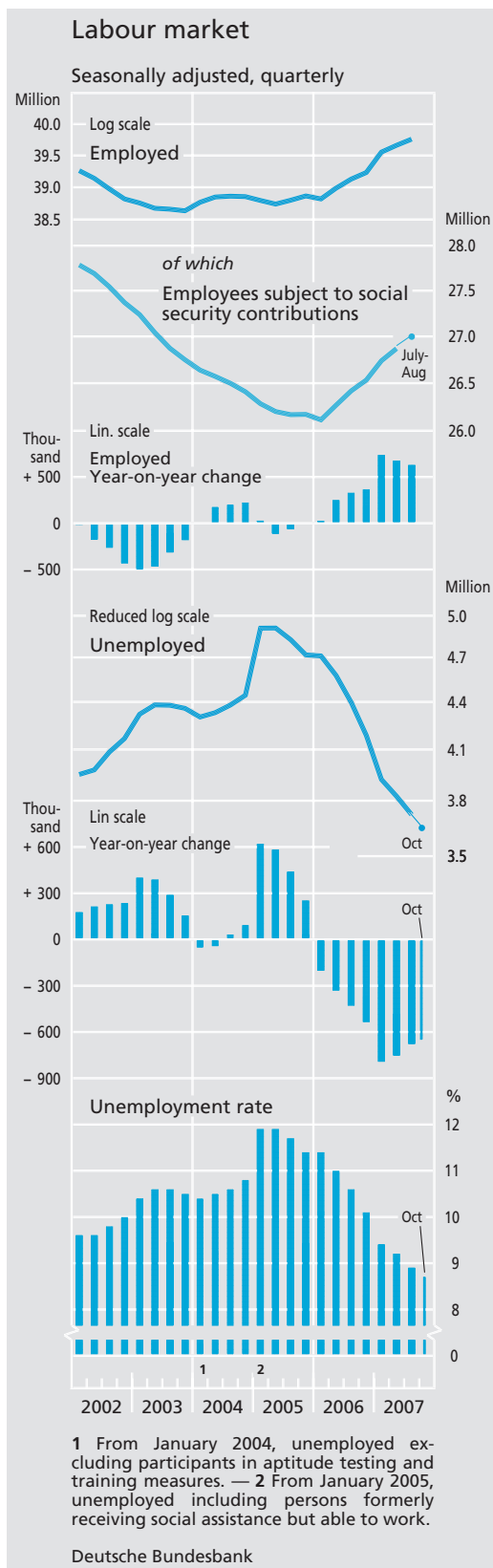
*Further rise in
employment*

The gratifying development in the labour market continued in the third quarter. The number of persons in work went up by a seasonally adjusted 98,000, or 0.2%, to 39.80 million. The year-on-year increase was 638,000, or 1.6%. This means that the rise was almost as sharp as on an average of the first half of 2007. In particular, employment subject to social security contributions again benefited most from this. According to estimations by the Federal Employment Agency, which are available up to August, there was an increase of 589,000, or 2.2%, on the year. Almost half of the increase was attributable

to the "finance, renting and business services" sector, which also includes temporary and subcontracted work. By contrast, other forms of employment (self-employment, "mini-jobs", government-assisted forms of employment) showed noticeably lower rates of growth.

In the third quarter, a seasonally adjusted 3.74 million persons were registered as unemployed at the Federal Employment Agency. This was 105,000 fewer than in the previous quarter and a fall of 677,000 on the year, which largely reflects the gain in employment. The demographic decline in the supply of labour was offset by an increase in labour market participation. The fall in unemployment benefited the long-term unemployed receiving unemployment benefit II to much the same extent as recipients of unemployment benefit I (-306,000 compared with -371,000 in the previous year). The seasonally adjusted unemployment rate fell from 9.2% in the second quarter to 8.9% in the third quarter. The figure one year earlier had been as high as 10.6%. The decline in unemployment continued in October. The unemployment rate, as defined nationally, fell to 8.7%. The standardised unemployment rate, calculated according to International Labour Organization (ILO) criteria, was 3.55 million in the third quarter with a matching rate of 8.2%. The standardised data were calculated for the first time on the basis of the continuous labour force survey. This involved a revision of the data for the past years (see The revision of the ILO unemployment figures for Germany, page 51).

*...and further
decline in
unemployment*



The leading indicators available suggest that the favourable development in the labour market will continue in the near future, albeit no longer at the rapid pace of the first three quarters of this year. The seasonally adjusted number of job vacancies reported to the Federal Employment Agency showed a further slight rise on the second quarter. However, the Ifo employment barometer for trade and industry was pointing to somewhat more cautious employment arrangements at the end of the period under review. Furthermore, there are already signs that it is becoming increasingly difficult to recruit additional staff in some areas of the labour market

Favourable outlook for employment

Wages and prices

With the improvement in the labour market situation, pay agreements have been somewhat higher in the current year. This is gradually being reflected in the negotiated basic rates of pay, which were up 1.7% on the year in the third quarter. Including one-off payments, the increase was somewhat lower than in the second quarter, however. This was due, first, to substantial one-off payments in the metal-working industry in the second quarter and, second, to the fact that, in the third quarter, the volume of lump-sum payments included in pay agreements was only slightly larger than in the previous year. Despite higher negotiated rates, wage cost pressure has remained quite moderate overall so far this year. This is due, first, to the fact that, in the services sector, wage negotiations from previous years are still in effect; these provide for no or only small wage increases (as in the

Negotiated pay rates increasing more sharply with marked sectoral differentiation

The revision of the ILO unemployment figures for Germany

From the reporting month of September 2007, the German unemployment statistics have been collected on a new recording basis. The International Labour Organization (ILO) defines the unemployed as those persons who are not in paid employment but are actively seeking and immediately available for work. The unemployment figures and the matching unemployment rates are used mainly for international comparisons since, in this context, the irregular influences of differing social security systems and registration requirements are largely eliminated. In contrast to registered unemployment, which is derived from the current statistics of the labour exchanges, the level of joblessness is calculated with the aid of household surveys.

In Germany, this is now done by means of the continuous microcensus, an official multi-purpose sample. This replaces the telephone survey, which had been used from mid-2003 onwards while changing over from the earlier usual annual microcensus to the more frequent survey required by the EU.¹ The continuous microcensus surveys started in early 2005 but the initial results were deemed not to be robust.

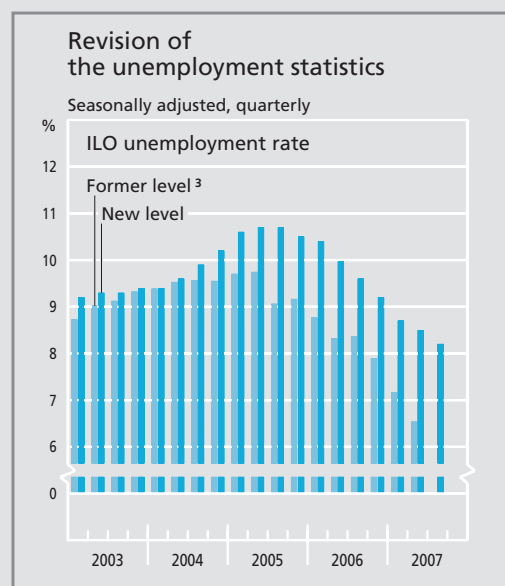
As the group of those surveyed in the continuous microcensus differs from month to month – the persons providing information in any given month are not surveyed again until a further 12 months have passed – and the monthly samples are therefore largely independent of one other, month-on-month comparisons present problems. These problems are exacerbated by the fact that data on a comparable basis are available only from January 2007, which means that seasonal adjustment is not yet possible. The seasonally adjusted monthly ILO unemployment figures are therefore derived from the Federal Employment Agency's seasonally adjusted series of registered unemployment, as used to be the case when the

¹ The telephone survey was for a limited period until April 2007, which meant that a further interim solution had to be found for the following months. The last seasonally adjusted unemployment level recorded using the telephone survey was carried forward with the change in registered unemploy-

ment according to the Federal Employment Agency. — ² At the current end, the extrapolation factor is carried forward using the most recent 12-month average and then successively revised. — ³ Based on the rates calculated by Eurostat.

labour force was surveyed annually. This is now done with a level correction via the quotients of centred moving 12-month averages of unemployed persons and persons without work.² The data on employment required for calculating the unemployment rate are likewise derived from the monthly employment figure of the national accounts and not from the microcensus.

The rebasing of the ILO data on the continuous microcensus has led to a marked upward revision of the data on unemployment. Instead of a seasonally adjusted rate of 6.9% for the first half of 2007, 8.6% is now reported. Similarly large changes have resulted for 2005 and 2006. One crucial reason for the marked revisions is likely to be the fact that the continuous microcensus records fewer instances of marginal employment than were captured by the earlier telephone survey. In addition, the questions on the job-seeking behaviour of the unemployed are now worded differently.



public sector). Second, wage agreements have expired without a follow-up agreement having been negotiated yet (as in the retail and insurance sectors). In some sectors (such as cleaning services), new pay agreements do not provide for an increase until 2008. In the production sector, which is particularly benefiting from economic developments, negotiated rates of pay increased by 3.1% on the year in the third quarter, which is a much higher rate than the average for the economy as a whole.¹

Temporary easing in price increases for imports...

Prices were influenced more strongly by external factors after mid-year. Seasonally adjusted import prices increased by only 0.4% on an average of the third quarter, however, compared with 1.5% in the quarter before. One factor was that the pressure on energy prices was eased for a time by a temporary slowdown in the rise of oil prices. Another was that the cost of imports of other goods fell by a seasonally adjusted 0.2% owing to the strong appreciation of the euro. Lower prices for intermediate and capital goods and hardly any change in the prices of durable consumer goods masked sharp price increases in the case of non-durable consumer goods, however. This sharp increase in the cost of non-durables was caused by the sharp rises in the prices of food and animal feeds due to the tense situation in the international markets for agricultural products. Overall, imports were 0.4% more expensive than in the same period last year. As export prices developed along similar lines to import prices, there was no change in the terms of trade in seasonal adjusted terms. In year-on-year terms, there was an increase of 1.2%

Upward pressure on prices eased temporarily in the second quarter at the producer level, too. The seasonally adjusted price level of goods intended for domestic sale went up by 0.3% in the third quarter, compared with +0.6% in spring. Temporary price reductions for energy made a noticeably smaller contribution to this than did the marked slowdown in the rise in the cost of intermediate goods, which was caused by cheaper imports. Nevertheless, as there was stronger upward pressure on the prices of consumer goods, the seasonally adjusted increase in the cost of industrial goods (excluding energy), at 0.6%, was only slightly weaker than in the previous quarter. This was mainly attributable to markedly higher selling prices of the food and drink industry. The factory gate prices of industrial products rose by a total of 1.2% on the year, or 2.5% if energy is excluded. The upward trend in farm gate prices continued. Farmers earned almost 17% more for vegetable products and around 13½% more for animal products than in 2006. Construction work became even more expensive in the third quarter. All subsectors of the construction industry were affected by this. There was a 7% rise on the year.

...and slight deceleration at domestic producer level

At a seasonally adjusted 0.6%, the increase in consumer prices in the third quarter was much the same as in the second quarter.

Continuing sharp rise in consumer prices

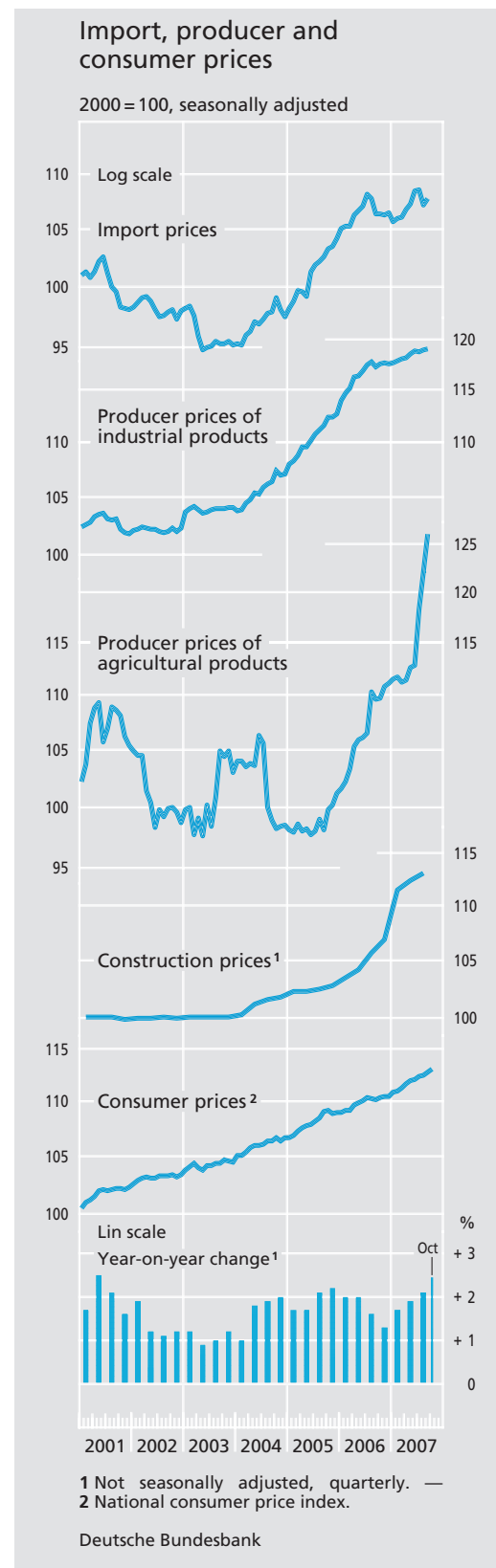
¹ After difficult wage negotiations in August, management and labour in the construction sector finally agreed to incorporate the provisions of the June arbitration proposal into a pay agreement. This proposal envisaged an agreement running for an overall period of 24 months with a phased increase in remuneration totalling 6.2% as well as supplementary lump-sum payments and an increase in minimum wages. The pay dispute at Deutsche Bahn continues, however.

Seen over four quarters, the rate of consumer price increase has clearly accelerated, however. Higher crude oil prices and the introduction of tuition fees in a number of federal states as of the 2007 summer semester kept inflationary pressure at a high level in the second quarter. In the third quarter this was due mainly to food products. These increased by as much as 1.6% on the quarter and 2.4% on the year. There was a 1.8% increase in the case of goods (excluding energy) and a 2.8% increase for services. The increase in VAT and insurance tax at the beginning of the year also played a part in this. If the rises in energy prices (2.7%) and housing costs (1.0%) are also taken into account, the year-on-year increase in the national consumer price index (CPI) for the third quarter was 2.1%. The rate also increased over four quarters owing to a baseline effect – crude oil prices had fallen for a time one year previously – of 1.9% in July and August and 2.4% in September. Measured by the Harmonised Index of Consumer Prices (HICP), the inflation rate, in fact, went up, from 2.0% to 2.7%.²

Very sharp increases in the price of dairy products

The increase in consumer prices was particularly marked in the case of dairy products. The consumer price of milk increased by 21% within the space of a few months (from May to October), while farm cheese (*Speisequark*) went up by 34% and butter by as much as 43%. In the case of cheese, the price rise which did not begin until September, has, up

² Of the relatively large 0.3 percentage point gap between the annualised CPI and HICP rates in September and October 2007, 0.2 percentage point may be explained by the combined effects of marked relative price changes and differing baskets of goods. The remainder is due to rounding effects.



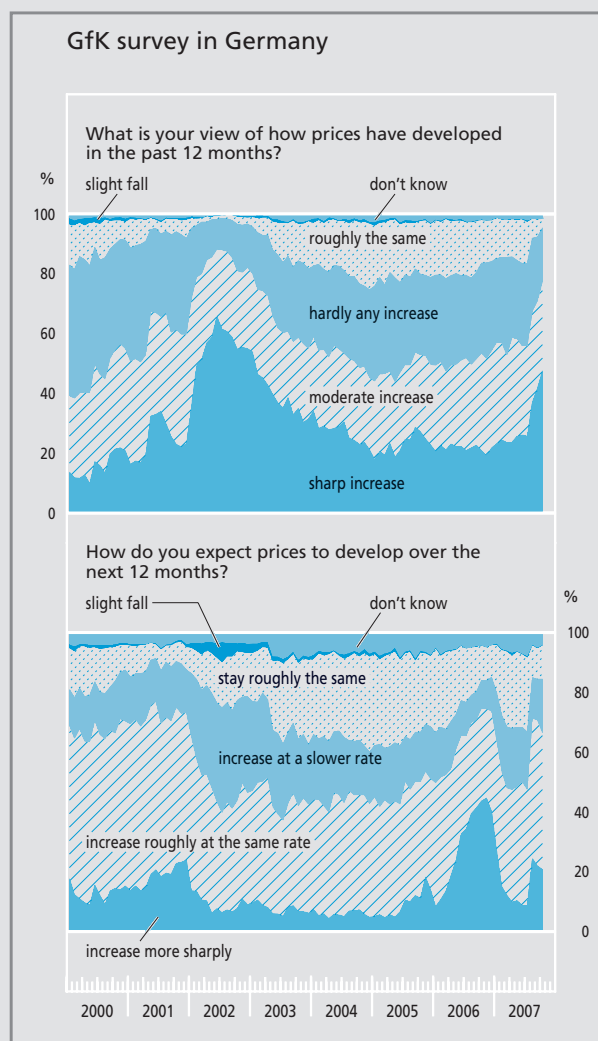
Measured, perceived and expected price developments

Once a month, the market research institution, Gesellschaft für Konsumforschung (GfK) surveys 2,000 households in Germany on how they perceive price developments in recent months and on their expectations of inflation in the next 12 months. The findings of this

survey are incorporated into the collection of sentiment indicators published each month by the European Commission.¹ This is the only survey which provides information on how consumers in Germany have perceived past price developments and what they expect for the near future. Calculations of perceived inflation, are, by contrast, based on assumptions regarding how households may have perceived the (average) change in individual prices as captured in the official consumer price statistics. The informative value of such calculations can be called into question for a number of reasons.²

The GfK does not ask households directly about the percentage change in consumer prices but instead asks for qualitative assessments of whether prices have risen sharply, moderately or hardly at all or have, in fact, fallen. Households are also asked whether prices will increase more sharply, roughly at the same rate as before or more slowly than before, stay roughly the same or even fall.

The European Commission calculates weighted “balance statistics” which, in the case of Germany, go back to 1985. “Extreme” responses are emphasised twice as strongly as the more moderate assessments. The middle category response is not taken into consideration. Analysing these weighted balances can provide initial information on both perceived and expected price developments. It should, however, be noted that the question about future price developments is linked to the assessment of past developments. Therefore, the relevant responses and balances cannot be interpreted meaningfully on their own. For analytical purposes, it is advisable to analyse the responses by their individual categories or to quantify them using a less rigid framework.



1 www.ec.europa.eu/economy_finance/indicators/businessandconsumersurveys_en.htm. — 2 See J Hoffmann, H-A Leifer and A Lorenz (2005), Index of Perceived Inflation or EU Consumer Surveys? – An assessment of Professor H W Brachinger’s approach, in Review of European Economic Policy, Vol 41, Intereconomics, May 2006 pp 142–50. — 3 This phenomenon has been observed in many euro-area countries. See, for example, L Aucremanne, M Collin and T Stragier (2007), Assessing the Gap between Observed and Perceived Inflation in the

Euro Area: Is the Credibility of the HICP at Stake?, BNB Working Paper No 112 and the literature cited there. — 4 See Deutsche Bundesbank, How informative survey data on private sector inflation expectations are for monetary policymakers, Monthly Report, October 2006, pp 15–28, and C Gerberding (2006), Household versus Expert Forecasts of Inflation: New Evidence from European Survey Data, in Peter Sinclair (ed), The Role of Inflation Expectations in Modelling and Monetary-policy Making, forthcoming. — 5 The quantification procedure

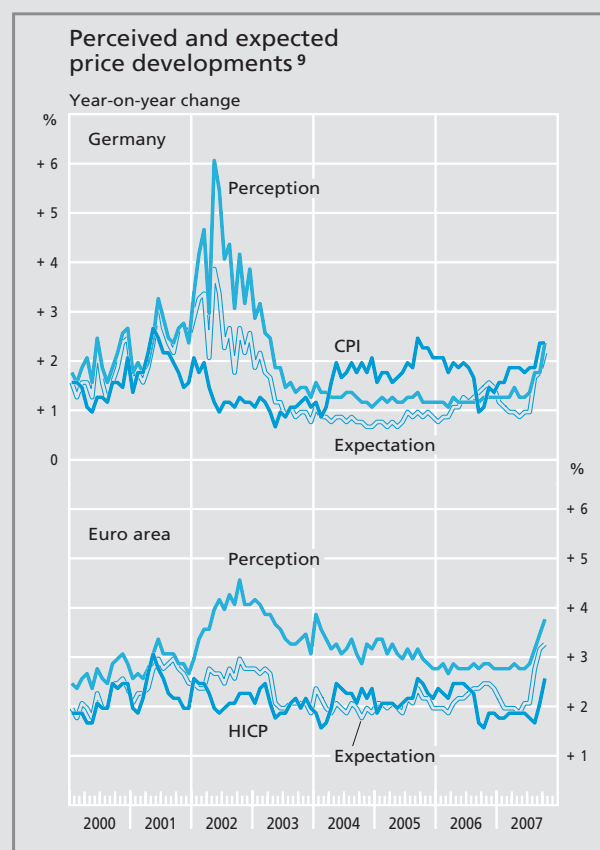
Over time, distinct shifts in the percentages between the individual categories become apparent, which are closely related, to a greater or lesser extent, with the measured inflation rates. For instance, over the past three months, in parallel with the sharp rise in the consumer prices for dairy products (and consumer prices in general), the percentages of persons who have perceived a sharp rise in prices has shown a marked increase. By contrast, the “moderate increase” and “roughly the same” response categories were chosen significantly less often. At the same time, the share of those expecting a stronger rate of price increase in the future first went up to 25% in August 2007 before going down slightly in the following two months. Almost half of those surveyed expect a continuation of the hefty surge in prices over the next 12 months with only a quarter expecting a moderation (somewhat fewer in August, somewhat more in October). Hence, the price climate in Germany has become considerably gloomier since the middle of the year.

Against this background, the question arises as to whether a major discrepancy has emerged between the price perception of consumers and officially measured inflation³ – as happened following the introduction of euro banknotes and coins. To shed light on this matter, it is necessary to transform the qualitative data of the consumer surveys into quantitative results, which can be done using certain simplifying assumptions (in particular, that the perception of past price developments is unbiased on a long-term average basis).⁴ With this qualification, it becomes apparent that the perceived price increase in October was no higher than the official statistic.⁵ Nevertheless, the perceived rate of inflation in the past few months rose much faster than measured infla-

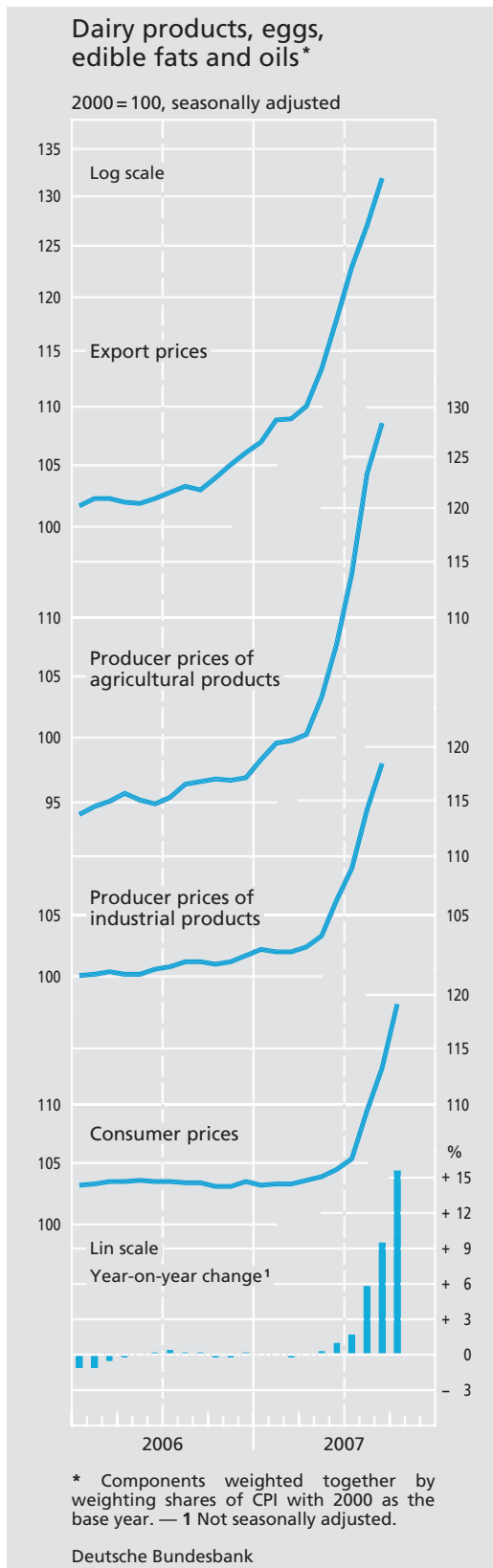
used here is J Berk (1999), *Measuring Inflation Expectations: A Survey Data Approach* in *Applied Economics*, 31, pp 1467–1480. — ⁶ Applying a slightly modified conversion method (J Döpke et al, *European Inflation Expectations Dynamics*, Deutsche Bundesbank Research Centre, Discussion Paper, Series 1, No 37/2005, p 21, method 5) results in a more subdued increase in terms of both the perceived and the expected inflation rates. — ⁷ The survey results show that, unlike in Germany, the “overshooting” of inflation perception, which began

tion. According to this calculation, the expected inflation rate in fact more than doubled within the space of just three months.⁶

A similar picture emerges from the survey results for the euro area. There has been an even bigger change in the perception of price developments than in the measured inflation rate.⁷ Here again, as far as the future outlook for price stability is concerned, consumers are much more pessimistic than they were just a few months ago.⁸



with the changeover to euro banknotes and coins, has not yet receded in a number of countries in the euro area. For this reason, the quantified perception of inflation is much higher here than the measured inflation rate. — ⁸ The modified conversion method after Döpke et al also indicates a somewhat more moderate reverse in inflation perception and expectation for the euro area, too. — ⁹ In accordance with the Berk procedure using GfK data.



to now, been less marked at 11%. Although these products (in the subcomponent “dairy products and eggs, edible fats and oils”) only take up a small part of the budget of an average household and, accordingly, have only a relatively low weighting of 1.7% in the consumer price index, these extremely sharp price increases are likely to have had an adverse impact on the perception of general price developments and on inflation expectations (see the explanatory notes on page 54-55). The sharp price movements were due to external factors. The price of dairy products has increased worldwide owing to shortfalls in production and an increasing demand. The German dairy industry has been achieving higher prices in exports since as long ago as summer 2006. Prices paid out to farmers have increased sharply since spring 2007. The wholesale prices charged by the dairy industry to retail chains in Germany, which are fixed at fairly long intervals in negotiations, first showed a marked rise in June 2007 after previously showing a rather subdued increase. Essentially, the retail chains generally passed on the increased wholesale prices to consumers from August onwards. The consumer prices of dairy products had already gone up by 1½% since May and then increased in the three following months by a further 13%.

In October, consumer prices showed a further marked rise at a seasonally adjusted 0.3% on the month, although the higher crude oil prices had not yet been passed on to the prices of fuel and heating oil. Food, in particular, showed further perceptible price rises. The prices of goods (excluding energy) and of services, including housing costs, increased

Unfavourable price trend continues in October

moderately. The year-on-year increase in both the national CPI and the HICP remained unchanged in October at 2.4% and 2.7% respectively. There was a dampening effect on the rate of inflation due to the fact that the price adjustments of tobacco products to the higher rate of VAT had been anticipated in October 2006 and "dropped out" of the year-on-year rate of change.

Outlook

Consumer prices are expected to go on rising sharply up to the end of 2007. Energy, in particular, is likely to become significantly more expensive due to the fact that higher crude oil prices only began to be passed on to consumers in November. Sharp increases in electricity and gas prices have already been announced for the beginning of 2008. Moreover, the effects of the boom in the international agricultural markets are likely to fade only slowly. Given an incipient return to normal conditions in the international agricultural markets and owing to baseline effects resulting from the VAT increase in January 2007 as well as the introduction of tuition fees in April 2007, the year-on-year rates are unlikely to go back down to more moderate levels until the second quarter of 2008.

Orders received and outlook

Economic outlook still positive

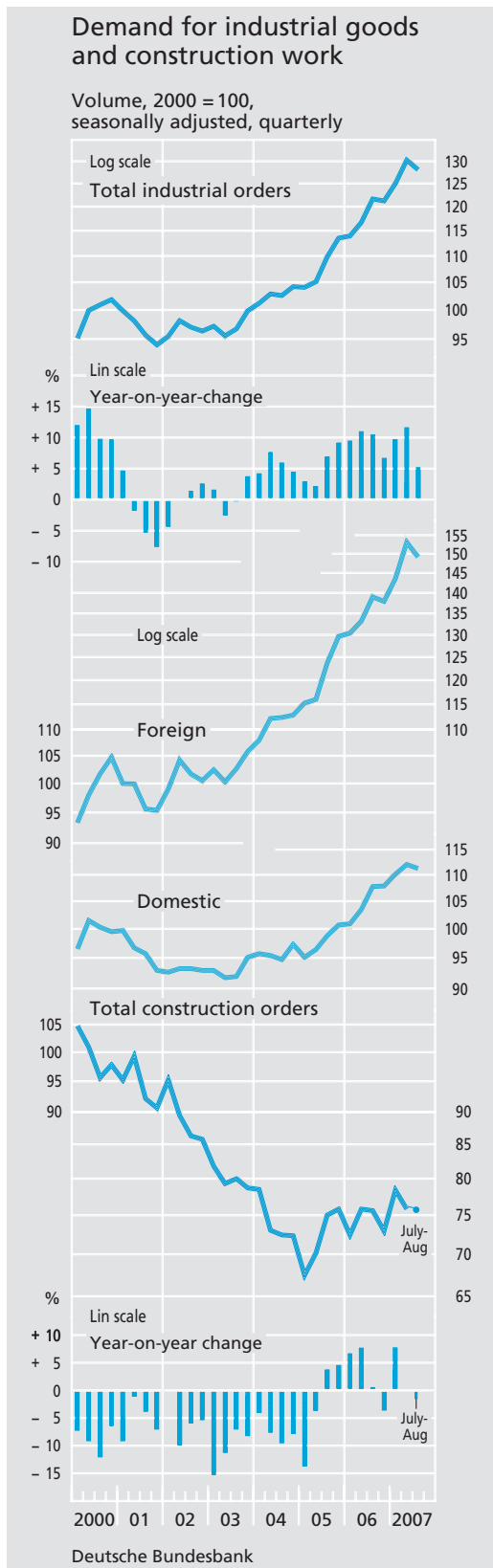
In parallel with the marked deterioration in the price climate, the cyclical risks increased in the third quarter. To some extent, these are to be seen as being directly related. The unfavourable rate of inflation is placing a strain not only on household's current budgets but also on their future real income prospects,

for example. Moreover, the renewed sharp increase in oil prices harbours severe risks for the world economy. Furthermore, the financial market turbulence may be expected to have negative repercussions to a certain extent. From a German point of view, recent exchange rate movements are ambivalent in character. On the one hand, they are helping to ease the price climate and are forming a certain counterweight to the deterioration in the terms of trade due to oil prices. On the other hand, they are impinging on profit margins and reducing sales opportunities abroad. The economy is, therefore, currently subject to quite a number of strains. Nevertheless, the positive underlying trend is not open to doubt over the coming months.

This assessment is based, in particular, on the robust condition of industry. In purely mathematical terms, the volume of orders received in the third quarter was 1¾% down on the quarter in seasonal and calendar-adjusted terms. However, it should be taken into account that some extremely large orders, especially in the aircraft and aerospace industry, had a major impact in the second quarter. The cyclical component is easier to identify if the volume of orders is adjusted for extremely large orders.³ When calculated in this way, there was an increase of ½% in the third quarter, compared with 2% in the preceding period. Orders are invariably accompanied by a large number of orders on hand. Since the turn of the year, the reach of the order books

*Orders received
by industry*

³ As orders starting from a value of more than €1 million are counted in the statistics as large orders and these are by no means rare, it would not be appropriate to adjust for all large orders.



has stood at the exceptionally high level of around three months. The ratio between the order volume of order-based manufacturing industry and available production capacity is still pointing to a comfortable order situation on the whole.⁴

Business conditions and expectations in trade and industry support this conclusion. Accordingly, enterprises have steadily been lowering their extremely positive and optimistic estimations over the past few months in the wake of rising crude oil and commodities prices, the appreciation of the euro, and the occasionally increasing tensions in the financial markets. Nevertheless, the current situation is characterised by a continuing quite confident underlying sentiment in the German economy. This assessment is also reinforced by the fact that enterprises' export expectations have declined, if anything, only moderately in comparison with the other expectation indicators. This is also particularly noteworthy in view of the economic outlook in the United States, which has been adversely affected by the real estate and mortgage crisis. The still high growth expectations for the emerging market economies, the OPEC countries and east European transition countries evidently represent a sufficiently large counterweight, especially as the German economy offers a very attractive range of products to meet the notably strong demand for capital goods in those countries. The relatively low price elasticity of such goods makes it easier to cope

Positive underlying sentiment, trend more cautious

⁴ For the methodology used, see Deutsche Bundesbank, Industrial orders and production: how informative is the order capacity index?, Monthly Report, February 2007, pp 52-53 and Deutsche Bundesbank: Economic conditions in Germany, Monthly Report, August 2007, p 54.

with shifts in the exchange rate pattern, especially as less expensive imports of intermediate goods potentially afford relief, and profitability, which is good on average, could cushion some of the exchange-rate-induced fluctuations for a time.

*Investment
activity still
strong*

Given the fact that enterprises are currently utilising their existing capacities to the full, continued buoyant foreign business should cause them to invest more in the coming months. This will be aided by the fact that expenditure on movables enjoys preferential tax treatment until the end of this year owing to the improved depreciation facility. Not least against the backdrop of Germany's regained attractiveness as a production location, growth may also be expected in industrial construction, which lags behind investment in machinery and equipment in cyclical terms. By contrast, the outlook for housing construction is less favourable. Measured by construction orders, the construction permits issued and increased building costs, there are currently no stimuli in place in the new-build

sector. The trend in the area of housing modernisation is, however, much better.

With regard to private consumption, the dampening effects of the VAT increase have now probably petered out to a considerable extent. This is also indicated by the sharp increase in new passenger car registrations by private owners in the third quarter, although the level is still clearly depressed. The higher level of employment is likely to support private consumption over the coming period. The recent price surges in energy and some food items are reducing consumer budgets' purchasing power, however. Another factor which should not be underestimated in this context is an uncertainty component based, for the most part, on subjective perceptions. In view of rising prices, this has clearly been depressing the propensity to purchase again since the third quarter. In this context, it seems all the more important that European monetary policy remains a reliable anchor of stability.

*Good
fundamentals
for private
consumption.*