

Economic conditions in Germany

Macroeconomic situation

Strong growth surge in 2016 Q1

The German economy grew very strongly at the start of 2016. According to the Federal Statistical Office's flash estimate, real GDP in the first three months of 2016 was 0.7% up on the quarter after seasonal and calendar adjustment. Growth thus accelerated perceptibly and was clearly above the growth rate of potential output. Aggregate capacity utilisation reached its highest level since 2012, which was when the cyclical effects of the sovereign debt crisis were beginning to put a brake on the German economy. Economic growth was still being sustained chiefly by private consumption and buoyant construction activity, but, in contrast to the end of 2015, also by stronger exports and investment in machinery and equipment again.

Strong domestic activity additionally benefiting from temporary stimuli

This surge in demand in private consumption was due mainly to a further decline in prices on the global oil markets, which had an impact on consumers' purchasing power in Germany. Furthermore, the positive outlook for the labour market and incomes was continuing to exert a positive influence on domestic activity. Construction investment showed a very sharp rise, buoyed by the exceptionally mild weather conditions. The fact that exports picked up again following the setback at the end of 2015 also made a significant contribution to this strong growth. The key factor in this context was the clear increase in demand from China recently. Together with the higher level of aggregate capacity utilisation, this also boosted enterprises' willingness to step up their investment again.

Exports showing a surplus again

Following a lull, German exports rebounded noticeably in the first quarter. Goods exports were clearly up on the quarter in price and seasonally adjusted terms. According to the regionally disaggregated figures, which are available only up to February and thus do not yet

include the strong export activity in March, a slight fall in exports to the rest of the euro area contrasted with a moderate expansion in exports to the other EU countries. Although there was a decline in exports to non-EU countries overall, there were marked differences between the individual regions. There was sharp growth in exports to the People's Republic of China, for example. This was due chiefly to a strong result in motor vehicle sales. This meant that it was possible to stop the downward trend that had stretched over a large part of last year. Exports to Russia, too, were up again after falls in the second half of 2015. This contrasted with a further downturn in exports to the United States, while exports to Japan and the OPEC countries suffering from low crude oil prices showed significant losses, albeit with a marked slowdown in their negative trend.

Overall output

2010 = 100, price- and seasonally adjusted



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

Foreign trade

Seasonally adjusted, quarterly



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

Investment in machinery and equipment likely to have risen again

Investment in machinery and equipment in the first three months of 2016 is likely to have shown a distinct increase on the quarter. Government investment in machinery and equipment, which includes military procurements, rose sharply in the final quarter of 2015, but probably failed to maintain this elevated level. Private investment in machinery and equipment, by contrast, is likely to have shown a marked increase. The considerable increase in the utilisation of production capacity may have prompted enterprises to give greater consideration to investment in extending capacity again as well. In particular, enterprises' motor vehicle fleets are likely to have undergone considerable

expansion. This is suggested by the steep rise in registrations of new commercial motor vehicles.

Construction activity picked up at the start of the year and benefited additionally from extremely mild temperatures in February. Since demand impulses in the preceding quarter were quite broadly spread, the expansion is likely to have embraced not only housing construction but also the commercial, industrial and public construction subsectors.

Construction activity still on the up and additionally boosted by the weather

There was a sharp rise in private consumption in the first quarter. As in the preceding quarters, one major reason for this was the considerable increase in households' incomes. There was a marked rise again in both employment and earnings. Added to this was the further sharp fall in oil prices at the turn of 2015-2016, which, in real terms, led to additional gains in purchasing power. These gave an additional boost to private consumption, even though they are likely to have led at first to greater saving to a certain extent. It was mainly passenger cars that were purchased on a larger scale. This is, at all events, indicated by the number of motor vehicle registrations. By contrast, retail sales were less buoyant. There was less demand, in particular, for footwear and clothing, probably on account of the mild winter weather. Standing out positively, however, were sales of building materials, furniture and home furnishings, probably in connection with buoyant construction activity. In the hotel and restaurant sector, business activity might in fact have slowed down slightly.

Substantial rise in private consumption

Imports showed substantial growth after the turn of the year in price and seasonally adjusted terms. Nominal expenditure on imports of goods was declining slightly, but import prices were going down sharply at the same time, resulting in substantial growth in real terms. There was significantly more demand for goods from EU countries, China and Japan. Imports from the United States declined, however.

Substantial increase in imports

■ Sectoral trends

Strong growth in industrial output

Industrial output grew strongly in the first quarter of 2016, and was 2% up on the final three months of 2015 after seasonal adjustment. The expansion in output was broadly based in sectoral terms, with a sharp expansion in production in intermediate goods as well as in capital and consumer goods. The strongest increase was in capital goods at 2½%. Here, it was the automotive industry that stood out with an exceptionally sharp increase in output (+5¼%). This appears to signify an overcoming of the temporary dip at the end of last year, which, given lower intakes of orders, was already evolving even before the scandal surrounding the manipulation of exhaust emissions became public knowledge.

Manufacturing capacity utilisation still at a high level

According to the Ifo Institute, the level of capacity utilisation of tangible fixed assets in industry was at 84½% in April. Despite a slight quarter-on-quarter decline, it was thus markedly above its multi-year average, which is regarded as the normal utilisation rate, and was still up on its 2015 level. This suggests that the strong increase in industrial output in the first quarter could, to some extent, point to what is now a higher level of industrial activity.

Construction activity expanded sharply, energy production contracted

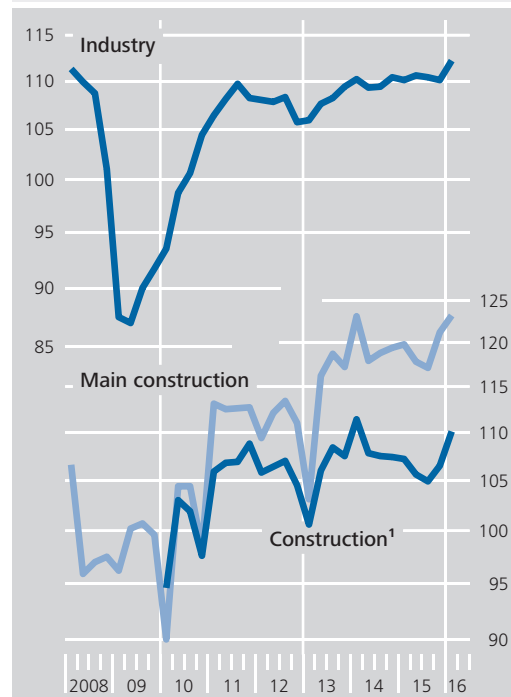
Construction output underwent a strong expansion in seasonally adjusted terms compared with the final quarter of last year. This was due mainly to a sharp increase in output in the finishing trades, the data for which are, however, highly susceptible to revision. The main construction sector also saw positive growth, however, the key reason being the mild weather in February. By contrast, energy production was significantly reduced during the reporting period.

Wholesale key mainstay of services sector activity

The sharp expansion of output in industry and construction in the first quarter was also reflected in the services sectors. The volume of wholesale sales has shown a clear seasonally adjusted increase since the start of the year, for example. As in the case of the other industry-related service providers, this is likely to have

Output in industry and in construction

2010 = 100, seasonally adjusted, quarterly, log scale



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

been given a boost by the very sharp expansion in industrial production. The business situation in the wholesale sector is rated as very good according to the Ifo survey. This also applies to the rest of the services sector excluding trade, where high figures were still being achieved despite certain downward revisions. Given buoyant car sales, the automotive sector considerably increased its turnover. There were additional, albeit rather muted increases in sales in the retail sector, too.

■ Employment and labour market

Employment saw very strong growth in the first quarter owing mainly to positive developments in jobs subject to social security contributions. As in previous months, the high demand for labour was met to a very significant extent by labour market-oriented immigration, especially

Labour market situation still very positive; outlook marginally more subdued

from within the EU. Although the influx of refugees is gradually starting to become apparent in the unemployment statistics, unemployment has fallen again over the course of the year so far.

Strong pace of growth in employment continued in Q1

The seasonally adjusted number of persons in work in Germany in the first quarter of 2016 went up by 181,000, or 0.4%. This growth was sustained in turn by the positive development in employment subject to social security contributions. According to the initial figures of the Federal Employment Agency, the number of such employees in January and February was up by an estimated 0.5% (or 143,000 persons) compared with the average of the final quarter of 2015. By contrast, the number of persons working exclusively in low-paid part-time jobs showed a marginal fall. In this context, there was a continuation of the ongoing decline since the introduction of the general statutory minimum wage at the beginning of 2015. The ongoing fall in the number of self-employed over the past few years came to a standstill towards the end of the period under review, at least for the time being.

Increase mainly in some services subsectors and in construction

In January and February, new jobs subject to social security contributions were filled mainly in those services subsectors already showing rapid growth over the past few quarters. Business-related services and the health and welfare sectors together were alone responsible for roughly half of the increase in employment. Hotels and restaurants and the transportation and storage sector also played a part, however. Growth in jobs in the construction sector accelerated considerably during the past half year and is now likewise higher than average. This contrasts with manufacturing, where there has been no identifiable surge in recruitment so far this year, despite the marked rise in output.

A substantial part of the increase in employment continued to be met by immigrants, mainly from the east European EU member states. According to the immigration monitor-

ing figures of the Institute for Employment Research (IAB), non-German nationals contributed roughly one-half to the rise in the number of persons in employment subject to social security contributions or working in low-paid part-time jobs within the past 12 months (+634,000 up to February 2016). Owing to the times for processing applications for asylum, as well as language and skills obstacles, the inflow of refugees has been reflected up to now only to a small extent in additional employment. There was only a year-on-year increase of 24,000 in the number of persons employed subject to social security contributions or working in low-paid part-time jobs coming from the most important war-torn and crisis-stricken countries of Asia and Africa.¹

Additional demand for labour still being covered to a considerable extent by a high level of immigration from the EU

Registered employment fell perceptibly in the first quarter in seasonally adjusted terms. The unemployment rate went down by 0.1 percentage point to 6.2%. There was a decline both in the number of more short-term unemployed persons drawing unemployment benefits and in the number of persons registered as out of work receiving basic social security payments. Registered unemployment showed a further considerable decline in April 2016. Nevertheless, this is likely to be due solely – in contrast to the winter months – to an expansion of active labour market policy measures. Overall underemployment, which also includes persons taking part in labour market policy measures, in fact showed a slight increase in April.

Further fall in unemployment in Q1

The influx of refugees is increasingly making itself felt in the unemployment statistics. The unemployment figure in April showed a year-on-year fall of 99,000. However, underemployment among German nationals showed an even more marked fall (-161,000), whereas unemployment among persons from the war-torn and crisis-affected countries of Asia and Africa

Increasing impact of refugees on the unemployment figure

¹ See IAB (2016): Zuwanderungsmonitor April 2016, Aktuelle Berichte des IAB, Nuremberg. The IAB counts Syria, Iraq, Iran, Afghanistan and Pakistan as well as, from Africa, Eritrea, Nigeria and Somalia as being among the most important countries at war or in crisis.

increased by 64,000. At the same time, the unemployment figure among persons of other nationalities remained constant despite a high level of immigration. This is an indication that these immigrants have integrated comparatively well into the labour market.

Somewhat gloomier, but still positive outlook for employment

According to the leading labour market indicators, it is possible that the positive development in employment will continue in the coming months, albeit at a more moderate pace than of late. This is suggested by both the Ifo employment barometer, which surveys the employment plans of trade and industry over the coming three months, and a new IAB employment index.² The Federal Employment Agency's BA-X job index, which contains information on the existing number of reported vacancies as well as their dynamics, is still relatively constant at a very high level. More unsubsidised vacancies were reported by business-related services, but also by public authorities and the construction sector. The subcomponent on unemployment of the revised IAB labour market barometer, which projects developments in unemployment in the coming three months, showed a fall at the end of the period under review. It is now marginally below the neutral threshold, pointing to a slight increase in registered unemployment over the next few months.

■ Wages and prices

Weaker rise in negotiated rates of pay in 2016 Q1

Overall negotiated rates of pay (including one-off payments and ancillary agreements) went up considerably less in the first quarter of 2016 than in the final three months of 2015. The year-on-year increase went down from +2.3% to +2.0%. This was chiefly attributable to nega-

² In parallel with its labour market barometer for unemployment, the IAB has designed a similar index for employment based on a survey of the managers of all the regional employment agencies. This survey has been conducted since as long ago as the beginning of 2011. See C Hutter, E Weber, K Schmidt S Delfs (2016): Frühindikator für Arbeitslosigkeit und Beschäftigung: IAB-Arbeitsmarktbarometer 2.0, IAB-Kurzbericht 09/2016, Nürnberg.

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.



tive base effects owing to one-off payments in the same quarter of last year but also, to an increasing extent, to the relatively low increases in the second stage of a number of pay agreements negotiated in earlier pay rounds. Basic negotiated rates of pay, which are less subject to special factors, were showing only a slightly flatter four-quarter pattern during the same period. Actual earnings in the first quarter of 2016 may have marginally outpaced negotiated rates of pay.

2016 pay round more moderate so far than 2015

In this year's pay round, increases of 2.8% from July 2016 and of a further 2.0% from April 2017 were agreed in the metal-working and electrical engineering industries. The pay settlement in the central and local government public sector provides for a 2.4% increase in negotiated rates of pay this year and a further 2.35% increase after 11 months next year. Additional agreements, such as guarantees regarding the supplementary pension scheme and the introduction of a new pay scheme for local governments, are likely to have increased the willingness of the trade unions to agree to this comparatively modest wage increase. The moderate pay settlement could, nonetheless, send out a signal to wage bargainers currently in negotiations in other sectors.³

In the first quarter of 2016, price trends at all stages of the economy continued to point distinctly downwards, mainly reflecting the slump in crude oil prices that persisted until mid-January. As a result, on a quarterly average, they remained very clearly down on their level in the final quarter of 2015. During the past quarter, they rebounded quite significantly, however, and price trends at the stages of the economy turned. Furthermore, the falls in the prices of other commodities – in some cases with a time lag – and the slight appreciation of the euro since November 2015 are likely to have had a dampening effect on prices (excluding energy), especially at the upstream stages. This had no more than a limited impact at the consumer level, where prices (excluding energy) rose moderately.

Price trends at all stages of the economy still shaped by fluctuating crude oil prices

Seasonally adjusted import prices fell by a seasonally adjusted 3.0% in the first quarter, which was twice as strongly as in the previous quarter. Energy became almost 18% cheaper. The decline in prices accelerated not only in the case of refined petroleum products, but also natural gas. If energy is excluded, price mark-downs were likewise extremely steep at a seasonally adjusted 1.5%. The downward movement in the prices of industrial commodities came more or less to a standstill, but earlier price reductions continued to have a lagged impact on the import prices of intermediate goods. Capital goods likewise became somewhat cheaper for the first time in two years. Finally, declining prices for food raw materials played a major part in the lower costs of consumer goods. Year-on-year import prices were down by more than 5% overall. The rate of inflation for imports turned clearly negative even if energy is excluded. Industrial producer prices in domestic sales showed a quarter-on-quarter movement similar to that of import prices.

Steep falls in import prices reflected in attenuated form in domestic sales

³ From a stability policy perspective, it is crucial that the currently low inflation rates do not lead to second-round effects. This would be the case if possibly lower inflation rates or expectations were to be used as a benchmark in wage negotiations rather than the desired inflation rate of below but close to 2% .

Prices of capital and consumer goods persisted virtually at their level before the start of the year, however; as a result, prices excluding energy did not show such a sharp fall. Overall, the figure was 2.8% down on the year. The year-on-year decline in prices was significantly more moderate in the case of exports than it was for imports, leading to a marked improvement in the terms of trade.

Moderate rise in construction prices

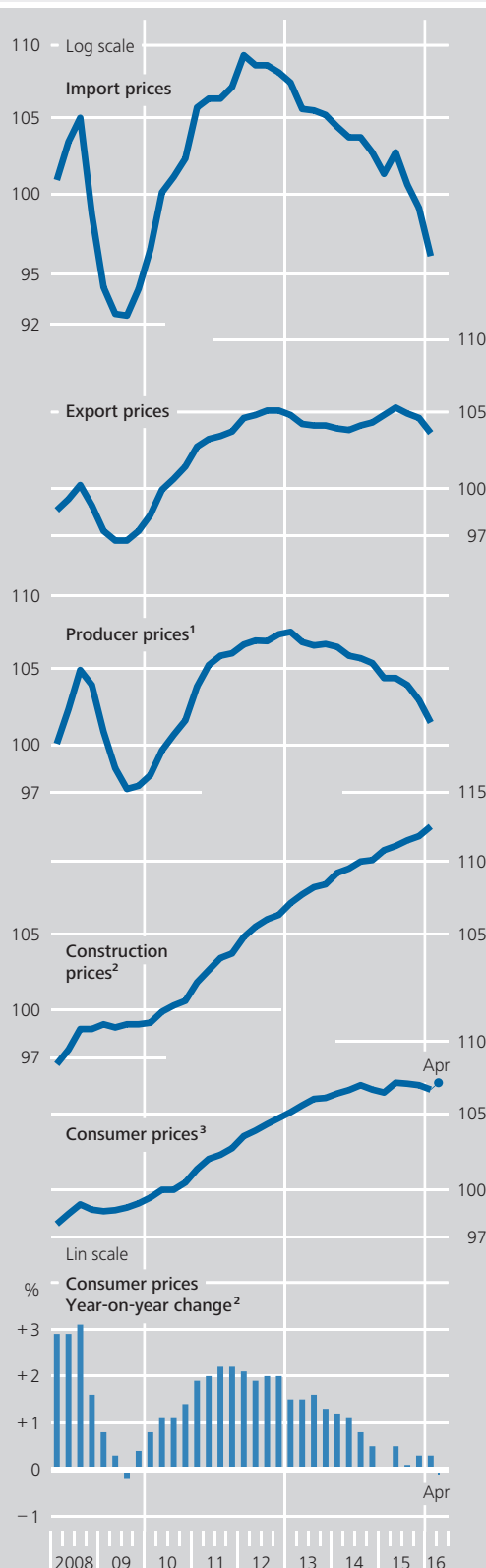
The annual increase in construction prices, at +1.7%, was hardly stronger than in the preceding quarters. Upward price pressure persisted in the real estate market in the first quarter. According to the Association of German Pfandbrief Banks (Verband deutscher Pfandbriefbanken – vdp), the prices of owner-occupied housing rose by 4.4% on the year.

Consumer prices, excluding energy, going up more slowly

The fall in consumer prices in the first three months of the year, at a seasonally adjusted 0.3%, was stronger than in the two preceding quarters. This was due almost exclusively to the accelerated decline in the prices of fuel and heating oil. Along with lower crude oil prices, these hit their lowest level for more than ten years. Very little of the long-continuing decline in import prices for natural gas was passed on to consumers. If energy is excluded, the upward price pressure of the past few quarters continued, albeit somewhat more moderately. Prices of services (excluding rents) went up almost as strongly as in the fourth quarter of 2015. However, this contrasted with food products becoming somewhat cheaper in seasonally adjusted terms, and it became noticeable in the case of industrial goods that price inflation for clothing and footwear was significantly weaker than it usually is at this time of year, as it already was in the final quarter of last year. Given the likewise fairly sharp decline in prices in the first quarter of 2015, the annual rate of consumer inflation in the first quarter of 2016 remained unchanged at +0.3% as measured by the national Consumer Price Index (CPI), and decreased marginally to +0.1% as defined by the Harmonised Index of Consumer Prices (HICP). Excluding energy, price inflation in the

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

current quarter was somewhat weaker than in the same quarter last year. Accordingly, the CPI rate fell slightly to +1.2% and the HICP rate went down somewhat more to +1.1%

Significant price increases in April mainly due to volatile components

There was a quite marked seasonally adjusted rise of 0.3% in consumer prices in April. This was due chiefly to industrial goods. Higher energy prices were probably mainly the result of more strongly expanded margins. In the case of clothing and footwear, there was an abrupt countermovement to the earlier seasonally adjusted fall in prices. In addition, cigarette prices were increased. Food prices remained virtually unchanged in seasonally adjusted terms. There was a fall in services prices overall owing to cheaper package holidays. Other services and housing rents continued to edge up at a moderate pace. Despite the seasonally adjusted month-on-month price rise, the overall annual rate of consumer price increases was down and turned negative again owing to the fact that Easter fell late last year. The CPI rate was -0.1% and the HICP rate was -0.3%. Mainly on account of the relatively sharp increase in prices last year, it is likely that rates will still be around zero in the next few months, too. After that, they will turn positive again and slowly rise in line with the current path of crude oil prices.

■ Orders received and outlook

Weaker growth in Q2 owing to less buoyant domestic activity as a result of special factors ceasing to apply

Growth in the German economy is likely to lose momentum in the second quarter. Given the recent firming up of crude oil prices, increases in purchasing power are unlikely to be as large in future. It is unlikely that the additional financial scope available to consumers has been used entirely for higher spending; instead they probably saved a part of it initially. Even so, private consumption will probably not increase to the same extent as in the preceding quarter. Moreover, the strong pace of expansion in the construction sector is unlikely to be maintained in the second quarter, since favourable weather conditions are no longer a factor. Furthermore, if construction work has been brought forward

because of the mild weather, additional impulses will be lacking in the second and third quarters. In view of the healthy level of construction activity, as is reflected, for example, in a large number of incoming orders and strong capacity utilisation, such bounce-back effects are unlikely to be playing a significant role at present. Even though fiscal policy remains fundamentally accommodative, the added boost provided by rising government spending related to the influx of refugees is likely to subside seeing as the incoming numbers have become significantly smaller of late. Finally, there is no guarantee that exports will match their first-quarter performance. The solid underlying cyclical trend will probably remain intact in the second quarter, too, however.

Current expectations in German industry reflect the fact that enterprises are taking a “wait and see” approach. Export expectations in manufacturing have declined somewhat at the current end, although an increase was recorded for output expectations. Business expectations in the manufacturing sector are, admittedly, in the slightly negative range, but have shown no deterioration either of late. Looking at the individual categories of goods reveals that it is, above all, producers of capital goods who were rating the outlook favourably at the end of the period under review. In the domestically oriented services sectors (including trade), surveys continue to paint an optimistic picture of the outlook.

Enterprises still undecided about future developments

At a seasonally adjusted ½%, growth in new industrial orders at the start of the year was somewhat slower than in the previous quarter. While there was a marked decline in domestic orders, the volume of export orders, especially from non-euro-area countries, showed a substantial increase. After adjustment for large-scale orders, the differences between regions become significantly less marked, but the underlying trend remains in place. A sectoral analysis reveals that the volume of orders (including large-scale orders) expanded most strongly in the capital and consumer goods

Strong flow of orders from abroad

sectors, with non-euro-area countries playing a key part in this. This indicates that – in line with the findings of surveys among German capital goods producers – investment activity in those countries is on the up. There was particularly strong growth in the volume of export orders in the automotive industry. This contrasted with a sharp decline in the intake of orders for intermediate goods. Despite the significant rise in export orders, there is likely to be no more than moderate growth in exports in the second quarter. This is suggested by the major contribution of large-scale orders, a considerable number of which are likely to result in exports only at a later date, and, above all, by the recently lower export expectations.

Positive sentiment in construction continues

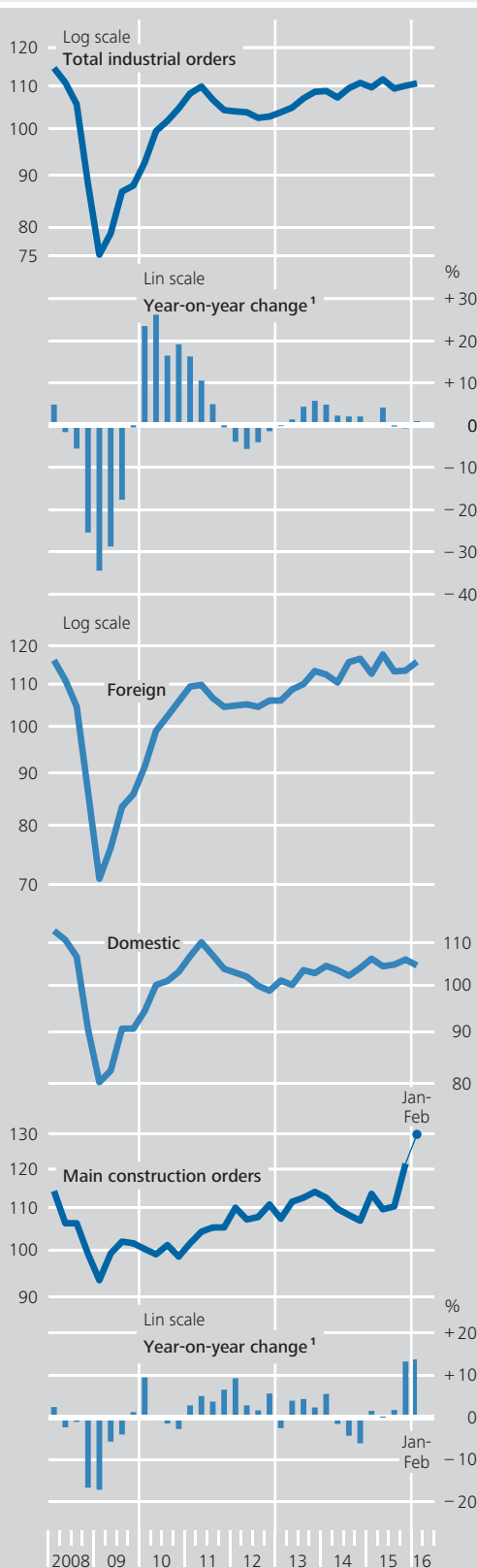
The construction sector is set to maintain its robust underlying growth path, sustained by very favourable financing conditions and income prospects as well as strong immigration. Nevertheless, growth in the second quarter is likely to be dampened temporarily by the fact that the positive weather effects from the final quarter of 2015 and the first quarter of this year are no longer a factor. The volume of orders in the main construction sector has grown very substantially since the beginning of the year. This applies particularly to housing construction and public sector construction. Building permits, too, have seen extremely strong growth. This was probably due in part to the fact that a new energy saving directive came into force at the turn of the year. In order to ensure compliance with the old statutory *status quo*, many prospective house-owners are likely to have submitted applications at the end of 2015, which were then approved in the first quarter of 2016. Part of the construction permits might therefore lead to construction orders only with some time lag.

Consumption still a major mainstay of economic growth

The ongoing positive situation in the labour market, rising income expectations along with stable prices mean that favourable underlying conditions are in place for sustained buoyant consumption activity. This is reflected in the high level of the consumer climate index of the

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

market research institution Gesellschaft für Konsumforschung (GfK), which showed a further marked improvement in April in fact. A part in this is played by the fact that consumers

expect a moderate upward trend for the German economy and are rating their income prospects more optimistically.