

## Economic conditions in Germany

### Macroeconomic situation

*Marked decline in economic output in 2012 Q4*

The upturn in overall German economic output was interrupted at the end of 2012. According to the Federal Statistical Office's flash estimate, quarter-on-quarter real GDP growth fell by 0.6% in the fourth quarter of 2012 after adjustment for seasonal and calendar variations. Economic activity in Germany suffered a noticeable dampener caused by the ongoing weakening of demand. This had set in over one year earlier owing to the slower pace of global economic growth, recessionary tendencies in the euro area and considerable uncertainty associated with the resolution of the debt crises. Normal capacity utilisation was only just maintained in the autumn after capacity utilisation waned in the preceding quarters as a result of economic growth falling below the potential rate. After

adjustment for calendar effects, GDP showed an increase of no more than 0.4% on the year.

Declining exports were one factor behind economic output falling into negative territory in the reporting period. Another was the persistent underlying negative movement in investment. The components displaying a more upward development did very little overall to counteract these strongly dampening effects. Once again, no more than subdued stimuli came from private consumption. Apart from the effects of the weather at the end of the year, a further increase in the existing heightened level of activity in housing construction was restricted by the shift in the focus of demand from owner-occupied houses to apartments. Given the usual time lags, it is not surprising that the calming of the situation in the euro-area financial markets during the fourth quarter has not yet had any stimulative effects, especially on firms' propensity to invest.

*Contractionary effects from exporting and investment in machinery and equipment were the main factors*

#### Overall output

2005 = 100, price and seasonally adjusted



Deutsche Bundesbank

Enterprises' export business saw a broadly based decline in the fourth quarter of 2012, with real exports of goods likely to have been around 2¼% down on the quarter in seasonally adjusted terms. Above all, export sales of capital goods were down. Besides hitting automotive firms, this affected manufacturers of computer, electronic and optical products. Mechanical engineering underwent a marked decline for the second quarter in succession. By contrast, exporters of intermediate and consumer goods suffered hardly any export losses.

*Significant fall in exports of capital goods*

Automotive exports to countries outside Europe, which were the main factor providing strong momentum well into the third quarter, moved into negative territory. This marked reversal in motor vehicle sales is consistent with the fact that exports to the United States, which increased significantly in the third quarter, were not so high this time in seasonally adjusted terms. The same effect is likely to have

*Marked reversal in automotive business with non-euro-area countries*

also placed a strain on exports to the OPEC countries. Negative results were likewise in the majority in trade with Asia, with fewer motor vehicles being exported, first and foremost, to China. The new industrial countries of this region were the sole exception, following a stagnating development in the second and third quarters of the year. Furthermore, there was a slackening of exports to central and eastern European countries and Russia.

*Exports to other euro-area countries still in negative territory*

In the reporting period, the fall in exports of goods to the rest of the euro area was not quite as sharp as that in exports to non-euro-area countries. Here, though, the dampener did not disrupt an underlying upward movement but instead gave a downward push to a development that was already feeble. Once again, business not only with Italian but also Spanish customers proved to be a straining factor. Furthermore, negative figures have also been posted in other major euro-area markets, such as the Netherlands and Austria. The fact that exports to France held up in the fourth quarter was due solely to the strong deliveries of goods for joint aircraft production.

*Smaller decline in volume of imports*

Imports performed better than exports in the final quarter of 2012. Seasonally adjusted real imports to Germany fell by roughly 1¼% in the reporting period. There was a marked reduction in the foreign trade surplus, which increased sharply in the second and third quarters of the year. There was a pronounced large expansion in energy imports at the end of the year. On an average of October and November, they were around one-tenth higher in real terms than in the third quarter. Even so, this did not offset the decline in imports of intermediate and capital goods. While imports of machinery and computers, electronic and optical products as well as electrical equipment were clearly less in demand than in the preceding quarter, imports of motor vehicles and motor vehicle parts declined only slightly. Also of relevance was the considerable fall in imports of other transport equipment; these often fluctuate heavily from quarter to quarter and showed high growth in the pre-

### Underlying trends in foreign trade

Seasonally adjusted, quarterly



1 Adjusted for the price indices for foreign trade.  
 Deutsche Bundesbank

vious quarter. Imports of consumer goods were slightly up on the quarter, however.

The acquisition of moveable fixed assets eased off further in the fourth quarter of 2012. This means that investment in machinery and equipment has been on a downward path for more than a year now. Given the moderate utilisation of fixed assets, capacity extensions were understandably not on the agenda. Such caution seems to have spread to modernisation of machinery and equipment as well as vehicle fleets. This is suggested by the fact that spending on new machinery and equipment in the period under review was only slightly higher than writ-

*Further weakening of investment in machinery and equipment*

edowns on assets owing to technical wear and tear and economic obsolescence. Given frail investment activity, commercial construction is likewise lacking impetus. The fact that the tendency towards weakness in this sector was not quite as strong as it was in investment in machinery and equipment may have been due to the extremely favourable financing conditions. These are of key importance for construction projects because they have a relatively large share of outside financing. Moreover, the long amortisation period for construction projects means that the current weakening of demand and uncertainty have less of an influence on considerations of profitability than they have in the case of fixed assets with a shorter period of use.

*Housing construction tending to be no longer quite so expansionary*

The underlying conditions for investment in housing construction remained decidedly advantageous in the fourth quarter. As in the preceding quarters, however, the expansion is unlikely to have matched the strong pace of 2010 and 2011. To a considerable extent, this is due to the focus of new construction activity shifting away from owner-occupied housing towards apartment blocks; the elevated level that has already been achieved is an additional factor, however. The demographic benchmark data limit demand for new single-family housing more than demand for apartments. Especially if capital investment decisions are a major factor, demand for apartments can react relatively strongly to low interest rates. In public sector construction, the stabilisation at a low level may have been tending to continue.

*Further subdued increase in private consumption*

Consumer demand continues to provide no more than subdued stimulus. Private consumption in the fourth quarter was again slightly up on the preceding three-month period after seasonal adjustment. Retail sales were down in the final quarter of the year. In the same period, however, there were more new private passenger car registrations again in seasonally adjusted terms, and supplies of heating oil were replenished. The surveys of the consumer research institution, *Gesellschaft für Konsumforschung*

(*GfK*), indicate that the consumer climate continued to be highly optimistic. The main reasons for this were the positive labour market situation and strong growth in earnings.

## ■ Sectoral trends

Industrial output in the fourth quarter of 2012 was 3¼% down on the preceding quarter in seasonally adjusted terms. At 4¼%, there was a larger-than-average decline in the case of capital goods. This was due mainly to the fact that automotive production was cut back by 8% following an exceptionally high level achieved in the third quarter owing to shorter holiday-related plant shutdowns. Furthermore, manufacturers of machinery and equipment as well as manufacturers of computers, electronic and optical products and electrical equipment, at 3¼% and 5% respectively, reined back their output on a considerable scale. This contrasted with the manufacture of other transport equipment, where there was a marked expansion in output in order to quickly satisfy the relatively buoyant demand of more recent months. In the intermediate goods sector, the fourth quarter saw a seasonally adjusted 2¾% fall in output, following on from what was already a distinct decline in the summer months. Output of consumer goods in the reporting period showed a relatively minor fall on the quarter (-¾%).

*Very steep drop in industrial output*

The decline in output in the fourth quarter is consistent with the data collected by the Ifo Institute on manufacturing capacity utilisation, which showed a marked reduction at the beginning of the reporting quarter compared with the middle of the year. In January 2013, enterprises reported a slight increase in utilisation for the current quarter. Nevertheless, at just over 82% of full operational capacity utilisation, it was still distinctly below its long-term average. The improvement in capacity utilisation is due mainly to producers of intermediate goods. Utilisation in the capital goods sector at the current end, however, is still well below its long-term average.

*Industrial capacity below normal utilisation*

*High year-end level of construction output not maintained, energy production also down*

Seasonally adjusted construction output in the fourth quarter of 2012, at 2¾%, was well down on the summer months. This was due chiefly to a sharp fall in construction activity in December. This could be explained by the fact that, following the interruption due to ice and snow in the first half of the month, construction firms did not resume production until after the end of the year.<sup>1</sup> The decline in civil engineering, at 4¼%, was significantly sharper than in building construction (-2%). Seasonally adjusted energy production in the fourth quarter failed to match the heightened level of the summer months (-1¾%).

*Activity in the services sector in the wake of weak industrial output*

Business activity in the services sector may have eased somewhat in the final quarter of 2012 as a result of weak output in the production sector. One indication of this is provided by assessments of the business situation, which were scaled back moderately according to Ifo Institute and Centre for European Economic Research (ZEW) data. Mainly industry-related services are likely to have been impeded. For example, the seasonally adjusted mileage of heavy goods vehicles on roads subject to toll charges suggests that the transport sector was also affected. Information on sales currently available only for October and November shows that the motor vehicle trade also suffered losses. Wholesale turnover remained at the considerably lower level of the third quarter. Business also declined in some consumption-related service sectors, however. There was a moderate fall in retail sales. Moreover, the turnover of hotels and restaurants failed to hold up at the level of the third quarter. Construction-related service providers continued to benefit from the high level of activity in the construction sector.

## Employment and labour market

*Sideways movement in the labour market*

The cyclical slowdown has hardly left any mark on the labour market so far. The data, which have been revised several times over the past

### Output in industry and in construction

2005 = 100, seasonally adjusted, quarterly



Deutsche Bundesbank

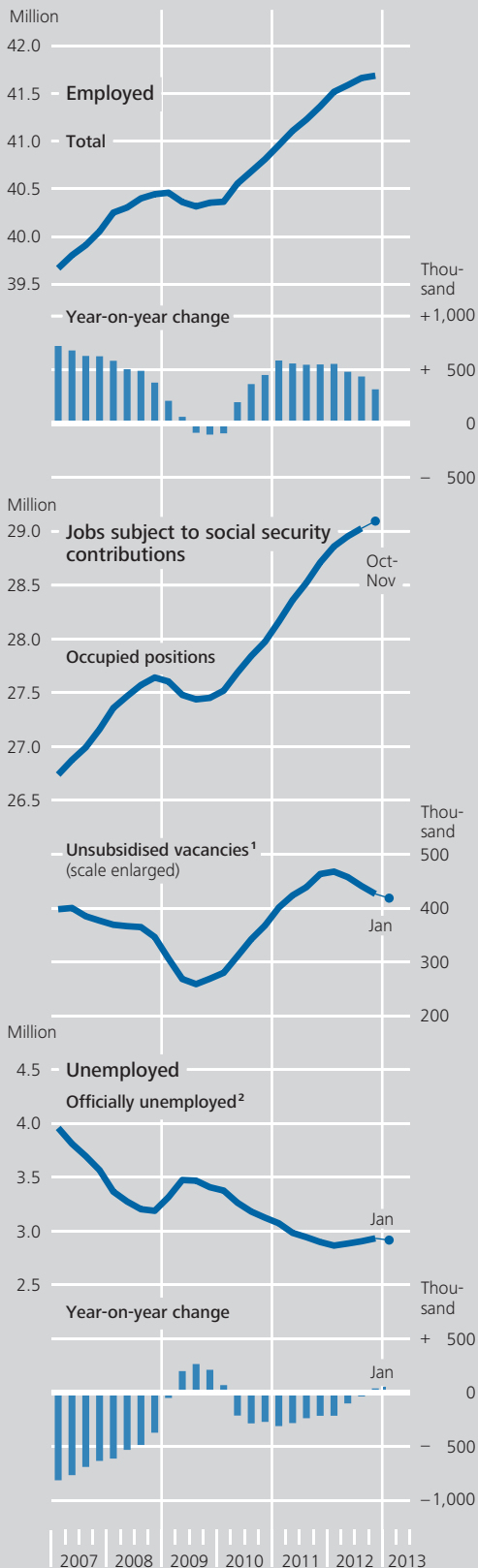
few months,<sup>2</sup> now show that the level of employment in the final quarter of 2012 was 24,000, or 0.1%, higher than the average of the third quarter. It was mainly jobs subject to

<sup>1</sup> Measured by the Ifo Institute's survey findings on the scale of production stoppages due to weather-related factors, the outcome for December 2012 is not above average on a seasonal comparison. The same applies on a monthly analysis to the number of ice days. However, this time they were all in the first half of December. Furthermore, the Ifo Institute also conducts a monthly survey of the utilisation of construction equipment in this sector; in December, it was well down in seasonally adjusted terms on the cyclically high level of the second and third quarters.

<sup>2</sup> Following a downward revision in November, the Federal Statistical Office has revised the data on employment upwards considerably twice in quick succession, especially for the second half of the year.

## Labour market

Seasonally adjusted, quarterly



**1** Excluding seasonal jobs and jobs located abroad. **2** From May 2009, unemployed excluding persons newly registered on the books of private employment agencies.

social security contributions that were filled. By contrast, there was a decline in self-employment and in “one euro” jobs owing to reduced labour market policy assistance. The level of persons solely in marginal employment has not been showing a clear trend for some while.

There was a seasonally adjusted 49,000, or 0.2%, increase in employment subject to social security contributions in the fourth quarter. This was due chiefly to the business services sectors (excluding temporary agency employment), which grew by 1¼%. Health and education services were still making a positive contribution, at +¼%, although there will be no further strong surges in employment in this sector for the time being. There was a slight increase in manufacturing despite the setback in this sector’s activity. The effects of weak industrial output on the labour markets are reflected, above all, by the fact that temporary employment went down by a further 2¾% in October and November after declining by a total of 5% in the second and third quarters.

*Employment subject to social security contributions on the up*

In the reporting period, the seasonally adjusted official unemployment figure was 27,000 higher than in the third quarter. This meant that the number of persons out of work rose to 2.93 million, with the unemployment rate going up by 0.1 percentage point to 6.9%. In mathematical terms, the increase was due entirely to a rise in the number of unemployed persons claiming insurance benefits, where cyclical factors, as a rule, first make themselves noticeable. Considering the fact that aggregate capacity utilisation, given the considerable losses in the final quarter of the year, has, at best, just about held up in its normal range, the still low level of 951,000 persons is remarkable. There was a slight decline in the number of unemployed persons receiving the basic welfare allowance. This means that adverse cyclical effects have not yet made themselves felt in the subsequent transfer system.

*Further rise in registered unemployment between October and December*

Total underemployment, which also includes persons involved in labour market policy

*Interruption of the sustained decline in underemployment*

measures, showed no further fall during the fourth quarter. This meant that there was a break in the sustained decline in underemployment; to a large extent, this was due to a reduction in employment agency measures – especially work opportunities and promoting self-employment – in the context of the favourable situation on the labour market. In the reporting period, there was a moderate expansion of instruments to get unemployed persons (back) into work. Somewhat greater use was also made of short-time working. Even so, 70,000 persons working short time for economic reasons in November points to a low takeup from a macroeconomic perspective, especially as there has been no further increase in registrations since September.

*Further fall in registered unemployment in January 2013*

January 2013 saw a marked decline in the seasonally adjusted official unemployment figure for the first time since the beginning of 2012, and the unemployment rate fell to 6.8%. One factor in this may be that the figures were collected before the cold spell in the middle of the month and that weather-related dampening effects were therefore not as strong as they usually are in January otherwise. However, it is also possible that firms have been guided over the past few months more by their medium-term recruiting needs.

*Labour market outlook less encumbered*

The leading labour market indicators are providing further evidence that there has been an increase in firms' willingness to recruit new staff since the autumn. The Ifo employment barometer has been pointing upwards since November, for example, after going down slowly from an all-time high for almost two years.<sup>3</sup> By contrast, the Federal Employment Agency's BA-X job index was still showing a slight decline in the final quarter of 2012. This was probably due mainly to the fall in demand in temporary employment, since this sector generally accounts for many of the jobs on offer. Apart from temporary employment, vacancies are largely stable; even so, the number of vacancies in manufacturing was somewhat lower than in the preceding quarter.

## ■ Wages and prices

Growth in negotiated rates of pay in the final quarter of 2012, at 2.8%, were just as high as in the third quarter. The annual increase in the agreed basic rates of pay fell slightly from 2.9% to 2.8%, however.<sup>4</sup> In the forthcoming major pay round, the trade unions will evidently be attaching importance again to large pay increases. The wage and salary claims published so far are no lower than those last year.

Developments in earnings in the past year were shaped by the overall positive situation in the economy and on the labour market. In 2012, actual earnings rose only slightly more strongly, at 2.6%, than did negotiated rates of pay at 2.5%. The total amount of bonus payments was thus probably at much the same level as in 2011. For some time now, overall growth in negotiated rates of pay has not differed significantly from the rise in basic rates of pay. This is due to the fact that pay rounds over the past two years have, for the most part, seen permanent increases in wages and salaries with one-off payments being a factor only in isolated cases.

Despite the sideways movement of crude oil prices and the recovery in the euro exchange rate, there was a marked quarter-on-quarter increase in prices at all stages of the economy in the final three months of 2012. Import prices for energy showed quite a sharp increase on

*Continuing strong growth in negotiated pay*

*Actual earnings and negotiated pay almost in step in 2012*

*Rise in import prices and producer prices*

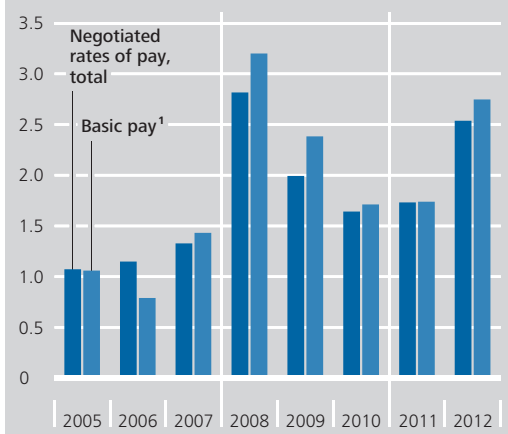
<sup>3</sup> In December 2012, the Ifo employment barometer was published for the first time based on an extended reporting population. Besides trade and industry (ie manufacturing, construction, as well as the wholesale and retail trades), data on the short-term employment plans of business-related services are now incorporated when the index is calculated. The new index goes back to the year 2002. The fact that the time series of the new index is less volatile than that of the old one can be explained by the generally lower susceptibility to fluctuations of employment movements in the services sector. At the current end, the index curves in the new and old definitions are very similar apart from a difference in level.

<sup>4</sup> The Federal Statistical Office reports a 3.1% increase in negotiated basic rates of pay in the fourth quarter, compared with 3.2% in the third quarter. Differences compared with the Bundesbank's pay index result from the fact that the Federal Statistical Office does not include civil servants in its index and reports only the first month of each quarter.



### Negotiated rates of pay

Year-on-year percentage change, on monthly basis



¹ Excluding additional benefits and lump-sum payments.  
 Deutsche Bundesbank

the quarter in seasonally adjusted terms, as the temporary weakness in the crude oil markets in June was still being reflected in the import prices for July. In the case of intermediate goods, the improved outlook for global economic activity was countering the appreciation of the euro. The prices of imported capital and consumer goods fell, however, owing to the exchange rate. At the domestic producer level, the lower percentage of crude oil meant that the rise in energy prices was much more subdued than in the case of imports. Otherwise, the underlying producer price movements showed themselves to be less favourable than at the import level. Overall, seasonally adjusted import prices were 0.4% up on the quarter, with a corresponding rise of 0.5% in producer prices. The increase in export sales prices was smaller, at 0.2%. The terms of trade eased only slightly. They were slightly up on the previous year's level, however. The annual rate of increase for import prices fell further to 1.0%, while the year-on-year figure for domestic producer prices went up again slightly to 1.5% following a low in the third quarter.

*Construction and property prices still rising*

Although demand on the housing markets remained quite buoyant, the rise in housing construction prices, at 0.3%, was moderate like in the previous quarter. The annual rate was unchanged at 2.5%. This may reflect the fact that

the rise in material costs eased off during the year. According to the Association of German Pfandbrief Banks (*Verband deutscher Pfandbriefbanken*), the price index for owner-occupied housing went up by 1% compared with the third quarter. The annual rate was 3½%. The sharp price increase that began in the previous year thus persisted in 2012 (more information on developments in the real estate markets and, in particular, house prices in 2012 may be found on pages 53 to 55).

In seasonally adjusted terms, the increase in consumer prices in the final quarter, at 0.5%, was just as sharp as in the previous quarter. Falling prices for refined oil products contrasted with considerable price rises for food. This unfavourable price development was due mainly to the world markets, although domestic distribution costs are likely to have risen as well. On an average of 2012, food prices went up by no less than 3.2%. In the case of other goods, the seasonally adjusted rate of price increase in the reporting period was 0.6% on the quarter. Although price rises for semi-durable consumer goods were very subdued in the third quarter, this was more than offset afterwards. Prices for services (excluding rents) increased only slightly to 0.4%. Despite reports of sharp rent increases in some towns and cities, the increase in the official rent index remained moderate. One factor in this is that existing rents play a dominant role in movements of the rent index; existing rents follow rents for new lettings with a major time lag and a lower amplitude. Consumer prices showed an overall annual increase of 2.0% according to both the national Consumer Price Index (CPI) and the Harmonised Index of Consumer Prices (HICP). The annual average rate of CPI inflation was also 2.0%. The HICP figure was somewhat higher at 2.1%. Excluding energy and food – on which price increases were concentrated – the rate was no more than 1.3%.

*Continuing rise in consumer prices*

As the consumer price index has been rebased on a new basket of goods for 2010, more precise information on price developments in

## House prices in 2012 in Germany

The strong upward movement in house prices in Germany continued in 2012. Although the rise in house prices slowed down somewhat in major cities and urban centres compared with 2011, it became conspicuously more broadly based. The price stimuli spread from towns and cities to their surrounding areas, from new dwellings to second-hand residential property and from apartments to single-family houses. There was also a discernible pick-up in momentum in the housing rental market. The underlying evasive movements, along with the still substantial growth in the housing stock, are counteracting the strained situation in the booming submarkets. However, the macro-economic risks potentially linked with strongly rising house prices continue undiminished owing not least to the upward pressure on prices being spread more broadly.

Calculations based on data provided by BulwienGesa AG for 125 towns and cities show that house prices in 2012 rose 5¼% on the year. House price inflation was therefore virtually just as strong as in 2011 (+5½%). The price rises reported for the 125 towns and cities are likely to have still exceeded the average for Germany as a whole. In 2012, owing to the regional spill-over effects, the differential was probably no longer as large as in 2011 when it stood at 2¾ percentage points, as measured by the rate of change in the overall index (413 towns and municipalities), which is available only at a later date. With this qualification, the picture is consistent with the trend acceleration that can be seen in other price indicators which are fairly representative of the market as a whole.<sup>1</sup> According to data provided by the Association of German Pfandbrief Banks (Verband deutscher Pfandbriefbanken, vdp), the prices for owner-occupied housing rose by 3% in

2012, compared with 2½% in the previous year.<sup>2</sup> The Hypoport composite index shows that house prices rose by 5% in 2012, compared with 3½% in 2011.

The regional profile and a look at the different market segments clearly show that in 2012 the distribution of property price increases displayed less of a peak than in 2011. The sharpest price increases are still in owner-occupied apartments in large cities of over 500,000 inhabitants. The price acceleration of newly constructed housing in 2012, at 7%, was still perceptibly lower than the 10% leap in prices in 2011. By contrast, not only existing owner-occupied apartments, but also terraced housing showed a significant increase in 2011. The largest price rises for owner-occupied apartments occurred in towns and cities of fewer than 250,000 inhabitants, even though upward price pressure there was still discernibly weaker than in larger urban centres.<sup>3</sup>

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<sup>1</sup> The indicators differ from one another mainly in their regional coverage and in the way they record the different types of dwelling. They also display differences in the way in which the data are compiled. See the information on house prices in the Bundesbank's Monthly Reports of February 2009 (pp 52-53) and February 2010 (pp 58-59).

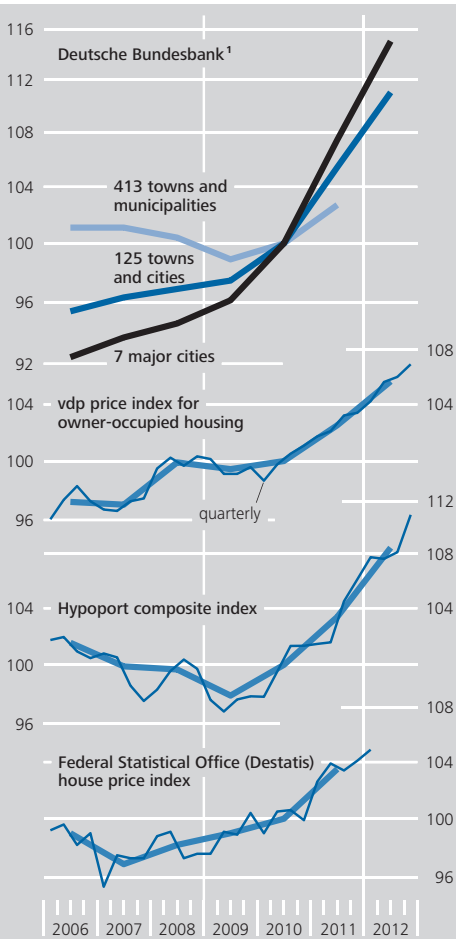
<sup>2</sup> The broadly based house price index of the Federal Statistical Office, which at present does not provide data beyond the reporting year 2011, reveals a slower pace for Germany as a whole compared with the data for 125 towns and cities. See J Dechent, *Preisindizes für Wohnimmobilien*, *Wirtschaft und Statistik*, October 2012, p 891ff.

<sup>3</sup> In the price data for medium-sized university towns and cities, in which students make up at least 15% of the resident population, the special effect due to the temporary sharp rise in demand for housing brought about by the double intake of final-year secondary school pupils and the suspension of compulsory military service is clearly visible. Prices of owner-occupied apartments in these towns and cities have risen by a total of roughly 10% over the past two years, for example. In all the recorded towns and cities of fewer than 250,000 inhabitants, which includes the university towns under consideration with the exception of Münster, price increases were significantly lower at just under 8%.



### Selected house price indices

2010 = 100, annual values, log scale



<sup>1</sup> Bundesbank calculations for terraced houses and owner-occupied apartments based on data provided by BulwienGesa AG.  
 Deutsche Bundesbank

With regard to the 125 towns and cities, the dispersion of the house price rises was somewhat lower than in the previous year. Furthermore, there was also a smaller number of towns and cities with declining or unchanged property prices.

In the reporting year, the acceleration in the prices of new residential property largely converged with the price trend for pre-owned property (around 5% again), after being noticeably higher, at more than 6%, in the previous year. Given the uniform price developments in the construction sector over the past two years, the easing of the exceptional upward price pressure in the

case of newly constructed housing may have been linked to the fact that property developers as well as general contractors active in apartment construction, which is booming at present, have no longer been able to maintain profit margins at the same level as when housing construction was just beginning to pick up. At that time, after years of market consolidation, there was a favourable opportunity to increase the depressed profit margins by raising prices sharply.

The upturn in the housing market affected not only owner-occupied housing, but also the rental sector. Rents for new lettings of existing housing showed a further marked rise in 2012. According to data provided by BulwienGesa AG for 125 towns and cities, the increase stood at 4¾% on average in the case of new dwellings and at 3½% for re-rentals. Since 2010, the increase in rents has been roughly four times higher for new dwellings, and roughly three times higher for existing dwellings than on an average of the preceding decade. So far, however, the increase falls a long way short of matching the price rises of the early 1990s.<sup>4</sup> Rental property prices in large towns and cities rose particularly sharply. Rents for new lettings have a major signalling function for investors as they play a key part in determining the expected return on investment and, thus, the future housing supply. The regulation of rents distorts the price-setting process and should be considered only if there are good reasons for doing so.<sup>5</sup> Limiting the amount by which rents can be in-

<sup>4</sup> According to the price index of the Association of German Pfandbrief Banks (Verband deutscher Pfandbriefbanken, vdp), which was published for the first time in October 2012, rental increases for new lettings of apartments in multiple-family dwellings, at 2¾%, were much steeper than the average at any other time since the start of the time series in 2003.

<sup>5</sup> In the case of existing rental contracts, rents can be increased only to a limited extent so as not to override regulations for the protection of tenants. Rents for new lettings, on the other hand, can largely be negotiated freely.

creased harbours considerable risks in terms of distorting market incentives for the creation of new residential property, which is still necessary given the widespread excess demand.

The expansion of the housing supply is making headway in response to the sometimes marked rises in rent and property prices. Construction of apartment blocks has increased significantly in importance of late compared with the construction of new owner-occupied housing. Building permits for three-family and multiple-family dwellings with a total of just under 100,000 living units were granted in 2012, compared with 85,000 in 2011. By contrast, the number of new permits for single-family and two-family houses remained unchanged at around 110,000 units per year.

Even so, taking into account departures from the housing stock owing to demolition and conversion, the provision of new residential property is hardly likely to have been sufficient to bring about a perceptible easing of the situation on the housing markets. A further surge in demand was generated by the fact that the resident population in Germany grew by an estimated 200,000 persons in 2012 due to strong immigration, which probably led to the creation of a large number of new households. Germany's attractiveness for non-residents is relevant for the German property market, but not just in terms of migration effects. Investors with a positive equity-to-debt ratio still seem to be finding suitable property for investment in Germany. Moreover, both effects are concentrated on the major urban centres. Immigrants are primarily attracted to economically prosperous regions with good employment opportunities. Furthermore, foreign investors are likely to prefer the relatively transparent and liquid housing markets of large towns and cities in order to minimise the costs of gath-

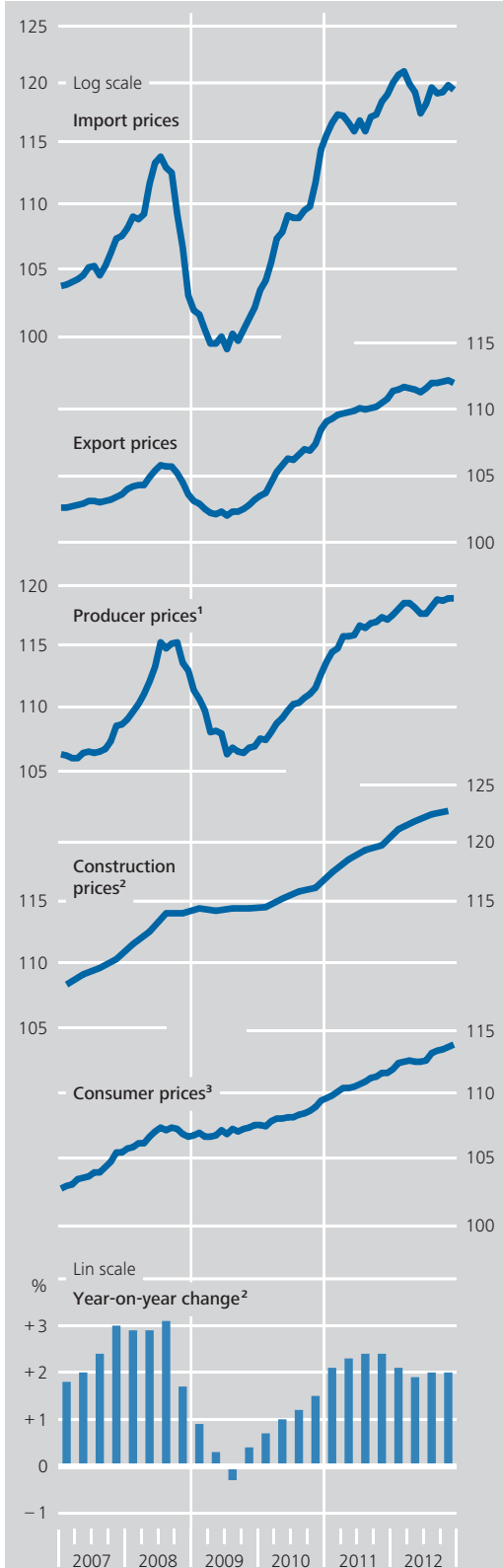
ering information on the market environment.

Furthermore, the exceptionally favourable financing conditions are stimulating housing demand to a considerable extent. On an annual average, banks were granting loans for house purchase at an interest rate of 3¼% in 2012, with the average rate for mortgage loans with a five to ten-year interest rate fixation even falling below 3% in the second half of the year. The initial interest and redemption burden declined again considerably, however, despite the generally greater volume of borrowing due to higher house prices. Property ownership is therefore becoming increasingly attractive not only as an alternative to renting, but also – based on standard calculation principles – as an affordable option for more and more households with limited income opportunities and heightened employment risks.

A watch therefore needs to be kept on this specific set of circumstances so as to prevent a major misallocation of resources, which could place a future strain on the housing markets and the economy as a whole. If the exceptionally favourable interest rate conditions persist, the risk of a lack of long-term debt sustainability could be counteracted by requiring stricter loan-to-value ratios. The practice of some banks to demand higher repayments from the outset is also proving helpful in this context. In the findings of the Bank Lending Survey, this is reflected in a perceptible tightening of credit standards for loans for house purchase over the past year.

### Import, export, producer, construction and consumer prices

2005 = 100, seasonally adjusted, monthly



1 Producer price index for industrial products in domestic sales.  
 2 Not seasonally adjusted, quarterly. 3 National consumer price index.

January 2013 will not be available until the end of February. According to provisional data, there was a 1.7% annual increase in consumer prices. The corresponding HICP figure was 1.9%.

### Orders received and outlook

Business expectations in the German economy have recovered quite rapidly and to a remarkable extent in the past three months. One key factor in the turnaround in sentiment is that fears of extreme scenarios for future developments in the euro area are fading. This means that there is a greater prospect of gradually overcoming the distinctly tentative attitude to investment, which is difficult to reconcile with the medium-term outlook for growth. Nevertheless, major dampening factors persist in the external environment, particularly the severe adjustment recessions in parts of the euro area. Under these circumstances, the glimmer of hope afforded by the gradual firming of the global economy cannot, by itself, be seen as having the force to provide an initial spark for a far-reaching upturn in demand.

*Improved outlook, but no far-reaching revival in sight*

As things stand, overall economic output can nevertheless be expected to increase in the first quarter of 2013. This view is supported by the probability of a countermovement, particularly in industry, in response to the considerable adjustments in production towards the end of 2012. This is supported by the brighter business outlook and the fact that orders from markets outside Europe are tending to improve. Housing construction and private consumption are components of domestic demand which are still expansionary. Although they cannot bring the economy back onto a path of growth on their own, they can do so together with stimuli to the export sector gradually becoming stronger.

*Countermovement in GDP likely in 2013 Q1*

According to the Ifo surveys, the business outlook for trade and industry has shown a marked improvement since November 2012. In manu-

*Marked improvement in business expectations*

facturing, this was associated with a more optimistic outlook for exports again. The improvement is not yet broadly based in industry, however. This is shown by negative reports to the Ifo Institute still being in the majority on balance and by roughly two-thirds of the surveyed firms reporting an unchanged outlook. Interestingly, the expectation component in the survey findings for the construction sector, the wholesale and retail trades and the surveyed services subsectors is displaying a quite synchronous upward movement starting from completely different positions. This suggests that the movement is due more to the general underlying economic conditions rather than sector-specific factors.

*New DIHK survey*

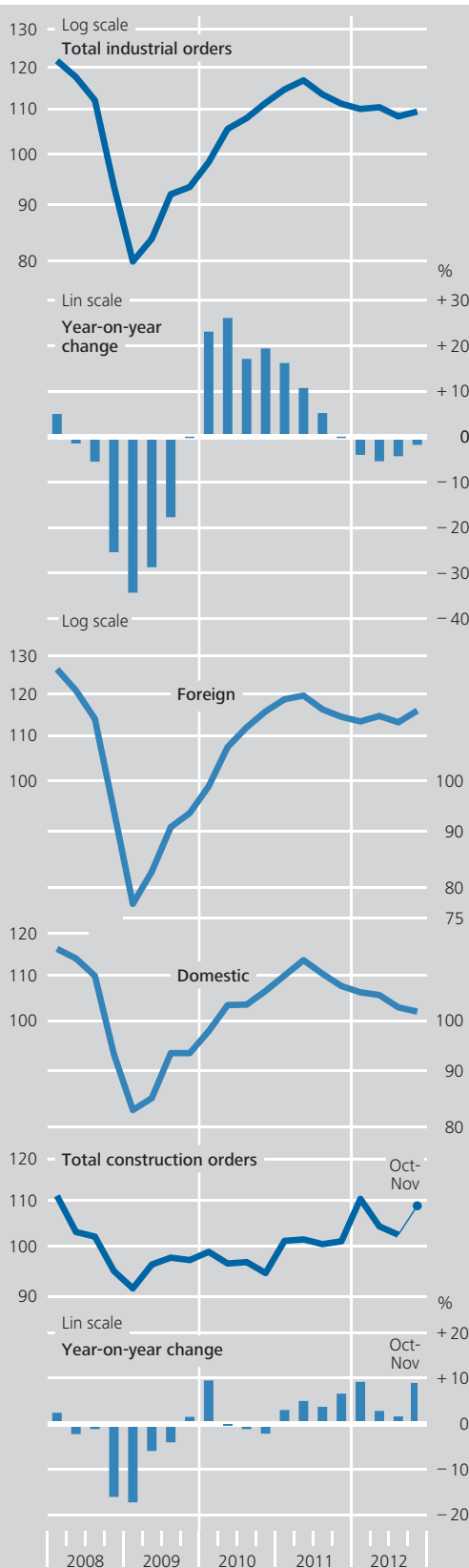
The latest DIHK survey, too, shows that the brighter economic outlook is due essentially to assessments of export prospects being more optimistic again. The major uncertainty that characterised corporate sentiment in the fourth quarter of last year has not entirely receded. The easing of the situation has nevertheless meant that there have been no further revisions to investment and employment plans.

*Increase in export orders confined to non-euro-area markets*

Current developments in industrial orders confirm that it is largely only firms exporting to countries outside Europe which have felt the effects of the upturn so far. In the final quarter of 2012, there was a sharp seasonally adjusted increase in orders from outside the euro area (+3%). This was due partly to a higher demand for intermediate goods (+1¾%). Nevertheless, the capital goods sector had a larger share in growth with a substantial number of major orders. Added to this was the fact that, following a dip in the third quarter, demand for motor vehicles returned almost to the very high level of the second quarter of 2012. Given the continuing gloomy situation in the economy, which is now increasingly taking hold in France, Germany's main trading partner, the volume of orders from the euro area persisted at a very low level, as it had done in the three preceding quarters. The fact that there was a pick-up in demand for capital goods in the euro area as a

### Demand for industrial goods and construction work

Volume, 2005 = 100, seasonally adjusted, quarterly



whole, was due essentially to a large number of orders being placed again in the context of combined European production of aircraft and spacecraft, while orders of motor vehicles, machinery and other equipment showed a further decline. Moreover, orders of intermediate goods from the euro area were only marginally up on the quarter.

*Continuing downward trend in domestic orders*

The fourth quarter of 2012 saw the inflow of domestic orders continuing its downward trend of one-and-a-half years with a figure that was almost 1% down on the preceding three-month period. Weak domestic investment made itself felt mainly in the order books of automotive manufacturers with a further sharp fall in the intake (-4¼%), while things were somewhat better in mechanical engineering owing to a number of large-scale orders at the end of the year (+2¼%). Domestic demand for intermediate goods in the period from October to December was not as high as in the third quarter owing to a smaller intake of orders in the chemicals industry and by manufacturers of electrical equipment. The decline in the case of consumer goods was considerable at 3¼%.

The construction sector continues to enjoy favourable conditions for demand. This is due,

first, to the large need for housing construction. Second, October saw more orders being placed for large-scale private and public civil engineering projects. This is helping to improve capacity utilisation for some time precisely in those construction subsectors that are tending to be less favoured by the current economic environment. In housing construction, the shift in focus from owner-occupied homes to building new multi-family dwellings became noticeably more accentuated towards the end of last year. The number of approved apartments in October and November was 3% up on the average of the third quarter, whereas the number of approved single-family and two-family houses fell by one-eighth.

*Construction demand remains buoyant*

It can be assumed that private consumption is continuing to support economic activity. This is suggested by the decidedly favourable consumer climate and the high propensity to purchase. Owing to the positive labour market situation and considerable growth in earnings, consumers remain very optimistic about their income expectations despite negative reporting on the economy. They now appear to be assessing the economic setting with more confidence, too, however.

*Private consumption still a mainstay of economic activity*