

Economic conditions in Germany

Macroeconomic situation

German economy lost some momentum temporarily in 2016 Q3

The third quarter of 2016 saw the German economy temporarily losing some momentum. According to the Federal Statistical Office's flash estimate, real gross domestic product (GDP) in the third quarter rose by only 0.2% on the quarter after seasonal and calendar adjustment. Following a decline that lasted into the second quarter, industrial output at least showed no further fall and construction activity moved onto a clear expansionary course; the slowdown in services sector activity, which had been very dynamic previously, is therefore likely to have been the key factor behind the weaker rise. Furthermore, the driving factors on the demand side changed compared with the previous quarter. Exports, which had been making a key contribution to GDP growth in the second quarter, suffered a setback, which was not entirely offset by domestic activity becoming stronger again. The underlying cyclical momentum continues to be quite strong, however. For the final quarter of the current year, it is to be expected that the GDP growth rate will continue where the faster pace of the first half of the year left off. This is indicated by the strong improvement in the indicators of sentiment. Utilisation of aggregate capacity continues to be higher than average.

Stronger domestic activity again ...

After the dip in spring, domestic activity returned to the sustained strong level seen since the end of 2014. The more dynamic pace of domestic economic growth was due primarily to government and private consumption. Along with the particularly strong pension increase in the middle of the year and the delayed payment of the negotiated pay increase in the public sector, private consumption received a strong boost from the ongoing favourable underlying conditions. First and foremost among these is the positive outlook for incomes and the labour market, although lower energy prices should also be mentioned. In the

case of construction investment, the period of adjustment in the second quarter following the weather-related exceptionally high level of output at the beginning of the year appears to have come to an end. Investment in machinery and equipment was still lacking stimulus, but did not dampen economic activity to the same extent as it had in the second quarter.

German exports experienced a lull in the third quarter of 2016 after making a strong contribution to GDP growth in the first half of the year. Exports of goods were, in fact, slightly down on the quarter in price and seasonally adjusted terms. They showed a marginal rise in nominal terms, however, as export prices went up. While the data available up to August show the value of exports to other euro-area countries following their tendency in the first half of the year with a moderate increase, exports to non-

... is masked by weaker exports

Overall output

2010 = 100, price- and seasonally adjusted



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



euro-area countries fell slightly in terms of value. This was due chiefly to weak demand for German products in the OPEC countries as well as to exports to the United Kingdom, which had been declining since the preceding quarter. In the case of exports to the UK, however, the fall was substantially smaller than it had been in the second quarter and thus before the referendum on EU membership. Following the sharp decline in the previous quarter, exports to the United States also showed no more than a slight increase. On the other hand, there was a strong rise in business with China. Goods exports to Russia – following the downward movement of the past few years – also saw a

strong expansion. In this connection, German exporters are likely to be benefiting from the slow recovery of the Russian economy following its severe recession.

The subdued development in industry and exports also left its mark in terms of investment. Investment in machinery and equipment in the third quarter of 2016 is likely to have shown a slight fall on the quarter. This is suggested by German industrial enterprises' domestic sales of capital goods, which – in contrast to export sales – showed a marked fall. Furthermore, the no more than weak increase in new registrations of commercial motor vehicles indicates that investment in firms' motor vehicle fleets has, on the whole, been marked by restraint.

Investment in machinery and equipment lacking momentum

After the weather-related period of adjustment in the second quarter, which led to a decline, construction investment picked up again in the summer months. Investment activity is likely to have shown an increase, especially in private housing construction.

Construction investment up again following bounce-back effects in the second quarter

Seasonally adjusted private consumption picked up with greater momentum in the third quarter than in the previous three-month period. Energy prices for consumers fell slightly in the third quarter. This meant that consumers' purchasing power was reduced less by price increases than was the case in the second quarter. Disposable incomes were also boosted by the exceptionally large 4½% pension increase as of 1 July and the delayed payment of the negotiated pay rise, including back payments, for central and local government employees. The continuing positive outlook for incomes and the labour market ensured that the underlying conditions remained favourable. Following the decline in the second quarter, price-adjusted retail sales increased slightly in the summer months. A negative factor in this regard was, above all, weak demand for textiles, clothing and footwear in September 2016. This effect was probably due to the exceptionally warm weather in that month, however, which means that a countermovement is to be ex-

Buoyant consumption activity mainly due to car purchases

pected for the following months. Passenger car sales imparted significantly more momentum to private consumption in the third quarter. New car registrations by private users showed a considerably stronger increase than before.

Subdued pick-up in imports

Imports gained some momentum in the third quarter in price and seasonally adjusted terms. This was due chiefly to the resurgence in domestic demand. The increase was perceptibly higher in nominal terms than it was in price-adjusted terms, as imports had been becoming more expensive again since the second quarter. The increase in nominal goods imports was broadly based regionally. More goods, especially from outside the euro area, were in demand. Imports from Russia and the United States stood out in this context. Considerably fewer goods were imported from China, however. Nominal imports from the OPEC countries also declined.

■ Sectoral trends

Industrial output persists at prior-quarter level

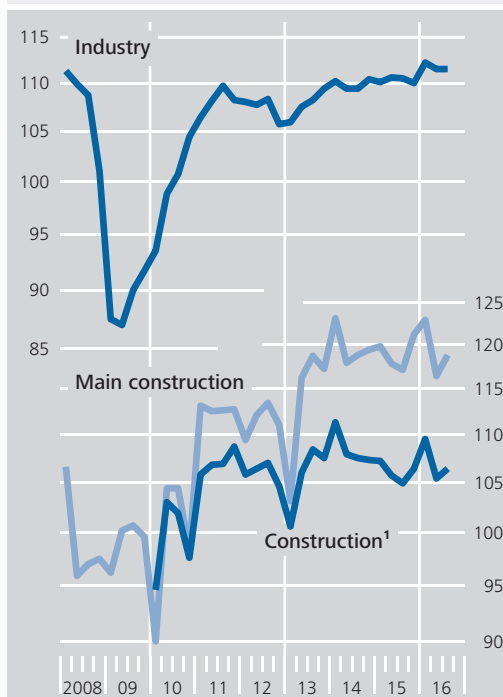
Seasonally adjusted industrial output in the third quarter remained at its prior-quarter level. As incoming orders increased somewhat at the same time, there was a closing of the gap between the unexpectedly sharp rise in output at the beginning of the year and the relatively subdued intake of orders. Industrial output could therefore pick up momentum again in the near future after tending to go down following the strong start to the year. With regard to sectoral developments, capital goods manufacturers registered a slight increase in the third quarter at ¼%, while producers of intermediate and consumer goods recorded losses of output (-¼%).

Capacity utilisation in industry risen to a five-year high

Despite industrial output stagnating on an average of the third quarter, Ifo Institute data show a marked increase in the level of capacity utilisation of tangible fixed assets in the manufacturing sector at the end of the period under review. At 85¾%, it reached a five-year high in October and was almost 1 percentage point up

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

on the figure for July and well above the multi-year average considered as normal utilisation.

Seasonally adjusted construction output in the third quarter was clearly up on the second quarter by 1%. The third quarter saw the end of the period of adjustment which followed the peaks in output – aided by the prevailing mild weather – in late 2015 and early 2016, leading to strong bounce-back effects in the spring, and the construction sector is clearly on a path of growth again. The expansion in the main construction sector was particularly strong at 2%. According to the Ifo Institute, the assessment of the business situation by enterprises in the construction sector was decidedly optimistic, hitting an all-time high. This, together with the very high level of equipment utilisation, likewise paints a very positive picture of construction activity.

Construction sector back on an expansionary course in Q3

For the services sectors as a whole – which were still very buoyant in the second quarter –

Mixed developments in services

the cyclical indicators point to a slower pace of growth in the summer months. Stagnation in industry is likely to have had the main negative impact, leaving its mark on the wholesale trade and elsewhere. Following the decline in sales in the second quarter, there are signs of a further clear downward movement in the current reporting period. In line with this, the assessment of the business situation in this sector – according to the Ifo Institute – showed a slight deterioration in the third quarter. Price-adjusted retail sales (excluding motor vehicles) were, by contrast, slightly up on the quarter. The volume of motor vehicle sales – statistical data are available up to August – is likely to have shown strong growth, in fact. This is also indicated by the figures on newly registered motor vehicles, which are already available up to and including October. The rest of services excluding trade probably showed quite subdued growth. This is suggested at all events by the weaker rise in employment in this sector.

Employment and labour market

Dip in the positive development on the labour market, but outlook improved

The very positive development on the labour market over the past few quarters suffered a dip, above all, in the months from June to August. Unlike in winter and spring, employment showed no more than a marginal increase in the third quarter. This was due to weak growth in jobs subject to social security contributions as well to a fall again in low-paid part-time work. Even so, the outlook for employment is favourable, as is suggested by the recent marked improvement in the leading indicators. Unemployment, too, showed only a small decrease at the end of the period under review. This, however, was due in part to the increasing number of refugees registering as job seekers after their applications for asylum had been approved.

Perceptibly slower employment growth in Q3 than before

Seasonally adjusted employment in Germany went up by 24,000, or just under 0.1%, in the third quarter of 2016. The increase was thus

much smaller than in the first half of the year. This is due mainly to the moderate growth in employment subject to social security contributions. According to the initial figures of the Federal Employment Agency for July and August, the number of employees subject to social security contributions in those two months rose by no more than an estimated 0.1% (or 20,000 persons) compared with the average of the second quarter. Exclusively low-paid part-time employment showed a further marked decline at the end of the period under review. There was little change in the number of self-employed persons.

Heterogeneous developments across sectors are behind the weak growth in jobs subject to social security contributions. There was a significant decline in employment mainly in manufacturing, trade, and the financial and insurance industries. This contrasted with a rise, albeit one that was less dynamic than before, in the health and welfare sector, business-related services (excluding temporary agency employment), the educational sector and in the comparatively small information and communication sector. According to the data available so far, the hesitant recruitment practice in construction in spring is still continuing.

Increase mainly in some services subsectors, decrease in industry

A large part of the increased year-on-year demand for labour was covered by immigration. According to the immigration monitor figures of the Institute for Employment Research (IAB), more than two-thirds of the 428,000 increase in the number of workers subject to social security contributions and low-paid part-time workers within the past 12 months up to August 2016 was due to non-German nationals. The vast majority came from other EU countries. The influx of refugees is also gradually making itself felt, although their employability in the German labour market is often limited. There was a year-on-year increase of 41,000 in the number of persons employed subject to social security contributions or working in low-paid part-time jobs coming from the most sig-

Additional demand for labour still being covered to a considerable extent by immigration

nificant war-torn and crisis-stricken countries of Asia and Africa.¹

Unemployment declining slightly despite rising number of refugees seeking work

The official unemployment figure fell slightly in the third quarter as well. On an average of the reporting quarter, a seasonally adjusted 2.68 million persons were registered as unemployed. This was 20,000 fewer than on an average of the second quarter of 2016; in the first half of 2016, however, there was a noticeably more rapid fall in the number of persons who were out of work. In October, the unemployment figure went down again more sharply to what was now 2.66 million. The unemployment rate fell from 6.1% in the third quarter to 6.0% at present. There was, in fact, an even considerably steeper fall in unemployment among Germans and non-German nationals who do not come from the main war-torn and crisis-stricken countries. The statistics are increasingly reflecting the fact that many refugees are now registering as looking for work. The number of refugees registered as unemployed was, however, reduced by the fact that labour market policy measures have been expanded.² Underemployment as defined by the Federal Employment Agency – where persons taking part in such measures are also counted – therefore showed a perceptible increase.

Very good outlook for employment

The leading indicators of employment and the steeper rise again in September suggest that the subdued upturn of the summer quarter could make way for more dynamic growth. In

¹ See Institute for Employment Research (IAB) (2016), Zuwanderungsmonitor Oktober 2016, Aktuelle Berichte des IAB, Nuremberg. The IAB counts the Middle Eastern countries of Syria, Iraq, Iran, Afghanistan and Pakistan as well as the African countries of Eritrea, Nigeria and Somalia as being among the most significant countries at war or in crisis.

² Since June 2016, the Federal Employment Agency has been publishing labour market statistics in the context of forced migration, which are based on residence status rather than the nationality of the asylum seekers' main countries of origin; these show 157,000 unemployed persons in October. The shortness of the time series does not allow either a year-on-year comparison or seasonal adjustment, however. For more details, see Federal Employment Agency, Geflüchtete Menschen in den Arbeitsmarktstatistiken – Erste Ergebnisse, Hintergrundinformationen, Nuremberg, June 2016.

Labour market

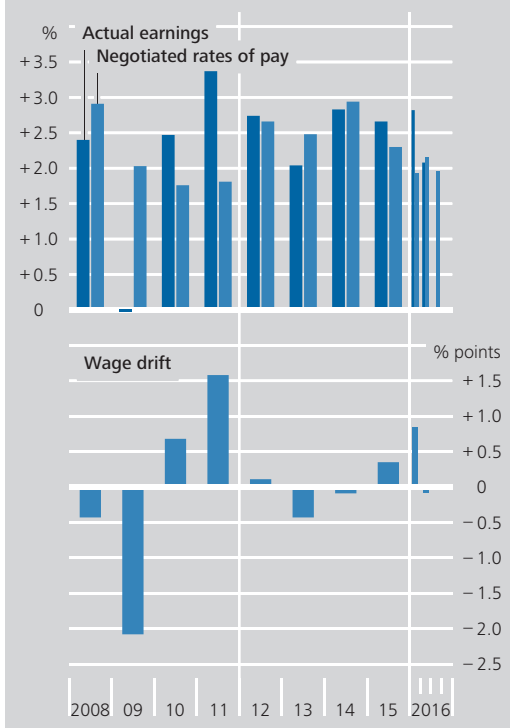
Seasonally adjusted, quarterly



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.

Rates of pay and wage drift

Year-on-year percentage change, on monthly basis



Sources: Federal Statistical Office (actual earnings) and Deutsche Bundesbank (negotiated rates of pay). Deutsche Bundesbank

particular, the Ifo employment barometer, which surveys the employment plans of trade and industry over the coming three months and which was already clearly expansionary, showed a further considerable improvement in September and October. The Federal Employment Agency's BA-X job index, which contains information on both the existing number of reported vacancies and their dynamics, rose to its highest level since its introduction. Some sectors with a slower pace of growth in recruitment lately, such as manufacturing and trade, reported more unsubsidised vacancies to the Federal Employment Agency. Job vacancies in the health and welfare sectors and in other business-related services are also pointing upwards, as is the construction sector to a certain extent. The IAB labour market barometer, too, is well into positive territory. The results of the autumn survey of the Association of German Chambers of Commerce and Industry (DIHK) on enterprises' staffing plans, spanning a somewhat broader horizon of 12 months, remained

just as positive as the survey undertaken in early summer. The unemployment subcomponent of the IAB labour market barometer, which projects developments in unemployment over the coming three months, is now perceptibly above the neutral threshold. This points to a further slight reduction in registered unemployment in the coming months.

Wages and prices

Overall, negotiated rates of pay (including one-off payments and ancillary agreements) have moved onto a flatter growth path over the course of this year. Following a muted rise of 2.2% in the second quarter of 2016, the increase in the third quarter, at 1.9%, was also no more than moderate. Wage growth was suppressed by both the low increases in negotiated wages from the second stage of earlier wage rounds and the new agreements concluded this year, which have been moderate on the whole. Furthermore, it has not been uncommon this year for agreements to include months with a pay freeze, which has led to delayed wage increases. It cannot be ruled out that, in a number of cases, the negotiated pay settlements were influenced not just by dominant determining factors, such as the general economic situation, but also by the low inflation rate or the expectation of continued moderate price increases over the term of the wage agreement. In many industries, the new collective agreements provide for staggered wage increases, with a somewhat higher wage increase in the first stage being followed by a lower increase in the second stage, usually in the following year. In the industrial sectors, the negotiated wage increases in the third quarter of 2016 were, on average, higher than in the services sectors. In the second quarter, the opposite had been the case, owing to higher rates of wage growth being recorded in the services sectors and the level of negotiated rates in some industry sectors being dampened by months with a pay freeze and negative base effects from the previous year's one-off and

Negotiated pay rates in 2016 Q3 also only moderately higher

special payments. Towards the end of the period under review, actual earnings could have risen to a similar extent as they did on average in the first half of the year.

Prices continuing to rise at all stages of the economy

Turning to prices, the third quarter of 2016 saw a continuation of the previous quarter's upward trend at all stages of the economy. Unlike in the second quarter, however, energy played mostly a minor role, while prices excluding energy rose in particular. That said, at the consumer level, prices excluding energy rose somewhat less strongly than in the second quarter.

Slight rise in import prices excluding commodities and food for the first time in a long while

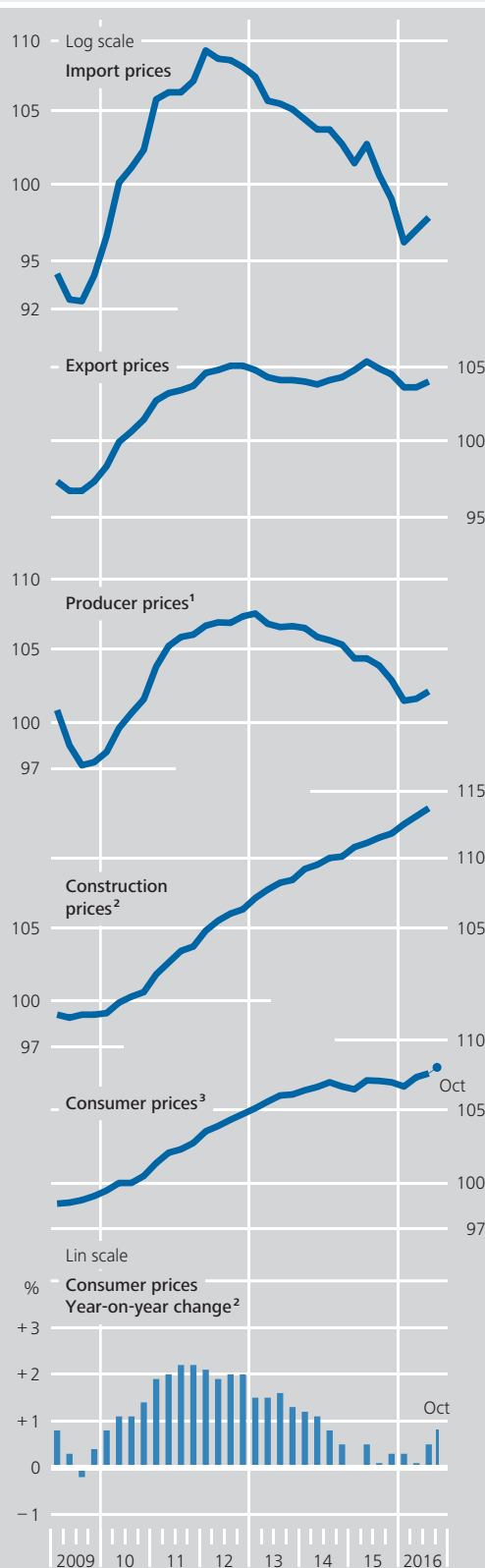
Seasonally adjusted import prices in the third quarter rose more or less as strongly as in the second quarter. Although the previously strong increase in crude oil prices has since plateaued, energy prices continued to rise, albeit only moderately. This is probably attributable to both lagged effects of the previous rise in crude oil prices as well as a widening of margins at refineries. For the first time in over a year, import prices excluding energy recorded an upward movement, and quite a significant one at that. This was mainly due to increases in the price of industrial raw materials and food. If these are excluded, we still see a shift to rising prices, but one that is much less pronounced. Domestic producer prices accelerated slightly. This was partially attributable to energy price inflation not being much lower than in the preceding quarter, despite the unchanged crude oil prices, but also to the higher prices seen for goods excluding energy. Here, however, price inflation of non-energy raw materials and food played a significantly smaller role than in the case of imports. Overall, year-on-year prices fell less strongly than in the second quarter, with domestic sales prices down by 1¾% and import prices by 2¾%.

Slightly higher rise in construction prices continues

Construction prices in the third quarter went up by 2.1% on the year, which was somewhat more pronounced than in the previous two years. On the real estate market, the significantly elevated price momentum witnessed since the second quarter continued. According

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

to the Association of German Pfandbrief Banks (*Verband deutscher Pfandbriefbanken – vdp*), prices of owner-occupied housing in the third quarter rose by 6.4% on the year.

Moderate rise in consumer prices excluding energy and food continues

Consumer prices showed a moderate increase of 0.2% in the third quarter in seasonally adjusted terms, following a rather strong rise of 0.6% in the previous three-month period. This was due chiefly to the fact that the considerable rise in energy prices seen in the previous quarter did not continue. Prices for petroleum products rose only slightly and were masked by lagged effects on consumer prices for gas and levies caused by the drop in crude oil prices recorded up to the fourth quarter of 2015/first quarter of 2016. Marginally lower energy prices contrasted with higher food prices caused by weather-related factors. After factoring out these two volatile components, prices continued to rise by 0.3% in seasonally-adjusted terms. There was hardly any increase in the price of industrial goods excluding energy. Significant price reductions in the case of clothing and footwear contributed considerably to this, which probably also had to do with the mild weather conditions in September. The price trend was rather modest in the case of other goods, too. The prices of services excluding rents rose only moderately. By contrast, rent increases were slightly more pronounced than in the preceding quarters. Overall, the annual rate of inflation rose by 0.5% as measured by the national consumer price index (0.1% in the previous quarter) and 0.4% as measured by the Harmonised Index of Consumer Prices (HICP) (0.0% in the previous quarter).

Prices increased fairly significantly in October

There was a fairly marked seasonally adjusted month-on-month rise of 0.3% in consumer prices in October. Prices for petroleum products rose significantly owing to the higher crude oil prices. Prices of industrial goods excluding energy also rose somewhat more sharply owing to a reversal of the marked price reductions for clothing and footwear seen in the third quarter. In addition, rents once again rose at a slightly higher rate. By contrast, the moderate price

trend for services excluding rents continued, while consumers had to pay no more for food than in the previous month. Year-on-year price inflation increased from 0.7% to 0.8% as measured by the CPI, and from 0.5% to 0.7% as defined by the HICP. Excluding energy and food, the inflation rate remained at just over 1% according to both definitions. Headline inflation in November is also likely to increase to just shy of 1% owing to price rises for dairy products.

■ Orders received and outlook

The German economy is likely to grow much more strongly in the final quarter of 2016 following the temporary slowdown in the summer months. Sentiment in the German economy has brightened significantly of late. This is especially true of the manufacturing sector, which additionally saw continued marked growth in capacity utilisation and a rise in new orders. It can therefore be assumed that industrial output in the final quarter of 2016 will probably make a significant contribution to aggregate growth. Moreover, the high level of capacity utilisation is likely to stimulate investment in machinery and equipment, which had been declining in the previous two quarters. Ultimately, markedly higher export expectations in industry and the upward trend in orders received from abroad indicate that goods exports will start to increase again following the lull in the third quarter. In the construction sector, the indicators are still pointing to buoyant economic activity, which means that construction investment is likely to remain an important driver of domestic growth. The ongoing favourable income and labour market prospects combined with positive consumer sentiment also suggest a distinct increase in private consumption expenditure. The short-term impact on the German economy of the announcement that the United Kingdom intends to leave the European Union could be noticeably weaker than some initially feared.

GDP growth could pick up considerable momentum in Q4

Pick-up in economic sentiment broadly based

Sentiment in the German economy has improved significantly on a broad front of late. In the industrial sector, the Ifo Institute's surveys on business, production and export expectations are pointing to a more favourable outlook. Business expectations in trade and in the services sector rose somewhat more moderately, but are nonetheless at a high level, which indicates that these sectors are also likely to see a stronger pick-up in economic activity than has recently been the case. By contrast, the business and export expectations surveyed by the German Chambers of Commerce and Industry (DIHK) fell slightly. However, as these results are based on a significantly longer time horizon (12 months) than in the case of the Ifo surveys, this somewhat less favourable assessment of the economic outlook is unlikely to have a material impact on the final quarter of 2016.

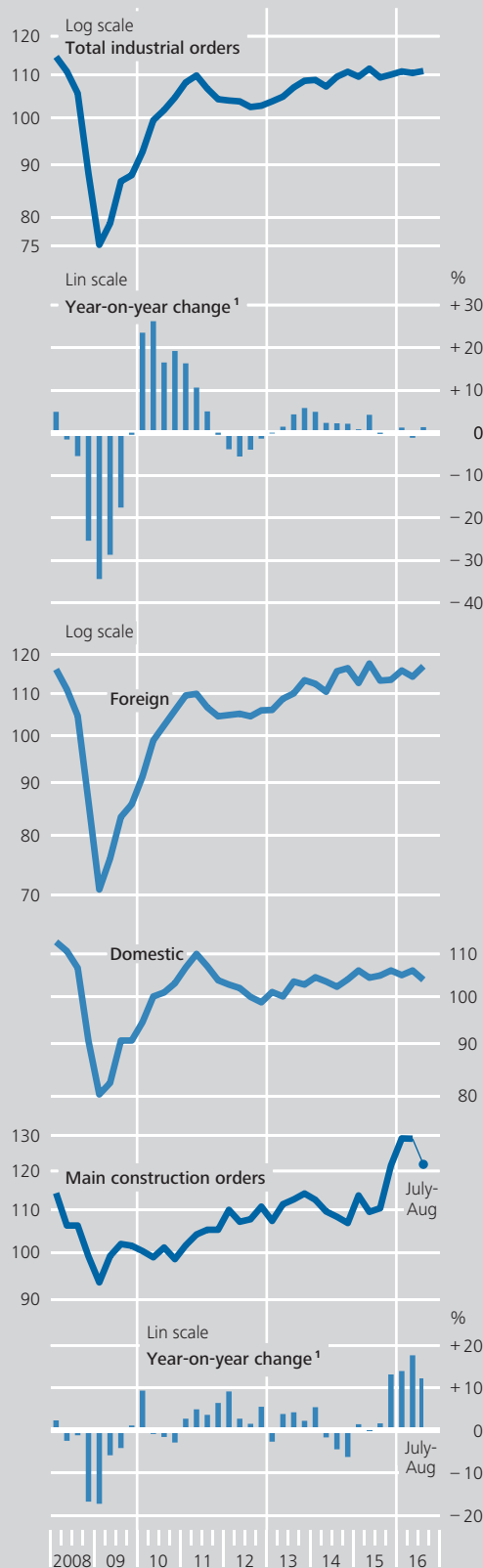
New industrial orders predominantly from abroad

Industrial orders rose by a seasonally adjusted ½% in the third quarter, with the main impetus coming from abroad. Orders from both the euro area and the rest of the world grew sharply, which is likely to boost German exports in the final quarter of the year. Motor vehicle orders from the euro area, which increased very significantly, stood out here in particular. By contrast, German industrial enterprises suffered significant losses with regard to domestic orders, which was due primarily to the weak flow of orders recorded by domestic producers of consumer goods. The lack of large-scale domestic orders also made itself felt. Excluding this, the volume of domestic orders would have been able to maintain its previous-quarter level. As large-scale orders are usually processed over a long period of time, and thereby have less of an impact on production in the short term than in the case of smaller order volumes with shorter processing times, the drop in domestic orders is therefore unlikely to place a perceptible strain on German industry in the fourth quarter.

The construction sector is likely to remain on an expansionary path in the final quarter. This is

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

Construction sector remains on growth path

indicated, in particular, by the sentiment indicators surveyed by the Ifo Institute, which show very optimistic expectations among construction enterprises. Business expectations even climbed to their highest level in over two decades. Only during the construction boom shortly after the reunification of Germany was the economic outlook for the construction sector deemed to be more favourable. In contrast to the sentiment indicators, the number of building permits and their estimated costs have fallen recently, as has the number of new construction orders. However, this should be interpreted merely as a partial normalisation following the exceptionally sharp rises at the turn of 2015-16. Given that both indicators are continuing to exceed their respective prior-year figure to a much greater extent than in the case

of construction output, the recent downturns do not dampen the optimistic outlook for the construction sector.

The dynamic consumption activity is likely to continue in the final quarter of the year. Although the consumer climate index calculated by the market research institution Gesellschaft für Konsumforschung (GfK) decreased slightly, it remains at a very high level. The ongoing fairly favourable outlook in the labour market together with sound income growth does not indicate that a major deterioration in consumer sentiment is on the cards. Moreover, it is likely that the exceptionally low expenditure on clothing and footwear in September owing to the warm weather will lead to a countermovement in the fourth quarter.

Dynamic growth of private consumption set to continue