

Economic conditions in Germany

Macroeconomic situation

Rapid recovery from dip in growth

Following extended periods of weak growth during 2014, economic activity in Germany regained considerable momentum even before the turn of the year. According to the Federal Statistical Office's flash estimate, real GDP in the final quarter of 2014 expanded strongly by a seasonally and calendar-adjusted 0.7% compared with the preceding quarter, when only very modest growth of 0.1% had been recorded. Growth in economic output was thus 1.6% for 2014 as a whole; compared with the first preliminary report in January, this represents an upward revision of 0.1 percentage point. Given that corporate sentiment did not begin to rebound until November, it is remarkable how quickly and, in particular, how strongly economic growth in Germany picked up towards the end of last year.

Economic activity stimulated by dramatic decline in oil prices and euro depreciation

The slide in oil prices and the depreciation of the euro, which began in mid-2014 and showed a marked acceleration at the end of the year, have considerably altered some key indicators of the global setting. Enterprises consequently stepped up their production – despite the moderate expectations for global economic growth – in the hope of an improvement in business. The upward movement was not based solely on export markets, however. An especially strong stimulus came from domestic demand. The background to this was the considerable increase in purchasing power due to the decline in energy prices, which helped to strongly boost private consumption. According to rough estimates, Germany's oil bill fell by €3½ billion in the second half of 2014, with the bulk of this saving being realised in the final quarter of the year. The saving could turn out to be even greater in the current year. A large part of the energy price-induced stimulus, however, is likely to have already been reflected in the high level of consumption at the end of last year, whereas the effects of

the euro depreciation on exports are likely to emerge only gradually. The boost to the German economy that is to be expected from external determinants is therefore not yet likely to have been exhausted in the reporting period.

The German economy's export sales showed a further perceptible rise in the final three months of 2014. Goods exports expanded by a seasonally adjusted 1¼% compared with the third quarter, which had already shown a considerable increase. There was probably also a pick-up in exports to both euro-area and non-euro-area countries. According to regional data currently available up to November, there was a further substantial rise in exports to the industrial countries and the emerging market economies of south and east Asia, although the pace of growth in business with China slowed down. Sales of goods to the United Kingdom

Marked rise in exports ...

Overall output

2010 = 100, price- and seasonally adjusted



Source of unadjusted figures: Federal Statistical Office. **1** Only calendar-adjusted.
 Deutsche Bundesbank

Underlying trends in foreign trade

Seasonally adjusted, quarterly



Source of unadjusted figures: Federal Statistical Office. 1 Adjusted using the price indices for foreign trade. Deutsche Bundesbank

and to central and east European EU countries, and possibly also to the USA, continued to rise after a major increase in sales to these countries had already been recorded in the third quarter. By contrast, sales to Japan might have declined again following strong growth in the summer quarter. The marked downward trend in trade with Russia continued.

... especially motor vehicles and machinery

In the final quarter of 2014, exports received a substantial boost from trade in motor vehicles and motor vehicle parts, which had receded somewhat in the third quarter. Significantly more machinery was also exported. By contrast, exports of computers, electronic and

optical products as well as electrical equipment did not expand on a comparable scale. Capital goods exports showed a marked increase on the whole, whereas exports of intermediate and consumer goods were more subdued. Nevertheless, exports of both intermediate and consumer goods performed better in the third quarter than capital goods.

In real terms, the increase in imports in the fourth quarter matched growth in exports. Imports of goods were up 1½% on the quarter in price and seasonally adjusted terms, with imports from both euro-area and non-euro-area countries posting an increase. Owing to the drop in energy prices, the total value of imports rose by a mere ½% on the third quarter, however. Price-adjusted energy imports went up particularly sharply in October and November. Imports of consumer goods also showed a significant rise, with pharmaceutical products playing a significant part in this. Imports of intermediate goods likewise picked up distinctly. By contrast, there was a further slight decline in imports of capital goods, which was due, in part, to other transport equipment, which is generally a volatile sector. Imports of machinery were also down. This contrasted with a steep rise in imports of motor vehicles and motor vehicle parts. This was possibly connected with the increase in motor vehicle exports owing to the close international production ties in the automotive industry. Imports of information and communications technology (ICT) products and electrical equipment again recorded moderate growth.

Imports also rose perceptibly

Investment in machinery and equipment lacking momentum, but greater investment in buildings

Investment in machinery and equipment is unlikely to have generated any stimuli in the final quarter of 2014 after the recovery in investment had suffered a set-back in the third quarter in view of the temporary deterioration in sentiment. Although more German-manufactured machinery was sold to domestic customers in the reporting period, imports of machinery declined. Motor vehicle registration figures show somewhat higher new purchases of commercial vehicles and commercially used

passenger cars. By contrast, there was probably more investment in buildings again in the final quarter of the year than in the third quarter. This is indicated by the growth in main construction output. Private housing construction has been tending to lose momentum, but demand conditions in this construction subsector were so favourable up to the end of the period under review that, in terms of construction investment as a whole, they not only offset the lack of impetus from industrial construction, but also the public sector reluctance to engage in new construction projects.

Very sharp growth in private consumption again

Private consumption saw very sharp growth again in the final quarter of 2014. The significant decline in energy prices provided a further boost to consumer demand in an environment that has already been buoyed for some time by marked pay rises and low unemployment. Retail turnover in the fourth quarter suggests that households took advantage of the reduced strain on their budgets – due chiefly to considerably lower fuel prices – to make other consumer purchases. Furthermore, a number of households also benefited from heating cost reimbursements towards the end of the year as a late effect of the very mild winter weather at the beginning of 2014. Households held back on making heating oil purchases in October and November. They were evidently speculating about further price cuts given the dramatic fall in crude oil prices, especially as households tend to still have sufficient reserves in their oil tanks at the beginning of the heating season. Households' increased real spending capacity was not reflected in the figures for private motor vehicle registrations up to the end of the year, but the sharp rise in domestic motor vehicle orders gives reason to expect that this will be the case in the first half of 2015.

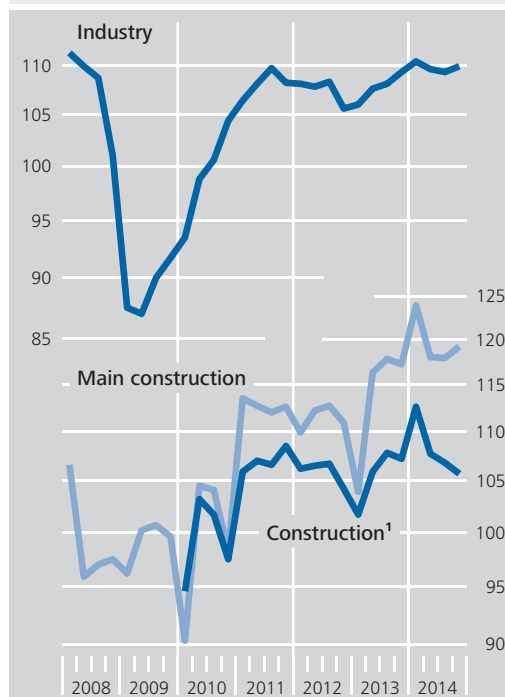
■ Sectoral trends

Industrial output pointing upwards again

Industrial output in the final quarter of 2014 was up ½% on the quarter in seasonally adjusted terms. Industrial enterprises stepped up

Output in industry and in construction

2010 = 100, seasonally adjusted, quarterly, log scale



Source of unadjusted figures: Federal Statistical Office. 1 Main construction and finishing trades.
 Deutsche Bundesbank

their output again slightly in light of the improved order situation after cutting back their production in the second and third quarters. Intermediate goods manufacturers increased their output by a seasonally adjusted ¾%, thereby offsetting the losses of the previous quarter. In the reporting period, the seasonally adjusted production of capital goods remained virtually at the third-quarter level, which, bucking the overall trend, saw an increase. This was due mainly to the fact that the production of machinery had been at a particularly high level. The sector did not quite match this in the fourth quarter. By contrast, there was an increase in the manufacture of motor vehicles and motor vehicle parts following a decline in the third quarter. The manufacture of other transport equipment again showed a further marked increase in output. Consumer goods output rose by 1% on the quarter.

Utilisation of tangible fixed assets in industry also rose in line with the expansion in output.

Rise in industrial capacity utilisation

According to Ifo Institute data, manufacturing firms reported that utilisation was running at 84½% of normal full capacity in January 2015. The longer-term average of 84%, which can be interpreted as a normal degree of utilisation, was therefore exceeded for the first time in almost three years.

Construction output showing sideways movement, energy production much higher

Construction output in the fourth quarter was down by a seasonally adjusted 1% on the quarter. This was due mainly to the extremely weak performance of the finishing trades towards the end of the year, according to the statistics, which showed a 3½% decline on the quarter. Data on the finishing trades are, however, susceptible to fairly strong fluctuations and are highly prone to revision. By contrast, output in main construction in the fourth quarter of 2014, with an increase of 1%, was up considerably on its rather weak level in the second and third quarters. The expansion in civil engineering was markedly greater than building construction. The continued very high level of utilisation of machinery and equipment reflects the unchanged positive cyclical position of the main construction sector. Energy output rose perceptibly in the fourth quarter by a seasonally adjusted 1¾%.

Continued upward trend in services sector activity

There is likely to have been positive economic activity in the services sector in the final quarter of 2014. The services industries, in particular, were feeling the effects of the current sizeable contribution to growth made by domestic activity, which is being supported by very strong private consumption at present. This is suggested by the favourable assessments of the business situation in major sectors of the economy which are reported to the Ifo Institute. The increase in the mileage of domestic heavy goods vehicles subject to tolls on motorways suggests that business activity has picked up in the transport sector. While the turnover of wholesale firms was only marginally up on the quarter, motor vehicle sales did not quite match their elevated level of the third quarter. Consumption-related service providers did, however, benefit from German households'

high propensity to purchase. This was also reflected in the sharp rise in retail sales. Hotels and restaurants are also likely to have increased their turnover strongly.

Employment and labour market

The labour market in the fourth quarter of 2014 was characterised by both a stable upward tendency in employment and a marked decline in unemployment. One factor in this is that firms again recruited more persons from among the unemployed. For one thing, there was a greater need for labour in the services industries, which are booming at present. For another, replacements had to be found for workers taking up the option of early retirement on a full state pension at the age of 63. The rapid increase in the number of vacancies reveals that it was not possible to meet the growing demand for labour immediately.

The number of persons in work in Germany rose by 84,000 in the fourth quarter of 2014 after adjustment for seasonal variations. Employment growth therefore stood at 0.2% as it did in the third quarter. The increase in regular jobs subject to social security contributions continued to provide the basis for this. On an average of October and November, an additional 100,000 jobs subject to social security contributions were filled, which was an increase of 0.3% on the third quarter. Broken down by sector, the strongest growth in relative terms was in employment in business-related services (including temporary agency employment, which is on the increase again) and in the hotel and restaurant sector (+¾% in each case), as well as in the health and social work sector and the logistics sector (+½% in each case). There was an increase on average in the number of positions filled in manufacturing and trade. There was marginal growth in the construction sector.

Stable employment growth and decline in unemployment

Growth in jobs subject to social security contributions in Q4 primarily in services sector

Growth in employment in 2014 again due primarily to high level of labour market-oriented immigration

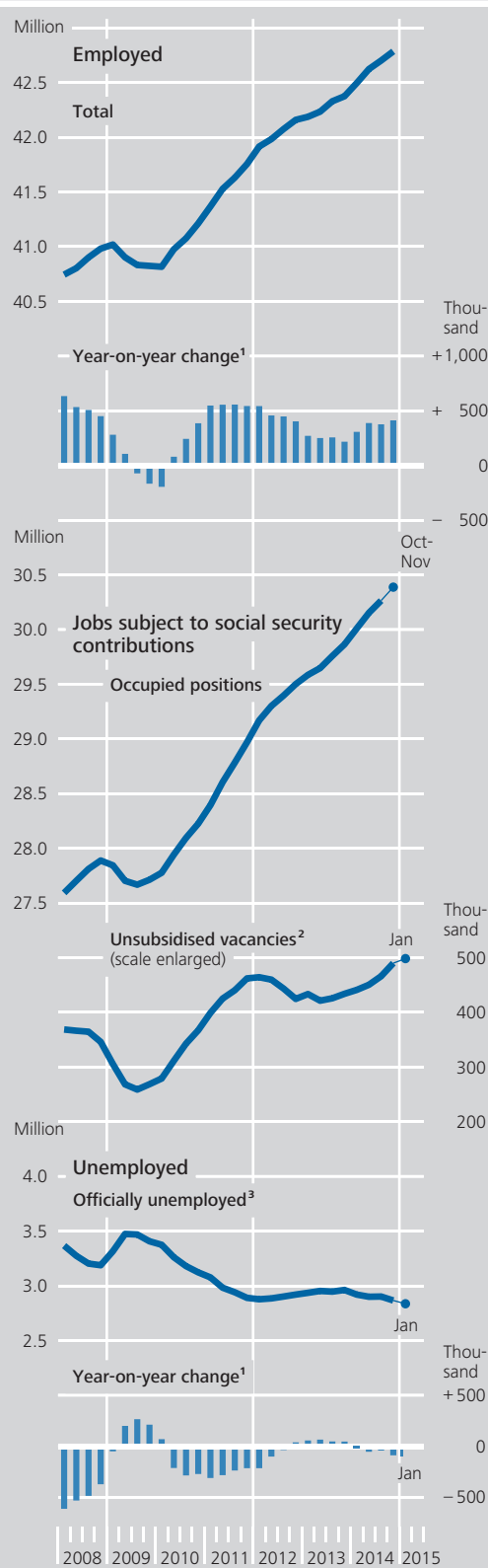
On an average of 2014, employment subject to social security contributions, with an increase of an estimated 500,000 jobs (+1.7%), likewise showed stronger growth than employment overall, which went up by 370,000 persons (+0.9%). According to the data available at present, the number of persons employed exclusively in low-paid part-time work is, at best, likely to have seen only marginal growth on an annual average. The number of self-employed persons fell by 1.2% last year. Furthermore, there were significantly fewer persons employed in the secondary labour market in job creation schemes, such as government-assisted working arrangements (one-euro workfare jobs) and community work. The decline in unemployment in 2014, at 52,000 persons, once again fell a long way short of the increase in employment. As in previous years, the labour force potential went up considerably as a result of labour market-oriented immigration. According to a current estimate by the Federal Statistical Office, net migration amounted to at least 470,000 persons in 2014, compared with 430,000 in the previous year. A large part of this increase is probably attributable to civil-war refugees and asylum seekers, although they are not granted immediate access to the labour market.

Perceptible fall in registered unemployment in Q4

Seasonally adjusted unemployment fell by 36,000 to 2.87 million in the fourth quarter of 2014 compared with the average of the third quarter. The unemployment rate fell by 0.1 percentage point to 6.6%. The number of unemployed persons covered by the statutory insurance scheme declined around twice as sharply as the number of persons receiving the basic welfare allowance. This difference can be explained primarily by a greater number of the more short-term unemployed being able to find a new job again recently. Registered unemployment declined further in January 2015, albeit at a slower pace than in the final three months of 2014. According to the figures of the Federal Employment Agency, 2.84 million persons are currently out of work, which corresponds to an unemployment rate of 6.5%.

Labour market

Seasonally adjusted, quarterly



Source of unadjusted figures: Federal Statistical Office and Federal Employment Agency. **1** Not seasonally adjusted. **2** Excluding seasonal jobs and jobs located abroad. **3** From May 2009, unemployed excluding persons newly registered on the books of private employment agencies.

Positive labour market developments expected to continue

The labour market could pick up momentum in the coming months, especially with regard to employment. In January 2015, the Ifo employment barometer, which provides information on the employment plans of enterprises over the coming three months, climbed to its highest level in almost three years. According to the most recent survey carried out by the German Chambers of Commerce and Industry (DIHK), however, firms' hiring intentions are less expansionary. This is likely to be due to the fact that, in a number of services sectors and regions, the general statutory minimum wage is being seen as a labour cost risk – something which is reflected to a greater extent in the results of the DIHK survey than in the Ifo Institute's data.

Large number of vacancies

The number of vacancies registered with the Federal Employment Agency in the final quarter of 2014 was up by a seasonally adjusted 25,000 on the quarter, and by a further 15,000 after the turn of the year. There was also a considerable increase in the Federal Employment Agency's BA-X job index, which besides the quarterly stock figures, also records the inflow of newly reported vacancies for unsubsidised jobs. The current quite high number of vacancies is an indication that a cyclically induced rise in demand, especially from the labour-intensive services sectors, appears to be accompanied by a still unmet need to find replacements following the early retirement of experienced skilled professionals in connection with the option to retire on a full pension at the age of 63. It can therefore be assumed that registered unemployment will continue to decline in seasonally adjusted terms. In any event, the IAB labour market barometer, which is based on surveys of the managers of all the local employment agencies, has moved into positive territory in recent months.

negotiated rates of pay.¹ This means that the increases in rates of remuneration negotiated by management and labour were the highest in almost 20 years. According to the provisional figures of the Federal Statistical Office, actual earnings grew slightly more moderately at 2.7%. A key reason for the negative wage drift of 0.3 percentage point, as in the previous year, was that voluntary payments made by employers, such as bonuses, were again smaller given the temporarily more difficult economic setting.

Negotiated rates of pay rose by 2.8% in the final quarter of 2014 compared with the same period of the previous year. As in the third quarter, the increase thus remained well down on the rates of the first six months of the year (+3¼%). This slowdown was due, on the one hand, to the collective labour agreements of the past two years often agreeing multi-stage rises with the largest increase at the beginning of the validity period. On the other hand, the wage agreements concluded after mid-2014 provided for somewhat more moderate increases owing to the economic slowdown and special sector-specific factors. Trade unions' wage demands for the 2015 pay round range so far from just under 5% to 6% and are thus somewhat lower than in last year's negotiations. This is due, firstly, to the fact that economic expectations, despite the improvement of the past months, are still lagging behind what was hoped for a year earlier. Secondly, this time some trade unions want pay negotiations to focus more on qualitative elements, such as arrangements for phased retirement and training.

The general statutory minimum wage of €8.50 per hour entered into force on 1 January 2015. It applies, with exceptions for some cat-

Negotiated rates of pay increase by 3% in 2014 but negative wage drift

Wage demands in 2015 slightly lower than last year

General and sector-specific minimum wages

■ Wages and prices

The 2014 pay round brought employees an average year-on-year rise of 3.0% in their

¹ The Federal Statistical Office is provisionally reporting an increase of 3.1% on the year in negotiated rates of pay (including one-off payments and fringe benefits). The slight difference compared with the Bundesbank's pay index is due to the various industry-specific employee weightings in the respective pay indexes.

egories of employees, in all economic sectors apart from those industries where the German federal government has declared sector-specific minimum wage levels to be generally binding, which occurred most recently in agriculture and forestry as well as horticulture. This sector belongs to the six industries making use of the transitional arrangement allowing pay below the general minimum wage to the end of 2017. The others are the meat industry nationally and in eastern Germany hairdressing, temporary agency work, textile and clothing and large laundries.

Drop in oil price determines price trends

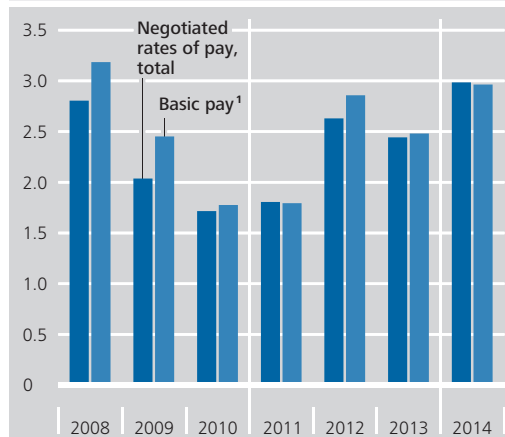
The fall in crude oil prices is the key factor shaping price developments at all stages of the economy at the current end. The countervailing trend in domestic wage costs and the marked depreciation of the euro against other major currencies will become more apparent in the headline rates only once the direct effects of falling oil prices have run their course. The annual rates for import, producer and consumer prices are therefore likely to be negative in the next few months if crude oil prices do not increase any further.

Excluding energy, import prices pointing upwards, producer prices not yet

The decline in energy import prices accelerated markedly in the final months of 2014. On an average of the fourth quarter, import prices were almost one-fifth down on the year. There was even a decline of just over one-quarter in December. If energy is excluded, import prices were showing a slight upward tendency in the fourth quarter, however, with the euro depreciation gradually having more influence here. While depreciation also meant that import prices (excluding energy) from non-euro-area countries increased by 1.2% on the year, import prices from other euro-area countries were down slightly by 0.4%. The upward movement of import prices for intermediate and consumer goods was more pronounced than for capital goods. Domestic sales prices for energy receded more slowly than import prices owing to the greater role played in the former by electricity and gas – the prices of which did not fall as much as those of refined

Negotiated rates of pay

Year-on-year percentage change, on monthly basis



¹ Excluding additional benefits and lump-sum payments.

Deutsche Bundesbank

petroleum products. The prices of consumer goods eased owing to discounts on food products. The moderate upward price tendency continued in the case of intermediate and capital goods. On the back of energy prices, the annual rates for domestic sales prices declined by 0.4 percentage point to -1.2% and for imports by 0.6 percentage point to -2.4%. As export sales prices went up slightly in fact by 0.2%, the terms of trade showed a considerable improvement.

Price inflation for domestic construction work continued to ease. The year-on-year figure for construction prices narrowed to 1.6% in the fourth quarter. In housing construction, the prices of the finishing trades rose a little more strongly than structural work. In this context, it is significant that cement has become cheaper recently. The calming of prices on the housing markets continued up to the end of the year. According to bulwiengesa AG data, the prices of freehold apartments in the seven largest German cities increased by 5½% in the fourth quarter, following annual growth rates of 5¾% in the third quarter and 7% in the first half of the year. More detailed comments on house price developments last year can be found on pages 55 to 57.

Increase in construction prices continues to slow down

Import, export, producer, construction and consumer prices

2010 = 100, seasonally adjusted, quarterly



Source of unadjusted figures: Federal Statistical Office. **1** Producer price index for industrial products in domestic sales. **2** Not seasonally adjusted. **3** National consumer price index.
 Deutsche Bundesbank

Consumer prices eased quite clearly by a seasonally adjusted 0.3% in the final three months of 2014 compared with the preceding quarter. This was mainly due to lower energy prices. Prices for food and industrial goods (excluding energy) showed very little change. Prices for services and rents continued their moderate upward trend. The annual rates of the national consumer price index (CPI) and of the Harmonised Index of Consumer Prices (HICP) declined further, from 0.8% in both cases, to 0.5% and 0.4% respectively.

Energy drives fall in consumer prices

The increase in consumer prices also clearly flattened out when looking at 2014 as a whole. According to the CPI, consumer prices went up by only 0.9% (0.8% according to the HICP). The increase had been as much as 1.5% (1.6%) in the previous year. A large part of this moderation can be explained by the decline in energy prices. Nevertheless, even if energy is excluded, price inflation contracted from 1.6% to 1.3% (1.2%) and was thus weaker than would have been expected in view of the position of the German economy and the favourable labour market situation. Key factors here were, firstly, that the extremely strong surge in food prices of the past two years did not continue and, secondly, that there was no substantial acceleration in the upward movement of prices for industrial goods and services. This was impeded by the appreciation of the euro, at least in the first half of last year, and, later, by price reductions for package holidays. Furthermore, housing rents are increasing only slowly. By contrast, the GDP deflator, which records the price components of domestic value added, increased by 1.7% last year, which is approximately as strongly as is to be expected given normal aggregate capacity utilisation.

Only moderate rise in consumer prices in 2014

Consumer prices in Germany continued their decline at the beginning of 2015 and the year-on-year rate turned negative. Measured in terms of the Consumer Price Index (CPI), it decreased to -0.4% and HICP inflation fell by as much as -0.5%. Along with the continued sharp decline in energy prices, this was due to

Energy main reason for negative year-on-year rate in January

Housing prices in 2014 in Germany

Housing prices in Germany continued their clear upward trend in 2014, although at a markedly slower pace than in previous years. This was particularly true for apartments in urban real estate markets, whereas prices for single-family houses in urban centres continued to rise substantially. Declining interest in buying residential property in the previously particularly booming submarkets could have played a role in the easing of the price trend in Germany as a whole. The price level in these segments, measured in terms of medium to long-term economic and demographic conditions, is estimated to still be at a fairly high level. In addition, the expansion of the housing stock has since progressed noticeably.

According to calculations based on data from bulwiengesa AG, housing prices in German cities rose by an average of 5¼% in 2014, after having increased by 7¼% in 2013. This means that the rate of growth has decreased for the first time since the upturn in the housing markets began in 2010. This reporting is based on comprehensively revised price indices, which do not, however, paint a fundamentally different picture for the previous years in qualitative terms. Quantitative effects on the composite index arise, on the one hand, from the fact that the reporting sample was expanded to include price data for detached single-family houses.¹ Taken in isolation, the below-average increase in the prices of detached single-family houses in recent years pulled down the rates of change in the price aggregate. On the other hand, individual data relating to regions and type of property are now weighted using their systematic shares in the total number of transactions.² Stock-weighted price indices

are also provided based on a new and homogenous data set.³

In the reporting year, the differences in price rises between the regions and between individual property types diminished again. This was primarily due to the fact that inflation in the housing markets in major cities, which had stood at almost 10% per year on average from 2010 to 2013, decreased significantly (+5½%). Although slowing price dynamics were also observed on average in the other cities, the increase in prices for freehold apartments, at 5¼%, was closer to the rates recorded in the preceding three years. It also marginally exceeded the price increase for houses. In the major cities, by contrast, houses saw greater price rises than apartments in the period under review. Overall, prices for residential properties in those cities rose by 5¾%, which was considerably lower than in the preceding three years.

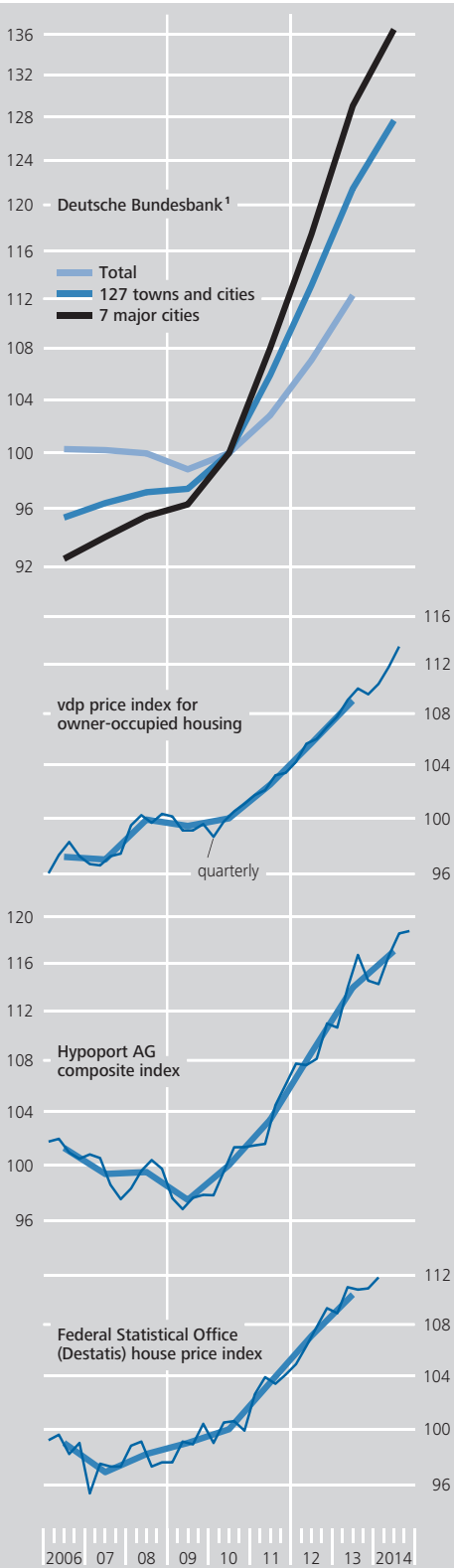
¹ By contrast, a number of data revisions and the expansion of the group of cities to include Bayreuth and Schweinfurt, taking the total to 127 cities, have no notable impact.

² The new weighting system aggregates housing prices at the administrative district level, which was not previously possible due to a lack of appropriate weights. To date, property-specific prices were regionally consolidated on the basis of population figures. For Germany as a whole, the aggregation of the prices of single-family houses and apartments was based on various data sources, such as construction statistics and survey results. See Deutsche Bundesbank, Real estate prices in Germany in 2008, Monthly Report, February 2009, pp 52-53.

³ Stock-weighted price indices may be useful for analysing wealth effects and fluctuations in the value of real estate assets pledged as collateral for a loan, for example. For a more detailed explanation of the newly weighted price indicators, including a description of the methodology, see Deutsche Bundesbank, Report on the methodology of housing price indices, available online at: www.bundesbank.de/Redaktion/DE/Standardartikel/Statistiken/publikationen_preise.html

Selected price indices for housing

2010 = 100, annual values, log scale



¹ Weighted by transaction. Bundesbank calculations based on price data provided by bulwiengesa AG.
 Deutsche Bundesbank

The weakened price dynamics in the German real estate market in 2014 in those segments which previously experienced the strongest momentum are also demonstrated by other price indicators. According to data provided by the Association of German Pfandbrief Banks (Verband deutscher Pfandbriefbanken, vdp), the price index for freehold apartments increased by an estimated 3% in 2014, following a rise of 5% the year before. Taking into account the fact that prices for owner-occupied houses rose steeply over the course of the reporting year, however, the annual rate of increase in the vdp price index for owner-occupied housing could have been roughly as high as in 2013 (+3¼%). According to the results of the composite index published by Hypoport AG, price increases for residential property declined from 5% in 2013 to 2¾% in 2014.⁴

The calming in the urban housing markets is also reflected in rents. As in 2013, rents for new lettings of existing apartments and rents for first-time occupancy saw somewhat weaker rises than in the previous year. Greater rent adjustments than before were observed in the major cities with respect to new contracts for existing apartments. Anticipatory effects in connection with the planned cap on rents in new contracts could have played a role in this segment.

The expansion of the housing supply, which has been discernible since prices for residential property began rising substantially in 2010, contributed to dampening the

⁴ The regionally broad-based Destatis house price index shows that housing prices rose by 2¾% in the first quarter of 2014, the most recent for which data is currently available, after an increase of 3% in 2013. The composite index of bulwiengesa AG for all 402 administrative districts, which rose more than the vdp index in 2012 and 2013 by an average of 1½ percentage points, also looks set to show a stronger increase in the reporting year.

price trend in the past year. With an estimated 285,000 building permits granted for housing units in new and existing buildings, planned construction activity in the reporting year exceeded the level in the previous year, when around 270,000 building applications were approved. The chief increase was in approvals for the construction of apartments in new multiple-family houses, which are now likely to make up just over half of all approved construction projects in new buildings. By contrast, approvals for the construction of new buildings containing one or two units have not picked up significantly since a clear increase in 2011. Overall, it is likely that considerably more dwellings were completed in 2014 than in 2013, when the figure was just under 215,000. Nonetheless, the additional supply probably falls short of the higher demand for housing at present.⁵

Besides the substantial inflow of immigrants, both persistently good income and employment prospects and the exceptionally favourable financing conditions for residential property are ensuring that demand for housing remains high. The affordability of housing is likely to have improved further, primarily owing to the low financing costs for acquiring residential property. While the price-to-income ratio⁶ barely changed in the reporting year, the average rate for mortgage loans declined by $\frac{3}{4}$ percentage point over the course of 2014 to 2 $\frac{1}{4}$ % at the end of the period under review. Adjusted for the expected longer-term inflation rate, the average interest rate on loans for house purchase was thus 2 percentage points lower in 2014 than in 2009.

Following the revision of the econometric model used for analysing residential property prices, evidence of a statistically significant impact of mortgage rates can be found.⁷ This can be used to calculate the

arithmetical effect of the currently exceptionally low interest rates on possible overvaluations of residential property. For example, the drop in interest rates since 2009, viewed in isolation, was a contributing factor to housing prices in 2014 being an average of 3 $\frac{1}{2}$ % higher than in a scenario of unchanged mortgage rates.

For Germany as a whole, there are still no signs of a substantial overvaluation of residential property. In cities, however, current estimates which now also take into account the prices of detached single-family houses continue to put upward price deviations at between 10% and 20%, with freehold apartments in major cities showing the strongest overvaluations. In the reporting year, however, price increases again approximated the rates of change which can be derived from the general trends in the economic and demographic fundamentals for housing prices. However, waning price dynamics did not reduce existing overvaluations.

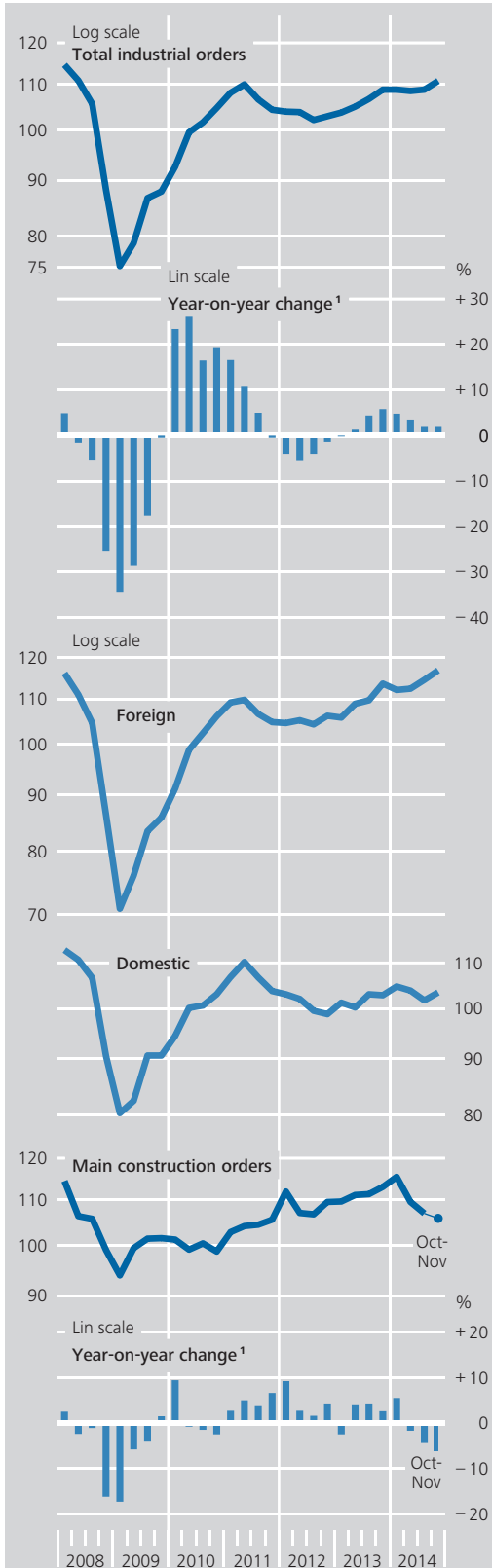
⁵ A quicker adjustment of the housing supply in the particularly booming urban areas is likely to be hindered by the fact that infill development can only create additional housing on a limited scale and new building land can only be approved with a time lag.

⁶ Measured as the ratio of the vdp index for owner-occupied housing to disposable household income, which is currently calculated using estimates in some cases.

⁷ See Deutsche Bundesbank, The determinants and regional dependencies of house price increases since 2010, Monthly Report, October 2013, pp 13-30, and F Kajuth, T A Knetsch and N Pinkwart, Assessing house prices in Germany: evidence from an estimated stock-flow model using regional data, Bundesbank Discussion Paper, No 46/2013.

Demand for industrial goods and construction work

Volume, 2010 = 100, seasonally adjusted, quarterly



Source of unadjusted figures: Federal Statistical Office. 1 Only calendar-adjusted.
 Deutsche Bundesbank

an exceptional moderation of prices for package holidays. The introduction of a general statutory minimum wage on 1 January 2015 has had only a very limited effect on consumer prices to date.

Orders received and outlook

The German economy will also continue to benefit from the economic upturn after the start of the new year. In the short term, the upturn will be sustained mainly by private consumption. Given the continued moderate global economic momentum, the distinct fall in the euro's external value will, nevertheless, provide German exporters with enhanced sales opportunities in export markets outside the euro area. Moreover, the stimulating effects of the euro's depreciation in the euro-area member states could also trigger secondary effects via the trade channel. This is indicated by the broad-based increase in industrial orders in the fourth quarter. Over time, improving business prospects and heightened capacity utilisation could give renewed impetus to the currently stalled recovery in investment. Given the brighter overall economic picture, it is understandable that current forecasts for economic growth in Germany this year are markedly higher than the projections made in autumn last year.

Economic upturn set to continue

Since the rebound in sentiment last November, optimism is growing among German enterprises, irrespective of whether their focus is on the domestic market or whether they have a strong European or international orientation. Fundamentally, this is also evident in the current business survey of the German Chamber of Commerce and Industry (DIHK), which covers a broad range of industries.

Enterprises more optimistic

Industrial activity at the beginning of this year is likely to have been boosted by the seasonally adjusted 1¾% quarter-on-quarter increase in new orders in the final quarter of 2014. The automotive industry once again assumed the

Distinct expansion in industrial orders primarily due to considerable increase in motor vehicle orders

role of frontrunner, with orders shooting up by 8% following a subdued phase in the second and third quarters. Demand for German-made motor vehicles and motor vehicle parts rose considerably in Germany as well as in and outside the euro area. The capital goods sector benefited from large orders for the aircraft and aerospace industry at the end of the year. Orders of computers and optical and electronic products almost offset the decline of the summer months. By contrast, the mechanical engineering sector suffered losses following a substantial increase in the third quarter. It is worth noting that, in this sector, a strong positive stimulus came from the euro area at the end of the period under review.

Orders of intermediate goods still moderate, particularly from Germany

There was an above-average seasonally adjusted 2% quarter-on-quarter increase in orders of intermediate goods. Even so, domestic orders in the final three months of the year were only marginally up on their subdued level of the third quarter. Evidently, there was not yet a need to order inputs and intermediate goods on a large scale in order to achieve the increase in industrial output at the end of the year. By contrast, demand from the euro area rose by 4%, after moving sideways for almost a year. Orders from non-euro-area countries, which had already increased in the third quarter, likewise saw a steep upturn (+3%). After seasonal adjustment, the consumer goods industry received 1¼% more orders in the period under review than they had done in the third quarter. Export orders rose slightly more than domestic orders.

No new stimuli for construction

Current order books are likely to ensure a relatively high degree of capacity utilisation in construction, although an expansion of activities beyond the current level cannot be expected in the short term. The retarding movement in demand for residential construction continued until the end of the year. Building permits

measured in terms of the estimated costs of work on new and existing buildings in the period from July to November 2014 were on average only 1% up on their level in the first half of the year after seasonal adjustment compared with 2¾% in the first six months of the year; the corresponding half-yearly rates were +6¾% and +5% in 2013. The slowdown is related to the fact that demand for apartments continued to increase in the second half of 2014, but the pace has waned. In any event, a sideways movement in demand for single-family and two-family houses has been evident for some time. Furthermore, enterprises were placing only a relatively moderate volume of orders for new construction projects at the end of the period under review and the volume of public sector construction orders showed a further clear slump in the fourth quarter.

Against the backdrop of very upbeat income expectations, energy price-related purchasing power gains and strong consumer confidence, private consumption has become the immediate mainstay of the cyclical upturn. Stable employment growth and marked wage increases have been supporting the consumer climate on the income side for some time now. In addition to these underlying trends, the easing of households' expenditure on energy currently represents a strong boosting factor. A sustained stimulus to growth is not to be expected from this, however. Many consumers appear to have used their unexpectedly enhanced scope for expenditure in last year's Christmas trading period. A large one-off effect for private consumption is still outstanding during the first quarter, as households are unlikely to miss out on the opportunity to replenish their heating oil tanks at very low prices. Furthermore, lagged effects in the wake of price adjustments for other energy sources can be expected.

Private consumption currently mainstay of economic growth