

Economic conditions in Germany

Macroeconomic situation

The decline in overall economic output in Germany came to a halt in the second quarter. Following the sharp downturn in the fourth quarter of 2008 and the first quarter of 2009, price-adjusted GDP – according to the flash estimate of the Federal Statistical Office – rose by a seasonally and calendar-adjusted 0.3% on the quarter, after declining by 5.9% in the preceding six-month period. Economic output was also 5.9% down on the year in the reporting quarter after calendar adjustment. Overall capacity utilisation is exceptionally low at present and is associated with a marked underutilisation of the workforce. This already takes into account the fact that the decline in the first quarter of 2009, at 3.5%, was somewhat weaker than initially reported. This year, hardly any changes were made during the revision of the previous year's figures. These revisions are carried out in the summer of each year to reflect new statistical basic information.¹

*End to
economic
downturn in
2009 Q2*

The main reason for the braking of the sharp downturn in global economic output is that the paralysing effect brought about by the Lehman insolvency has – not least owing to the extensive and very broadly based measures to stabilise the financial markets – markedly abated. Furthermore, strong expansionary stimuli were generated worldwide by the wide-scale use of monetary and fiscal policy

*Global stability
measures
brake global
economic
downturn*

¹ The type and scope of the statistical revisions of a large number of economic indicators over an extended period of time can now be researched in detail using the Bundesbank's real-time database, which is freely accessible via the Bundesbank's website (see also the explanatory notes on pages 50 and 51).



instruments. As a result, the slump in global output and world trade, which had placed an exceptional strain on the German economy in the fourth quarter of 2008 and the first quarter of 2009, came to a halt. Nevertheless, economic secondary effects in the form of inventory adjustments and declining corporate investment continued to have a detrimental impact on overall economic output in the second quarter of 2009. By contrast, construction activity and private consumption were in rather robust shape. Besides the favourable weather-related effects in the construction sector, this was due to the fact that impulses emanating from the government economic stimulus packages were having a significant impact. Consumer sentiment was also supported by the favourable price climate and, compared with the overall eco-

nomical environment, the downward pressure stemming from the labour market remained within narrow bounds.

Although German enterprises saw a further reduction in exports in the second quarter of 2009, compared with the already weak result posted in the first quarter, the seasonally adjusted decline in exports – according to the available indicators – was much weaker than in the preceding two quarters, however. Furthermore, data on the regional structure of foreign trade flows, which are now available for the first five months of this year, indicate that initial demand stimuli from East Asia were apparent in the second quarter. For example, the value of exports to China on an average for April and May was 3.1% up on the average for the first quarter in seasonally adjusted terms. Moreover, slight growth was also recorded in nominal exports to South-East Asian emerging market economies. There was a further sharp reduction in exports of goods to euro-area partner countries in April and May. This could be due to the fact that the decline recorded for this group of countries in the first quarter, at over 10%, was weaker than the drop in exports to most of the other trading partners.

*Rays of hope
for export
business*

Imports in the reporting period are likely to have declined by much the same amount as in the first quarter of 2009 and the fourth quarter of 2008 in seasonally adjusted terms. The rather low level of import activity was probably due largely to the fact that enterprises substantially cut back their procurement of raw materials as well as inputs and intermediary products against the backdrop

*Import activity
under strong
pressure*

of the high level of pressure on inventories. Furthermore, given the renewed rise in heating oil prices during the second quarter, oil imports may have declined again once the heating period was over. Purchases of machinery and equipment from abroad also remained weak. These dampening effects evidently far outweighed the high level of imports of foreign-manufactured cars, brought about by the environmental premium for the scrapping of old cars.

Decline in investment in machinery and equipment no longer as steep

With capacity utilisation at exceptionally low levels, enterprises again invested less in machinery and equipment in seasonally adjusted terms in the second quarter than in the first. However, the downswing slowed down noticeably in the reporting period after the sharpest quarter-on-quarter decline since German reunification, at just over 17%, had been recorded in the preceding three months. Furthermore, industrial investment demand appears to have become more broadly based again recently. While there were slumps in demand across the entire range of machinery and equipment in the first quarter, demand for new machinery and transport equipment in particular fell again substantially at the end of the period under review. By contrast, purchases of electrical equipment and goods in the information and communications technology sector decreased to a much lesser extent.

Weather-related effects and public orders stimulate construction investment

Construction investment is likely to have posted a marked seasonally adjusted increase in the second quarter, which was fuelled, on the one hand, by a counterreaction to weather-related losses in January and Febru-

Foreign trade by region

Percentage change

Item	2009 Q1 compared with 2008 Q4		Average of Apr-May 2009 compared with 2009 Q1	
	nominal/seasonally and calendar adjusted			
	Exports	Imports	Exports	Imports
Total	- 14.1	- 9.8	- 5.1	- 8.3
Selected countries or groups of countries				
Euro-area countries (15)	- 10.7	- 7.8	- 5.3	- 6.6
New EU member states (8) ¹	- 15.9	- 10.0	- 4.2	- 0.8
Other EU countries (3)	- 16.0	- 13.4	- 5.7	- 3.6
United States of America	- 16.2	- 0.8	- 2.8	- 18.0
Japan	- 14.0	- 11.8	- 2.9	- 17.7
China	- 3.0	- 10.5	3.1	- 3.9
Russian Federation	- 23.2	- 31.1	- 20.1	- 8.4
OPEC countries	- 24.1	- 28.4	- 4.8	- 5.1
South-East Asian emerging economies ²	- 12.7	- 13.8	0.6	- 6.9

¹ Excluding Slovenia, Cyprus, Malta and Slovakia, which now belong to the euro area. — ² Hong Kong, Singapore, South Korea, Taiwan, Brunei Daressalam, Indonesia, Malaysia, Philippines, Thailand.

Deutsche Bundesbank

ary. On the other hand, construction activity received impetus from a spate of public-sector orders, even though the financial resources earmarked for infrastructure projects in the economic stimulus packages have had only a minor impact on demand so far. Moreover, housing investment is likely to have increased noticeably.

As at the beginning of the year, household spending in the second quarter of 2009 is likely to have posted an increase in seasonally adjusted terms. Thus, consumption in Germany is remarkable in continuing to defy the negative effects of the global economic and financial crisis. Consumer sentiment has been improving continuously since the abrupt deterioration around mid-2008. This is due, first, to the exceptionally favourable price cli-

Consumer climate still robust

Publication of a comprehensive real-time database for the German economy

A large number of economic data are only provisional since initial publications are based in part on estimates. They are therefore subject to subsequent statistical revisions, which means that the results for one and the same reporting period may change over time. Real-time data sets store the data vintages of macroeconomic time series in chronological order. This makes it possible to analyse the susceptibility of economic indicators to revision and to trace the “revision history” of the results for individual periods. In addition, a database of this kind permits the exact reconstruction of the information base at given points in time in the past, which is important both for assessing the quality of economic projections and for evaluating economic policy decisions against their historical background.

In the past few years, the Bundesbank has been systematically collecting and processing the historical vintages of many economic indicators – like other central banks have done for their own country. This extensive database, which is attracting growing interest from commentators on current economic developments and researchers alike, has now been made generally available to the public in the statistics section of the Bundesbank’s website. The internet platform provided especially for this purpose offers a large number of different search options, screen views in table and graph formats as well as customised data export functions (CSV, Excel).

The address is
http://www.bundesbank.de/statistik/statistik_realtime.en.php.

Contents

The real-time database currently contains historical data vintages of some 280 economic indicators from the national accounts, the monthly business activity and labour market reports as well as price statistics, as both raw data and in seasonally adjusted and/or seasonally and calendar-adjusted form, depending on current availability. This includes the overwhelming majority of those macroeconomic indicators which are not only relevant for economic analysis but are also subject to regular revision. There are plans to add data from other revision-prone accounting systems.

The period covered by past data vintages varies from indicator to indicator. Generally, complete historical data

¹ See, for example, T A Knetsch and H-E Reimers (2009), Dealing with benchmark revisions in real-time data: The case of German production and orders statistics, *Oxford Bulletin of Economics and*

Statistics 71, 2, pp 209-235. — ² See, for example, C Gerberding, F Seitz and A Worms (2005): How the Bundesbank really conducted vintages of the national accounts and of the monthly economic indicators – marked with the exact dates of publication – are available since May 2005 and November 2005 respectively. For key economic variables (such as GDP and use of GDP, industrial production and orders received by industry), the data go back to the beginning of pan-German statistical reporting in 1995. These data vintages were recorded manually and are subject to ongoing quality review. The database is updated constantly.

Data structure

The evolution of an economic indicator over time is generally shown as a time series. When an indicator value for the current reporting period is published, the results for previous periods are often revised, too. In this case, not only is the time series augmented by a new figure, but indicator values that have already been published are also replaced by new results. In the usual time series format for displaying economic indicators, only the current vintage is shown. Typically, this results in a loss of information on past revisions.

By contrast, in a real-time database, a data matrix is allocated to each indicator. In this matrix, the reporting periods are listed vertically – as in the time series structure – while the data vintages are written next to each other in columns headed by the date of publication. The indicator’s “revision history” is therefore completely identifiable. It is, for example, possible to read off in the lines of the matrix how the statistical record of a given reporting period has changed between publication dates. Moreover, the main diagonals of the matrix generally provide insights into the revision structure of the indicator. If there is precisely one publication for each reporting period, the real-time data matrix is triangular at the bottom end, with initial publications located in the lowermost diagonal, second publications in the diagonal directly above it etc. The difference between the two diagonals is usually termed the “first revision”. Systematic cross-comparisons of various diagonals provide a detailed insight into the scale and time profile of the revisions to an indicator.

The characterisation of the revision structure using descriptive methods generally relates to those revisions which incorporate information from lagging primary statistics. A distinction should be made between such regular revisions and benchmark revisions which result in

Statistics 71, 2, pp 209-235. — ² See, for example, C Gerberding, F Seitz and A Worms (2005): How the Bundesbank really conducted

Excerpt from the real-time data matrix
for the economic indicator “Real output of the German economy”

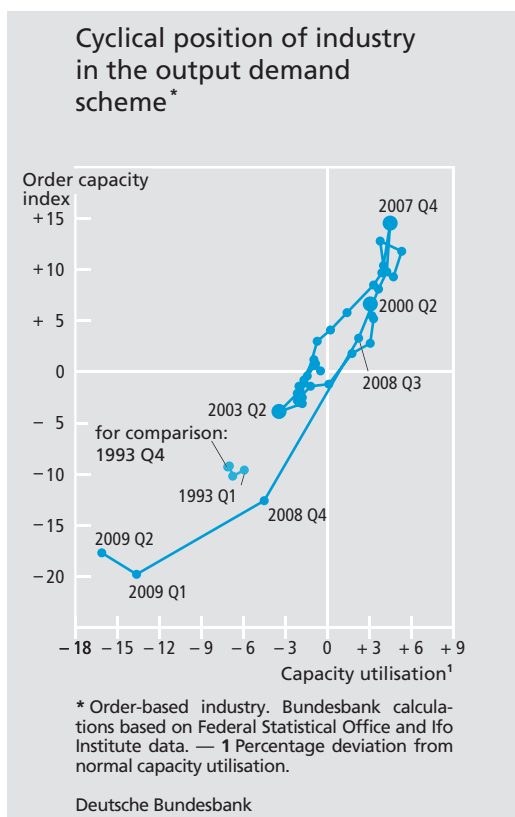
Statistical indicator definition	Quarterly GDP, seasonally and calendar-adjusted, at constant prices						Quarterly GDP, seasonally and calendar-adjusted, at previous year's prices				
Database key	Q:DE:Y:A:AG1:CA010:C:A						Q:DE:Y:A:AG1:CA010:A:I				
Publication date	6.9.1995	7.12.1995	...	4.3.1999	8.6.1999	...	15.2.2005	12.5.2005	...	15.5.2009	13.8.2009
Base year	1991	1991		1991	1995		1995	–		–	–
Measurement unit	DM bn	DM bn		DM bn	€ bn		€ bn	2000=100		2000=100	2000=100
1991 Q1	709.4	709.4		713.3	428.56		429.86	86.04		85.95	85.94
1991 Q2	717.3	717.3		716.4	428.97		428.43	85.32		85.30	85.31
...											
1995 Q1	750.1	750.1		746.2	447.89		447.23	89.77		89.82	89.81
1995 Q2	758.1	758.1		751.1	451.37		451.26	90.77		90.73	90.73
1995 Q3				748.9	451.57		451.16	90.92		90.86	90.87
1995 Q4		758.0		749.3	451.01		451.14	90.67		90.80	90.80
...											
1998 Q3				800.2	472.99		468.18	94.88		94.96	94.97
1998 Q4				797.2	472.33		468.67	94.85		94.78	94.79
1999 Q1					474.40		473.56	95.84		95.83	95.82
1999 Q2							472.39	95.71		95.78	95.78
...											
2004 Q3							502.77	102.62		101.80	101.85
2004 Q4							501.60	102.48		101.83	101.84
2005 Q1								103.55		102.00	101.98
2005 Q2										102.72	102.57
...											
2008 Q4										107.61	107.74
2009 Q1										103.52	103.93
2009 Q2											104.26

the introduction of new conventions, measurement systems and survey procedures into the statistical methodologies. In empirical studies, inadequate recognition of benchmark revisions can lead to considerable biases in the statistical revision measures.¹ Users are alerted to conceptual changes in the measurement of an economic phenomenon by means of metadata sheets which are attached to the indicators. The real-time database also supplies detailed information on the base year or the unit of measurement or currency in the form of vintage-related attributes. Major statistical changeovers (such as the introduction of chain-linked volume indices at previous year's prices in the national accounts) may, however, also lead to a change in the key under which an indicator is stored in the database. The table above illustrates the structure of a real-time data matrix using the indicator “Real output of the German economy”. The statistical measurement of this indicator has been fundamentally changed by two benchmark revisions since 1995.

“Data snapshots”

Real-time databases additionally offer the user the possibility of reconstructing the information on economic indicators that was actually available at a given point of time in the past. As these data panels are the points of reference for projections as well as the basis for decisions on economic policy, this option plays a major role not only in the evaluation of forecasts and forecasting methods but also for an understanding and scholarly assessment of economic policy. Judging *ex post* whether an economic policy decision was appropriate and/or conformed with a defined strategy can distort the results if the analysis is not based on the data available at the time the decision was taken.² The data vintages of specific points in time in the past can be exported as “snapshots” for a given set of indicators.

monetary policy, North American Journal of Economics and Finance 16, pp 277-292.



mate, but also to the multitude of economic policy measures implemented between early autumn 2008 and the beginning of 2009. Therefore, the government measures to stabilise the banking system and the political determination to guarantee the deposits of German savers were able to avert the undermining of confidence in the functional viability of the financial sector.

Moreover, the fiscal policy programmes – with the exception of the environmental premium for the scrapping of old cars, which served as a selective purchase incentive – focused on strengthening households' disposable income. In particular, the Federal Government's second economic stimulus package of January 2009 incorporated a number of tax relief measures and additional transfer

payments. These measures, together with the rise in child benefit, which had already been passed, and the reintroduction of the original commuting allowance (including a tax rebate for 2007), appreciably boosted the disposable income of households in the first half of 2009. Finally, arrangements extending short-time working offered firms strong incentives to resort less to laying off employees. As a result, the risk of unemployment has so far not been uppermost in households' minds when assessing their economic prospects.

Sectoral trends

The slump in industrial sector output recorded in the fourth quarter of 2008 and the first quarter of 2009 did not continue in the reporting period. Although industrial output in the second quarter of 2009 declined further by a seasonally adjusted 0.4% on the quarter, a trend towards stabilisation has now emerged. For example, following the very weak result in April – which was influenced, in part, by the exceptional production stoppages over the Easter holidays – industrial output went up by a seasonally adjusted 5.2% in May. This level was also maintained in June. Owing to the comparatively strong growth in demand for intermediate goods, output in this area went up again slightly on a quarterly average. By contrast, there was a further decline in the production of capital goods, as well as in consumer goods, in the second quarter. This was attributable above all to the mechanical engineering sector, while the production of motor vehicles, trailers and semi-trailers soared by 13%. The

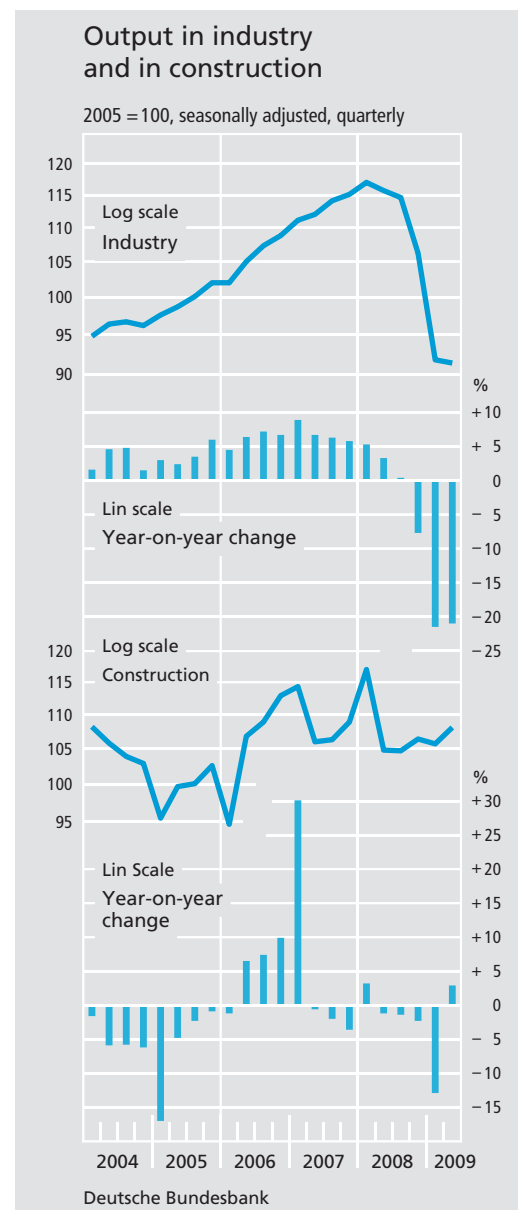
Trend towards stabilisation in industrial output ...

... points to a
turnaround
phase in
industrial
activity

year-on-year decline in industrial output in the second quarter of 2009, at just over 20%, remained at much the same level as in the first quarter.

According to the survey carried out by the Ifo Institute, capacity utilisation in the manufacturing industry in July was up slightly on the level recorded in April, although it was still at a historically low level on a longer-term average. As was the case three months earlier, manufacturers of capital goods recorded their lowest level of production capacity utilisation at the beginning of the third quarter as well, while manufacturers of consumer goods posted relatively moderate results. However, if the average value of the reports for April and July is taken as a measure of average capacity utilisation for the second quarter, capacity utilisation again declined further compared with the corresponding value calculated for the first quarter. This is also largely consistent with the results of production statistics. A rise in the volume of orders received and a revival of output, combined with a still low level of capacity utilisation, is a typical constellation for an economic turnaround. This is also suggested by the fact that the order capacity index calculated by the Bundesbank in the second quarter picked up from its all-time low recorded in the first quarter of 2009. It must be borne in mind, however, that there is heightened uncertainty with regard to the sustainability of this development.

Construction output between April and June 2009 rose by 2.3% on the quarter after adjustment for seasonal variations. Growth



was somewhat stronger owing to weather-related effects; furthermore, the stimulating effects of the economic recovery programmes started to take hold. Civil engineering grew much more sharply (4.5%) than structural engineering (1.1%) quarter on quarter. The construction-oriented services sectors are also likely to have benefited from the favourable construction activity. Given the robust private consumption, much the same may be as-

Economic activity stimulated by construction output as well as by construction and consumption-oriented service providers

sumed for the classic retail trade and the motor vehicle industry. Other, more non-business-related services sectors were probably also much less severely affected by the economic crisis than wholesale and foreign trade, the transport sector and other industrial service providers.

Employment and unemployment

Further decline in employment

Firms are responding to the cyclically-induced low level of output by making further staffing cut-backs. According to provisional figures released by the Federal Statistical Office, the decline in the number of people in work in the second quarter of 2009, at a seasonally adjusted 105,000 or 0.3%, was noticeably greater than in the previous period when, following a data revision, this figure was reduced from -123,000 to -34,000. However, with a decrease of just 0.1% on the year, the decline in employment has so far been extremely modest when compared with the sharp contraction in output.

Increasing importance of short-time work

The impact of the massive economic slump on the labour market has so far been dampened largely by reducing the number of hours worked per employee. Whereas in the first quarter of 2009, firms focused on trimming overtime, running down working time accounts and reducing the working week, short-time working has again gained in importance in the meantime. In the first quarter of 2009, 972,000 persons were receiving short-time working benefits (836,000 of whom for economic reasons); this figure may have increased to between 1.3 million and

1.4 million in the second quarter. Although there were significantly fewer new registrations for economically induced short-time working arrangements than in the previous period, 932,000 employees were still making use of this facility. In this connection, it should be noted that, since July 2009, when the period of entitlement to short-time working benefits was extended to 24 months, it is no longer necessary to submit a new application in the case of interruptions. As a result, the current volume of registrations (over three million since October 2008) will allow for a large volume of short-time work for some time to come.

Job losses have been concentrated in three sectors so far. In manufacturing, which has been especially hard hit by the global demand shock, the number of employees subject to social security contributions in May – according to provisional data from the Federal Employment Agency – was 1.8% down on the year.² The decline was even more pronounced in the sector “other business services”, at 3.5%. This is where most subcontracted workers are also recorded, irrespective of the sector in which they work. The number of such workers fell by one-quarter year on year. The deterioration in industrial orders is likely to have been the main reason for this. In the logistics sector, too, which also has very close links with manufacturing, employment was cut back perceptibly (-1.1%). By contrast, there was a rise in employment in the areas of education, health and social

Sectoral employment trends

² According to the industrial report of the Federal Statistical Office, which records only firms with 50 employees or more, the decline in June was as much as 3.0%.

work as well as in other services (including services for households) by an average of 3.7%. This reflects, for example, increases in staffing levels in the areas of childcare, full-time schools as well as care for the elderly and the sick. A significant part of this increase is likely to have been accounted for by jobs for part-time employees subject to social security contributions, the number of which – according to Federal Employment Agency estimates – might have risen by 200,000 on the year, while the number of full-time employees went down by 180,000. The number of persons working primarily in the tertiary sector in low-paid part-time jobs went up considerably, both in terms of those working on a full-time and a part-time basis.

*Outlook for
employment
still gloomy*

The decline in employment is likely to continue throughout the remainder of the year. Although the Ifo employment barometer for trade and industry has broken away slightly from its cyclical low, it is still in contractionary territory. The number of job vacancies reported to the Federal Employment Agency for non-government-assisted jobs subject to regular social security contributions is still declining. On an average for the second quarter, this figure was just over one-quarter down on the year. The decline in west German industry and in sectors with a close economic link to it was particularly pronounced. By contrast, there was a sharp rise in vacancies in the area of social services. This is also consistent with the results of the quarterly survey of the Institute for Employment Research (IAB), which recorded a decrease of one-fifth for the second quarter of 2009 in the number of vacancies in the economy as a whole.



*Rise in
unemployment*

The official unemployment figure in the second quarter of 2009 went up by a seasonally adjusted 130,000 to 3.47 million, compared with an increase of 139,000 in the first three months of the year. In the second quarter of 2009, too, the rise in unemployment was therefore greater than the decline in employment. The contrast is even more apparent if more recent changes in the statistical definition – above all, the non-inclusion of persons newly registered with private employment agencies – are excluded. Defined in this way, unemployment in the broader sense might have gone up even more sharply in the second quarter, as in the first quarter, with an increase of just over 150,000.

*Structure of
unemployment*

Four-fifths of the quarter-on-quarter increase in the number of persons officially registered as unemployed was concentrated on the group of persons out of work who are covered by the statutory insurance scheme. Persons out of work receiving basic welfare allowance accounted for only one-fifth. The majority of persons newly affected by unemployment are likely to have been entitled to unemployment benefits; recipients are required to have held a position subject to social security contributions for a period of 12 months within the last 24 months. One reason for the rise in the number of persons receiving the basic welfare allowance is the increased difficulty in moving from unemployment into paid employment in the current economic setting. Another is the inflow of persons who have been in paid employment up to now, but who do not yet qualify for unemployment benefits. It is primarily men who have borne the brunt of the effects of the

economic crisis, which has so far been concentrated on the industrial sector, yet they were also the main beneficiaries of the previous economic upturn. By contrast, the rise in unemployment among women, who are likely to have benefited to a much greater extent from the additional employment opportunities in social services, has so far been much weaker. A certain share of job vacancies in this area could even have been filled from the hidden reserve, which, in light of the demographically induced decline in the labour supply, may explain the surprising discrepancy between the development of unemployment and employment trends. In terms of age groups, both younger and older workers are disproportionately affected by the rising level of underemployment. Younger workers are likely to experience greater difficulties in finding paid employment after completing professional training. Furthermore, persons who have been employed for a relatively short period of time are usually at a disadvantage in the event of compulsory redundancies. One important factor regarding older workers is that the regulation allowing unemployed persons over the age of 57 to draw unemployment benefits without having to seek employment, and therefore without being registered as unemployed, has now been discontinued.

The seasonally adjusted number of persons registered as unemployed in July showed little change on the month. The corresponding unemployment rate held steady at 8.3%. By comparison, the figure one year earlier had been 7.7%. Unemployment in the broader sense, which is not affected by the reorgan-

isation of the statistics, might have increased by 30,000 on the month.

Wages and prices

2009 wage round with lower negotiated rates

As in the previous quarter, a number of collective pay agreements were concluded in the reporting period with significantly lower negotiated rates, in most cases, than in the previous year. This was the case, for instance, in the printing industry, retail trade, insurance and in the wood and plastics processing industry. Given the difficult economic situation, one-off lump sum payments, together with extended contract durations, were initially agreed in most cases. Permanent straight-line wage increases are to follow in a second stage. Here, trade unions were willing to substantially reduce their original demands. In exchange, employers abstained from using additional opening clauses.

Extension of sector-specific minimum wage agreements

The level and structure of minimum wages played a particular role in the wage negotiations in the construction and the painting and lacquering sectors. Here, there was a visible trend away from the minimum wage agreements graduated according to qualification and region towards a uniform rate at a higher level. Minimum wage agreements have been concluded in a total of 11 sectors so far, six of which have been declared as generally binding.³ Wage bargainers are expecting that minimum wage levels will be declared generally binding in a further five sectors in the near future.⁴ According to trade union estimates, around 2.6 million persons are employed to date in sectors where min-



imum wage agreements are in place, and this would increase further by just under 400,000.

The Deutsche Bundesbank's pay rate statistics show that the year-on-year increase in negotiated pay rates in the second quarter of 2009, at 2.8%, was not quite as sharp as in the first three months of the year. Excluding collectively agreed one-off and special payments, the increase in rates of pay remained unchanged on the year at 2.7%. According

Slower growth in negotiated pay rates in 2009 Q2

³ The generally binding minimum wage agreement for the demolition and scrappage sector has been suspended.

⁴ These are the security services industry, the waste management industry, industrial laundries, further training facilities for job seekers receiving unemployment benefits under the statutory insurance scheme and job seekers receiving the basic welfare allowance, as well as special mining services.

to the negotiated wage index of the Federal Statistical Office, which refers to basic pay rates and excludes civil servants, the increase in April, at 2.8%, was more or less on a par with the previous year. According to the WSI (Institute of Economic and Social Research), based on the wage agreements from the first half of 2009 and taking account of the wage increases concluded in the previous year, the average annual increase amounts to 3.0%.

Price climate still favourable on the whole

Price reductions at the upstream stages of the economy continued at a slower pace in the second quarter of 2009. Import prices fell by a seasonally adjusted 1.6% on the first quarter and industrial producer prices in domestic and foreign sales dropped by 2.4% and 0.6% respectively. The year-on-year decline in the prices of imports stood at 10.1%, in domestic sales 3.6%, and 2.5% in the case of exports. The terms of trade improved by 8.3% on the second quarter of 2008. By contrast, there was a slight seasonally adjusted rise in consumer prices after they had declined in the previous two quarters. Nevertheless, the year-on-year increase in the national consumer price index (CPI) narrowed to 0.3% on a quarterly average. A moderate year-on-year decline in consumer prices is to be expected for the third quarter.

Declining price reductions for energy and intermediate goods

In annual terms, the downward price corrections at the upstream stages of the economy were still very pronounced. The decline in the case of imported energy at more than one-third, which was due to the significantly higher share of crude oil and refined petroleum products, was much higher than that of energy from domestic production (6.2%). The

lower level of processing undergone by imported intermediate goods also explains why the decrease, at 9.8%, was perceptibly sharper than in the case of corresponding domestically produced goods. However, owing to developments on the commodity markets, the decline in prices of intermediate goods weakened substantially at the end of the period under review. In the case of energy, it almost came to a complete standstill.

The downward trend which had been observed in energy prices since the second quarter of 2008, and in the prices of other intermediate goods since the third quarter of 2008, is now also making itself increasingly felt at the upstream stages of the economy in the prices of finished products. The prices of imported capital goods fell perceptibly. The rise in prices of domestically produced capital goods came to a halt. In the consumer goods group, however, the decline in food prices appears to be petering out. Domestic agricultural producer prices are also showing signs of stabilisation at a reduced level. Conversely, the price increase in the case of consumer durables at the domestic producer level showed a marked fall, and there was even a decline in the corresponding import prices. Construction prices, which have risen substantially in recent years, fell slightly on the quarter, but were still up 1.5% year on year.

Increasing pressure on prices of finished goods

Despite the generally favourable framework conditions, consumer prices rose quite significantly over the course of the second quarter of 2009, at a seasonally adjusted 0.4%. This was due mainly to the pick-up in crude oil prices and a sharp rise in tobacco prices in

Moderate rise in consumer prices

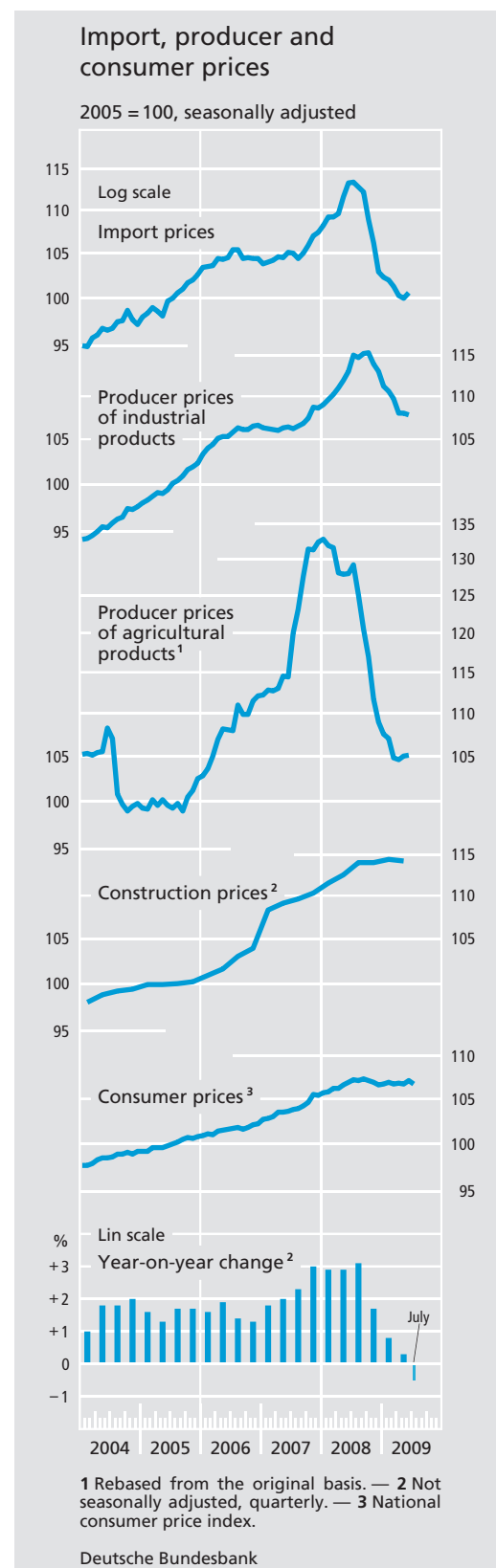
June. However, there was an increase of just 0.1% on the preceding three-month period on a quarterly average. Baseline effects also meant that the year-on-year increase went down from 0.9% to 0.3%; in the second quarter of 2008, the cost of energy and food in particular became considerably more expensive.

Structure of the price increase

With regard to energy prices, there was a quarter-on-quarter rise in the cost of fuel in the second quarter. By contrast, there was hardly any change in the cost of heating oil. Prices of gas, which lag behind crude oil prices, fell sharply. The fall in food prices was again somewhat greater than in the first quarter of 2009. With regard to seasonal food products, there was a particularly sharp decline in vegetable prices. The cost of dairy products also declined further (for details about the price developments of dairy products, see the explanatory notes on pages 60 and 61). By contrast, prices of industrial goods (excluding energy) experienced a slight rise in the rate of increase – even without tobacco products. The rise in the prices of services and housing rents continued at a moderate pace.

CPI rates temporarily negative

Consumer prices declined by a seasonally adjusted 0.4% in July and, at -0.5%, the annual rate of change in the CPI recorded a negative result for the first time in 22 years. The Harmonised Index of Consumer Prices (HICP) was down by as much as 0.7% on the year. This was due mainly to the fact that the sharp energy and food price hikes in the second half of 2007 and in the first half of 2008, which had driven up the annual CPI rate to 3.3% by



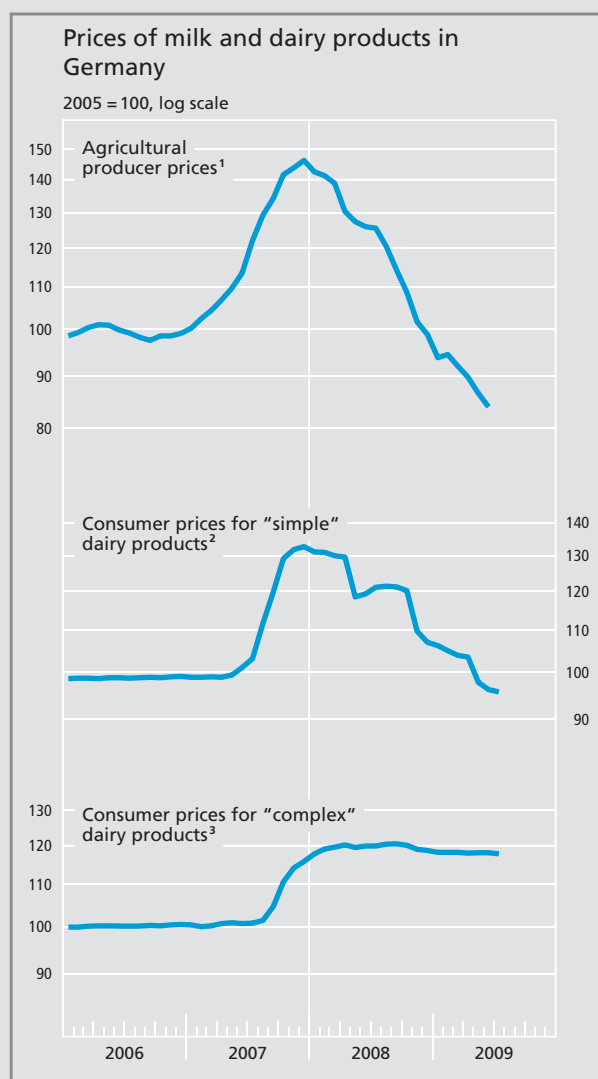
Marked fluctuations in milk prices: causes and future developments

One of the main driving forces behind the acceleration in consumer prices in the second quarter of 2008, also in Germany, was the sharp growth in agricultural prices, which was spurred on by the global markets. This growth eventually led to a peak in the CPI inflation rate of 3.3% in mid-2008. The supply and demand conditions in the global markets have since changed drastically. First, the global

economic crisis has reduced the demand for higher-quality foodstuffs. Second, the absence of weather-induced shortages and the reaction to the rise in sales prices pushed up supply on the world market. This resulted in severe downward revisions of quotations on the international agricultural markets. For example, according to data from the Food and Agriculture Organisation of the United Nations (FAO), world market prices of the most important internationally traded dairy products (skimmed and whole milk powder as well as butter) have now fallen back to summer 2006 levels on average, after they had risen to more than two-and-a-half times that amount within a one-year period. In the European Union, prices for milk deliveries to dairies are currently even lower than they were prior to the price shock,⁴ as are the prices paid out to German dairy farmers. Conversely, in July 2009 the average consumer prices for dairy products far exceeded their mid-2007 levels both in Germany and in the other euro-area countries. Further price adjustments are to be expected, however. Although dairy products do not play such a significant role in terms of consumption – in Germany in 2005, dairy products accounted for only 1½% of total expenditure in the basket of goods, upon which the consumer price index is based – price fluctuations on this scale have a perceptible impact on the overall index, and play an important role in the consumers' perceptions.

Consumer prices had reacted quite differently to the rise in milk quotations, both in respect of time and scope. The price shock was passed on relatively quickly in the case of less heavily processed "simple" products, such as butter, farm cheese, cream and fresh milk, while the prices of heavily processed and diverse "complex" products, like yoghurt and cheese, followed with some delay. The percentage mark-up was also smaller in this case. The price for butter and farm cheese, for example, rose by nearly one-half, while fresh milk prices increased by almost one-third. In contrast, the rise in hard cheese prices, at around one-fifth, was considerably more moderate. Furthermore, these prices did not peak until October 2008, when producer prices of milk had again fallen markedly. By contrast, the peak price for butter had already been reached in November 2007 and for fresh milk in April 2008.

Commission to the Council, COM (2009) 385/4. — 5 This can be proven using an error correction model. A distinction is made between two sub samples: January 1991 to December 2006 and January 2007 to May 2009, so that the period of strong price fluctuations can be considered separately. For the period 1991 to 2006, the consumer price adjust-



1 Rebased from the original basis; seasonally adjusted. — 2 Fresh whole milk, long-life milk, condensed milk, farm cheese, cream, butter. — 3 Yoghurt with or without added fruit, ready-made desserts (not yoghurt), fresh, soft, hard and semi-hard cheese. — 4 See European Commission, Dairy market situation 2009, Communication from the

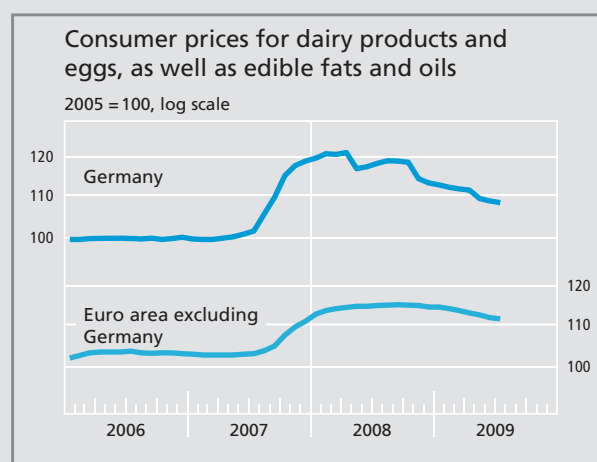
In a similar manner to the price increase, the decline in agricultural producer prices had a comparatively swift impact on less heavily processed dairy products. Since reaching their peak levels, retail prices for butter have fallen by just over 35%, and by around 25% in the case of fresh milk. Butter and milk prices are currently cheaper for consumers than they were prior to the price shock, with price reductions of 5% and 2½% respectively. In the case of highly differentiated products, prices have barely fallen so far. Unlike the price increase, the decline has not largely been a continuous process, but rather stepwise, with the driving force behind this coming mostly from food discounters. The food discounters initially focused their price reductions on butter and milk. This is why the time lags between the adjustment of producer and consumer prices in the case of less heavily processed products were, in some cases, even shorter than during the phase of rising prices. Considerably larger time lags were visible in the case of heavily processed products, however. Food discounters did not begin to focus their price reductions on cheese until the second half of 2009. In July 2009, the weighted average of dairy product prices still exceeded the pre-price surge level by 8%.

This therefore raises the question as to how far consumer prices for dairy products will continue to fall, and how quickly this adjustment could occur. An econometric analysis can be used to show that there is a long-term equilibrium relationship between producer and consumer prices in this segment. Deviations from this equilibrium relationship prompt an adjustment of consumer prices, while producer prices do not respond.⁵ A comparison of the pattern derived from the estimated model with the actual trend disproves the presumption that consumer prices are currently deviating from their usual course. However, given that the adjustment through to the estimated equilibrium relationship is not yet complete, further price corrections are likely. According to the model results, if agricultural producer prices remain at the current level for some time to come, the next twelve months will see a further drop in consumer prices for dairy products of around 7%, especially for heavily processed products. Conversely, a recovery in milk producer prices

ment coefficient is 0.01 (LR statistic 7.6; 5 percent critical value 3.8), while the producer price coefficient is not significant. For the period 2007 to May 2009, the coefficient for the consumer price adjustment is estimated to be 0.08 (LR statistic 5.0), while the producer price coefficient is again statistically insignificant. — 6 Only comparatively high

would cause consumer prices of “simple” dairy products to rise again.

According to the Harmonised Index of Consumer Prices, consumer prices of dairy products and fats (also including eggs, vegetable oils and oils⁶) in Germany rose especially quickly and extraordinarily sharply compared with other European countries. That said, however, the downward adjustment also took place more quickly and on a greater scale. While prices in Germany have been falling again since April 2008, prices in other euro-area countries did not peak until September 2008. The severity of the downward revision, at just over 10%, was also more than three times as high as in the euro-area partner countries. The greater volatility of German consumer prices is also likely to be connected with the highly competitive retail structure in Germany, which is characterised by a large proportion of discount retailers with low gross margins. This means that fluctuations in producer prices are passed on to consumers comparatively swiftly. This is backed up by a study by the Statistical Office of the European Communities in 2006, which shows that consumer prices for the product categories analysed here were considerably lower than in other euro-area countries.⁷ In July, prices in these product groups were still 8½% up on the pre-price-shock level, both in Germany and in the other euro-area countries.



aggregated data (4-figure COICOP) are provided for the Harmonised Index of Consumer Prices. — 7 See E Bochert and S Reinecke, Eating, drinking, smoking – comparative price levels in 37 European countries for 2006, Eurostat, Statistics in Focus 90/2007.

mid-2008, were later retracted in part. The marked month-on-month decline is largely attributable to the more volatile components, which became more expensive in June. Price developments in the case of other goods and services, as well as of housing rents, were much less volatile, with the result that the annual rate (excluding energy and food) fluctuated, with no clear trend, between 1.2% and 1.6% over the past few months. Against the backdrop of an, on the whole, favourable price trend, a reduction of the negative year-on-year figure is initially to be expected in the coming months, followed by a return to moderately positive rates later in the year.

Orders received and outlook

*Economy in
stabilisation
phase*

Given the marked – albeit not yet broadly based – impulses stemming from foreign trade, together with construction activity, which is still being positively influenced by special factors, and the private consumption activity, the outlook for the overall situation of the German economy has become increasingly stable. According to the leading indicators, there may even be a perceptible pick-up in overall economic output from a very low level in the third quarter of 2009, especially as the rise in demand, against the backdrop of cleared inventories, is likely to be converted into production relatively quickly. Even so, a cyclical turnaround is not yet guaranteed. At present, the expansionary effects of the massive monetary and fiscal policy stimuli, in particular, are starting to unfold both in Germany and abroad. However, given the pattern of specialisation of the German econ-

omy, an endogenously sustained recovery process relies predominately on steady and broadly based stimuli from exports. This is reinforced by the fact that enterprises' propensity to invest is likely to remain weak for some time to come and consumption could become less resilient during the course of the year.

Given the fact that the labour market situation is likely to deteriorate further, the rather favourable consumer sentiment on the basis of a cyclical comparison, which, according to the most recent survey results from the market research institution GfK in June, brightened again across all components, appears to be more of a transient nature. The income-supporting measures in the shape of tax reductions and transfer payments will not be as substantial in the second half of 2009 as in the first, even though the pension increase on 1 July, the lower health insurance contributions and the increase in the standard rate for recipients of unemployment benefits (Hartz IV) favour to an above-average extent households that tend to have a higher propensity to consume. The propensity to make large purchases has risen again from an already rather elevated level; it could, however, decline perceptibly towards the end of the year if the demand for new cars suffers a setback once the additional funds that were made available for the car scrapping scheme have also been exhausted.

*Consumer
sentiment still
relatively
favourable*

Construction investment will increasingly benefit from the fiscal policy stimuli in the second half of the year. It usually takes some time before public-sector infrastructure pro-

Stimuli from public construction orders and catching-up effects in housing construction

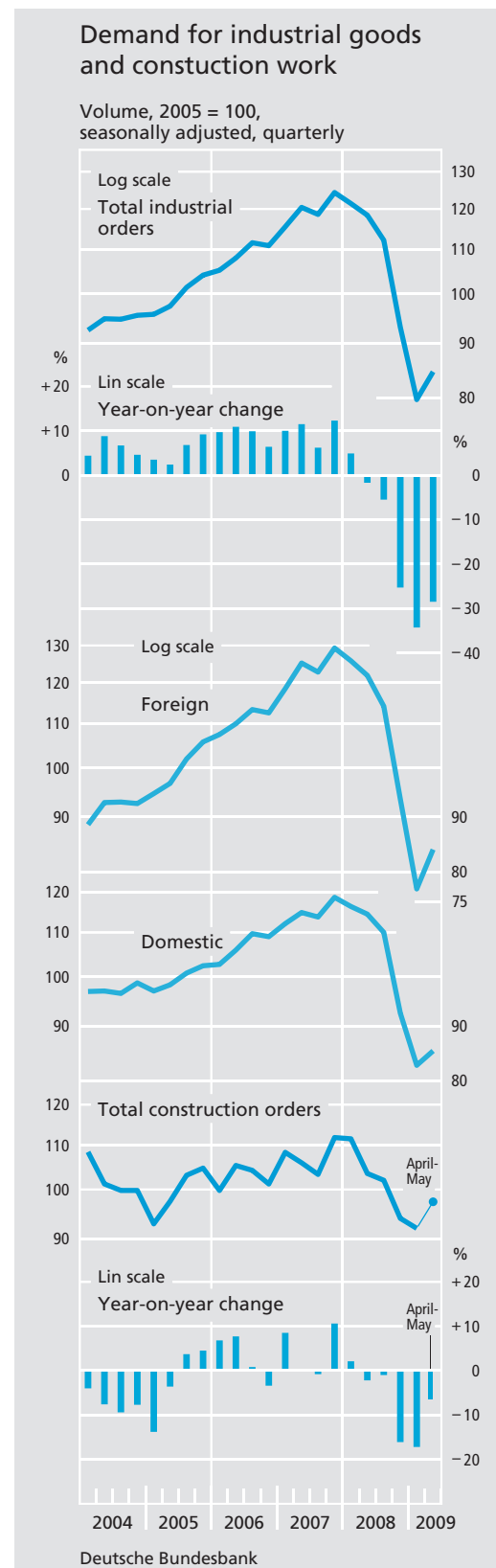
jects are actually implemented, which means that many measures were not initiated until the second quarter. On an average for April and May – more recent data are not yet available – public-sector construction orders were still 16½% up on the fourth quarter of 2008 in seasonally adjusted terms. Whereas central, state and local authorities had initially focused primarily on civil engineering projects, public-sector building construction also picked up at the end of the period under review. Furthermore, it is also to be expected that construction firms will make use of the summer and autumn months to work off the strong increase in approved new housing projects. There was further growth in the number of industrial orders in May.

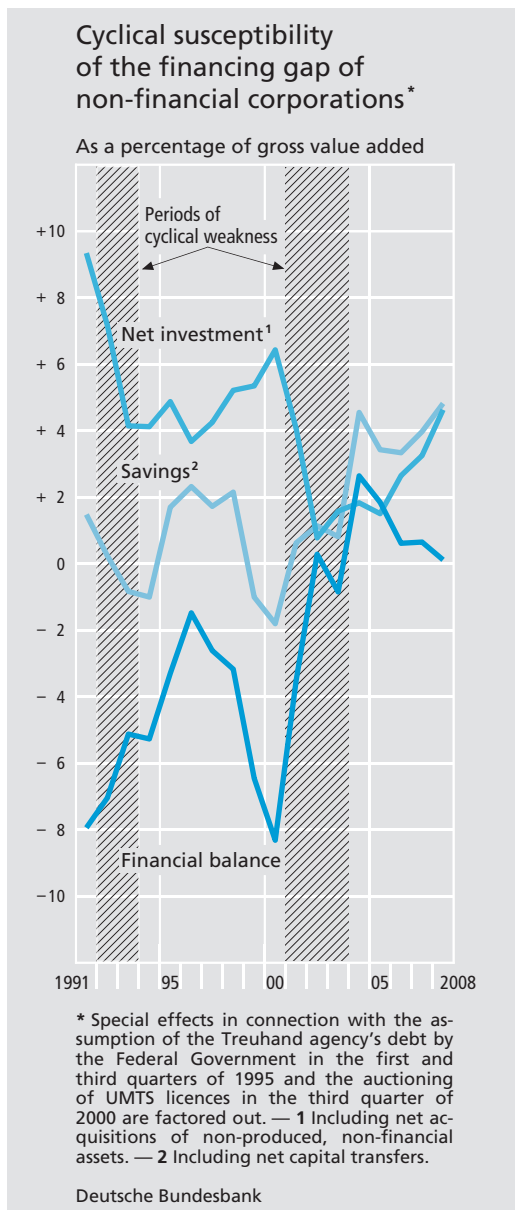
Business investment cyclically weak

The underlying trend in firms' orders of vehicles, machinery and other equipment will continue to decline. If the sector "manufacture of motor vehicles, trailers and semi-trailers" is excluded, which is currently distorted owing to the strong non-commercial demand, domestic orders for capital goods in the second quarter were still down by a seasonally adjusted 4½% on the quarter, after very strong decreases had been recorded in the first quarter of 2009 and the final quarter of 2008, at 22½% and 13½% respectively.

Response pattern of the financial balance

The cyclically induced restraint in investment is due largely to the significant capacity underutilisation at present. This, in turn, lowers demand for external financing. Added to this is the fact that the cyclical sensitivity of non-financial asset formation during periods of weakness is usually more pronounced than the corresponding cyclical responsiveness of





corporate earnings. Owing to the interaction of these two response patterns, the financial balance of non-financial corporations – both in relation to value added – improved perceptibly during the course of the last two periods of weak economic activity in 1992/1993 and from 2001 to 2003, compared with the respective levels at the end of the preceding upswing. A similar response pattern is entirely

plausible for the current cycle, albeit possibly in a weaker form.

In this connection, it is also significant that non-financial corporations' retained profits and net capital transfers received were greater than the expenditure on additional fixed assets, even during the upswing between 2006 and 2008. This combined with an accelerator mechanism which set in at a later stage points to structurally improved profitability and thus to a lower net demand for external financing. What is more, since the late 1990s, German firms have significantly bolstered their financial robustness and built up considerable reserves. According to the results of the Bundesbank's corporate balance sheet statistics, between 1998 and 2007 they raised their equity capital and return on sales ratios perceptibly and lightened their investment burden.

Firms' finances in sound condition so far

Another key factor in building up resilience to crisis situations has been that, in the past years of buoyant economic activity, undercapitalised firms not only positioned themselves more strongly in absolute terms, but also narrowed the gap between themselves and enterprises with a sounder equity base. This trend is apparent across the board. For example, smaller and medium-sized enterprises in particular significantly built up their capital between 2005 and 2007. Their share of the balance sheet total went up from 14¾% to 18½%. A further important factor in this connection is that, along with the construction sector and the retail trade, sectors in which a large number of enterprises typically face a high risk of insolvency during a recess-

sion, are benefiting the most from the economic stimuli generated by the fiscal policies.

*Further revival
of export
demand key
requirement for
sustainable
recovery*

Industry appears to have overcome the main effects of the massive shock to demand resulting from the international financial and economic crisis. German industry received considerably more orders compared with the low recorded in the first quarter of 2009; orders were 6.1% up on the preceding period after adjustment for seasonal variations. While domestic orders grew at a below-average rate of 3.1%, the volume of orders from the euro area went up by 6.6%, and non-euro area orders by as much as 10.6%. From the summer onwards, this will revive the export business, which is of great importance to

German industrial enterprises. This is consistent with the fact that the Ifo business climate for the manufacturing sector has brightened further. Not only were business and export expectations better rated – as they have been for some time – the current situation was assessed less pessimistically as well. With the improvement in foreign demand, a major requirement is in place for enterprises to continue to build up confidence. If this picture is confirmed and if enterprises gear their staffing and investment plans towards this perspective, the monetary and fiscal policy stimuli would have had a stabilising effect at just the right time, and the massive expansion of short-time work could fulfil its bridging function for the labour market.